African Economic Outlook 2021

From Debt Resolution to Growth: The Road Ahead for Africa

AFRICAN DEVELOPMENT BANK GROUP

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FOREWORD

The world is facing challenging times due to the COVID–19 pandemic, which has claimed millions of lives and affected countries and families around the world. The pandemic has caused a global economic crisis. Africa's GDP contracted 2.1 percent in 2020, the continent's first recession in half a century. It is estimated that about 39 million Africans could fall into extreme poverty in 2021 if appropriate support is not provided, with disproportionate effects on women.

In response to the crisis, the African Development Bank swiftly put in place a crisis response facility to support its Regional Member Countries in mitigating the health and economic effects of the crisis. The Bank also launched a $3 billion Fight COVID–19 social bond on global capital markets, the largest U.S. dollar-denominated social bond ever. It is now listed on the London Stock Exchange, the Luxembourg Stock Exchange and Nasdaq.

The continent is projected to grow by 3.4 percent in 2021. Yet the pandemic shock and ensuing economic crisis have had direct implications for budgetary balances and debt burdens: the average debt-to-GDP ratio for Africa is expected to climb by 10 to 15 percentage points in the short to medium term. That means serious debt challenges might be looming, and disorderly defaults and lengthy resolutions could become a major obstacle to Africa's progress toward prosperity.

With the 2021 *African Economic Outlook* theme on "From Debt Resolution to Growth: The Road Ahead for Africa," the Bank made a strategic and forward-looking choice to discuss a topic that could become a key policy concern in the near term. As highlighted in the report, recent debt restructuring experiences in Africa have been costly and lengthy due to information asymmetries, creditor coordination problems, and the use of more complicated debt instruments. The report examines current challenges in the international architecture for debt resolution. It discusses legal reforms, financial innovation, enhanced global coordination, and expanding the toolkit available to international financial institutions as possible ways to fix that architecture.

To avoid another "lost decade" and to build resilient economies, we need to address Africa's debt and development finance challenges, in partnership with the international community. Global partnership efforts are being made by the G20 to support temporary debt relief for developing countries through the Debt Service Suspension Initiative. However, debt payments are only deferred, and the initiative covers only a small fraction of Africa's total bilateral debt. Much larger financial support is needed, and the private sector creditors need to be part of the solution.

Even more important, the time for one last debt relief for Africa is now. But such relief would require that African countries credibly commit to their share of the deal through bold governance reforms to eliminate all forms of leakages in public resources, improve domestic resource mobilization, and enhance transparency—including on debt and in the natural resource sector. In addition to public policies in agriculture, industry or trade, African countries will need an all-out effort to harness digital technologies and an active promotion of free and fair competition to re-ignite growth, leveraging the African Continental Free Trade Area. The nexus between governance and growth is the right

focus for putting Africa on a sustainable debt path and forestalling any need for a future debt relief.

African policymakers therefore must turn the COVID–19 crisis into opportunities by focusing sharply on food and nutritional security; by re-thinking health care and social protection systems; by nurturing the private sector, especially small and medium-sized enterprises and women-led firms; by harnessing and better managing the natural resources revenue streams; by operationalizing the Africa Continental Free Trade Area; and by paying greater attention to climate change and resilience.

As new and effective vaccines and therapeutics against the virus become available, let us work together to build back better an inclusive, resilient, and integrated Africa.

Dr. Akinwumi A. Adesina, President
African Development Bank Group

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THEMATIC COVERAGE OF PREVIOUS EDITIONS

Edition	Thematic title
2003	Privatization
2004	Energy Supply and Demand
2005	Financing of Small and Medium-sized Enterprise (SME) Development
2006	Promoting and Financing Transport Infrastructure
2007	Access to Drinking Water and Sanitation in Africa
2008	Technical and Vocational Training
2009	Information and Communication Technology across Africa
2010	Public Resource Mobilization and Aid
2011	Africa and Its Emerging Partners
2012	Promoting Youth Employment
2013	Structural Transformation and Natural Resources
2014	Global Value Chains and Africa's Industrialization
2015	Regional Development and Spatial Inclusion
2016	Sustainable Cities and Structural Transformation
2017	Entrepreneurship and Industrial Development
2018	Infrastructure and Its Financing
2019	Integration for Africa's Economic Prosperity
2020	Developing Africa's Workforce for the Future

HIGHLIGHTS

The 2021 edition of the African Economic Outlook focuses on debt resolution, governance, and growth in Africa. Chapter 1 examines Africa's growth performance and outlook amid the COVID–19 pandemic. The chapter emphasizes policy options to mitigate the effects of the pandemic in the short, medium, and long terms. Chapter 2 explores the causes and consequences of Africa's debt dynamics by showing how the changing structure and composition of debt create vulnerabilities. In chapter 3, the report takes stock of the challenges in the current global architecture for debt resolution and explores the link between governance and growth with an emphasis on proposed reforms to improve the processes of debt resolution, governance, and sustainable growth.

CHAPTER 1 AFRICA'S GROWTH PERFORMANCE AND OUTLOOK AMID THE COVID–19 PANDEMIC

Africa is projected to recover in 2021 from its worst economic recession in half a century

Economic activity in Africa was constrained in 2020 by an unprecedented global pandemic caused by COVID–19. Real GDP in Africa is projected to grow by 3.4 percent in 2021, after contracting by 2.1 percent in 2020. This projected recovery from the worst recession in more than half a century will be underpinned by a resumption of tourism, a rebound in commodity prices, and the rollback of pandemic-induced restrictions. The outlook is, however, subject to great uncertainty from both external and domestic risks.

The economic impact of the pandemic varies across economic characteristics and regions, but the projected recovery is broad-based

Although all economies in Africa have been affected by the pandemic, tourism-dependent economies, oil-exporting economies and other-resource intensive economies were the most significantly hit by the pandemic. Tourism-dependent economies are projected to recover from an 11.5 percent GDP decline in 2020 to grow by 6.2 percent in 2021; oil-exporting countries, from a 1.5 percent decline to grow by 3.1 percent; and other-resource-intensive economies, from a 4.7 percent decline to grow by 3.1 percent. Non-resource-intensive countries, where output shrank by 0.9 percent in 2020, are projected to grow by 4.1 percent in 2021.

Uncertainty surrounding the growth outlook for Africa is high, but risks are tilted to the upside

Downside factors that could derail recovery include a resurgence of COVID–19 infections, debt overhang, financial market volatility that impedes capital flows, low commodity prices, low

tourism and remittances, extreme weather events, and social tensions. Upside factors that could result in better-than-anticipated growth for the continent include the effective deployment of therapeutics and vaccines for COVID–19, especially in African countries, full implementation of the Africa Continental Free Trade Agreement, and continued progress in structural transformation, including digitalization and work-from-home arrangements.

Macroeconomic fundamentals have weakened as a result of the pandemic

Although counterbalancing forces kept average headline inflation stable at 10.4 percent in 2020, core inflation (excluding food and energy prices) has risen in many countries. Significant currency depreciations have occurred in Africa, particularly in frontier market economies, partly as a result of the disruptions in external financial flows—including remittances, foreign direct investment, portfolio investment, and official development assistance. Fiscal deficits are estimated to have doubled in 2020 to a historical high of 8.4 percent of GDP, leading to increased debt burdens, but a gradual consolidation process is expected in 2021 and beyond. Countercyclical easy monetary policy and fiscal stimulus packages are expected to support the continent's economic recovery. Investor sentiment is still weak compared with pre-pandemic levels and the capital flight from developing countries experienced at the peak of the pandemic in March-June 2020 has been only partially reversed.

Countercyclical easy monetary policy and fiscal stimulus packages are expected to support the continent's economic recovery

The adverse effects of COVID–19 will reverse hard-won gains in poverty reduction in Africa

About 30 million Africans were pushed into extreme poverty in 2020 as a result of the pandemic and it is estimated that about 39 million Africans could fall into extreme poverty in 2021. Those with lower levels of education, few assets, and working in informal jobs are most affected. Inequality is also set to increase, because of the disproportionate impact of the pandemic on such vulnerable groups as women, youth, and low-skilled informal sector workers. These groups are particularly exposed because they often work in contact-intensive sectors with fewer opportunities to socially distance and work from home. Women and female-headed households could represent a large proportion of the newly poor. The monetary cost of lifting the newly extreme poor to the $1.90 per day poverty line is estimated at $4.5 billion for 2021—about $90.7 million on average per country.

Although lockdowns have been effective at mitigating the spread of COVID–19 in Africa, they have had severe economic consequences

Evidence shows that African countries with more stringent lockdown restrictions have experienced fewer COVID–19 cases than those with less restrictive policies. However, the estimated effect of lockdowns on the continent is modest compared with other regions, due to the inherent difficulties of enforcing such restrictions in Africa, where informal employment predominates. Workplace, public transport, and school closures and cancellations of public events have been more effective in curbing COVID–19 infections than other types of lockdown restrictions. Stringent lockdowns have, however, been associated with more severe economic contraction.

Policy recommendations to support economic recovery and build resilience:

- *Continue to support the health sector to consolidate gains in the fight against the pandemic.* It is not yet time for policymakers to be complacent in the fight against the virus. A second wave of the pandemic has occurred in several regions across the world. Countries must continue to make resources available for health care systems to cope with the virus and other preventable diseases. Routine public health campaigns—such as child vaccination against polio and measles, treatment for malaria, maternity care, and treatment for other chronic diseases should not be disrupted because of an excessive focus on the COVID–19 pandemic.
- *Sustain monetary and fiscal support to underpin economic recovery.* Where there is still fiscal space or access to liquidity, policymakers should maintain fiscal and monetary support until the expected economic recovery has fully materialized. Once the recovery has been achieved, governments need to commit to a

credible path of fiscal consolidation to restore debt and fiscal sustainability. Where there is no fiscal space, policymakers should seek international support through grants and concessional loans to support the recovery.

- *Address issues of increasing poverty by expanding social safety nets and making growth more equitable.* To avoid reversing more than two-decades of progress on poverty reduction, policymakers must step up efforts to lift people from extreme poverty and increase the coverage and scope of social protection to aid the newly impoverished. Policymakers can take advantage of increasing digitalization to boost the effectiveness, reduce the cost, and expand the reach of social protection programs using in-kind support such as free food banks, medical supplies, and free housing.
- *Minimize the long-term implications of the pandemic on human capital accumulation.* Whenever in-person learning is practical, policymakers should immediately open schools, with the appropriate safety protocols in place. When in-person classes are impractical, learning should continue using traditional print, radio, and TV media, and digital technologies such as smartphones and computers.
- *Scale up active labor market policies to retool the labor force for the future of work.* Policymakers must scale up efforts to retrain and reskill the labor force as quickly and broadly as possible to facilitate workers' transition from low productivity, obsolete sectors and jobs into new and emerging ones. They should encourage labor reallocation through job search and matching policies and establish public works as a source of training and experience for the new digital economy. Other active labor market policies include helping in the process of labor reallocation through job search and matching policies.
- *Accelerate structural transformation through digitalization, industrialization, and diversification.* As the world continues to grapple with the COVID-19 crisis, Africa's policymakers must look ahead and build a more resilient future. To make Africa's economies more resilient, countries need to deepen structural reforms and diversify their productive base. Fostering resilience will also require adopting policies that create room to make quick changes and reforms that promote economic flexibility. Policymakers should accelerate the diversification of their economy's productive base through human capital development, promoting jobs in high-productivity sectors, intensifying reforms to improve the investment climate, and advancing digitalization. They should adopt policies that promote economic flexibility by strengthening macroeconomic stability, improving market flexibility, and enhancing political, social, and environmental governance.
- *Strengthen regional and multinational solidarity to enable shared and sustainable recovery.* Africa's policymakers must continue to call for greater coordination among countries in the fight against the virus and in the provision of financial support to countries experiencing liquidity and debt challenges.

CHAPTER 2 DEBT DYNAMICS AND CONSEQUENCES

The COVID–19 pandemic has caused a surge in government financing needs in Africa

Since the COVID–19 pandemic began in early 2020, governments have announced fiscal stimulus packages ranging in cost from about 0.02 percent of GDP in South Sudan to about 10.4 percent of GDP in South Africa. The Bank estimates that African governments need additional gross financing of about $154 billion in 2020/21 to respond to the crisis. These fiscal stimulus packages have largely had immediate, direct implications for budgetary balances, borrowing needs, and debt levels.

The average debt-to-GDP ratio in Africa is expected to climb significantly in the short to medium term

The surge in government spending and the contraction of fiscal revenues as a result of COVID–19 will result in fast-paced debt accumulation in the near to medium term. Although the average debt-to-GDP ratio, a standard measure of debt sustainability, had stabilized around 60 percent of GDP

African governments need additional gross financing of about $154 billion in 2020/21 to respond to the crisis

between 2017 and 2019, it is projected to increase by 10 to 15 percentage points by 2021 as a result of COVID–19. Countries expected to account for the most significant increase in Africa's overall average debt levels are tourism-dependent economies and other resource-intensive (non-oil) economies.

The average debt-to-GDP ratio is projected to increase by 10 to 15 percentage points by 2021 as a result of COVID–19

Recent debt accumulation has been driven mainly by the depreciation in exchange rates, growing interest expenses, and high primary deficits

A decomposition of Africa's debt dynamics shows that debt accumulation has been driven by exchange rate depreciation, growing interest expense, high primary deficits, poor governance, weak institutions, ambitious public investment programs, and increased defense-related expenditures. But the strong GDP growth recorded before the pandemic has helped to dampen the rate of growth of the debt-to-GDP ratio. The dynamics are, however, different for different groups of economies. For oil exporters and other resource-intensive economies, debt dynamics have primarily been driven by exchange rate depreciation and primary deficits, largely as a result of volatility in commodity prices. For non-resource-intensive economies, interest expenditures have been the major driver.

Africa's debt continues to shift from traditional lenders toward private and commercial debt

The creditor base for Africa's debt continues to shift away from traditional multilateral and bilateral Paris Club sources toward commercial creditors and non-Paris Club official lenders. The share of commercial creditors in Africa's external debt stock has more than doubled in the last two decades, from 17 percent in 2000 to 40 percent by the end of 2019. At least 21 African countries accessed international capital markets between 2000 and 2020. Non-frontier-market economies and low-income countries—which do not have access to international capital markets—have continued to rely on bilateral and multilateral concessional credit, although there has been a shift away from traditional Paris Club lenders to non-Paris Club lenders, notably China.

Significant vulnerabilities are emerging as a result of the changing landscape for Africa's debt

As of December 2020, of the 38 countries for which debt sustainability analyses are available, 14 were rated in high risk of debt distress and another six were already in debt distress. Sixteen countries have a moderate risk of debt distress, while two are considered at low risk. However, safety margins are being eroded by COVID–19, as spending rises and revenue falls. Moreover, credit rating downgrades are likely to occur for many countries in the near to medium term. Other emerging vulnerabilities include loss of access to international capital markets as a result of deteriorating debt sustainability ratings; fast-growing interest expenses as a share of revenue; rollover risks due to shorter debt maturities; a narrowing of the differential between the real (inflation-adjusted) interest rate and growth; expanding contingent liabilities; and limited transparency of debt collateralization.

Evidence shows that favorable external conditions, supported by sound domestic policies, contribute to shorter durations of bond market distress

Using secondary market information to assess the role that policies play in fostering recovery from debt distress, the report shows that the interaction between domestic policy and favorable external conditions help to speed up the recovery from debt distress. Specifically, greater openness to trade supports faster bond-market distress recovery and the presence of an economic program supported by international financial institutions contributes to reducing debt distress episodes. Stronger political rights also have a positive association with the speed of recovery from debt distress. But higher interest rates on the 10-year US Treasury bond tend to extend the duration of debt distress.

Strengthening the links between debt financing and growth returns is crucial for debt sustainability in the continent

To grow out of debt in a sustainable manner, countries need to improve the efficiency of debt-financed investments. This is best done by ensuring that debt is used to finance the most productive

projects—those that generate sufficient growth to pay for the debt in future. Policymakers should take advantage of current low global interest rates to borrow relatively inexpensive capital for high return public investments that accelerate growth.

CHAPTER 3 DEBT RESOLUTION AND THE NEXUS BETWEEN GOVERNANCE AND GROWTH

Debt resolution in Africa has often been disorderly and protracted, with costly economic consequences

The economic consequences of sovereign debt restructuring are less severe in countries that act pre-emptively and collaboratively and in those countries where economic governance is stronger. However, the Heavily Indebted Poor Countries initiative took more than a decade to be implemented, and recent debt resolution in Africa has been delayed by long-lasting litigation with private and official creditors. The absence of orderly and successful sovereign debt resolution, especially with private creditors, makes the prospects of debt distress worrisome for African economies.

The current international financial architecture makes orderly sovereign debt restructuring complex to achieve

The fundamental difficulty with sovereign debt is that there are no formal bankruptcy procedures, as there are in corporate bankruptcies. While restructuring in most emerging markets has been relatively smooth, pre-emptive, and with a high participation of creditors, some episodes, especially in Africa, have been protracted, incomplete, and non-transparent.

The current global architecture is further challenged by a lack of transparency and an ongoing race to seniority. The increasing use of collateralized and resource-backed borrowing by sovereigns, and the lack of transparency in those loans, makes fair burden-sharing more difficult and reduces the chances that future debt restructuring operations will proceed smoothly. This problem is most prevalent in countries where state-owned enterprises are a source of hidden debts, leakages, and corruption.

To avoid high debt resolution costs and limit the likelihood that debt crises re-emerge, the international community needs to push for enhanced global coordination

The G20 Debt Service Suspension Initiative (DSSI) for low and lower-middle-income countries is positive and welcome. The inclusion of nontraditional official creditors is a significant step toward global coordination. Yet, although the DSSI called on private creditors to agree to provide similar terms, if asked, the initiative does not include them. Without all actors participating, the scope of any relief agreement is limited.

Global coordination to facilitate debt resolution can be improved by leveraging on the official sector through a strengthened version of the Paris Club's comparability of treatment clause, which would ensure that official relief translates into private relief, regardless of the residence of the creditors.

Also deepening the toolkit of international financial institutions can help mitigate the negative effects of belated and insufficient debt restructuring. Further improvements in institutions (such as the African Legal Support Facility) and policies (such as the provision of partial guarantees) directed at supporting the restructuring process might help overcome the concerns of debtors and creditors and facilitate speedier and more smoother debt restructuring.

African countries need to adopt or keep abreast of legal and financial innovations that facilitate debt restructuring

Various legal changes, such as collective action and aggregation clauses, may be considered to enhance the ability of countries to engage with the creditors and avoid the negative costs from holdout creditors willing to litigate.

To deal with the recurrence of debt crises, it may be time to reconsider whether state-contingent debt instruments that link debt service payments to a country's ability to pay can be used extensively as a tool to minimize the possibility of future unsustainable debt dynamics. Several recent restructurings have also featured clauses that make debt relief contingent on reform

Policymakers should take advantage of current low global interest rates to borrow relatively inexpensive capital for high return public investments

implementation, to provide incentives to pursue responsible fiscal policies. These instruments can be valuable for African countries.

International financial institutions are in a position to partner in this effort, by providing debtor countries with incentives to own this initiative.

For Africa, the nexus between governance and growth is the right paradigm to get out of the COVID–19 crisis and avoid a looming debt crisis

Experience shows that debt restructuring has not delivered lasting resolution of crises and has instead left countries unreformed and unable to grow. This highlights two intertwined problems of the current framework. First, the framework fails to facilitate early restructuring and a fair burden-sharing. Second, it fails to elicit genuine reforms of economic governance to re-ignite growth.

A more conducive global debt resolution architecture combined with bold governance system reforms in Africa would help to put the continent on a sustainable debt path and re-ignite growth

African countries must eradicate all forms of "leakages" in public resource management

Eradicating leakages to ensure that transfers reach their desired targets will require the strengthening of Public Financial Management (PFM), focusing on four fundamental dimensions: prudent fiscal decisions, credible budgets, reliable and efficient resource flows and transactions, and institutionalized transparency and accountability, including in the natural resource sector. Of particular importance are also three key components of PFM—debt management, domestic resource mobilization, and budgeting.

Digitization and fair competition will be fundamental levers for re-igniting growth

COVID–19 and its aftermath increase the urgency for countries in Africa not only to ensure resilience (for example, by addressing deficiencies in the health sector), but also to chart a course for economic transformation. Two important tasks could underlie programs to revitalize African economies:

- Launching an accelerated digitalization—an all-out effort to harness digital technologies—to propel Africa into the Fourth Industrial Revolution and boost job creation.
- Promoting free and fair competition and investing in transparency to enhance production efficiency. At the national level, three policy actions can be considered to boost competition and promote growth: radical transparency, competitive neutrality, and the independence and accountability of competition and regulatory authorities.

A more conducive debt resolution architecture at the global level combined with bold governance system reforms in Africa would significantly help to put the continent on a sustainable debt path and re-ignite growth.

1

AFRICA'S GROWTH PERFORMANCE AND OUTLOOK AMID THE COVID–19 PANDEMIC

KEY MESSAGES

- **Africa's GDP is expected to grow by 3.4 percent in 2021 after shrinking by 2.1 percent in 2020 because of the COVID–19 pandemic.** This recovery will mark the end of the worst recession in more than half a century and will be underpinned by an expected resumption of tourism, a rebound in commodity prices, and a rollback of pandemic-induced restrictions.
- **The pandemic's economic impact varies across countries.** Tourism-dependent economies are projected to recover from an 11.5 percent decline in 2020 to grow 6.2 percent in 2021; oil-exporting countries, from a 1.5 percent decline to grow 3.1 percent; other resource-intensive economies, from a 4.7 percent decline to grow 3.1 percent; and non-resource-intensive countries, from a 0.9 percent decline to grow 4.1 percent.
- **Africa's macroeconomic fundamentals have been weakened by the pandemic.** Fiscal deficits are estimated to have doubled in 2020 to a historical high of 8.4 percent of GDP. Debt burdens are likely to rise by 10 to 15 percentage points in the short to medium term. Exchange rate fluctuations have been elevated, and inflation has inched up, with external financial inflows heavily disrupted.
- **COVID–19 effects could reverse hard-won gains in poverty reduction over the past two decades.** Revised estimates show that up to 38.7 million more Africans could slide into extreme poverty in 2020–21, pushing up the total to 465.3 million people, or 34.4 percent of the African population, in 2021. The estimated cost of bringing their income up to at least the poverty line is about $7.8 billion in 2020 and $4.5 billion in 2021. Inequality is likely to increase, and school closures could have long-lasting consequences for human capital accumulation and productivity growth.
- **Lockdowns have been effective in curbing COVID–19 infections in Africa but at the expense of economic activities.** African countries with more stringent lockdown restrictions have experienced fewer COVID–19 cases than others. However, the estimated effect of lockdown restrictions is modest compared with that in other regions.
- **Policy priorities to accelerate Africa's transformation to a more resilient, inclusive, and sustainable postpandemic recovery include:**
    - Continuing support for the health sector to consolidate gains in the fight against the pandemic.
    - Effectively using monetary and fiscal support to underpin the economic recovery where policy space remains available.
    - Expanding social safety nets and making growth more equitable to address increasing poverty.
    - Scaling up active labor market policies to retool the workforce for the future of work.
    - Intensifying structural transformation through digitalization and economic diversification to build resilience.
    - Fostering regional and multinational cooperation to ensure sustained and widespread recovery.

MACROECONOMIC PERFORMANCE AND PROSPECTS

Africa's GDP is projected to recover in 2021 after shrinking by 2.1 percent in 2020

Africa suffered its worst recession in more than 50 years in 2020 due to the COVID–19 pandemic, as its GDP declined by 2.1 percent. But it is expected to increase by 3.4 percent in 2021. GDP per capita is estimated to have contracted by 10 percent in nominal terms in 2020. Because of the pandemic's lower-than-expected impact on Africa,[1] the recession in 2020 was not as severe as the Bank projected earlier. Africa suffered fewer economic losses from the pandemic than other regions of the world (figure 1.1). Similarly, the fatality rates per million people have been relatively modest in relation to other regions (figure 1.2).

The global economy is expected to have shrunk 4.4 percent in 2020, less severe than the 4.9 percent contraction the International Monetary Fund (IMF) forecast at the onset of the crisis.[2] The better-than-anticipated growth reflects the second- and third-quarter GDP performance in advanced and emerging-market economies, especially China, after lockdown measures were scaled back and prospects brightened for COVID–19 vaccines and therapeutics. The IMF now projects 5.2 percent global growth in 2021.

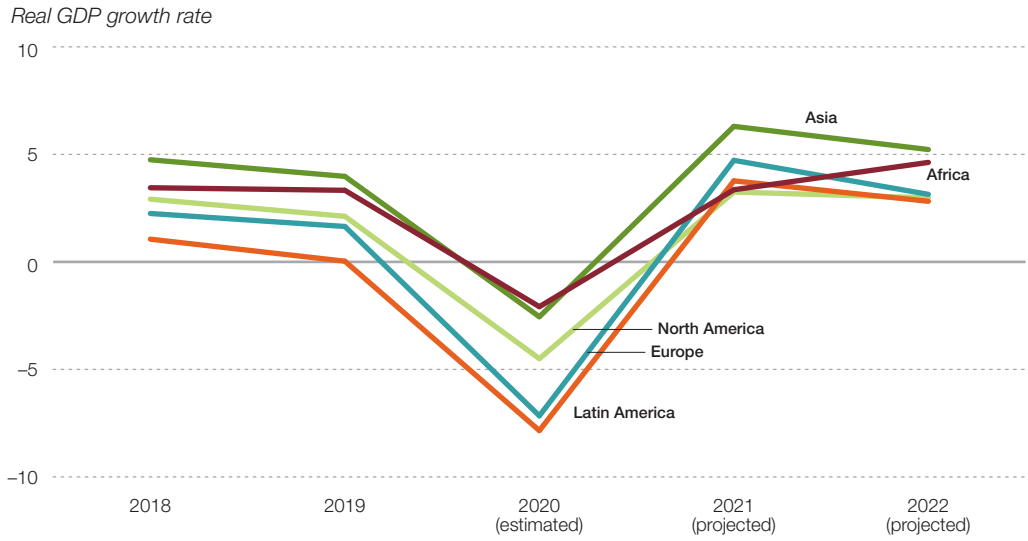
Leading indicators point to a recovery of economic activity. Indicators of business confidence around the world, such as the industrial production indexes and the purchasing managers indexes, especially for Africa's major trading partners, have picked up in the third and fourth quarters of 2020. High-frequency leading indicators such as major trading partners' stock market indexes have rebounded from declines that exceeded 50 percent between March and May 2020 (figure 1.3). Commodity prices—especially energy and metals—recovered from the mid-2020 decline but remain subdued (figure 1.4).

Since July 2020, capital flight has reversed in Africa, and sovereign bond spreads continue to narrow

The high volatility in global financial markets in the first half of 2020 stabilized towards the end of 2020 (see figure 1.3). Increasingly accommodative monetary policy by major central banks around the world (figure 1.5) has helped stem the capital flight from Africa that occurred at the peak of the crisis (figure 1.6). Since July 2020, capital flight has reversed in Africa, and sovereign bond spreads continue to narrow from the more than 700 basis points that prevailed in March and April 2020 (figure 1.7).

Healthcare systems have improved in many countries, thanks to increased investments; digitalization has ramped up in the wake of the crisis; and social protection schemes have broadened their coverage to include previously neglected

FIGURE 1.1 Depth of recession, Africa and other regions, 2018–22



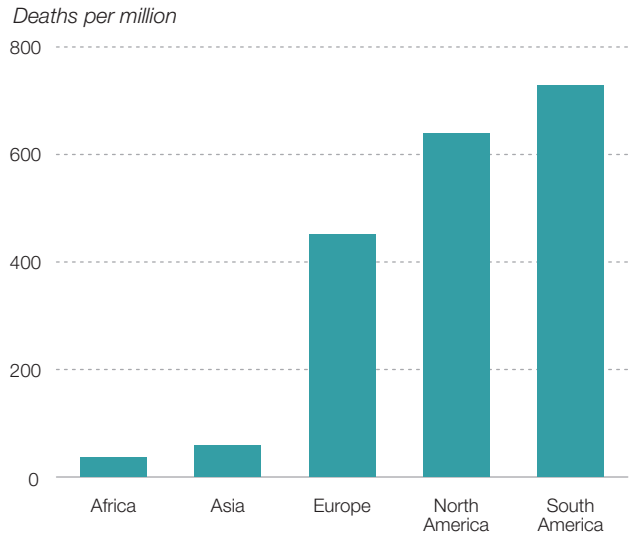
Source: African Development Bank statistics and IMF World Economic Outlook database.

groups (for example, the reach of cash transfer programs expanded after the programs began to distribute funds through mobile money accounts in Benin, Côte d'Ivoire, The Gambia, Lesotho, Madagascar, and Namibia). But debt levels are expected to rise sharply, and if they are not addressed promptly, some countries might find themselves with a debt burden they cannot service (a "debt overhang"), which might slow recovery in the medium term (see chapters 2 and 3).

Growth performance varies by regions and economic characteristics

Africa's growth performance and recovery prospects vary across regions and economic groupings (table A1.1 in annex 1.1). The average GDP decline of 2.1 percent in 2020 and projected recovery to 3.4 percent growth in 2021 mask significant heterogeneity (figures 1.8 and 1.9).

FIGURE 1.2 COVID–19 deaths per million, by region, 2020



Source: Staff calculations based on World Health Organization dashboard.

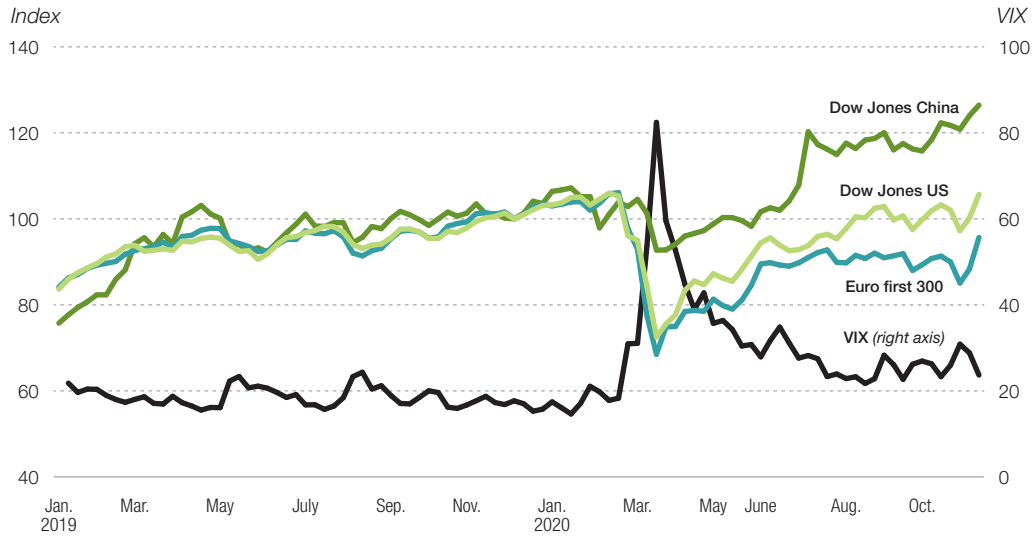
East Africa seems to be the most resilient region, thanks to less reliance on primary commodities and greater diversification.[3] It enjoyed 5.3 percent growth in 2019 and an estimated 0.7 percent growth in 2020. In 2021, growth of real GDP is projected at 3.0 percent, and in 2022, 5.6 percent. The top performers in 2021 would be Djibouti (9.9 percent), Kenya (5.0 percent), Tanzania (4.1 percent), and Rwanda (3.9 percent).

Southern Africa is the region that was hardest hit by the pandemic, with an economic contraction of 7.0 percent in 2020. It is projected to grow by 3.2 percent in 2021 and 2.4 percent in 2022.

GDP in **West Africa** is estimated to have contracted by 1.5 percent in 2020, better than the initial projection of a 4.3 percent decline in June

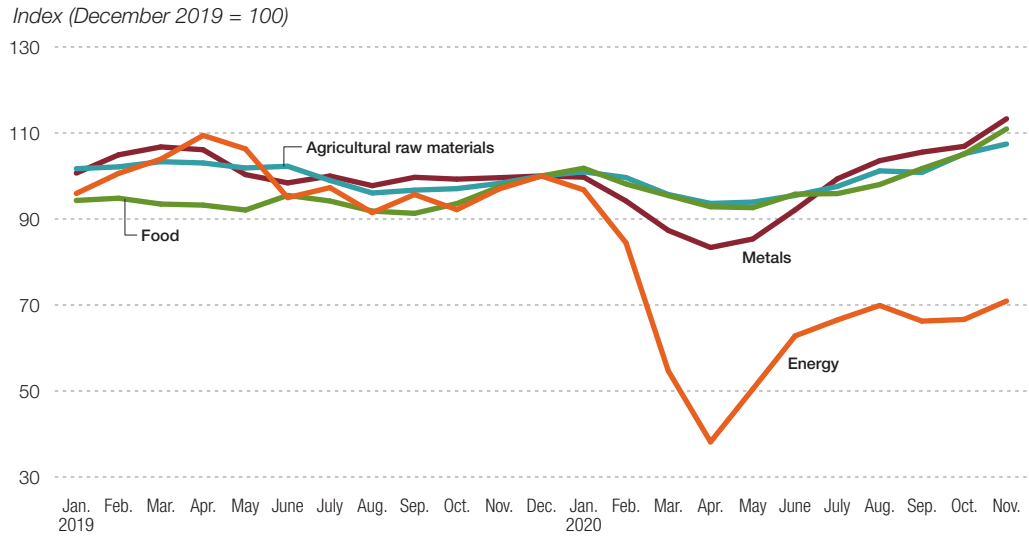
The average GDP decline of 2.1 percent in 2020 and projected recovery to 3.4 percent growth in 2021 mask significant heterogeneity

FIGURE 1.3 Stock market indicators and investors sentiment improving, January 2019–November 2020



Source: African Development Bank statistics and Haver Analytics.

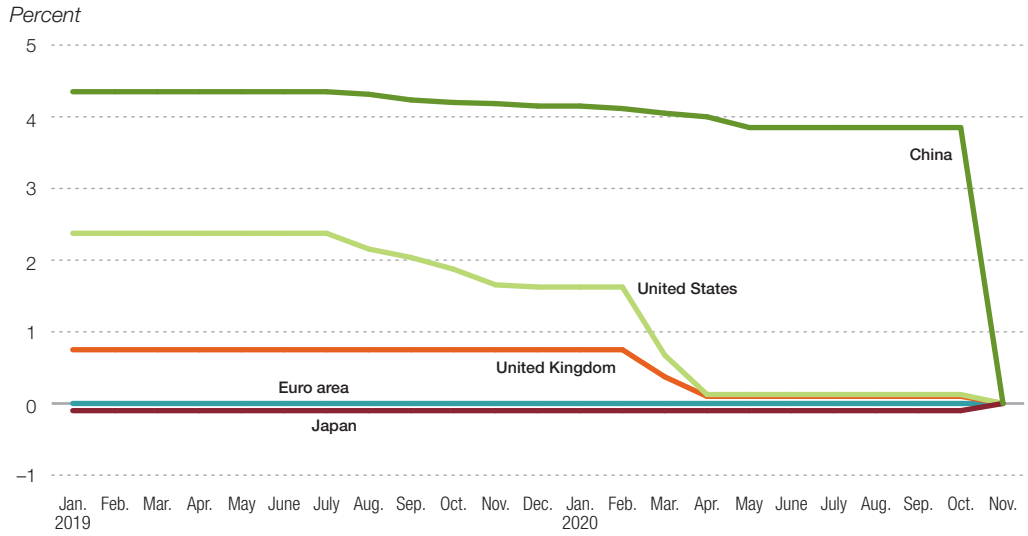
FIGURE 1.4 Commodity price indices, January 2019–November 2020



Source: Staff calculations based on IMF World Economic Outlook database and World Bank Commodity database.

Commodity prices recovered from the mid-2020 decline but remain subdued

FIGURE 1.5 Central bank policy rates headed for zero, January 2019–November 2020

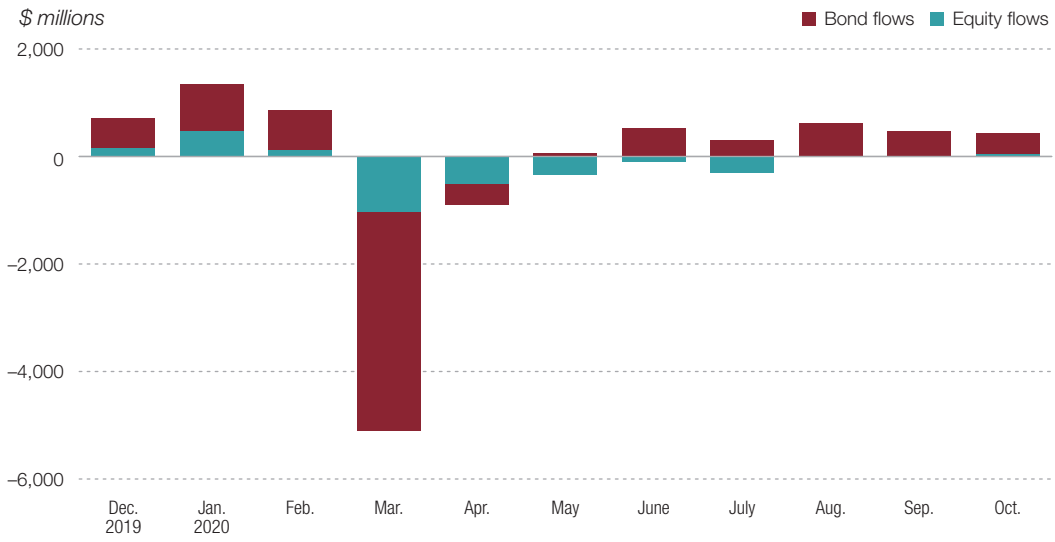


Source: Haver Analytics.

2020, partly due to the relatively limited spread of the virus in the region. Many West African countries maintained positive growth in 2020 thanks to more targeted and less restrictive lockdowns—including Benin (2.3 percent), Côte d'Ivoire (1.8 percent), and Niger (1.2 percent). Other countries such as Cabo Verde (–8.9 percent), Liberia (–3.1 percent), and Nigeria (–3 percent) were in recession in 2020. Growth in the region is projected at 2.8 percent in 2021 and 3.9 percent in 2022, as lockdowns are eased and commodity prices rebound.

In **Central Africa,** real GDP is estimated to have contracted 2.7 percent in 2020. Countries significantly impacted by the crisis in the subregion include Cameroon (–2.4 percent), Republic of Congo

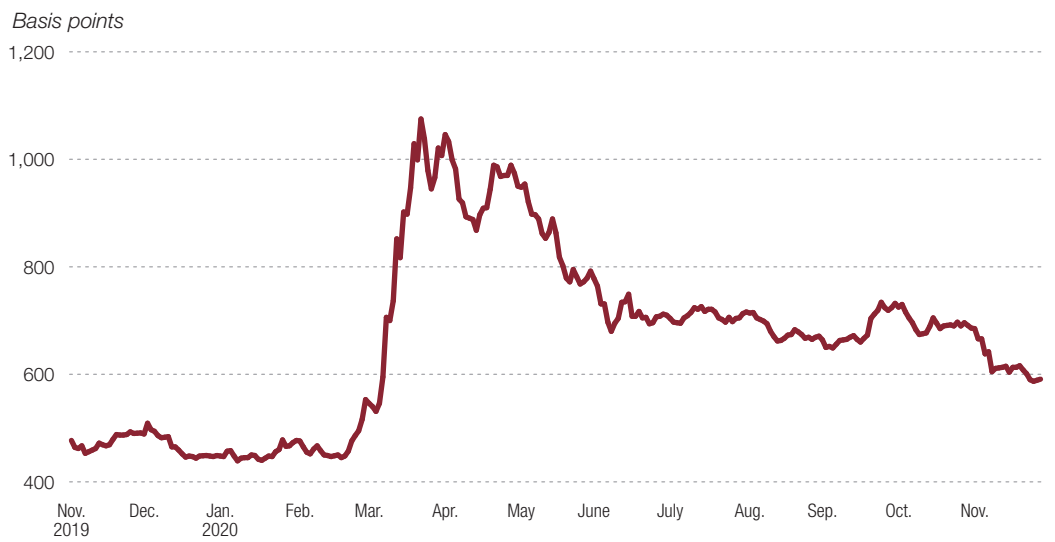
FIGURE 1.6 Bond and equity flows plummeted in March (December 2019–October 2020)



Source: African Development Bank statistics and Haver Analytics.

Bond and equity flows plummeted in March

FIGURE 1.7 The EMBI Global Africa spread, after spiking in March, returned to 600 basis points by November (November 2019–November 2020)



Source: Haver Analytics.

(–7.9 percent), Democratic Republic of Congo (–1.7 percent), and Equatorial Guinea (–6.1 percent). Growth is projected to recover to 3.2 percent in 2021 and 4 percent in 2022 in Central Africa.

The economies of **North Africa** contracted by an estimated 1.1 percent in 2020, propped up mainly by Egypt, which maintained 3.6 percent growth despite the relatively severe health impact of the virus in the country. Other countries contracted significantly in 2020, including Tunisia (–8.8 percent), Morocco (–5.9 percent), and Algeria (–4.7 percent). The effects of COVID–19, internal conflict, and a drop in oil prices caused an estimated 60.3 percent

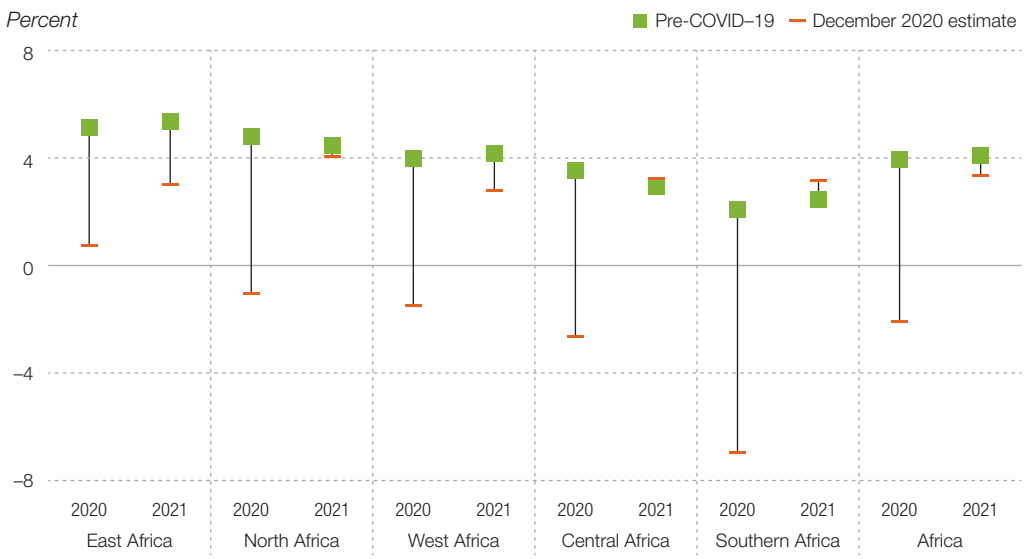
FIGURE 1.8 Growth contracted most for tourism-dependent countries, least for low-income countries

Note: All data are predicted values.

Source: African Development Bank statistics.

Tourism-dependent economies are estimated to have experienced the sharpest decline in growth in 2020, –11.5 percent

FIGURE 1.9 Growth's decline was steepest in Southern Africa, 2020–21



Source: African Development Bank statistics.

contraction of real GDP in Libya. North Africa is projected to experience robust recovery of 4 percent in 2021 and 6 percent in 2022.

Similarly, Africa's growth performance varies across country groups depending on structural characteristics.

Tourism-dependent economies are estimated to have experienced the sharpest decline in growth in 2020, –11.5 percent for the group, which includes, among others, Mauritius (–15 percent), Seychelles (–12 percent), and Cabo Verde (–8.9 percent). The group is expected to bounce

back in 2021 with a projected growth rate of 6.8 percent, assuming that the pandemic is subdued, permitting a resumption of international travel and tourism.

GDP in oil-exporting countries is estimated to have contracted by 1.5 percent in 2020, due to the collapse in oil demand and prices, with Libya (–60.3 percent), Equatorial Guinea (–6.1 percent), Algeria (–4.7 percent), Angola (–4.5 percent), Nigeria (–3.0 percent) suffering the most. The recovery in 2021 is projected at 3.1 percent, following an expected modest recovery in oil prices.

Other resource-intensive economies are estimated to have contracted by 4.7 percent in 2020 because of a drop in metal and mineral prices due to lower demand. Botswana (–8.9 percent), South Africa (–8.2 percent), Zambia (–4.9 percent), and Liberia (–3.1 percent) were particularly hard hit. Growth is projected to recover to 3.1 percent in 2021.

Growth in non-resource-intensive economies is estimated to have contracted by 0.9 percent in 2020. This group was least affected by the crisis, thanks to diversified economic structures and earlier strong public investments. Most of these countries entered the pandemic from a position of strength, with average GDP growth of 5.3 percent in 2019, and many did not implement stringent lockdown measures in 2020. Countries that maintained growth in 2020 include Ethiopia (6.1 percent), Benin (2.3 percent), Tanzania (2.1 percent), and Côte d'Ivoire (1.8 percent). This group is expected to rebound in 2021 with growth of 4.1 percent.

Headwinds and tailwinds to the Outlook

The outlook for growth recovery is subject to headwinds and significant tailwinds

The projected growth recovery of 3.4 percent in 2021 and 4.0 percent in 2022 is subject to high uncertainty. New waves of the COVID–19 infections could require reimposition of severe containment measures—such as lockdowns and quarantines—that would retard or derail the recovery process. Downside economic and social factors include the risks of social tensions, debt overhang, extreme weather events, subdued commodity prices, weaker tourism and remittances, and financial market volatility that impedes capital flows.

But the projected recovery could be better than anticipated if effective vaccines become available and universally accessible sooner than expected and if countries' efforts at structural transformation, including digitalization and work-from-home settings, continue to be intensified.

Tailwinds and upside factors

The recovery will likely be better than expected if:

- Universal access to *safe and effective COVID–19 therapeutics and vaccines* occurs (box 1.1) and if vaccine availability permits activity to return to prepandemic levels, boosting consumer and business confidence, consumption, and investments.
- The modest *fiscal stimulus packages* deployed by African governments can be sustained through 2021, so additional aggregate demand could help crowd in private investments and consumption.
- The *accelerated digitalization* in Africa resulting from pandemic-related containment measures continues to boost the productivity of human and physical capital in the private and public sectors.

Headwinds and downside risks

The projected recovery would be threatened by:

- Repeated *COVID–19 waves,* and slower-than-expected progress on deploying safe and effective treatments and vaccines.
- *Wary investor sentiment* despite looser financing conditions (see figure 1.3) and only partially reversed capital flight from developing countries. High debt and liquidity shortfalls by African sovereigns and corporates could tighten financing conditions for both.
- *An increase in conflict-related events,* which rose in 43 countries in 2020, bringing policy uncertainty and dampening investor confidence.[4]
- *Natural and weather-related catastrophes,* such as the recent locust swarm, droughts, floods, cyclones, and the expected return of El Niño conditions to East Africa.

The projected growth recovery of 3.4 percent in 2021 and 4.0 percent in 2022 is subject to high uncertainty

BOX 1.1 Fostering global partnerships for universal access to COVID–19 vaccines and treatments in Africa

Universal access to effective and affordable treatment and vaccines is critical to halt the course of the COVID–19 pandemic. At the end of 2020, a few candidate vaccines that showed promising results were approved by regulators and were being administered, particularly to people in developed countries. Countries were scrambling to secure adequate supplies of vaccines even before regulatory approval. At the end of December 2020, more than half of all advance market commitments for COVID–19 vaccines had been made by high-income countries, possibly leaving African countries hard pressed to obtain much.

Accessibility for low-income groups requires collaboration among governments, the private sector, global health and multilateral agencies, and local communities. The COVAX initiative—a cost-sharing global alliance of more than 170 countries for COVID–19 treatment—aims to accelerate the development, production, and equitable access to COVID–19 vaccines for low-income economies that otherwise could not afford them. Other multilateral and global health agencies such as the United Nations and the Bill & Melinda Gates Foundation are stockpiling medical equipment, such as syringes and glass vials, to ensure effective vaccination programs in Africa.

But challenges remain, most importantly, producing vaccines fast enough for equitable distribution—which requires clockwork-like production, top-notch distribution networks, and efficient global coordination. Private philanthropic institutes are taking up the challenge. The Serum Institute of India has agreed to scale up production of COVID–19 vaccines to supply low- and middle-income countries at affordable prices when regulatory restrictions are lifted. Governments and global health agencies could incentivize more pharmaceutical firms to do the same. Better yet, the region could collaborate with vaccine manufacturers and pharmaceutical companies to bring vaccine manufacturing closer to home, where possible. This would help reduce distribution costs and ensure timely supply, while building capacity within the region.

Authorities must intensify efforts to assure the public of vaccine safety with the buy-in of local communities and civic and religious leaders—as was done with polio vaccine in the 1990s. Multilateral agencies such as the African Development Bank can support regional institutions and governments to promote regional collaboration and peer-to-peer learning by health authorities in the deployment of effective measures.

While supply chain networks established at the start of the pandemic to distribute personal protective equipment will prove useful for vaccine distribution, current available vaccines require special treatment and handling in transit and when being administered. This presents unprecedented logistical hurdles due to limited cold chain transport infrastructure and poor connectivity within Africa. Internationally, global courier services are working with governments to set up urgently needed distribution chains, but local preparedness is inadequate in most countries. Local governments must work with the private sector to establish specialized transport modes to reach less accessible communities. Local public health officials must be trained quickly to handle and administer vaccines effectively. The pandemic has highlighted the need to correct Africa's weak health and transport infrastructure.

- *A sluggish rebound in tourism, remittances, and commodity prices,* which could constrain public finances for tourism-dependent and oil-dependent economies.
- The projection assumes that oil prices rise from $41 per barrel in 2020 to $44 per barrel in 2021 and to $50 per barrel in 2022 (still far below the prepandemic price of $60 per barrel). It also assumes that remittance flows, which dropped by 9 percent in 2020, pick up and that tourism resumes.

MACROECONOMIC ENVIRONMENT AND FUNDAMENTALS

Fiscal, monetary, and financial sector developments

Exchange rate depreciations have continued

Significant currency depreciations observed in April (during the peak of the crisis) continued through the fourth quarter of 2020 (figure 1.10). For

frontier market economies integrated into global financial markets, such as South Africa, recent depreciations can be attributed to sudden stops and reversals of capital flows. Exchange rate volatility is particularly severe in tourism-dependent economies (such as Mauritius and Seychelles), and resource-intensive economies. High external debt service obligations (see chapter 2), dwindling foreign reserves, and rising fiscal issues will prolong depreciation pressures for most African currencies.

Counterbalancing forces will keep inflation muted over the medium term

Inflation in Africa in 2020 was estimated at 10.4 percent, almost the same as the 9.8 percent in 2019. It is projected to moderate to 9.0 percent in 2021 (figure 1.11). The price level in Africa is subject to countervailing pressures. Upward price pressures arise from accommodative monetary policy, the pass-through from exchange rate depreciation to prices, rising food prices because of low agricultural output, and increased production and distribution costs due to supply-chain disruptions. Downside pressures include cheaper imported oil, increased precautionary savings due to perceived uncertainties, and the credible anchoring of inflation expectations in countries belonging to a currency union.

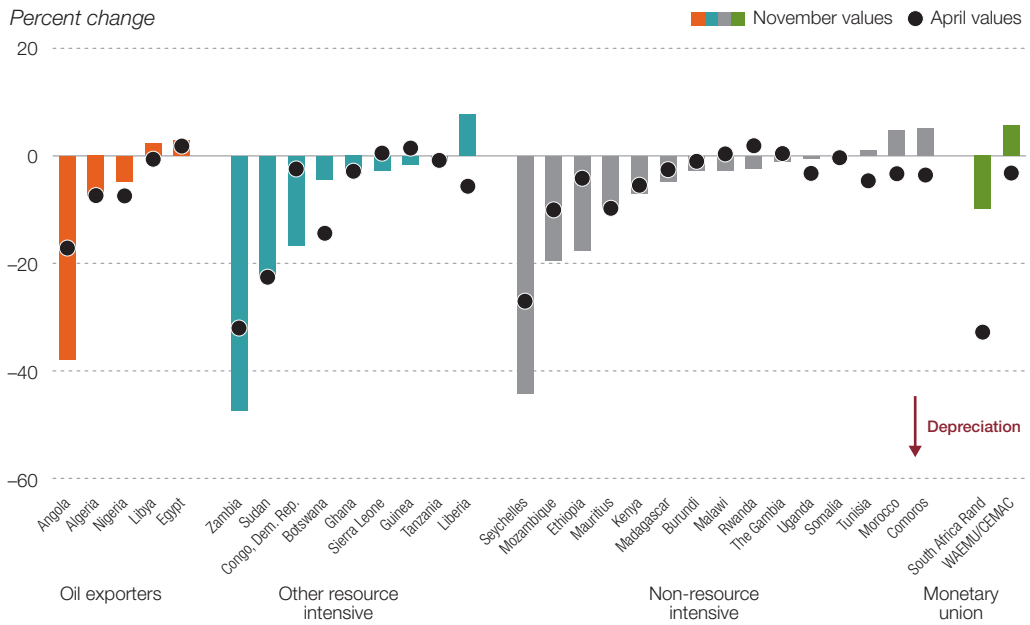
Accommodative monetary policy stance has been used to prop up liquidity

Monetary policies varied among countries prior to the pandemic. But the spread of COVID–19 has triggered a synchronization of policies, all of which are providing liquidity to ease the pandemic's impact. African central banks have eased monetary conditions with a variety of policy actions. Most central banks have cut monetary policy rates since January 2020 (figure 1.12). Central banks have also injected liquidity into the banking system, ranging from 0.5 percent of GDP in Angola to about 3.1 percent of GDP in Zambia.

Central banks have also used unconventional monetary and macroprudential tools, such as temporary suspension of loan payments by distressed firms and households. They have relaxed prudential constraints, for example, by reducing bank capital requirements. Other actions include the purchase of government securities (South Africa) and the delay of the transition to Basel III norms (the West African Economic and Monetary Union).

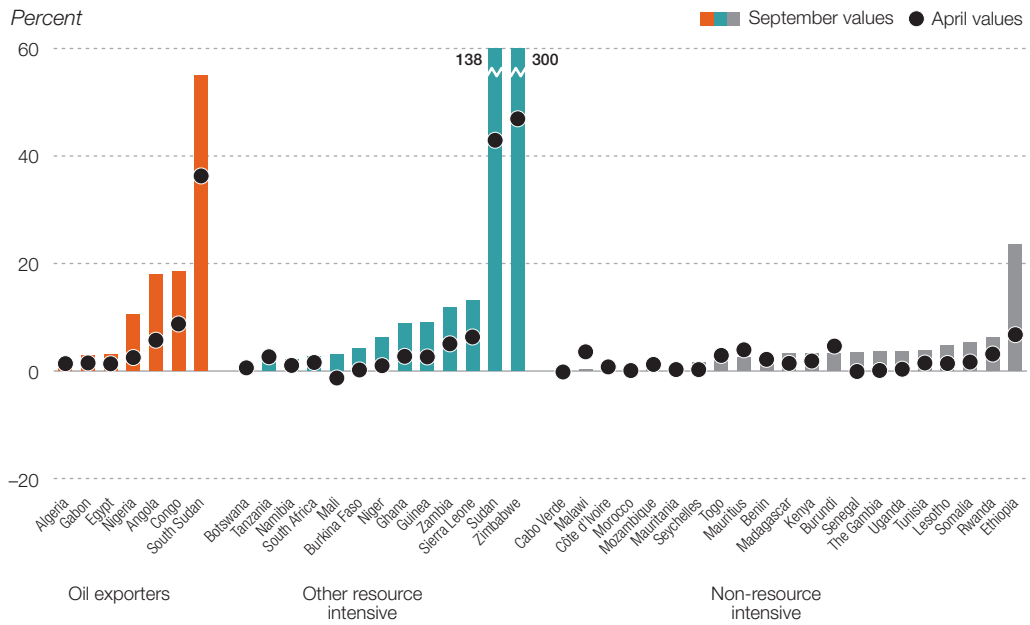
Inflation in Africa is projected to moderate to 9.0 percent in 2021

FIGURE 1.10 Exchange rate changes: January–November vs January–April in 2020



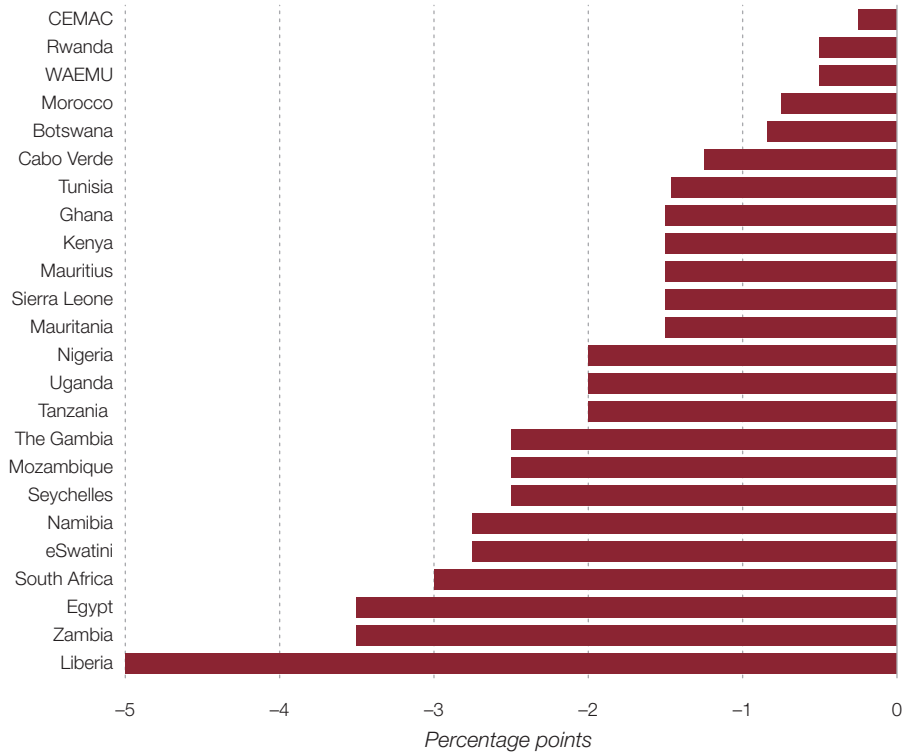
Source: African Development Bank statistics.

FIGURE 1.11 Consumer price indices changes, January–September vs. January–April in 2020



Source: African Development Bank statistics.

FIGURE 1.12 Monetary policy rate changes, January 2020 to September 2020



Source: IMF International Financial Statistics database and Haver Analytics.

The surge in fiscal deficits due to COVID–19 interventions is expected to moderate with the recovery

Fiscal deficits are estimated to have nearly doubled, to 8.4 percent of GDP in 2020, from 4.6 percent in 2019, because of heavy stimulus spending by many countries to alleviate the pandemic's economic impact. The fiscal measures included above-the-line budgetary support through investments in health systems, expansion of social protection programs, and support to the private sector, for example through tax relief. Some countries have also used below-the-line measures such as guarantees to support ailing businesses (see chapter 2). The average size of the fiscal stimulus packages deployed by countries is about 3 percent of GDP, but it varies significantly, from about 32 percent in Mauritius to 10 percent in South Africa to less than 1 percent in Tanzania (figure 1.13).

Besides the additional spending related to COVID–19 interventions, fiscal deficits in 2020 were the result of revenue shortfalls for oil exporters, a narrowed tax base due to the economic contraction, and a decline in both imports and exports. Growing debt levels and debt service burdens (more than 20 percent of tax revenue for many countries) have squeezed available fiscal space for most countries, adding to gross financing needs. But the temporary debt service suspension granted by G20 countries and the emergency budget supports by multilateral institutions have helped alleviate the financing constraints (figure 1.14).

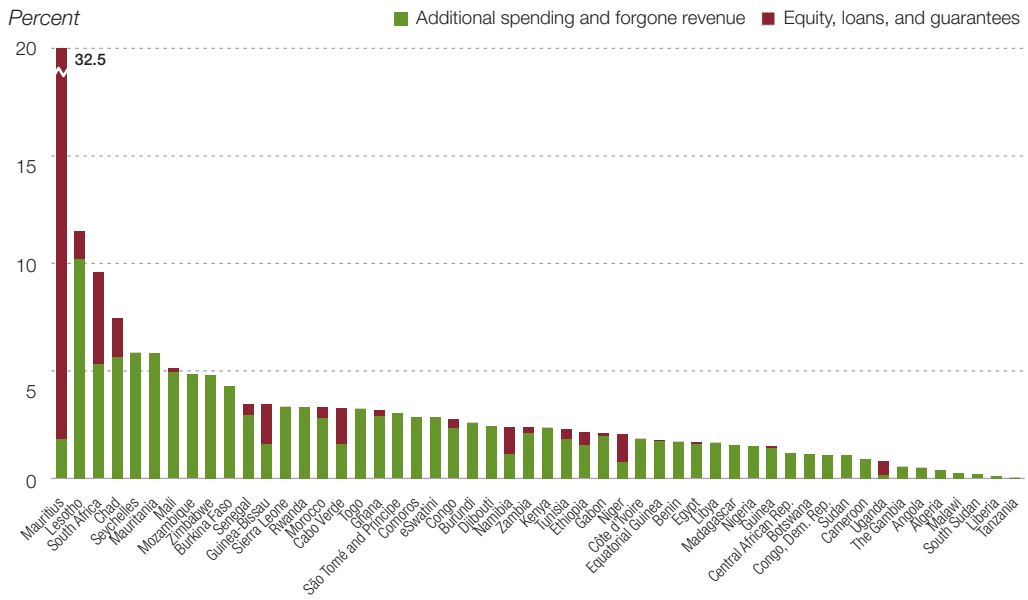
Modest fiscal consolidation measures are expected as economic activity resumes in 2021.

Macrofinancial regulatory forbearance has helped cushion the adverse effects of COVID–19 but raised financial vulnerabilities

COVID–19 has caused many businesses and households to face severe insolvency and illiquidity constraints that hamper their ability to pay back maturing bank loans. Non-performing bank loans could lead to significant macrofinancial vulnerabilities in the banking sector. Non-performing loans have increased the most in Angola, Republic of Congo, Kenya, Tanzania, Uganda, and Zambia (figure 1.15). Prolonged forbearance of prudential rules and high levels of non-performing loans could be a major source of macrofinancial risk that could, in turn, derail the expected recovery. Financial market regulators must strike a balance

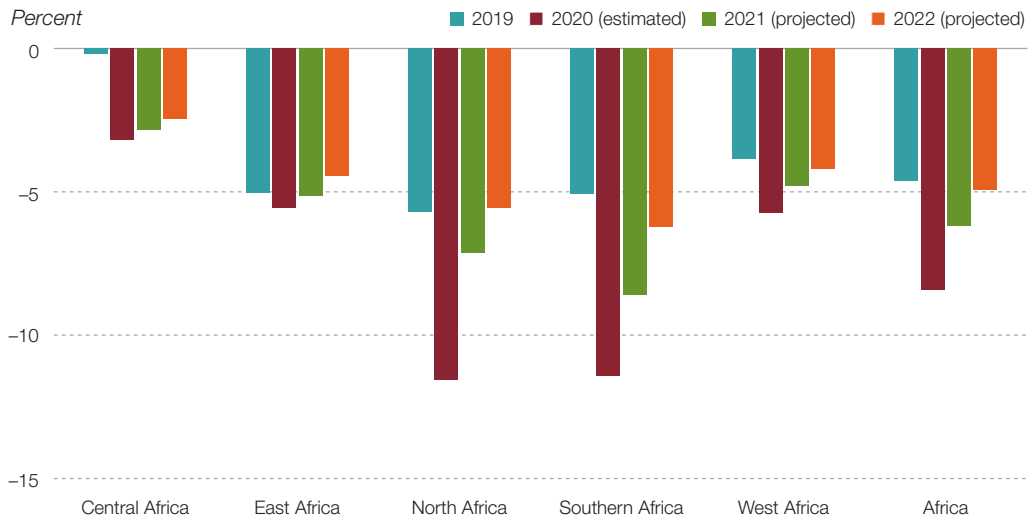
The fiscal stimulus packages vary from about 32 percent in Mauritius to 10 percent in South Africa to less than 1 percent in Tanzania

FIGURE 1.13 Above-the-line measures and liquidity support, 2020



Source: Staff calculations based on IMF Fiscal Affairs Department database.

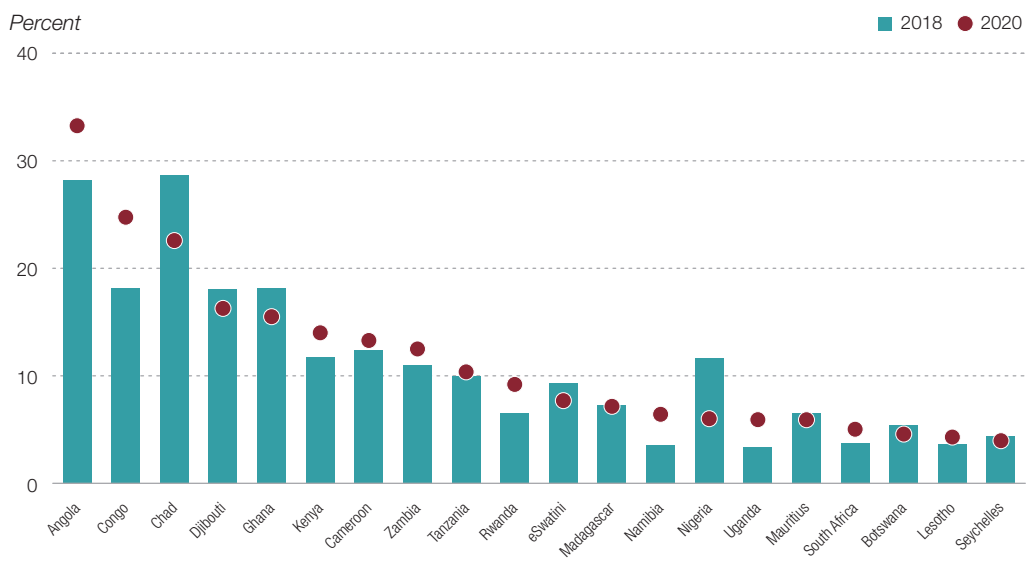
FIGURE 1.14 Fiscal balance to GDP, by region



Source: African Development Bank statistics.

Financial vulnerability can propagate and amplify the pandemic's negative effects on the real sector

FIGURE 1.15 Non-performing bank loans in total gross loans, 2018 and 2020



Source: Staff calculations based on IMF International Financial Statistics database.

between preserving financial stability, maintaining a healthy banking system, and sustaining economic activity during the pandemic. This is a tricky but important assignment because financial vulnerability can propagate and amplify the pandemic's negative effects on the real sector—what economists call the "financial accelerator".[5] Where loan restructuring is inevitable, regulators should work with banks to ensure that such processes are transparent, fair, and expeditiously completed.

Financial flows: Foreign direct investment, remittances, tourism, and official development assistance

Financial inflows have been disrupted but are expected to rebound

Financial inflows have been significantly disrupted by the pandemic. Major inflows, including foreign direct investment (FDI), portfolio investments, remittances and official development assistance

(ODA), declined between 2019 and 2020 (figure 1.16). FDI flows are estimated to have declined by 18 percent, from $45.37 billion in 2019 to an estimated $37.20 billion in 2020—mainly due to heightened uncertainty in the investment climate. The decline in investment flows is broad-based, affecting all sectors, including tourism, leisure, energy, aviation, hospitality, and manufacturing.[6]

Portfolio investments completely reversed in 2020 from a net inflow of $23 billion in 2019 to a net outflow of $27 billion in 2020, as investors liquidated their investments in search of safer assets elsewhere. ODA is estimated to have decreased by 10 percent in 2020, from $52.88 billion in 2019 to $47.59 billion in 2020.

Remittances and migrant flows have contracted for most countries

Remittances, the most significant source of external financial inflows to Africa, had been increasing until the pandemic in 2020 (figure 1.16). Remittances to Africa declined from $85.8 billion in 2019 to $78.3 billion in 2020. Countries with the most significant drop in remittances were Lesotho, Mozambique, and Seychelles (figure 1.17).

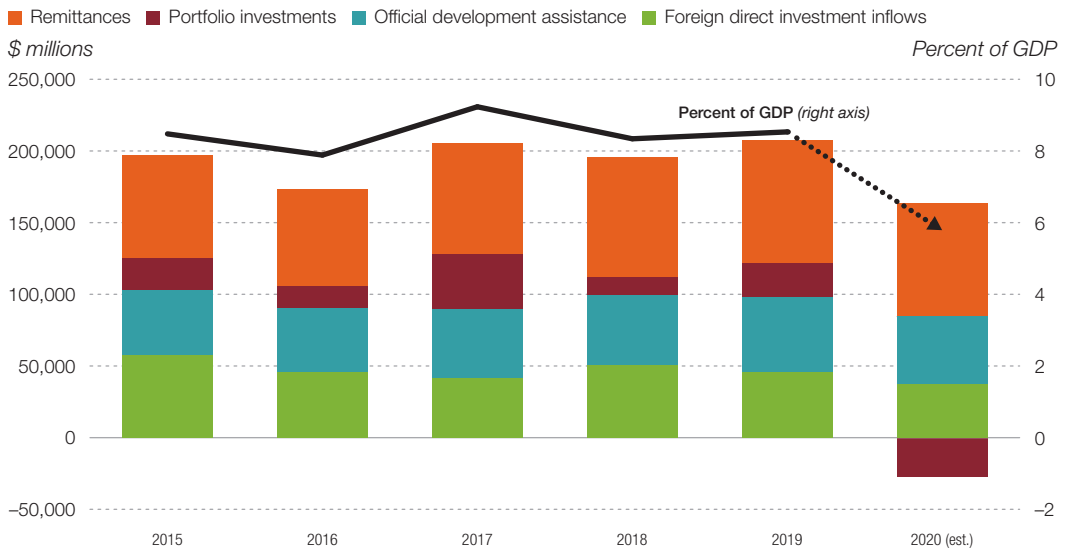
The economic fallout of the pandemic, including lockdowns, job losses, and business closures has affected migrant workers in popular destinations across the world. Many migrant workers—in particular those in low-skill and part-time jobs—work in contact-intensive sectors such as tourism, hospitality, and retail businesses and have suffered job and income losses. Many migrants also work in health and other so-called essential jobs, where they are disproportionately exposed to COVID–19, which may affect their ability to work and send money home. Moreover, for the first year in recent decades, international migration decreased in 2020, suggesting that future migrant remittances will moderate until international labor mobility fully resumes. Policymakers must address challenges with migration and remittances to make them crisis-proof in the future (box 1.2).

Tourist arrivals in Africa nearly ceased at the pandemic's peak

Africa had the world's second-fastest growing tourism sector before the pandemic—it grew 5.6 percent between 2017 and 2018 and lagged behind only Asia and the Pacific. In 2018, the sector accounted for 8.5 percent of Africa's GDP and employed about 24 million people.[7] The pandemic virtually halted international tourism. The number of international tourist arrivals between April and June 2020 was 98 percent lower than in the same period in 2019 and only started a halting recovery in August

FDI flows are estimated to have declined by 18 percent, from $45.37 billion in 2019 to an estimated $37.20 billion in 2020

FIGURE 1.16 All financial flows have been declining since 2017



Source: Staff calculations based on African Development Bank statistics, UNCTAD, OECD, World Bank, and IMF Balance of Payments Statistics databases.

BOX 1.2 Increasing remittances' resilience to shocks

Gains in poverty reduction, human capital, and sustainable development are under serious threat because of the pandemic, which makes it imperative to keep migrants' transfers flowing. Although remittances have been adversely affected by the COVID–19 pandemic, they have been less volatile and more resilient than foreign direct investment. Remittances have also decreased much less than what was initially projected earlier in 2020. This resilience can be explained by several factors. Migrants dipped into savings for money to send back home. They were more likely to send remittances through recorded channels and digital means. And many migrants had income from host governments' cash transfers, which dampened the pandemic's effect on remittances flows.[1] However, migrants may not be able to keep up this behavior if more policies to support them are not adopted.

Governments' pandemic relief policies must include migrants in both destination and origin countries. For instance, Senegal, a top remittance-receiving country in Africa, has allocated financial aid to its diaspora of about $23 million. This is both a signal of solidarity and a way to cushion the impact of the crisis on migrants' transfers. Destination countries should also include migrants both in their income support programs and in their health strategies.

To support efforts to keep remittances flowing during the pandemic, several countries and international organizations have launched a call for action. Key recommendations include mobilizing migrants' savings through diaspora bonds and improving data monitoring to track nonrecorded flows, including those through informal channels or digital means. It is critical to enhance the remittance infrastructure by incentivizing digital payments, enabling better access to banking and transfers services, and reducing the cost of transfers through more competition or tax credits to providers.[2] Beyond money transfers, there is a need to find ways to invest more remittances in transformative projects in, say, the health or education sectors. The value of social remittances —that is, migrants transferring their knowledge and experience to foster change in social norms or in public policy—should not be neglected either during the pandemic or after it.

Finally, beyond keeping remittances flowing, it is important to keep migration and human capital flowing. Given that most immigration happens within Africa, regional integration through the African Continental Free Trade Agreement and effective implementation of the Free Movement Protocol in Africa would temper adverse shocks and maintain the remittances increasingly vital for many countries and households across the continent.[3]

Notes

1. Ratha and others 2020.
2. Mohielden and Ratha 2020.
3. Konte and Mbaye 2020.

2020 (figure 1.18). The pandemic also hurt aviation. The International Air Transportation Association estimates that Africa's aviation industry lost $2 billion in 2020. Demand for air travel is not expected to reach its pre-COVID–19 levels before 2023.

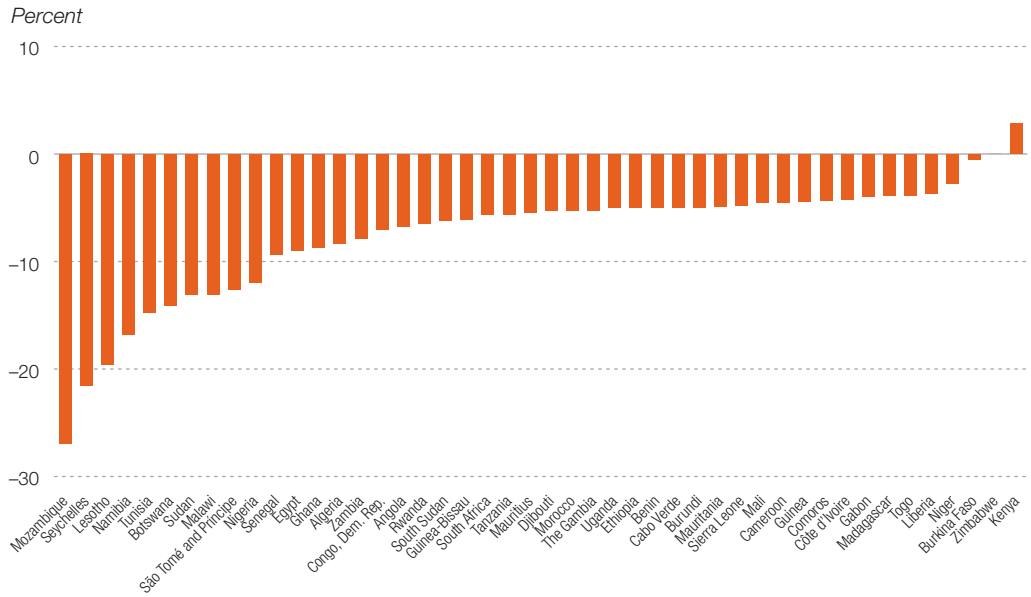
External positions and current account balances

External positions deteriorated during the crisis but are projected to recover in the near term

The overall current account deficit for Africa is estimated at 5.5 percent of GDP in 2020 and is projected to narrow to 4.1 percent in 2021 and 2.7 percent in 2022. The narrowing largely reflects the expected recovery of GDP and of Africa's major commodity exports. Weak domestic demand and fewer capital projects are expected to lower import demand in the medium term. The projected improvement in current account balances is, however, particularly uncertain for countries with contact-intensive sectors such as tourism, hospitality, entertainment, and transportation (figure 1.19).

The current account has been driven primarily by trade deficits and net factor payments abroad

FIGURE 1.17 Remittance inflows declined in almost all African countries between 2019 and 2020

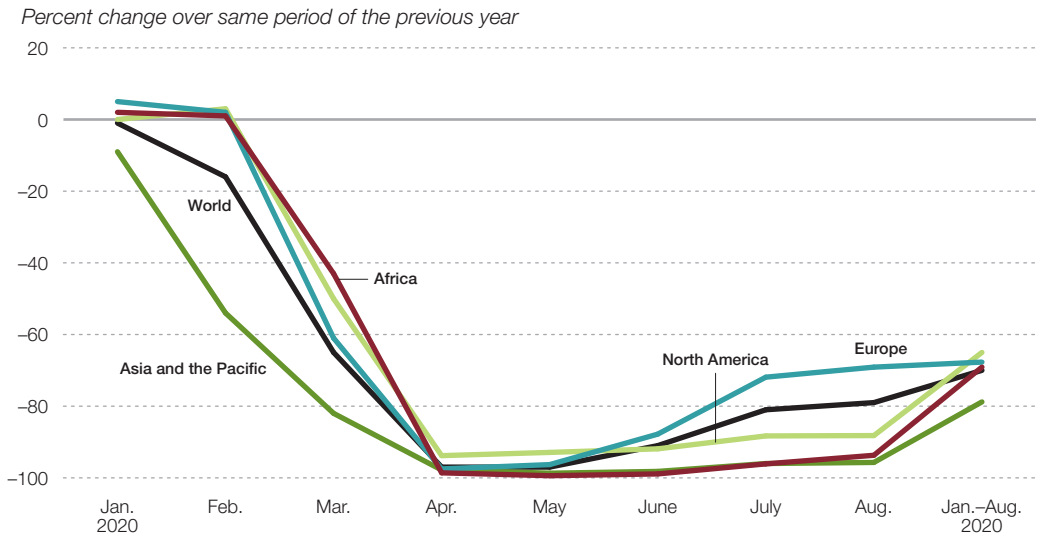


Note: Data for 2020 are estimated values.

Source: African Development Bank, World Bank, and IMF Balance of Payments Statistics database.

Remittances to Africa declined from $85.8 billion in 2019 to $78.3 billion in 2020.

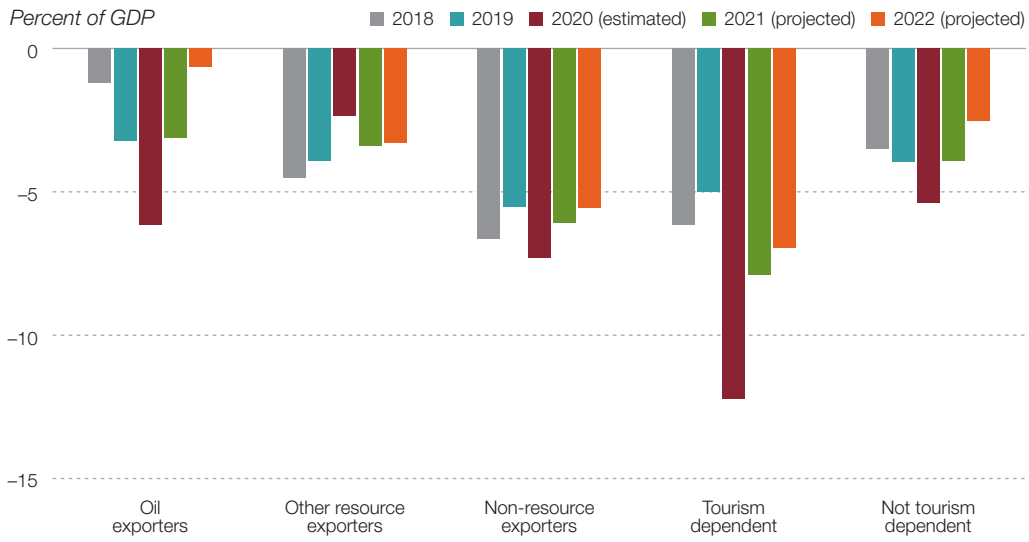
FIGURE 1.18 Africa is one of the regions where international tourist arrivals have fallen the most (January–August 2020)



Note: Percentage change over same monthly variations, calculated over 2019–20.

Source: World Tourism Organization.

FIGURE 1.19 Current account balances by economic region, 2018–22



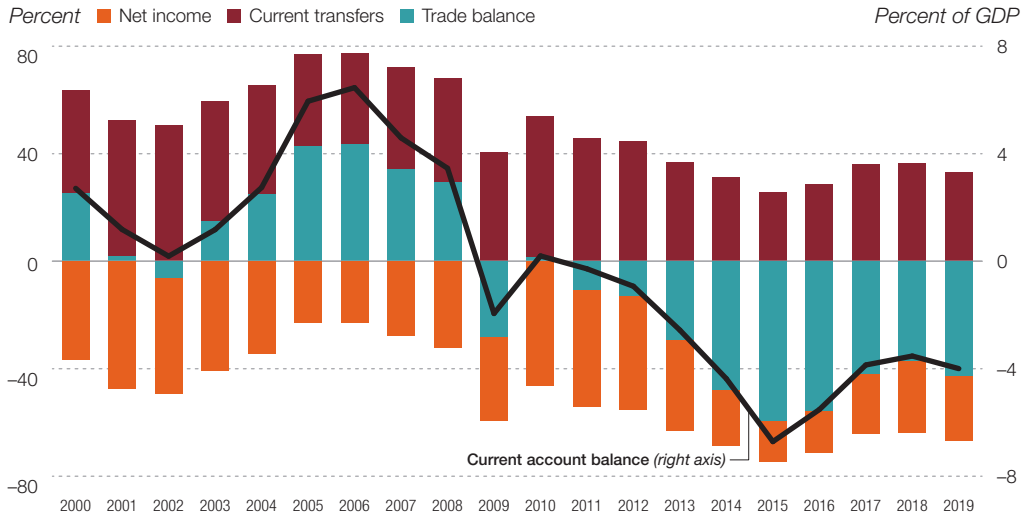
Source: African Development Bank statistics.

The current account has been driven primarily by trade deficits and net factor payments abroad and propped up by current transfers, including remittance inflows and foreign aid

(the value of earnings on foreign investments minus payments to foreign investors) and significantly propped up by current transfers, including remittance inflows and foreign aid (figure 1.20).

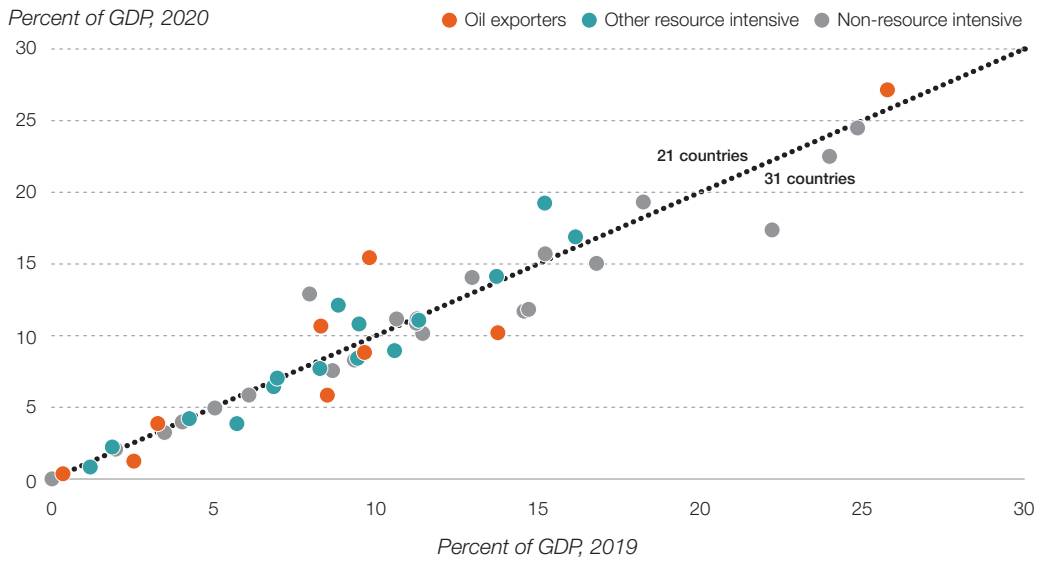
The number of months of imports that foreign exchange reserves can cover has narrowed because many countries depleted their external reserves to finance pandemic-related expenditures. External buffers measured as a percent of GDP fell for 31 of the 52 African countries with available data between 2019 and 2020 (figure 1.21). Depleting buffers might lead to foreign exchange shortages, which could put further depreciation pressures on a country's exchange rate and undermine its ability to service debt denominated in a foreign currency.

FIGURE 1.20 Current account balance decomposition, 2000–19



Source: African Development Bank statistics.

FIGURE 1.21 External reserves in 2020 fell in 31 countries



Source: IMF World Economic Outlook database.

SOCIAL AND ECONOMIC EFFECTS OF LOCKDOWNS IN AFRICA

Poverty and welfare impact of COVID–19 in Africa

COVID–19 effects will reverse hard-won gains in poverty reduction

The pandemic's impacts have reversed hard-won gains in poverty reduction and inclusive growth. COVID–19 is estimated to have increased the proportion of people living on less than $1.90 per day by 2.3 percentage points in 2020 and by 2.9 percentage points in 2021,[8] leading to extreme poverty rates of 34.5 percent in 2020 and 34.4 percent in 2021 (figure 1.22). COVID–19's effect on poverty has been the worst for oil-exporting countries, which experienced a decline in export volume and price. But it was less than anticipated partly because of the mild recovery in global oil prices that started in May 2020.

Updated estimates show that up to 38.7 million more Africans could slide into extreme poverty due to COVID–19

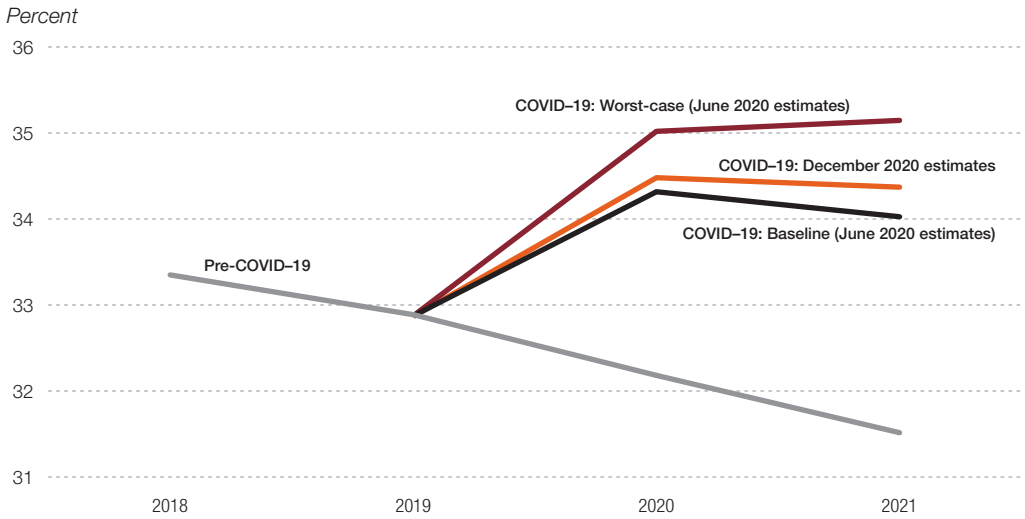
More than 30.4 million Africans were pushed into extreme poverty in 2020 and as many as 38.7 million could be in 2021 as a direct consequence of COVID–19 (figure 1.23). Most of the people falling into extreme poverty are those with lower levels of education and few assets, those in vulnerable employment and informal jobs, low-skilled workers, and those already in precarious situations (such as households affected by locust invasions or drought). These groups are more exposed because they often work in contact-intensive sectors, such as retail services, or in labor-intensive manufacturing activities with fewer opportunities to socially distance, or work from home. Women and female-headed households could represent a large proportion of these newly poor.

Women and female-headed households could represent a large proportion of the newly poor due to COVID-19

On average, African countries needed to allocate more than 0.8 percent of their GDP in 2020 to close the extreme poverty gap caused by COVID–19

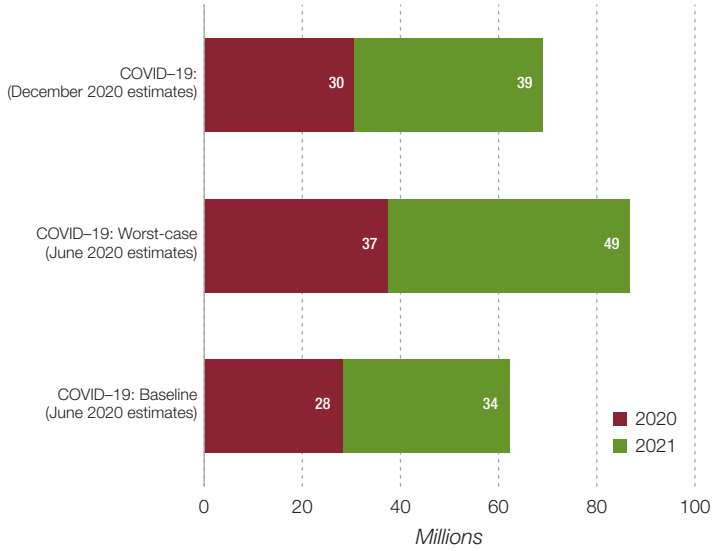
The African Development Bank estimates that African countries would have needed to spend about $158 million on average in 2020 (or 0.8 percent of GDP) to raise all their new extremely poor citizens to the $1.90-per-day poverty line (to close the extreme poverty gap). For 2021, it is estimated that countries would have to spend $90.7 million on average, or about 0.5 percent of GDP. Combined, African countries with available data would need to allocate $7.8 billion in 2020 and $4.5 billion in 2021 to eliminate the income shortfall of the new poor caused by COVID–19.

FIGURE 1.22 Africa's extreme poverty rates, 2018–21



Source: Staff calculations based on World Bank PovcalNet datasets, growth projections by African Development Bank Statistics Department, and population projections by United Nations Population Division.

FIGURE 1.23 Additional number of extreme poor due to COVID–19, at the $1.90-a-day poverty line



Source: Staff computations using World Bank's PovcalNet datasets, growth projections by African Development Bank Statistics Department, and population projections by United Nations Population Division.

Effectiveness and consequences of COVID–19 lockdown measures in Africa

African countries have imposed lockdown measures—closing schools, workplaces, and public transport; cancelling public events; restricting private gatherings, domestic and international travel; and issuing stay-at-home requirements—to contain the spread of COVID–19.

African countries took preventive measures as soon as COVID–19 cases were reported

At the height of the COVID–19 outbreak in Africa, between March and July 2020, governments across the continent instituted stringent restrictions regarding international and domestic transport, public events, and school openings. African countries have been proactive in their responses, taking preventive measures as soon as confirmed COVID–19 cases were reported (figure 1.24). One day after the first COVID–19 case was detected, half of African countries with available data restricted international travel through arrival screening, quarantines, bans of arrivals from some or all regions, and even total border closures. It took just three days for 50 percent of African countries with available data to announce restrictive measures on schools and universities and less than two weeks to impose stay-at-home restrictions.

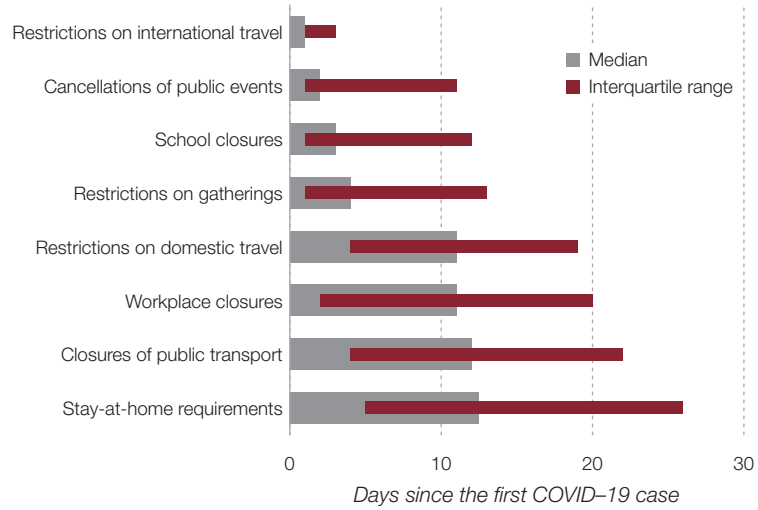
As confirmed COVID–19 cases increased, African countries tightened their lockdown measures: the lockdown stringency index[9] increased exponentially between 30 and 60 days after the first COVID–19 cases (figure 1.25, left panel). It declined thereafter as countries started to

gradually relax restrictive measures following a reduction in daily new COVID–19 cases. Figure 1.25, right panel, shows that a quarter of African countries reached full lockdown restrictions within 12 days after confirmation of their first COVID–19 case. On average, it took a month for African countries to achieve full lockdown stringency. At maximum stringency, daily COVID–19 infections approached on average 0.1 cases per thousand people in Africa, compared with 2.5 cases in other regions and 1.8 cases on average in the world.[10]

Lockdowns have been effective at mitigating the spread of COVID–19 in Africa…

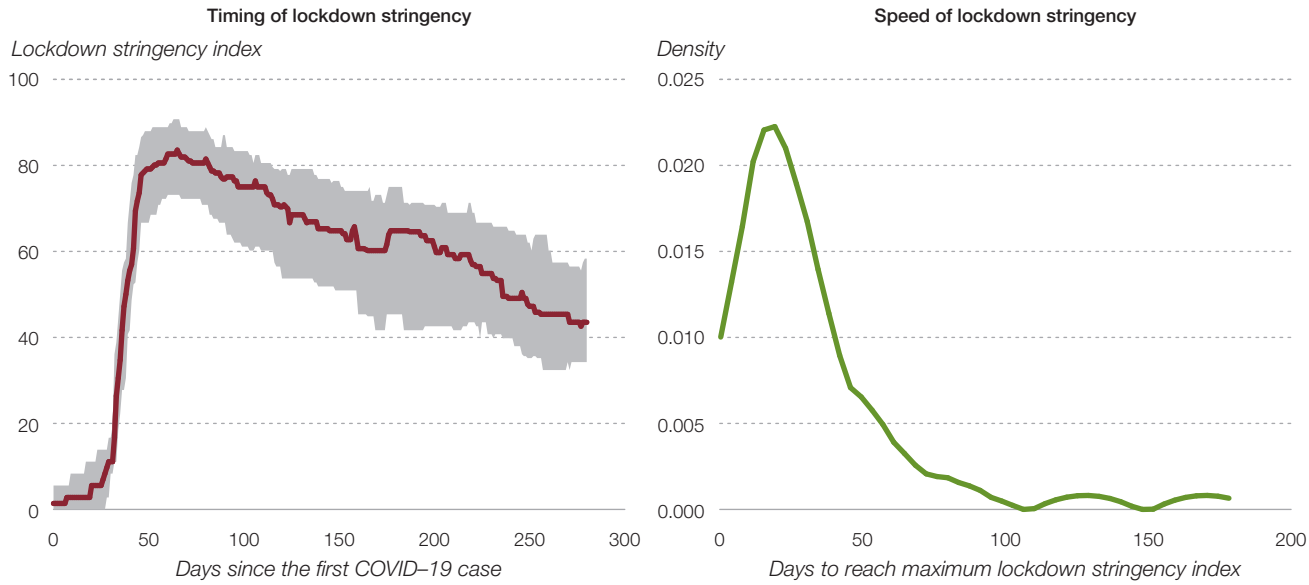
Regression analyses of COVID–19 infections in relation to the stringency of lockdowns—with other covariates such as public information campaigns, testing, and contact tracing controlled for—show that stringent lockdowns effectively reduced COVID–19 infections in Africa, with effects starting about 30 days after implementation (figure 1.26). The lag in response could stem from the COVID–19 incubation period of up to two weeks, the time necessary for testing, and the lag between the official announcement of lockdown measures and their enforcement (see annex 1.2 for details on methodology). Evidence suggests that schools, public transport, and workplace

FIGURE 1.24 Timing of COVID–19 lockdown measures in Africa, 2020



Source: Staff calculations based on data from Oxford Coronavirus Government Response Tracker.

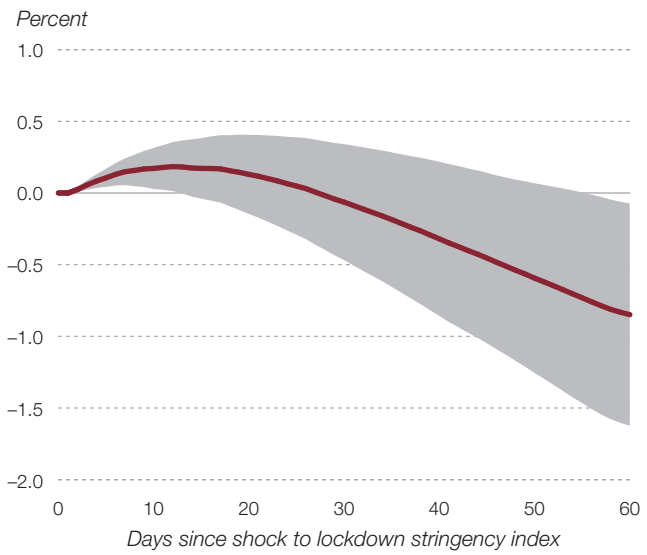
FIGURE 1.25 Timing and speed of lockdown stringency in Africa, 2020



Note: The left panel shows the evolution of the (median) lockdown stringency between 14 February 2020 (date of the first confirmed COVID–19 case) and 18 November 2020 (280 days after). The shaded areas refer to the interquartile range.

Source: Staff calculations based on data from Oxford Coronavirus Government Response Tracker.

FIGURE 1.26 **Responses of COVID–19 cases to lockdown stringency in Africa**



Note: The figure reports the response of COVID–19 cases per thousand people (in percent) to one unit shock to the lockdown stringency index using local projections (Jorda 2005). The shaded area denotes the 90 percent confidence interval with standard errors clustered at country level.

Source: Staff calculations based on data from Oxford Coronavirus Government Response Tracker.

closures, cancellations of public events, and stay-at-home requirements have been more effective in curbing COVID–19 infections than other types of lockdown restrictions (figure 1.27).

…but they have only had a marginal effect on COVID–19 infections in Africa compared with other regions

Even though lockdowns dampened COVID–19 infection rates, they appear to have done so at a lower rate than in other regions of the world. A stringent lockdown induces a reduction in the cumulated COVID–19 infection cases of about 0.1 percent after a month and about 1 percent after 60 days since the announcement of a lockdown. In comparison, using subnational data for 339 units in 15 of the G20 countries (with the largest economies), the IMF found that a month after imposition of a lockdown, COVID–19 cases were 58 percent lower than in subnational units without a lockdown.[11]

The lower impact of lockdown measures on COVID–19 cases in Africa could result from various factors. For example, the structure of African economies and labor markets is dominated by informal workers—almost 90 percent of all employment, or 77 percent when agriculture is excluded—who are unable to work from home.[12] In this context, the marginal impact of imposing more stringent lockdown measures is low because they are difficult to enforce. For informal sector workers, staying home means potentially losing their jobs and livelihoods, leading to the dilemma of choosing between suffering from hunger at home and going to work, risking exposure to the coronavirus.

Countries that introduced more stringent lockdown measures suffered sharper economic contractions in 2020

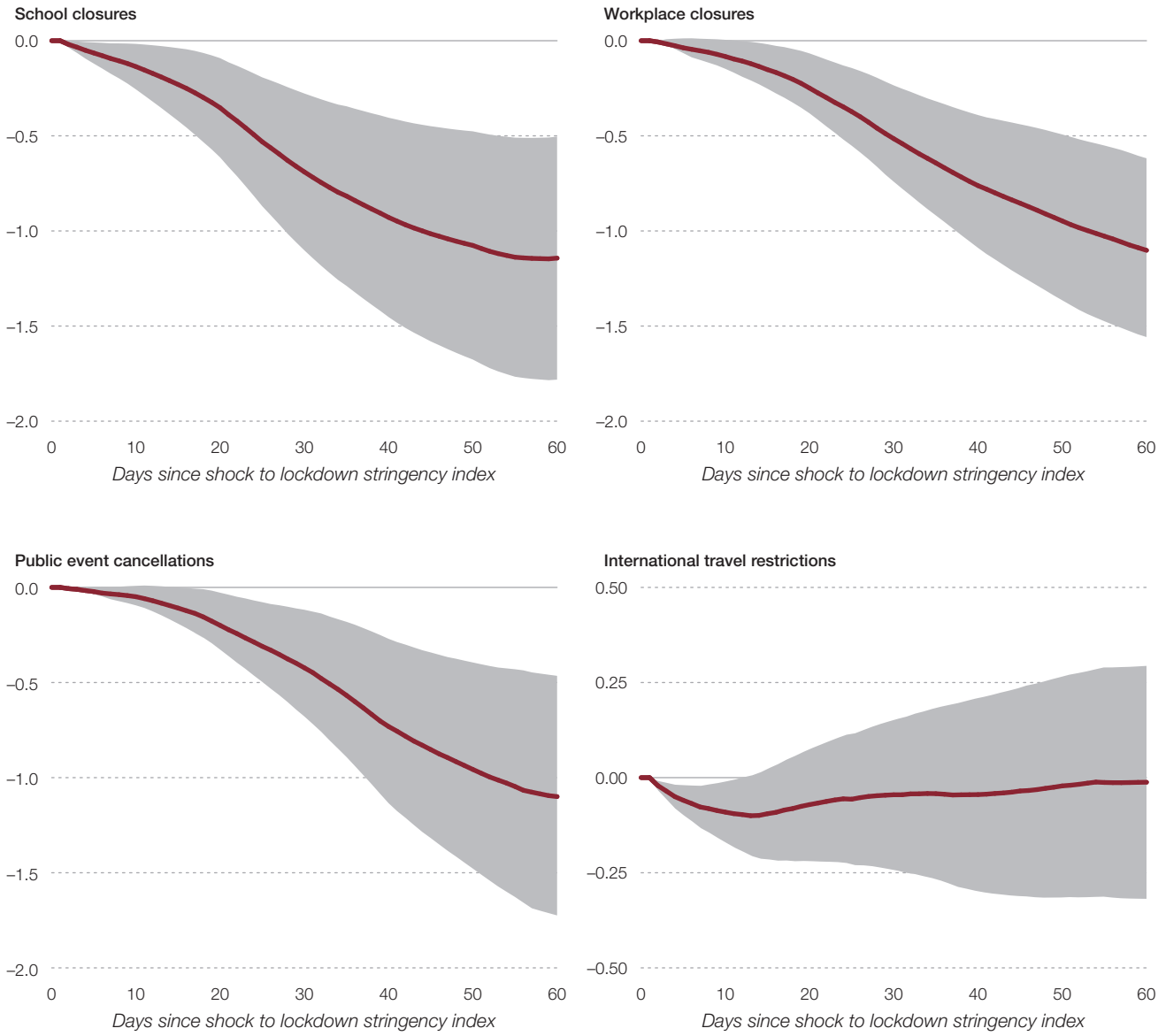
Lockdowns can have serious economic consequences because they disrupt economic activities, livelihoods, and mobility. Figure 1.28 shows the association between lockdown stringency during the first half of 2020 and the growth rates of two economic indicators—GDP and the industrial production index (IPI)—in a regression analysis weighted by each country's COVID–19 cases (per thousand people) to control for the spread of the virus. The results suggest that African countries with available data that implemented more stringent lockdown measures experienced more significant economic contractions.

LONG-TERM HUMAN-CAPITAL IMPLICATIONS OF COVID–19

The pandemic has long-term implications for human capital development

Millions of children have already lost a half year to a full year of learning, with poor communities disproportionately affected. Disruptions in routine essential healthcare services—such as malaria prevention and treatment, vaccinations, and maternal and child health services—have resulted in a secondary health crisis. Also, a disproportionately high rate of pandemic-induced job loss and livelihood damage among women will degrade human capital through lower investment in children's health, nutrition, and education. Unless there are effective remediation policies, the loss

FIGURE 1.27 Responses of COVID–19 cases to different lockdown measures in Africa



Note: The figures report the responses (in percent) of COVID–19 cases per thousand people to one unit of shock from the different lockdown measures using local projections (Jorda 2005). Each lockdown index has been normalized between 0 and 100. The shaded area denotes the 90 percent confidence interval with standard errors clustered at country level.

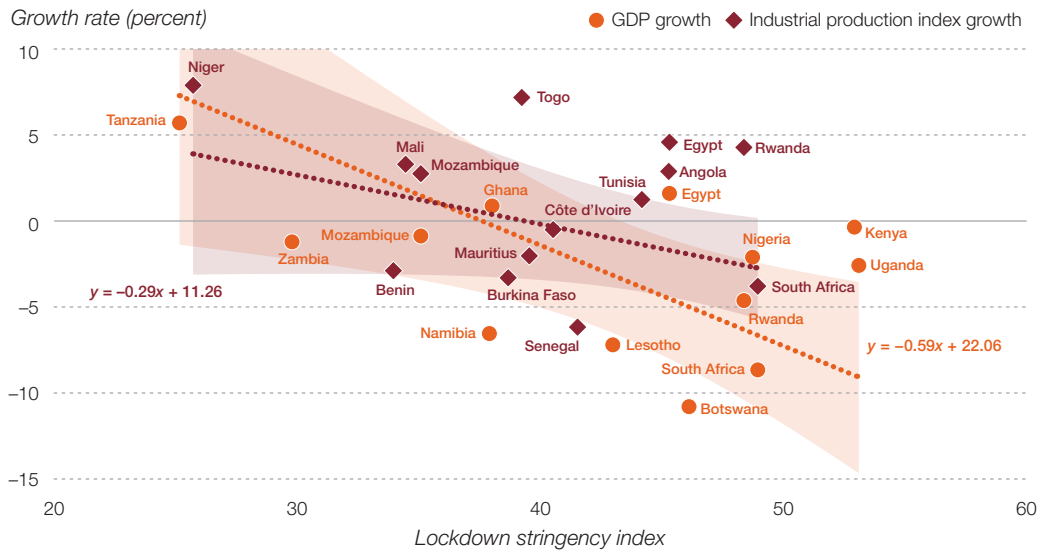
Source: Staff computations based on data from Oxford Coronavirus Government Response Tracker.

will reverse some progress in human capital development over the past two decades.

Protracted school closures will exacerbate learning inequality and increase dropout rates

Almost all African countries closed schools for a protracted period because of COVID–19.[13] During the 2020 academic year, schools were closed for more than 100 days, a full semester's worth of education (table 1.1). In some regions, such as East Africa and North Africa, schools were closed for much longer—an average of 137 days in East Africa and 106 days in North Africa. In most cases, virtual or hybrid classes were not options. In some countries, such as

FIGURE 1.28 Lockdowns and economic activity in Africa during the first half of 2020



Note: The figure gives the relationship between lockdown stringency, averaged over the first half of 2020, and the growth of GDP and the industrial production index (IPI) over the same period. For GDP, the data cover the first two quarters of 2019 and 2020, while IPI data are available for only the first quarters of 2019 and 2020. For each indicator, the growth rate is calculated as a relative change between 2020 and 2019 over the same quarters. The shaded areas denote the 95 percent confidence intervals. Growth rates were truncated at the 5th and 95th percentiles to remove outliers.

Source: Staff calculations based on data from Haver Analytics and the Oxford Coronavirus Government Response Tracker.

During the 2020 academic year, schools were closed for more than 100 days, a full semester's worth of education

TABLE 1.1 School closures by African region and selected countries, 16 February 2020–1 December 2020

	Average number of days			
	Academic breaks	Closed due to COVID–19	Fully open	Partially open
Africa	66	101	84	57
East Africa	58	137	93	41
North Africa	91	106	55	49
Central Africa	67	92	78	53
West Africa	73	91	81	58
Southern Africa	53	85	92	73
Rest of the world	63	99	95	62
Finland	90	58	142	…
Japan	34	24	176	56
Republic of Korea	…	79	175	36
Singapore	29	27	207	27

Source: United Nations Educational, Scientific and Cultural Organization database.

Ethiopia, Uganda, and South Sudan, schools were closed for more than 200 days in the 2020 academic year (figure 1.29). When virtual schools were available, most students missed classes, even where the internet was widely available. For example, about 80 percent of students missed virtual learning in Kenya—which has an 83 percent internet penetration rate.[14] Virtual schooling also raises concerns about learning inequality between students who have internet access and those without access, particularly in rural areas with lower internet access.

School closures adversely affect educational outcomes such as test scores, test score–adjusted years of schooling, and dropout rates. It is estimated that about 6.8 million students are likely to drop out of school globally, with a typical student losing a Program for International Student Assessment (PISA) score of up to 16 points, equivalent to 6 months of learning.[15] The loss in learning outcomes is expected to be worse for low-income countries, for girls, and for students in poorer communities, exacerbating gender and income inequality in learning. The estimated lifetime earnings loss from school closures related to COVID–19 is 43 percent to 61 percent of current GDP in low-income countries, 15 percent to 22 percent in middle-income countries, and 6 to 8 percent in high-income countries.[16] School closures also damage children's nutrition and health because school-feeding programs are disrupted.

Disruptions in health care systems from COVID–19 have led to a secondary health crisis

The pandemic has disrupted healthcare systems worldwide, provoking a secondary health crisis. The disruption has affected both healthcare supply and demand. Health facilities and professionals were forced to repurpose for COVID–19 treatment, disrupting elective and outpatient services. About 90 percent of countries experienced disruptions in their healthcare services between March and June 2020.[17] Routine but essential services, such as HIV therapy, immunization, family planning and contraception, and mental health care were considerably disrupted in low-income countries (see table A1.3 in annex 1.1).

Demand-side factors due to loss of livelihood have resulted in declining healthcare utilization.[18] Almost 25 percent of individuals reported that they or someone in their household missed or delayed healthcare services due to the pandemic, and more than one-third reported difficulties in obtaining medicines (figure 1.30). Social distancing and other measures also imposed significant constraints on physical access to healthcare. For instance, about 76 percent of countries reported reductions in outpatient care due to lower demand.

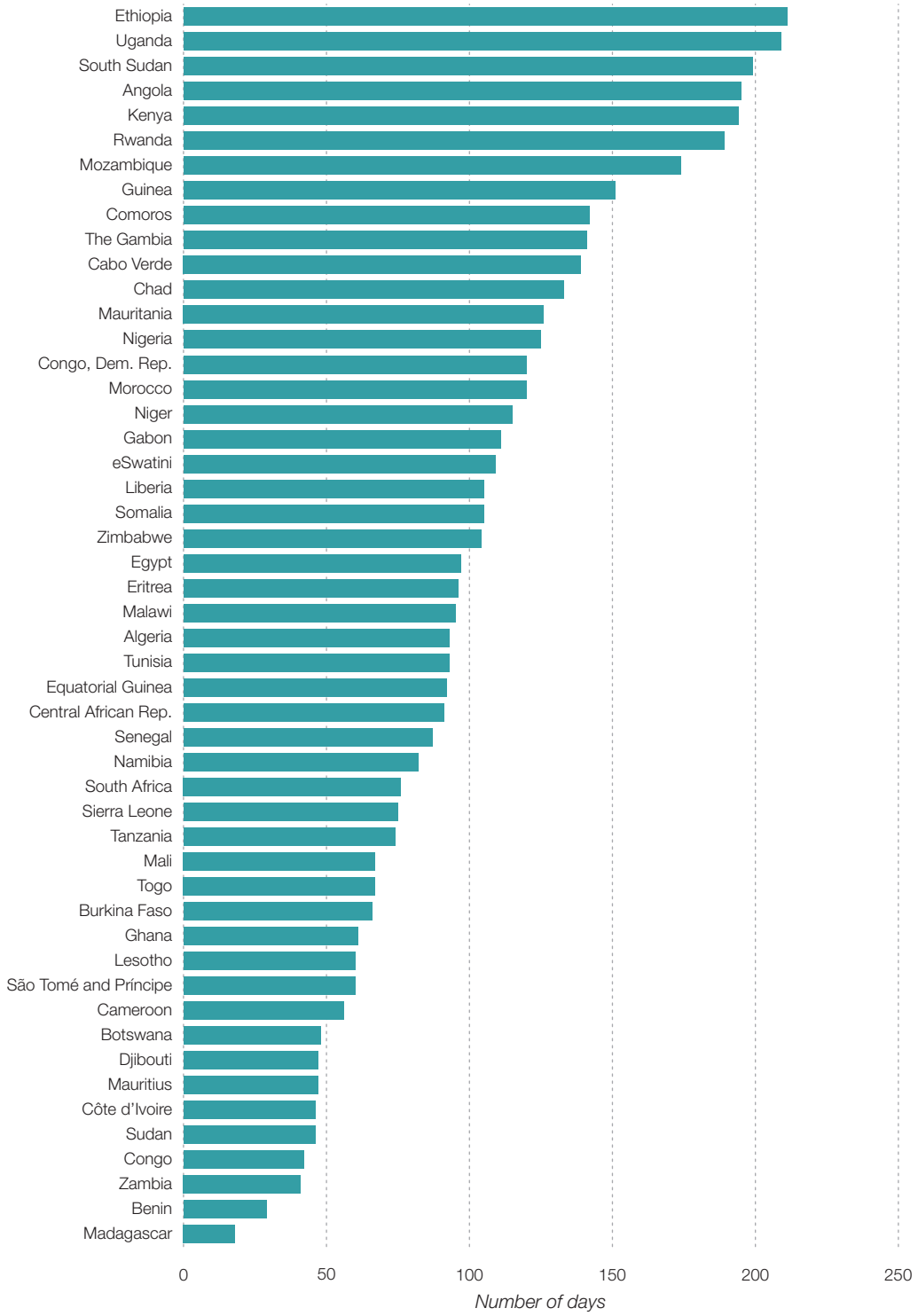
COVID–19's disproportionate effect on women's jobs could widen gender disparities

The pandemic severely affected sectors where female employment is disproportionately high, such as hotels and restaurants.[19] As workplaces closed, earnings decreased or disappeared for self-employed and hourly wage workers. World Bank data for 15 African countries show that about one-third of working-age individuals in Africa stopped working during the pandemic (figure 1.31). Even most of those who kept their jobs through the pandemic experienced a reduction in their working hours by 11.5–15.6 percent. Globally, during the first two quarters of 2020, more than 103 million full-time jobs were lost, with an estimated average loss of income of 10.7 percent.[20]

Women are more vulnerable than men to job losses in times of crisis: they account for 39 percent of global employment, and have accounted for about 54 percent of overall job losses during the COVID–19 pandemic.[21] The risk of job losses for women due to COVID–19 is much higher than for men in part because the pandemic affected sectors where female employment is high. Women's loss of income often has long-lasting effects, such as increased levels of child malnutrition, school dropout, poor health, and child labor. Left unmitigated, the pandemic's negative effect will have both short-term welfare implications and lasting consequence for human capital and growth (box 1.3).

Health facilities and professionals were forced to repurpose for COVID–19 treatment, disrupting elective and outpatient services

FIGURE 1.29 Number of days school closed due to COVID–19 in African countries



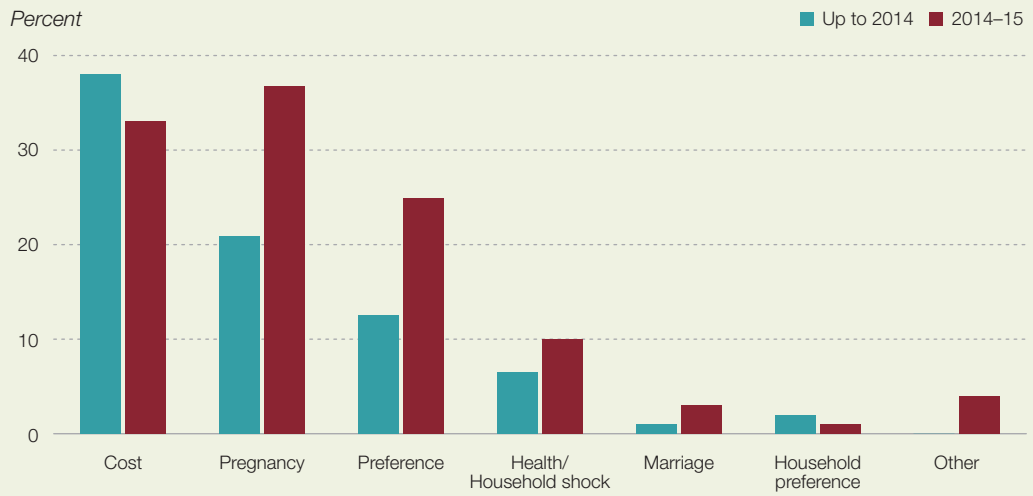
Source: United Nations Educational, Scientific and Cultural Organization database.

BOX 1.3 Providing protective spaces for girls during COVID–19 school closures: Lessons from the Ebola outbreak in Sierra Leone

In times of pandemics and disease outbreaks, school closure is often one of the preferred tools to stop the spread of infections. During the 2014–15 Ebola virus disease (EVD) outbreak in West Africa, Sierra Leone, one of the worst-hit countries, closed schools for more than nine months—sending thousands of students home with no alternatives, such as virtual classes. Young girls, in addition to losing learning from school closure, spent a significant amount of time with men in an unsafe environment, exposing them to violence and sexual exploitation.[1]

Teenage pregnancies increased significantly during the closure, with an unusually high percentage of adolescent girls reporting first-time pregnancies. Teen pregnancy is one of the primary causes of death among adolescent girls in Sierra Leone, where illegal abortion practices are widespread. Pregnancy can force girls to drop out of school, with a life-altering impact. For instance, box figure 1.3.1 shows that teen pregnancy became a major reason for dropout among girls ages 12–17 during the EVD outbreak in 2014–16 compared with the pre-Ebola periods.

BOX FIGURE 1.3.1 Reasons for girls ages 12–17 dropping out of school in Sierra Leone study villages



Source: Bandiera and others 2020.

A randomized control trial study by Bandiera and others (2020) estimated the benefits of a protective space for young girls in Sierra Leone during EVD outbreak school closures. Young girls who did not have access to safe spaces during the crisis had a higher risk of pregnancy after the pandemic. They also spent 50 percent more time with men, 25 percent less time on formal learning activities, and had school enrollment rates that were 17 percentage points lower.

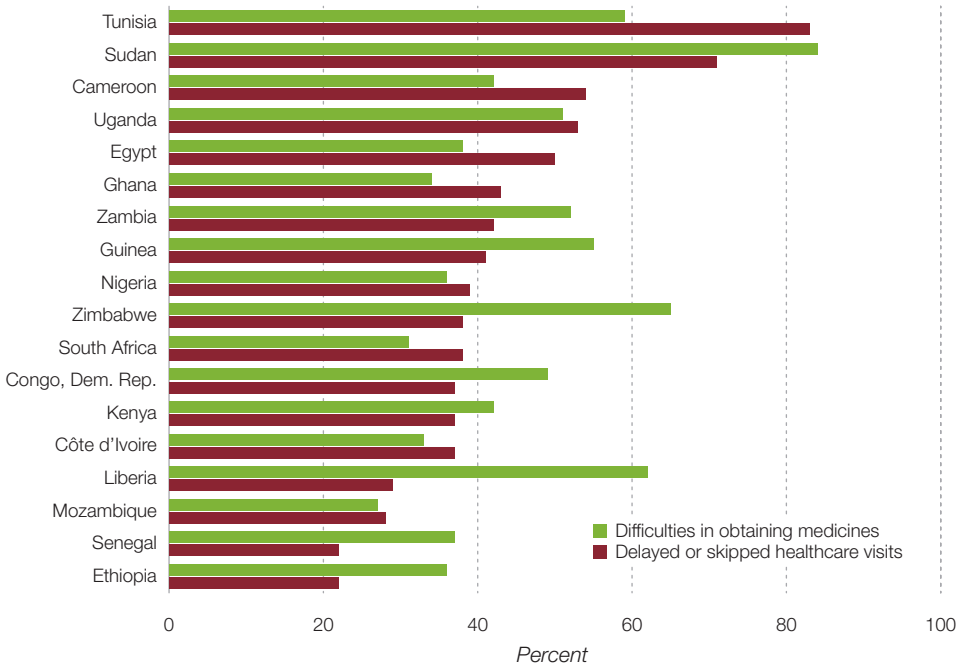
In the study, a local nongovernmental organization provided a safe space (club) under an empowerment and livelihood for adolescents program for randomly selected young girls. The safe space offered an environment in which girls could meet and socialize, acquire life skills to improve their reproductive knowledge and health, and receive vocational training to improve their labor market prospects. The study shows that providing safe spaces for girls during extended school closures reduced teen pregnancy in the postcrisis period by 50 percent. A long-term follow-up also indicated that such interventions resulted in a relatively improved human capital accumulation by young girls. Overall, the study showed that providing safe spaces for young girls during extended school closures has a lasting beneficial impact on human capital accumulation.

Note

1. Taulo 2020.

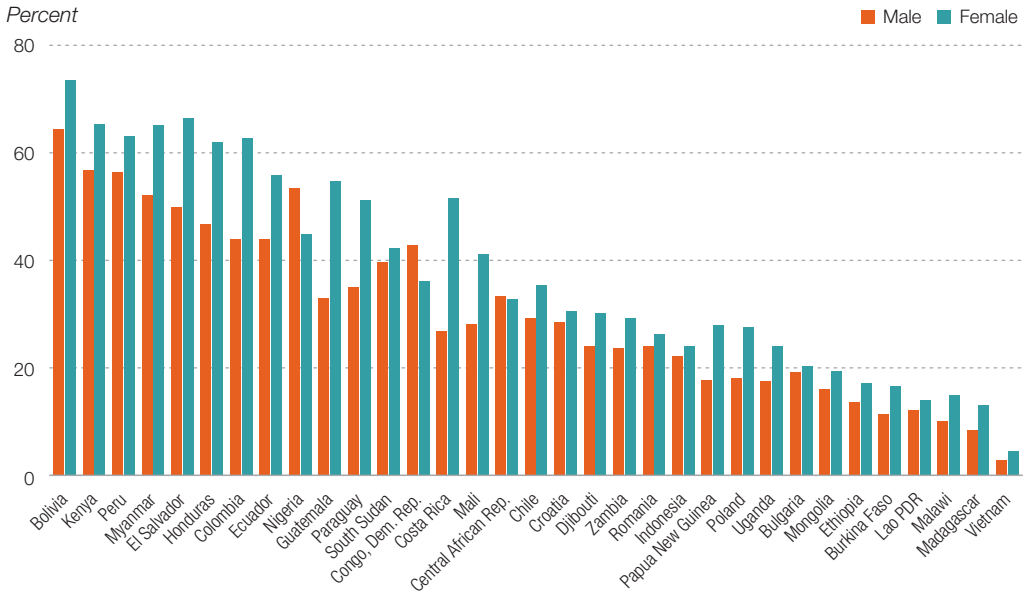
Source: African Development Bank staff based on Bandiera and others (2020).

FIGURE 1.30 Disruptions in accessing health care and obtaining medicines due to COVID–19



Source: Data from Partnership for Evidence-Based Response to COVID–19 surveys, various country reports. https://preventepidemics.org/covid19/perc/.

FIGURE 1.31 Male and female individuals who stopped working since COVID–19 outbreak



Note: Percent of working-age respondents (ages 18 and older) who stopped working during the pandemic.
Source: World Bank n.d.

BUILDING RESILIENCE AND ACCELERATING RECOVERY

Building economic resilience and reducing vulnerabilities

The pandemic has exposed the economic vulnerabilities of many African countries. The focus of governments now that the pandemic appears to be abating in most countries should be to reopen economies safely, accelerate recovery, and reduce economic vulnerabilities. Building resilience and accelerating economic recovery requires:

- Reducing an economy's vulnerability to shocks.
- Increasing its capacity to absorb shocks.
- Improving its ability to reallocate resources and recover from shock.

Economic vulnerability is measured by the structural features of an economy that determine the extent to which its development trajectory is distorted by an exogenous shock. To assess this, the African Economic Outlook team constructed economic vulnerability indices (EVI) for all African countries.[22] The index focuses on structural characteristics that accentuate underdevelopment and factors that are not the result of misguided policies but limit policymakers' capacity to respond to shocks and are beyond the country's control.[23] A lower EVI index indicates lower economic vulnerability.

Two-thirds of countries in Africa had high economic vulnerability and exposure to shocks before the pandemic

The EVI index shows that 31 African countries are above the United Nations Department of Economic and Social Affairs threshold of 36 points and therefore classified as economically vulnerable, suggesting that more than half of African countries were highly economically vulnerable in the prepandemic period (figure 1.32).

Economic resilience indices (ERI) were constructed for 46 African countries. Economic resilience refers to an economy's policy-induced ability to recover from, or adjust to, the negative impacts of adverse exogenous shocks and to benefit from positive shocks.[24] The ability to recover is often associated with an economy's flexibility. That flexibility could be limited, depending on the country's room for policy maneuver.[25] If the economy possesses discretionary policy space to counteract the effect of shocks, it would be more resilient. Resilience also captures the ability to absorb shocks, so the overall effect of a shock is neutralized or made negligible. The ERI indicates that the six least resilient economies are Angola, Central African Republic, Chad, Democratic Republic of Congo, Guinea-Bissau, and Sudan, while the six most resilient are Botswana, Mauritius, Namibia, Rwanda, Seychelles, and South Africa (figure 1.33).[26]

Some highly vulnerable countries have managed to use appropriate policies to boost their economic resilience

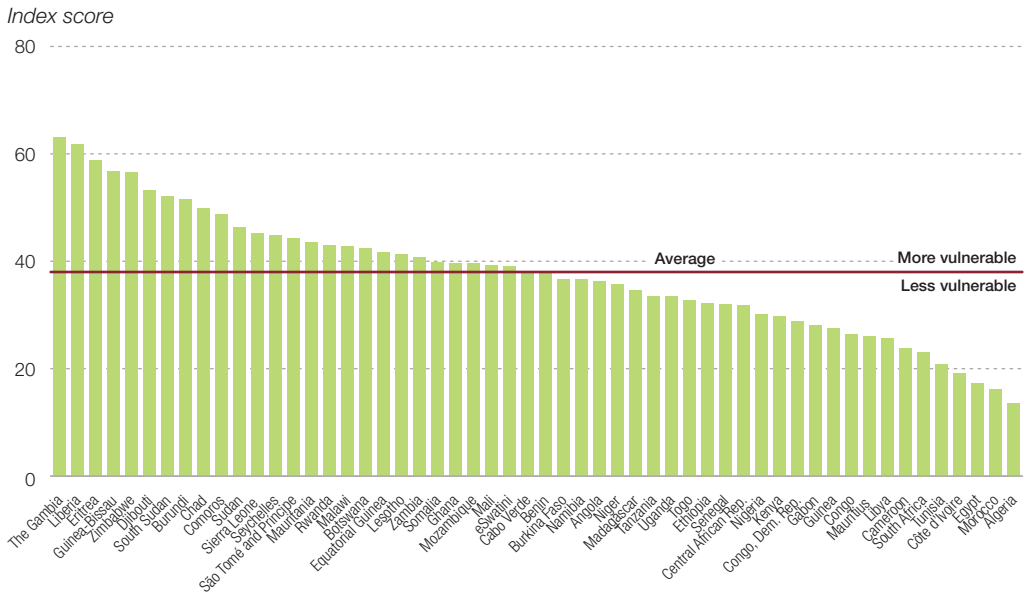
Figure 1.34 classifies countries into four possible situations in terms of their vulnerability and resilience characteristics. The best-case quadrant displays countries that are not inherently vulnerable and have resilience-building policies, such as Mauritius and Namibia. The worst-case quadrant contains countries that are inherently vulnerable economically, yet have policies that further weaken their resilience. Countries with high economic vulnerability that use appropriate policies to boost their resilience and withstand exogenous shocks are classified as "home-made" and include Botswana, Rwanda, and Seychelles. Finally, countries in the "self-inflicted" quadrant have low economic vulnerability but policies that have adversely affected their economic resilience, exposing them to adverse effects from shocks from past policies. Most African countries fall into this category.

Government size, financial sector development, and export concentration are the three primary drivers of the capacity to absorb shocks and recover quickly

Results from a dynamic output-gap regression model identify government size, financial sector development, and export concentration as the main determinants of an economy's ability to absorb shocks and recover quickly (figure 1.35). First, the government can use its size—its ability to spend, invest, and make transfers—to lift aggregate demand, which can help create employment and boost recovery. However, a balanced use of

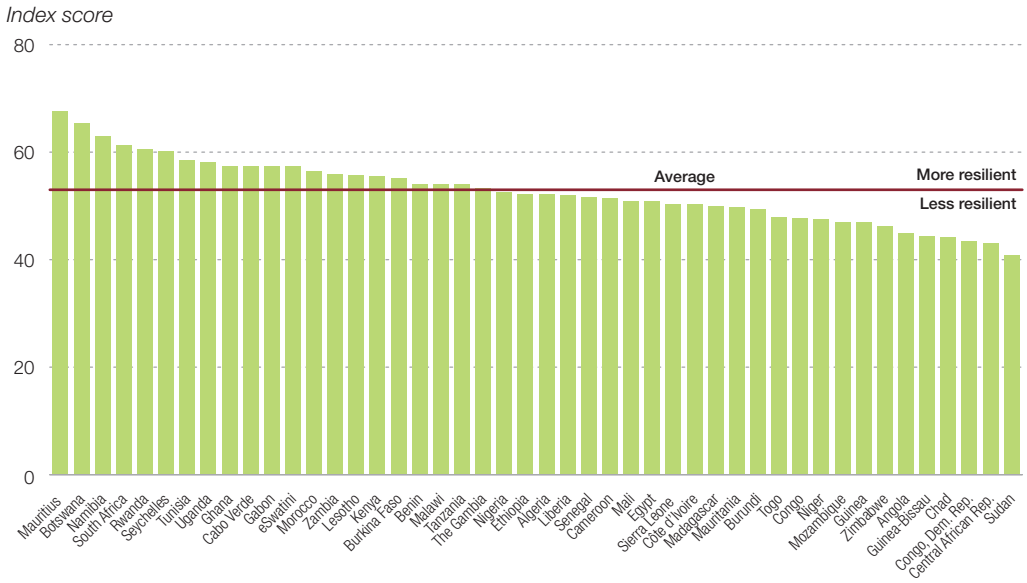
The focus of governments should be to reopen economies safely, accelerate recovery, and reduce economic vulnerabilities

FIGURE 1.32 Rankings on the economic vulnerability index



Source: African Development Bank staff calculations.

FIGURE 1.33 Rankings on the economic resilience index



Source: African Development Bank staff calculations.

The government can use its size to lift aggregate demand, which can help create employment and boost recovery

government size should be maintained to avoid crowding out the private sector through high taxes and interest rates. Second, financial sector development could absorb or amplify shocks, depending on how governments use macroprudential policies. The financial sector can be used to reallocate savings and borrowings during a time of crisis. Third, export concentration plays an important role in an economy's ability to absorb shocks and recover quickly. Reliance on a narrow range of export products tends to amplify the impact of external shocks in Africa. Economic diversification, therefore, is key to building Africa's shock absorption capacity. These results do not suggest

FIGURE 1.34 Classification of countries by vulnerability and resilience characteristics

Source: African Development Bank staff calculations.

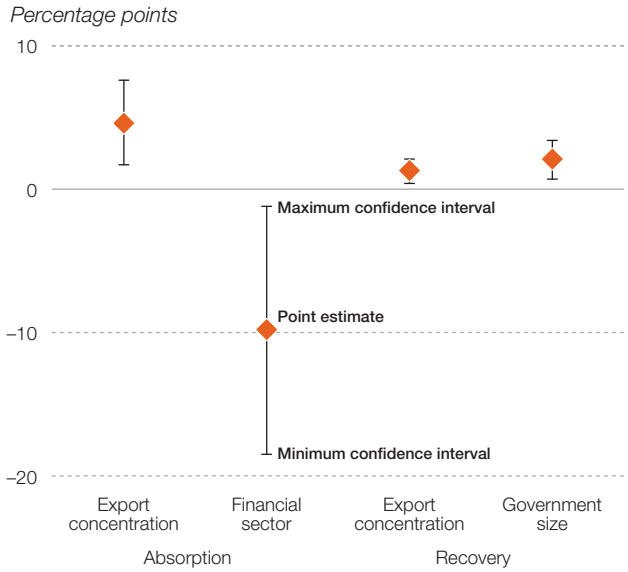
that other factors are not important for building Africa's resilience but identifies these as the most significant.

POLICY RECOMMENDATIONS

The global scale of the COVID–19 pandemic and its repercussions require that the policy responses be bold, coordinated, targeted, and sustained until full recovery is achieved. Withdrawing policy support prematurely might undermine gains already made. The following actions are recommended:

- **Continue support of the health sector to consolidate gains in the fight against the pandemic.** In the face of a second wave of the pandemic observed in several regions during the last quarter of 2020, countries must continue to make resources available for the healthcare system to cope with the virus and other preventable diseases. Also, routine public health campaigns, such as child vaccinations against polio and measles, treatment for malaria, maternity care, and treatment for other chronic diseases, must not be disrupted due to excessive focus on the COVID–19 pandemic. To reduce overreliance on foreign industries, policymakers need to develop the

FIGURE 1.35 Factors determining absorption capacity and recovery speed



Note: The chart shows the 90 percent confidence interval and the point estimate. A positive coefficient of an absorption-related variable indicates respectively that the factor amplifies the impact of a shock. Likewise, a positive coefficient of a recovery-related variable indicates respectively that the factor speeds up the recovery. Negative coefficients show the reverse.

Source: African Development Bank statistics.

medical equipment and pharmaceutical industry in Africa.[27]

- **Sustain monetary and fiscal support to underpin the economic recovery.** Where there is still fiscal space or access to liquidity, policymakers should continue fiscal and monetary support until the expected economic recovery has fully materialized. Once recovery has been achieved, governments should commit to a credible fiscal consolidation path to restore debt and fiscal sustainability. Where there is no longer fiscal space, policymakers should seek international support through grants and concessional loans to support the recovery process. Unfortunately, many countries already face difficulties with high public debt levels. Support programs are likely to lead to a further build-up of debt. Policymakers should prepare early for debt restructuring and resolution (see chapter 3).

Where there is still fiscal space or access to liquidity, policymakers should continue fiscal and monetary support

- **Strengthen the effectiveness of macroeconomic policies to accelerate economic recovery.** Authorities should strike a balance between mitigating the impact of the crisis and maintaining macrofinancial stability. Policymakers must counteract the pandemic's impact with sound, broad-based macroeconomic management through appropriate monetary, fiscal, and financial policies. While central banks continue to boost liquidity through monetary policy easing, inflation expectations should continue to be credibly anchored to avert any instability that could deepen the pandemic's adverse economic impact. Countries should allow exchange rates to adjust in an orderly manner to cushion the pandemic's effects, particularly where external buffers are low. For frontier market economies facing sudden stops and reversal of financial flows, temporary capital controls can stem capital flight until markets normalize. Where financing constraints permit, carefully designed fiscal policies, such as broad-based tax cuts and pandemic-proof public infrastructure investments in strategic sectors, can be used to lift aggregate demand and accelerate the anticipated recovery. Macroprudential vigilance by supervisors and regulators should encourage early, proactive identification of non-performing loans and actively support preemptive corporate and private debt restructuring to avoid a financial system crisis.
- **Address increasing poverty by expanding social safety nets and making growth more equitable.** About 30.4 million more Africans were pushed into extreme poverty in 2020 as a result of the pandemic. Policymakers must avoid losing more than two decades of progress in poverty eradication by stepping up efforts to lift people from extreme poverty and increasing the coverage and scope of social protection to find and lift the newly poor. Policymakers can take advantage of increasing digitalization to boost the effectiveness, reduce the cost, and expand the reach of social protection programs. In countries where safety nets are narrow and mobile penetration is still low, policymakers should explore innovative ways to identify and reach vulnerable groups through such steps as providing in-kind support, including free food banks, medical supplies, housing, and other aid through local governments or faith-based and community-based organizations.
- **Minimize the long-term implications of the pandemic on human capital accumulation.** Without effective interventions to reverse some of the pandemic's adverse effects on education, health, and nutrition, long-term damage to the continent's human capital is likely. Whenever in-person learning is practical with appropriate safety protocols in place, policymakers should immediately open schools. When in-person classes are impractical, learning can continue using traditional print, radio, television, and digital technologies such as smartphones and computers.
- **Scale up active labor market policies to retool the labor force for the future of work.** Policymakers must prepare workers for a transition to automation that was accelerated as employers coped with the side effects of COVID–19. This acceleration of digitalization will be disruptive, so policymakers must scale up efforts to retrain and reskill the labor force as quickly and broadly as possible to facilitate workers' transition from low-productivity and obsolete sectors and jobs into new and

emerging ones. They should encourage labor reallocation through job search and job matching policies and establish public works as a source of training and experience for the new digital economy. Policies should also eradicate labor market rigidities to smooth the reallocation of workers into growing sectors. That might require legislative changes.

- **Accelerate structural transformation through digitalization, industrialization, and diversification.** Africa's policymakers can make their economies more resilient by implementing structural reforms that diversify their productive base. This includes building Africa's human capital and promoting jobs in high-productivity sectors, intensifying reforms to improve the investment climate, and advancing digitalization. They should adopt policies that promote economic resilience by strengthening macroeconomic stability, improving market flexibility, and enhancing political, social, and environmental governance.
- **Strengthen regional and multinational solidarity to enable shared and sustainable recovery.** Regional cooperation is essential to safeguarding gains in the fight against the pandemic and creating conditions for a sustainable recovery. Africa's policymakers must continue to call for greater coordination among countries, especially in the health sector. While the announcement of COVID–19 vaccines appears to be a welcome step toward subduing the virus, the massive purchase of doses by the world's rich countries and the complex storage and distribution issues for at least one of the vaccines raise concerns about vaccine availability to people throughout the world regardless of wealth. Developing countries have already taken steps to present a solid front for vaccine purchases. South Africa and India, supported by many developing countries, recently submitted an urgent proposal to the World Trade Organization to temporarily suspend patents on COVID–19 vaccines and treatments until the end of the pandemic.
- **Institute governance reforms to enhance the efficiency of public spending and to block leakages to ensure transfers reach their intended targets.** Good governance remains paramount to an effective response to the crisis. Countries must implement governance reforms to rebuild and strengthen trust in public institutions. Citizens and businesses would be reluctant to adhere to public decisions when trust in public institutions is eroding. Trust can be achieved through greater accountability, transparency, and compliance standards. Reforms should also build capacity to respond to new challenges, including the digital transformation of economies. A greater challenge ahead for policymakers is debt management, because many countries already face problematic build-ups of public debt.

A greater challenge ahead is debt management, because many countries already face problematic build-ups of public debt

ANNEX 1.1 STATISTICAL APPENDIX

TABLE A1.1.1 Real GDP growth (percent)

	December 2020 estimates			
	2019	2020 estimated	2021 projected	2022 projected
Central Africa	**2.9**	**–2.7**	**3.2**	**4.0**
Cameroon	3.7	–2.4	3.5	4.0
Central African Rep.	4.5	0.4	3.3	5.1
Chad	3.0	–0.6	6.1	5.0
Congo	0.2	–7.9	0.7	0.6
Congo, Dem. Rep.	4.4	–1.7	3.3	4.5
Equatorial Guinea	–5.6	–6.1	2.6	3.3
Gabon	3.9	–2.7	2.1	3.8
East Africa	**5.3**	**0.7**	**3.0**	**5.6**
Burundi	4.1	–3.3	3.5	2.1
The Comoros	2.0	–0.9	3.5	4.5
Djibouti	7.8	1.4	9.9	8.1
Eritrea	3.8	–0.6	5.7	3.7
Ethiopia	8.4	6.1	2.0	7.9
Kenya	5.4	1.4	5.0	5.9
Rwanda	9.4	–0.4	3.9	6.9
Seychelles	4.7	–12.0	4.6	5.8
Somalia	2.9	–1.5	2.9	3.2
Sudan	–2.5	–8.4	–1.1	1.4
South Sudan	7.4	–3.6	0.1	2.5
Tanzania	6.8	2.1	4.1	5.8
Uganda	7.5	–0.5	4.8	5.4
North Africa	**4.0**	**–1.1**	**4.0**	**6.0**
Algeria	0.8	–4.7	3.4	2.9
Egypt	5.6	3.6	3.0	4.9
Libya	9.9	–60.3	37.5	54.9
Mauritania	5.9	–3.6	2.8	4.2
Morocco	2.5	–5.9	4.5	3.2
Tunisia	1.0	–8.8	2.0	3.9
Southern Africa	**0.3**	**–7.0**	**3.2**	**2.4**
Angola	–0.6	–4.5	3.1	2.4
Botswana	3.0	–8.9	7.5	5.5
Lesotho	0.6	–5.2	4.1	4.4
Madagascar	4.4	–4.0	3.5	4.5
Malawi	5.7	1.7	3.3	6.2
Mauritius	3.0	–15.0	7.5	6.7
Mozambique	2.3	–0.5	2.3	4.5
Namibia	–1.6	–7.9	2.6	3.4
São Tomé & Príncipe	1.3	–6.4	2.1	5.4
South Africa	0.2	–8.2	3.0	1.6
eSwatini	2.2	–3.2	1.4	0.7
Zambia	1.4	–4.9	1.0	1.9
Zimbabwe	–6.0	–10.0	4.2	3.0
West Africa	**3.6**	**–1.5**	**2.8**	**3.9**
Benin	6.9	2.3	4.8	6.5
Burkina Faso	5.7	–0.2	5.1	5.2
Cabo Verde	5.7	–8.9	4.4	4.8
Côte d'Ivoire	6.4	1.8	6.2	6.5
The Gambia	6.2	–2.4	3.2	5.1
Ghana	6.5	1.7	4.0	4.1
Guinea	5.6	5.2	5.6	5.1
Guinea–Bissau	4.5	–2.8	2.9	3.9
Liberia	–1.4	–3.1	2.8	3.5
Mali	5.1	–2.0	4.0	5.7
Niger	5.9	1.2	6.9	7.8
Nigeria	2.2	–3.0	1.5	2.9
Senegal	5.3	–0.7	5.1	6.0
Sierra Leone	5.4	–2.7	3.1	4.3
Togo	5.5	0.4	4.3	5.6
Africa	**3.3**	**–2.1**	**3.4**	**4.6**
Excluding Libya	3.2	–1.8	3.1	4.0
Excluding Nigeria	3.5	–1.9	3.7	4.9
Memorandum items				
North Africa (including Sudan)	3.6	–1.6	3.7	5.7
Sub–Saharan Africa	3.0	–2.6	3.0	3.9
Sub–Saharan Africa (excluding South Africa)	3.6	–1.5	3.0	4.3
Oil–exporting countries	3.2	–1.5	3.1	4.9
Oil-importing countries	3.6	–2.8	3.7	4.3

Source: African Development Bank statistics.

TABLE A1.1.2 Country groupings

Oil exporters	Other resource intensive	Non-resource intensive	Tourist dependent	Low income	Middle income
Algeria	Botswana	Benin	Cabo Verde	Benin	Algeria
Angola	Burkina Faso	Burundi	The Comoros	Burkina Faso	Angola
Cameroon	Central African Republic	Cabo Verde	Mauritius	Burundi	Botswana
Chad	Congo, Dem. Rep.	The Comoros	São Tomé and Príncipe	Central African Republic	Cabo Verde
Congo	Ghana	Côte d'Ivoire	Seychelles	Chad	Cameroon
Egypt	Guinea	Djibouti		Congo, Dem. Rep.	The Comoros
Equatorial Guinea	Liberia	Eritrea		Eritrea	Côte d'Ivoire
Gabon	Mali	Ethiopia		Ethiopia	Djibouti
Libya	Namibia	The Gambia		Guinea	Egypt
Nigeria	Niger	Guinea-Bissau		Guinea-Bissau	Equatorial Guinea
South Sudan	Sierra Leone	Kenya		Liberia	Gabon
	South Africa	Lesotho		Madagascar	The Gambia
	Sudan	Madagascar		Malawi	Ghana
	Tanzania	Malawi		Mali	Kenya
	Zambia	Mauritania		Mozambique	Lesotho
	Zimbabwe	Mauritius		Niger	Libya
		Morocco		Rwanda	Mauritania
		Mozambique		Sierra Leone	Mauritius
		Rwanda		Somalia	Morocco
		São Tomé and Príncipe		South Sudan	Namibia
		Senegal		Tanzania	Nigeria
		Seychelles		Togo	Congo
		Somalia		Uganda	São Tomé and Príncipe
		eSwatini			Senegal
		Togo			Seychelles
		Tunisia			South Africa
		Uganda			Sudan
					eSwatini
					Tunisia
					Zambia
					Zimbabwe

TABLE A1.1.3 Disruptions in healthcare services due to COVID–19

Healthcare services	Proportion (percent)
Outreach services	70
Facility-based services	61
Noncommunicable diseases diagnosis and treatment	69
Family planning and contraception	68
Mental health	61
Cancer diagnosis and treatment	55
Malaria diagnosis and treatment	46
Tuberculosis case detection and treatment	42
Antiretroviral treatment	32
24-hour emergency room services	22
Urgent blood transfusion	23
Emergency surgery	19

Source: World Health Organization.

ANNEX 1.2 ESTIMATING THE IMPACT OF LOCKDOWNS USING LOCAL PROJECTIONS

To estimate the impact of lockdowns on COVID–19 cases, we rely on the Local Projections (LP) framework.[28] LPs are flexible tools that accommodate a panel structure, do not constrain the shape of the impulse response functions, and are thus less sensitive to misspecification. The following specification has been used on a sample of 50 African countries with data from 14 February 2020 (the date of the first confirmed COVID–19 case in Africa) to 30 November 2020:

$$lnC_{i,t+h} - lnC_{i,t-1} = \alpha_{i,h} + \gamma_{t,h} + \sum_{p=0}^{P} \beta_{h,p} SI_{i,t-p} + \sum_{p=0}^{P} \tau_{h,p} X_{i,t-p} + \sum_{p=1}^{P} \sigma_{h,p} lnC_{i,t-p} + \varepsilon_{i,t+h}$$

where $lnC_{i,t+h}$ denotes confirmed COVID–19 cases per thousand people (in log) in country i on day $t + h$, with h being the horizon (h = 1, 2, …, 60). $lnC_{i,t-1}$ refers to COVID–19 cases per thousand people (in log) on day $t - 1$. $SI_{i,t-p}$ is the lockdown stringency index in country i on day $t - p$, where p features lags to account for the impact of past values. $lnC_{i,t-p}$ is used to track the stage of the pandemic in the country. The specification also includes a week's worth of lags (p = 1, 2, …, 7). X_i refers to a vector of control variables: public information campaigns, testing, and contact tracing. $\varepsilon_{i,t+h}$ is the error term. The specification also includes country ($\alpha_{i,h}$) and time ($\gamma_{t,h}$) fixed effects to capture time-invariant country features and shocks that are common across countries. The impulse responses are constructed based on the estimated $\beta_{h,p}$ coefficients of lockdown stringency SI at each horizon. The confidence bands are based on the respective estimated standard errors for each horizon, clustered at the country level.

NOTES

1. Some forecasts had suggested that up to 3 million people would die in Africa (UNECA 2020), but by the end of November, there were about 50,000 COVID–19 deaths.
2. IMF 2020.
3. East Africa was the second most diversified region in terms of exports over the past five years, with a concentration index of 0.37 (based on UNCTAD's Hirschman-Herfindahl index), after North Africa (0.32), and followed by Southern Africa (0.43), West Africa (0.48), and Central Africa (0.54).
4. ACLED 2020.
5. Bernanke, Gertler, and Gilchrist 1999.
6. UNCTAD 2020.
7. African Development Bank 2020.
8. Estimates include 50 of 54 African countries. Data for Equatorial Guinea, Eritrea, Libya, and Somalia are unavailable.
9. The lockdown stringency index is provided by the University of Oxford's Coronavirus Government Response Tracker. It ranges between 0 (no lockdown restriction) and 100 (maximum lockdown stringency). It averages the eight lockdown measures listed in figure 1.24.
10. The estimated results are valid to the extent that the COVID–19 infection rates reported in countries are accurate.
11. IMF 2020.
12. ILO 2018.
13. https://en.unesco.org/covid19/educationresponse.
14. Miller 2020.
15. Azevedo and others 2020.
16. Azevedo and others 2020; Psacharopoulos and others 2020.
17. WHO 2020a.
18. WHO 2020b.
19. Abay, Tafere, and Woldemichael 2020.
20. ILO 2020.
21. Madgavkar and others 2020.
22. The index was constructed using the UN-CDP methodology (UN 2018).
23. The EVI is composed of eight indicators, grouped under subindices with different weights, including size of population (0.125), remoteness or landlockedness (0.125), merchandise export concentration (0.0625), share of agriculture in value added (0.0625), share of the population in low coastal zones (0.125), instability of exports of goods (0.25), instability of agricultural production (0.125), and victims of natural disasters (0.125). Indicator values are converted into index scores between 0 and 100, using the max-min approach.
24. Briguglio and others 2009.
25. For example, if debt levels or deficits are already very high, there would be limited room to facilitate recovery.
26. The economic resilience index captures four major components: macroeconomic stability, microeconomic market efficiency, good governance, and social development.
27. For more details on how African countries can strengthen their health systems amid the COVID–19 pandemic, please refer to African Development Bank (2020).
28. Jorda 2005; IMF 2020.

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2

DEBT DYNAMICS AND CONSEQUENCES

KEY MESSAGES

- **The COVID–19 pandemic has caused a surge in public financing needs as governments spend more to mitigate the socioeconomic consequences of the pandemic.** African governments required additional gross financing of about $125 to $154 billion in 2020 to respond to the crisis.
- **In the short term, the average debt-to-GDP ratio in Africa is expected to increase significantly to over 70 percent, from 60 percent in 2019.** Most countries in Africa are expected to experience significant increases in their debt-to-GDP ratios for 2020 and 2021, especially resource-intensive economies.
- **Debt decomposition indicates that the debt dynamics have been driven mainly by cumulative depreciation in exchange rates, growing interest expenses, and high primary deficits.** Strong growth recorded over the years has helped to dampen the rate of growth of the debt-to-GDP ratio. Other major drivers of debt dynamics are high inflation, weak governance, security spending, and weaknesses in revenue mobilization.
- **The composition of Africa's debt continues to shift toward commercial and non-Paris Club creditors, and from external to domestic sources.** Commercial creditors and non-Paris Club official creditors have increasingly supplied new financing to African governments. Between 2000 and 2019, 18 African sovereigns have made debuts into international capital markets and issued more than 125 eurobond instruments valued at more than $155 billion. Local currency debt has increased since 2019, accounting for close to 40 percent of the total debt stock.
- **The outlook for Africa's debt sustainability is challenged by emerging risks and vulnerabilities.** Six countries were in debt distress and 14 others were at high risk of debt distress as of December 2020. Other emerging risk factors include fast-growing interest expenses as a share of revenue, rollover risks due to shorter debt maturities, a narrowing of the differential between real interest rate and growth, expanding contingent liabilities, and debt collateralization with limited transparency.
- **Going forward, strengthening the links between debt financing and growth returns would play an important role in ensuring debt sustainability on the continent.** Improvements in the efficiency of debt-financed investments would ensure that debt is used to finance the most productive projects that generate sufficient growth and complementarities to payoff the debt in future. Also, low global interest rates present an opportunity to use cheap capital for high return public investments that accelerate growth on the continent.

Many African governments undertook a wide range of steps to mitigate the economic and social disruptions caused by the COVID–19 pandemic, which has significant implications for debt sustainability. These measures include increased health expenditures, large fiscal stimulus packages, direct transfers to vulnerable groups, automatic fiscal stabilizers, and direct liquidity injections. These interventions were delivered in various ways, including lump-sum payments to households, broad-based tax relief, wage and utility subsidies, unemployment benefits, loans and loan guarantees to businesses, and equity investments by governments in distressed companies. Unless they are properly managed, monitored, and gradually phased out after the pandemic, these necessary but costly interventions could have far-reaching implications for debt sustainability—that is, the ability of governments to meet their current and future debt obligations on their own.[1]

This chapter analyses debt dynamics, including recent trends and developments in Africa's public debt, financing conditions, and debt management strategies. The first section examines recent debt and financing developments in Africa in relation to changes in the spending and financing environment. The second focuses on the changing structure and drivers of Africa's debt. The third examines emerging debt vulnerabilities and the outlook for debt in Africa. And the fourth discusses debt distress and recovery episodes.

Tightening global financing conditions make it more expensive for governments to get the financing they need to recover from the pandemic and to refinance maturing debt

THE RECENT DEBT AND FINANCING LANDSCAPE IN AFRICA

Government gross financing needs have surged since the onset of the pandemic

Since the COVID–19 pandemic began in early 2020, governments have announced fiscal stimulus packages ranging in cost from about 0.02 percent of GDP in South Sudan to about 10.4 percent of GDP in South Africa (see figure 1.10). Government financing needs surged as countries had to fund the packages aimed at allowing their citizens to weather the social and economic consequences of the pandemic. The Bank estimates that African governments need additional gross financing of about $154 billion to respond to the crisis in 2020/21. The gross financing needs as a percent of GDP varies across countries and exceeds the critical threshold of 15 percent for most countries, with levels exceeding 30 percent of GDP in Somalia, Sudan, Mauritius and Tunisia (figure 2.1).

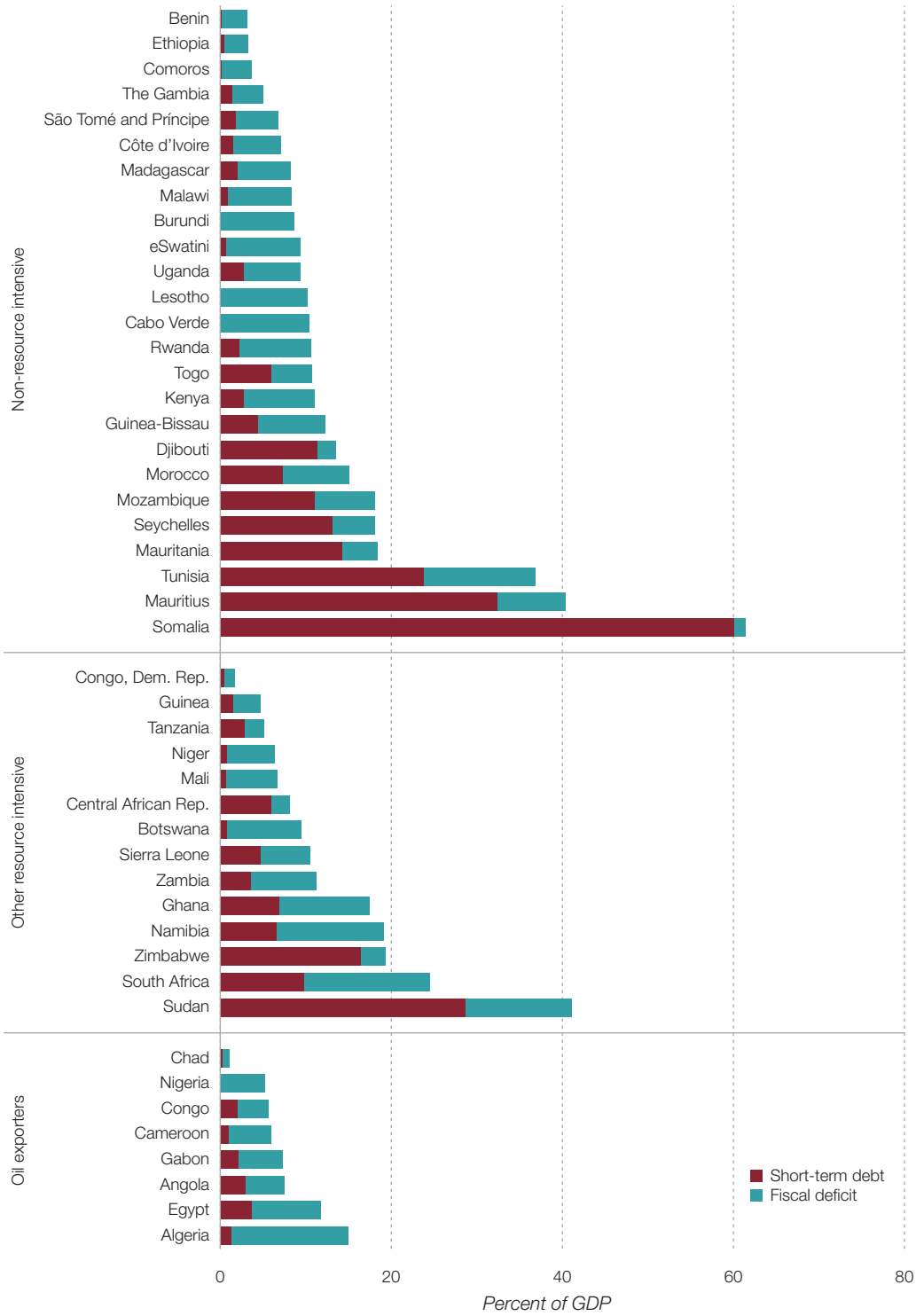
These fiscal stimulus packages have largely had immediate direct implications for government spending, budgetary balances, borrowing needs, and debt levels. Although about a quarter of countries used revenue measures such as tax relief and tax payment deferrals, most have intervened using expenditure measures such as direct public investments in health, support to small- and medium-sized enterprises (SMEs), and cash transfers (figure 2.2). Measures such as government guarantees to firms, equity injections, and loans could also expose governments to contingent liabilities in the medium to long term.

The surge in government financing needs as a result of COVID–19 spending will result in fast-paced debt accumulation. Although the average debt-to-GDP ratio, a standard measure of debt sustainability, had stabilized at around 60 percent of GDP at the end of 2019, pandemic-related spending is estimated to have caused the debt-to-GDP ratio to average as many as 10 percentage points higher at the end of 2020. Countries expected to account for the most significant increase in Africa's overall average debt levels are those that have non-oil resource-intensive economies (figure 2.3).

Challenging global financing conditions amid considerable uncertainty

Access to international capital markets, which had been a growing source of debt financing for many African countries, has declined as investors' perception of risks increases and capital flees to safety. Capital flight from Africa, estimated at over $90 billion since January 2020, and investor risk aversion have caused volatile market movements and widening spreads on African sovereign bond yields (figure 2.4). Spreads have widened by about 700 basis points since February 2020, with the largest increases for oil exporters—although there was some moderation in the last quarter of 2020. Tightening global financing conditions make it more expensive for governments to get the

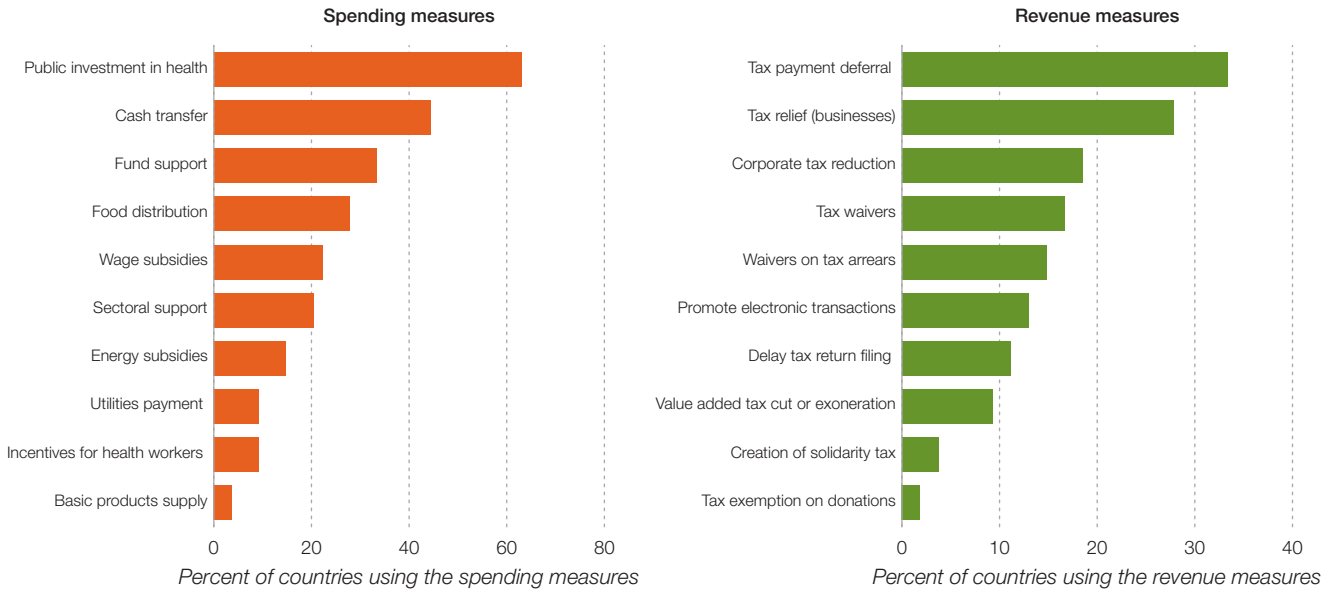
FIGURE 2.1 Gross financing needs in 2020



Source: African Development Bank statistics and World Bank, World Development Indicators database.

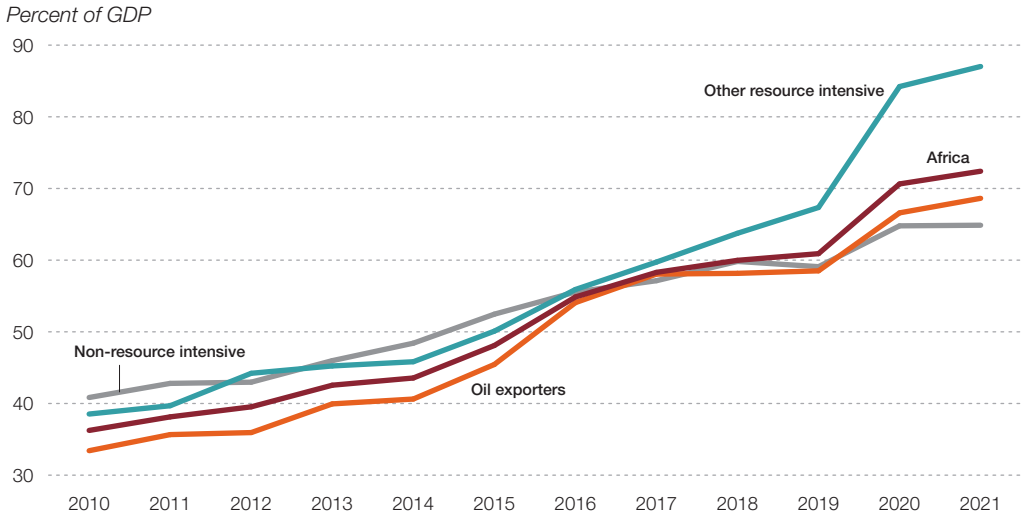
The surge in government financing needs as a result of COVID–19 spending will result in fast-paced debt accumulation

FIGURE 2.2 Fiscal measures of African governments, 2020



Source: Staff calculations based on IMF Policy Tracker.

FIGURE 2.3 Gross government debt has been increasing since 2010

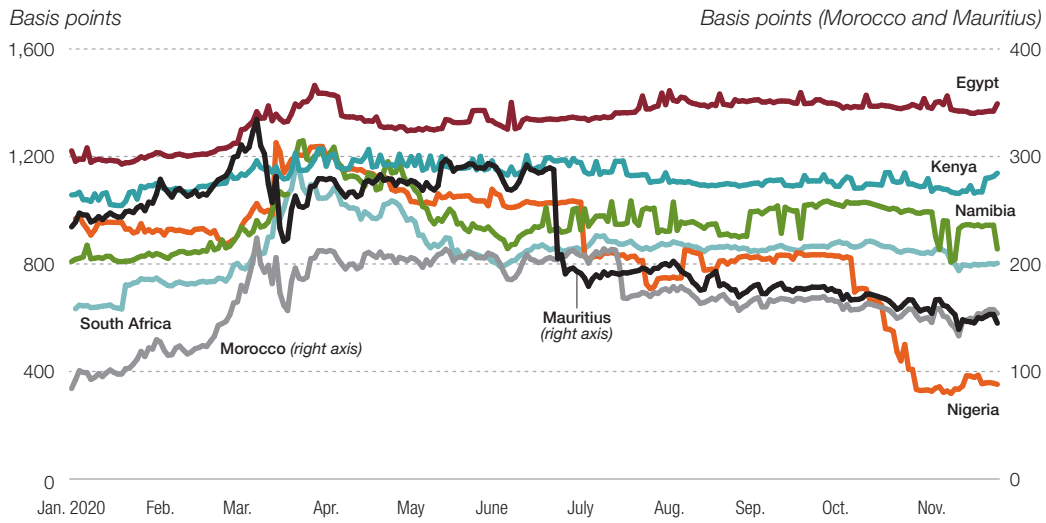


Source: Staff calculations based on IMF World Economic Outlook database.

financing they need to recover from the pandemic and to refinance maturing debt.

As discussed in chapter 1, the contraction in net financial inflows—foreign direct investment (FDI), official development assistance (ODA), portfolio investments, and remittances—will affect corporate and household financing and debt. Domestic sources of financing such as tax and non-tax revenues, which were already modest, are expected to contract as GDP drops and exports and imports decline. Government revenue, which has been a primary source for financing government budgets, was around 20 percent of GDP before the pandemic, lower than other regions such as Asia and Latin America and the Caribbean (figure 2.5). The supply and demand shocks caused by the COVID–19 pandemic directly impact the revenues of many African governments through reduced exports earnings and

FIGURE 2.4 10-year bond spreads, January–November 2020



Source: Staff calculations based on Bloomberg database.

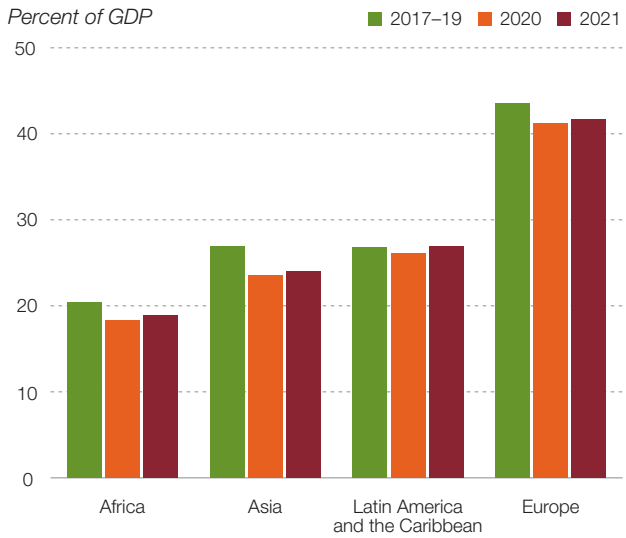
lower domestic tax revenues. The collapse in both the demand for and price of oil and other primary commodities—which account for more than 60 percent of government revenues in the 17 African countries classified as oil- and other-resource-intensive economies—means that governments do not have the required financial capacity to respond to the pandemic and have to rely on debt instruments.

THE CHANGING STRUCTURE AND DRIVERS OF AFRICA'S DEBT

The composition of Africa's debt continues to shift toward commercial and non-Paris Club creditors

The creditor base for Africa's debt continues to shift away from traditional multilateral and Paris Club lenders toward commercial creditors and official lenders who are not Paris Club members. The share of multilateral debt in Africa's total external debt has remained relatively stable over the past two decades—around 30 percent (figure 2.6). The share of bilateral debt in total external debt, on the other hand, has fallen by almost half in the last two decades. In 2000, bilateral lenders, mostly Paris Club members, accounted for 52 percent of Africa's external debt stock, but by the end of 2019, their share had fallen to 27 percent.

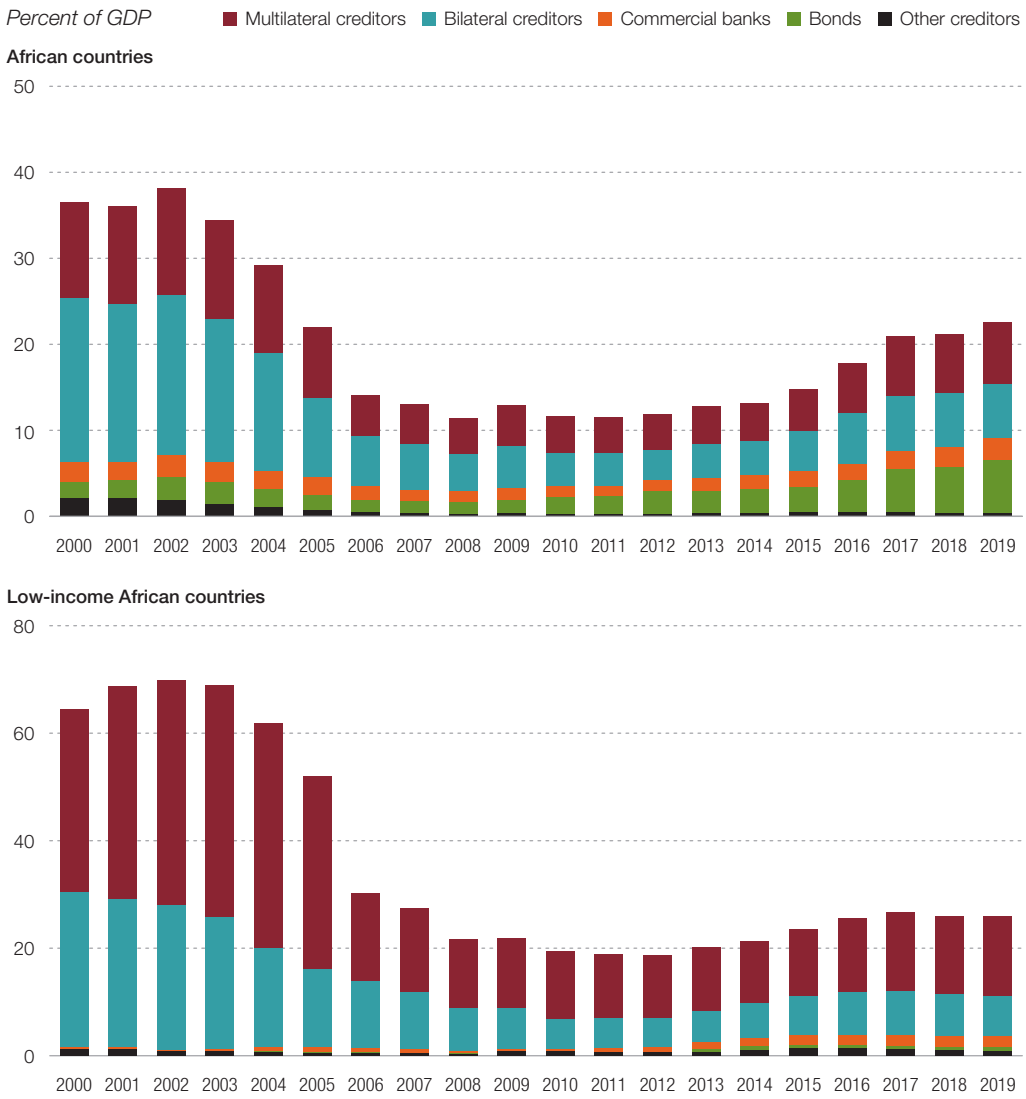
FIGURE 2.5 Government revenue to GDP, 2017–21



Source: Staff calculations based on IMF World Economic Outlook database.

By contrast, commercial creditors (bondholders and commercial banks) have more than doubled their share in the last two decades. In 2000, 17 percent of Africa's external debt was from commercial banks, private bondholders and other creditors. That share grew quickly since 2011 as more African countries gained access to international capital markets. By the end of August 2020, about 21 African countries had issued eurobond instruments valued at over $155 billion. In 2001

FIGURE 2.6 Disbursed debt by creditor type, 2000–19



Source: Staff calculations based on African Development Bank statistics and World Bank International Debt Statistics.

The creditor base for Africa's debt continues to shift away from traditional multilateral and Paris Club lenders toward commercial creditors

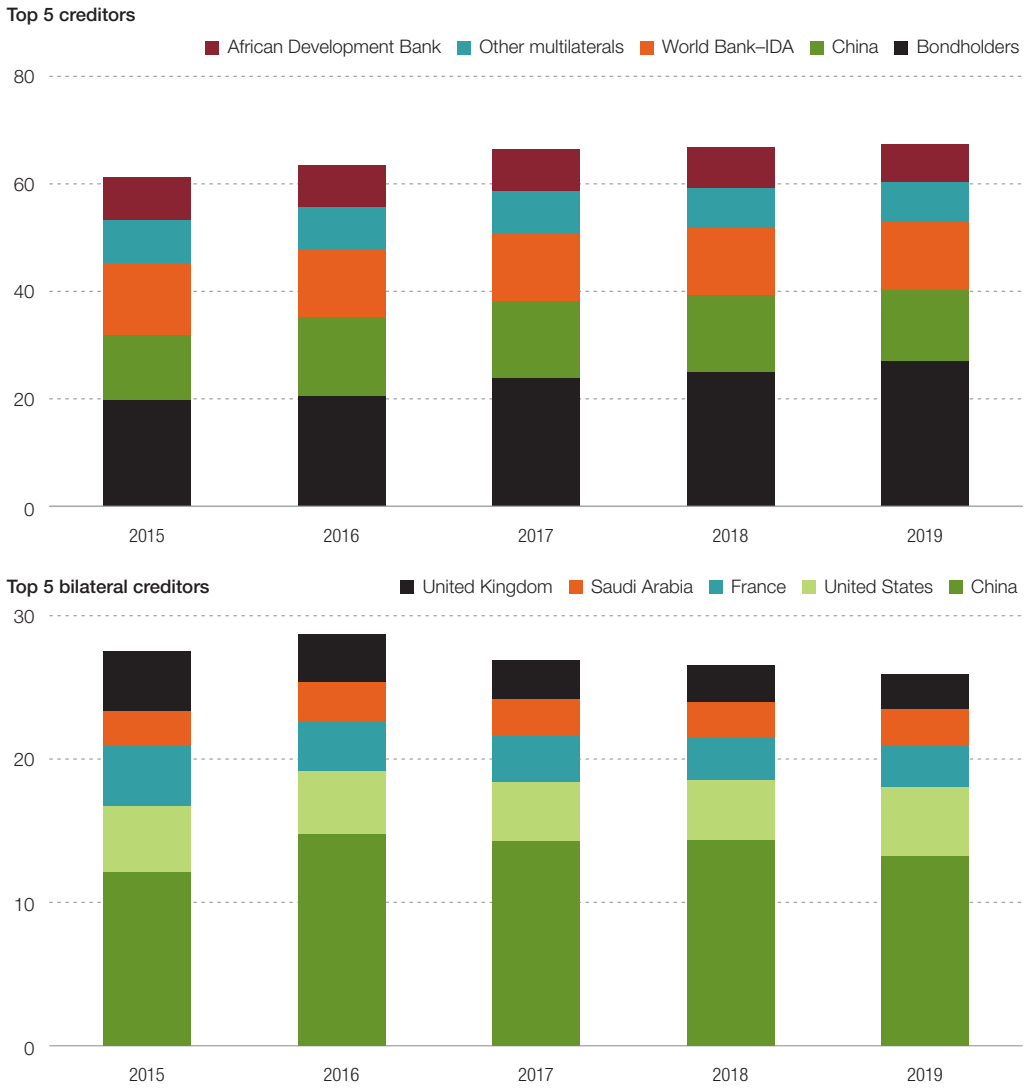
only three African countries borrowed commercially. Commecial creditors accounted for 40 percent of Africa's total external debt at the end of 2019 compared with 17 percent in 2000. It is not clear whether the pandemic will reinforce or diminish this trend as financial markets and traditional Paris Club and multilateral lenders have all been adversely impacted by COVID–19.

The top five creditors to Africa since 2015 are bondholders (which account for 27 percent of the continent's external debt at the end of 2019), China (13 percent), the World Bank-International Development Association (12 percent), the African Development Bank (7 percent), and other multilateral lenders (7 percent) (figure 2.7). The top-five bilateral creditors to Africa are China (13 percent), the United States (4 percent), France (2.9 percent), Saudi Arabia (2.5 percent) and the United Kingdom (2.4 percent). Other top creditors include Germany (2 percent), Japan (1.7 percent), Kuwait (1.6 percent), UAE (1.5 percent), India (0.7 percent), and Italy (0.6 percent) (see figure 2.7).

Although commercial creditors are playing an increasingly important role in frontier market

FIGURE 2.7 Top five creditors to African economies, 2015–19

Percent of total external debt stock



Source: World Bank International Debt Statistics.

The top five creditors to Africa since 2015 are bondholders, China, the World Bank–IDA, the African Development Bank, and other multilateral lenders

economies, non-frontier market and African Development Fund (ADF) economies continue to rely on official creditors, particularly multilateral and, increasingly, non-Paris Club members. Non-frontier market economies and low-income ADF countries, which do not have access to international capital markets, have continued to rely on multilateral concessional credit. There has been a growing shift among these countries away from traditional Paris-club lenders to non-Paris Club lenders, notably China (see figure 2.7). The scale of non-Paris Club lending has increased for these countries, but due to lack of transparency, it is not clear what the precise magnitudes of borrowing have been.

Sovereign eurobond issuances in the last decade have increased the significance of private creditors

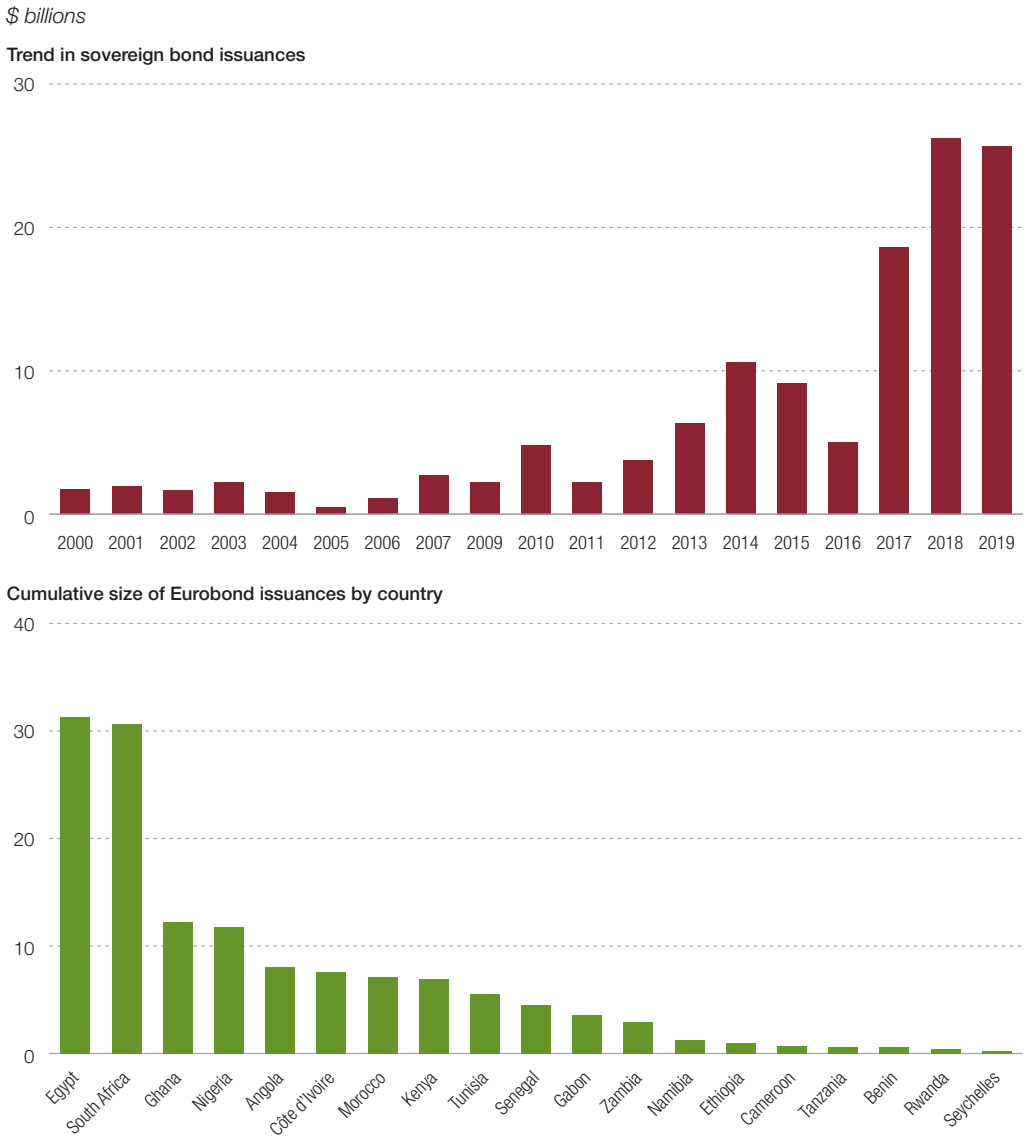
Since 2003, there has been a surge in eurobond issuances. About 19 countries made their first appearance on international capital markets with bond issuances as large as 3 percent of GDP. The number of international bond issuances by African countries has risen sharply to an estimated total

in excess of $155 billion by the end of 2019 (figure 2.8). This has helped drive the changing composition of Africa's debt. Eurobond issuances have been led by middle-income heavyweight countries such as Egypt, South Africa, and Nigeria, followed by resource-intensive middleweights such as Zambia, Angola, and Ghana, among others (see figure 2.8).

Private commercial issuances have become an increasingly popular source of funding because they often come without the conditionalities attached to multilateral and bilateral loans. However, Morsy and Moustafa (2020) show evidence of mispricing of African sovereign risk due to herding by international investors and their tendency to lump all African bonds in one asset class, making them highly susceptible to shifts in market sentiment. If not properly managed, eurobond issuances could elevate debt vulnerabilities as shown in a recent synthetic control experimental study by Chuku and Mustafa (forthcoming). They found that the estimated impact on the debt-to-GDP ratio in the eurobond issuance post-intervention period caused an increase of about

The number of international bond issuances by African countries has risen sharply to an estimated total in excess of $155 billion by the end of 2019

FIGURE 2.8 Africa Eurobond issuances, 2000–19



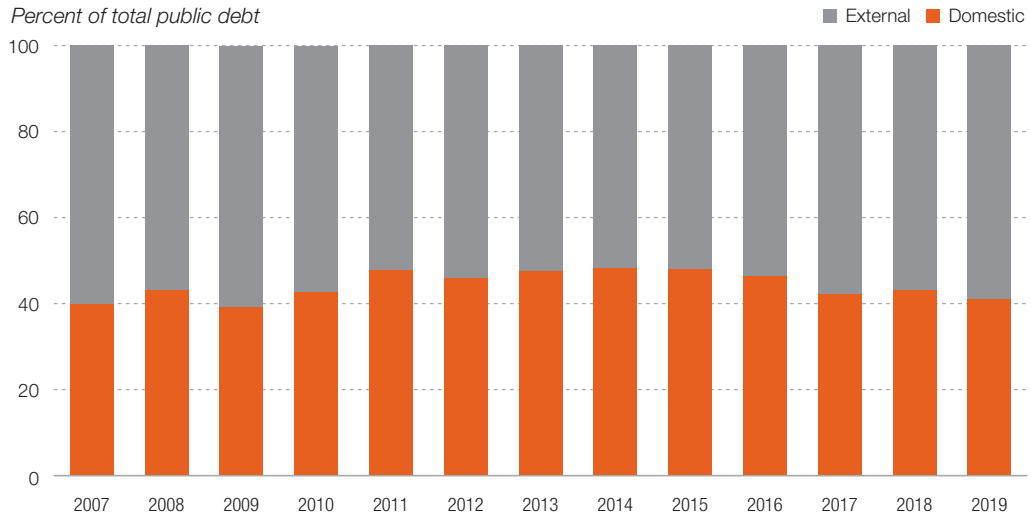
Source: Bloomberg database.

13 percentage points on average above the level of debt in the counterfactual scenario.

Domestic bond issuances and contingent liabilities from public-private partnerships are becoming significant components of Africa's debt

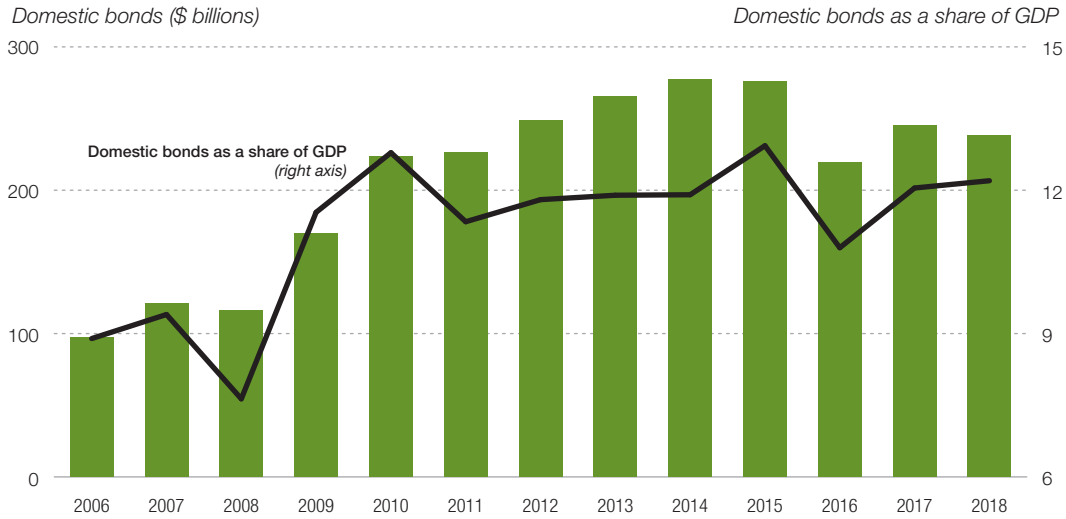
Although domestic bond issuances have risen in the last decade, local currency debt financing has increased only slightly since 2007, climbing to 38 percent of total debt in 2019 (figure 2.9). This trend has reflected recent deepening in Africa's local bond markets, enabling countries to mobilize domestic resources and tap into idle domestic savings (figure 2.10). Although increasing domestic borrowing helps to mobilize idle domestic savings, it carries the risk that in troubled times, governments could inflate away the debt in nominal terms by devaluing the domestic currency, in turn damaging the health of the

FIGURE 2.9 Shares of domestic and external public debt in Africa, 2007–19



Source: Staff calculations based on IMF and World Bank databases.

FIGURE 2.10 African domestic bond markets are deepening, 2006–18



Source: African Development Bank, African Bond Markets database.

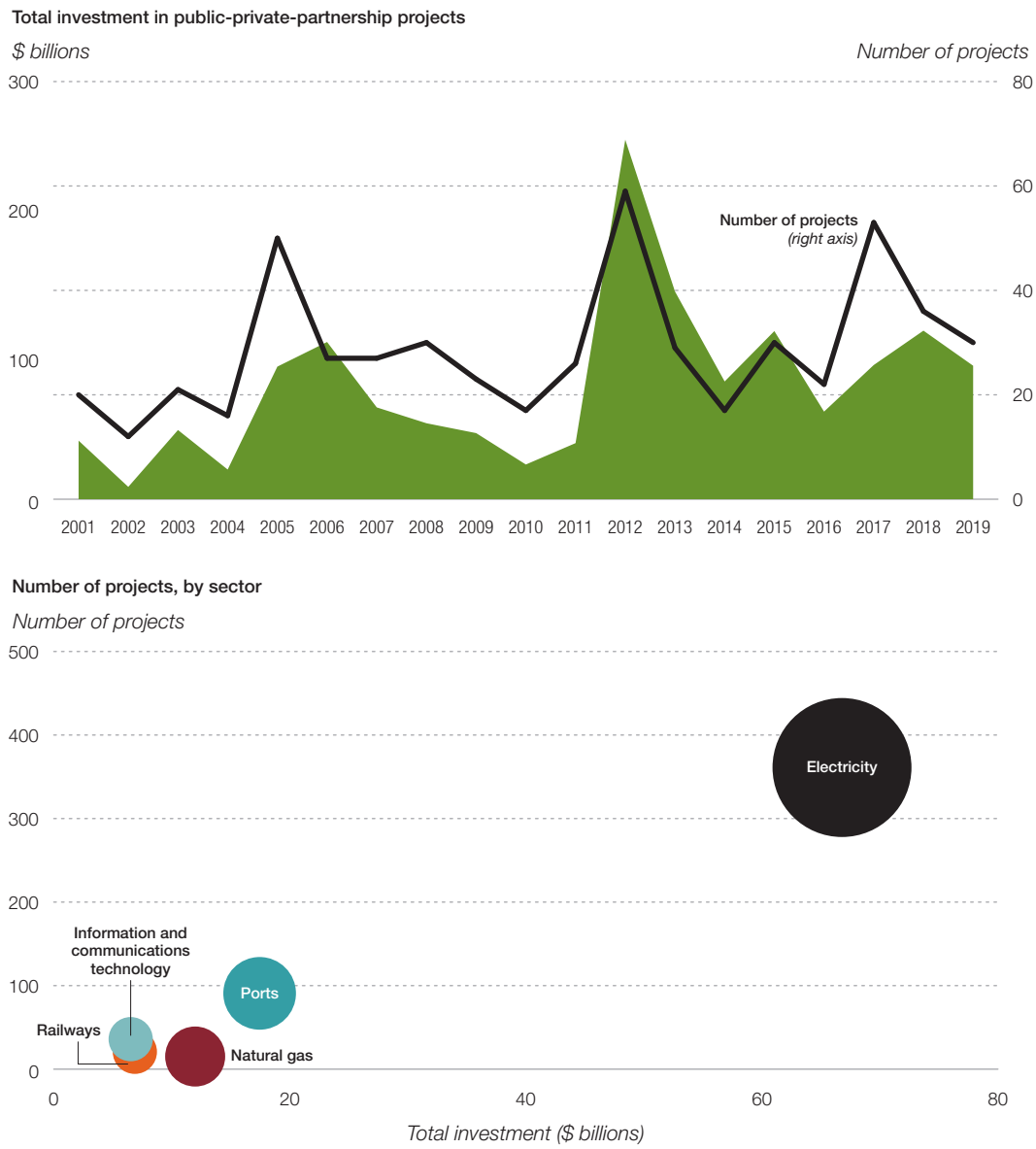
Deepening local bond markets enable countries to mobilize domestic resources and tap into idle domestic savings

domestic economy and leading to potential banking instability.

Syndicated loans and public-private-partnership (PPP) project finance are playing an increasingly important role in Africa's financing mix. Total investments in PPP infrastructure rose nearly six-fold from $1.2 billion in 2004 to $6.9 billion in 2019, while the number of PPP projects doubled from 16 to 30. In 2012 alone, there were more than 59 new PPP projects in Africa with a total value of $17.2 billion (figure 2.11). These investments are mostly concentrated in the energy and transportation sectors. Market failures and deep structural problems in these sectors elevate the risks to contingent liabilities—which are those that kick in only when a future event occurs. A government, for example, may guarantee loans contracted by a state-owned enterprise (SOE) or a PPP. If the government has to repay a guaranteed loan that defaults, it will likely have to borrow to do so—adding to its debt stock.

Syndicated loans and public–private-partnership project finance are playing an increasingly important role in Africa's financing mix.

FIGURE 2.11 **Public–private-partnership projects in Africa, 2001–19**



Source: Staff calculations based on World Bank Private Participation in Infrastructure database.

Debt decomposition analysis shows that debt dynamics have been driven by depreciation in exchange rates, growing interest expenses, and high primary deficits

A decomposition of Africa's debt identifies three main drivers: the cumulative depreciation in exchange rates, growing interest expenses, and high primary deficits. Strong economic growth over the years has helped to dampen the rate of growth of the debt-to-GDP ratio, but was insufficient to reduce debt because of growing interest expenses (figure 2.12). For oil-exporters and other resource-intensive economies, the decomposition shows that debt dynamics have primarily been driven by exchange rate depreciation and primary deficits, largely as a result of volatility in commodity prices. Whereas for non-resource–intensive and tourism-dependent economies, interest expenditures and other factors (contingent liabilities, reserve drawdowns) have been the major drivers.

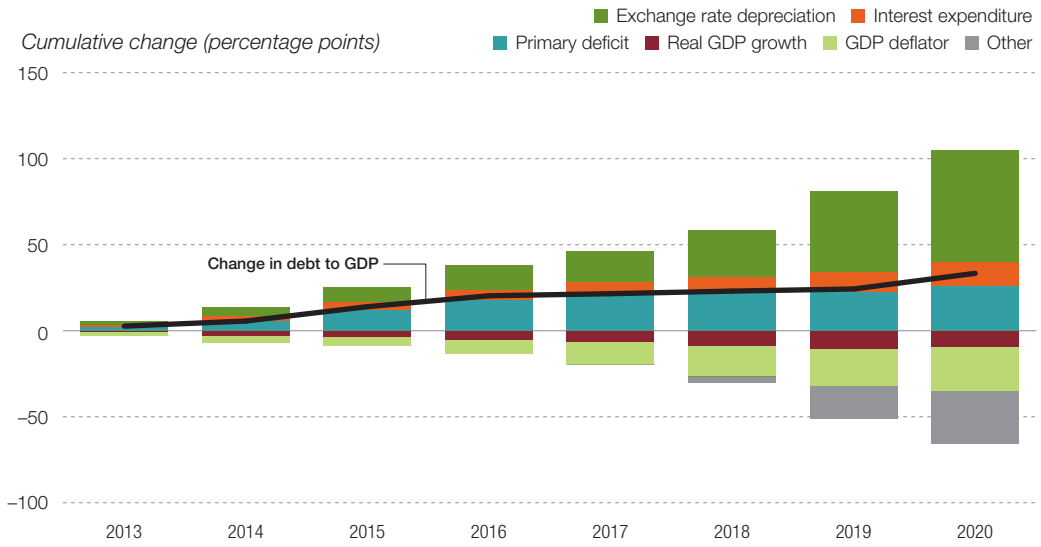
Other factors driving the debt accumulation include governance issues, large public investment programs, and defense-related expenditures

Poor governance and weak institutional capacity have also been responsible for the recent debt build-up in some countries. In some cases, countries had "hidden debt"—obligations that were not on the public books—in Mozambique, Cameroon, and Chad, for example. After the hidden debt was discovered, the countries reported a sudden surge in debt burdens. Problems with economic governance, corruption, and mismanagement have been identified as a culprit in the debt distress episodes that recently occurred in countries such as The Gambia, Democratic Republic of Congo, and Republic of Congo.[2] Also, the mismanagement of SOEs has contributed to the most recent surge in the debt build-up.[3] In the past five years, many countries in Africa have experienced a deterioration in their Country Policy and Institutional Assessment (CPIA) ratings from the World Bank on debt management and policy, while only a few have improved (figure 2.13).

Large and ambitious public investments, while needed, have been a significant source of the recent debt build-up, especially for the lower-income countries. Although fiscal balances deteriorated for most African countries between 2015 and 2020, it was mostly the result of borrowing to increase investments (box 2.1). Public capital investments as a share of total expenditure have increased for most of the countries faster than recurrent expenditure. Growth returns to debt-financed investment are found to be lower in Africa than in other low- and middle-income economies.[4]

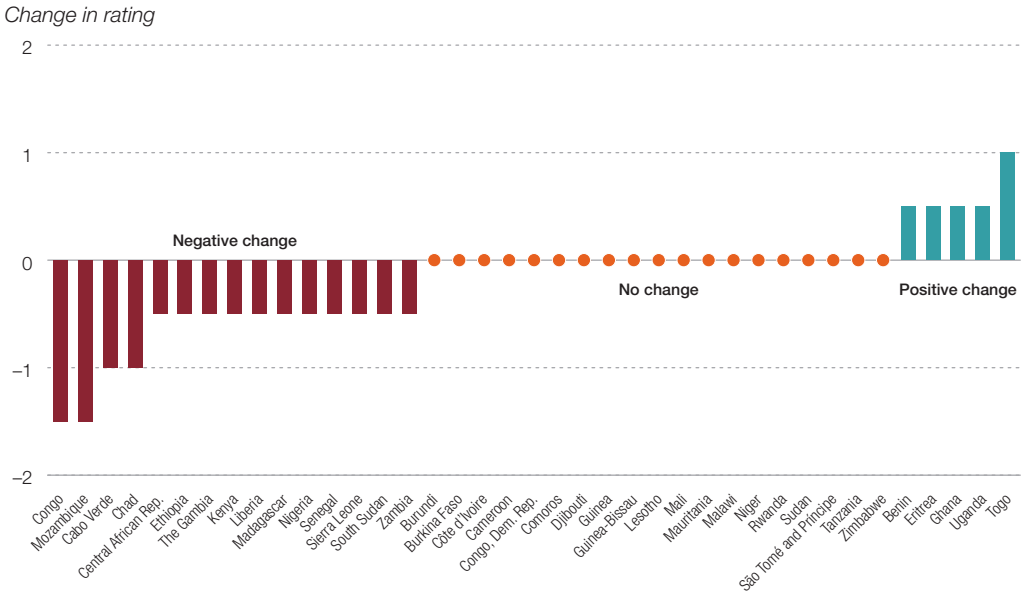
Poor governance and weak institutional capacity have also been responsible for the recent debt build-up in some countries

FIGURE 2.12 Decomposition of drivers of Africa's debt, 2013–20



Source: African Development Bank statistics and the IMF World Economic Outlook database.

FIGURE 2.13 CPIA ratings for debt management are declining or unchanged for most African countries, 2015–19



Source: Staff calculations based on World Development Indicators database.

Strengthening the link between debt and investments would play an important role in ensuring debt sustainability on the continent

Recent debt-investment-growth models developed by the African Development Bank in collaboration with the International Monetary Fund (IMF) show the links between debt and investments in social and economic infrastructure given segmented labor markets. Merely by increasing returns, African countries can maximize outcomes on investment without increasing spending (see box 2.1). Going forward, strengthening this link between debt and investments would play an important role in ensuring debt sustainability on the continent. Improvements in the efficiency of debt-financed investments would ensure that debt is used to finance the most productive projects that generate sufficient growth and complementarities to pay off the debt in future.

Increased defense-related expenditures to contain rising conflict and terrorism in the Sahel and some transition states has contributed to rising debt levels. Before the COVID–19 pandemic, insecurity was on the rise in many parts of the continent. The pandemic has helped to reinforce the stressed situation in many countries. The number of conflict-related events—including political violence, protests, and riots—is higher in 43 countries than before the pandemic.

EMERGING VULNERABILITIES AND THE OUTLOOK FOR DEBT IN AFRICA

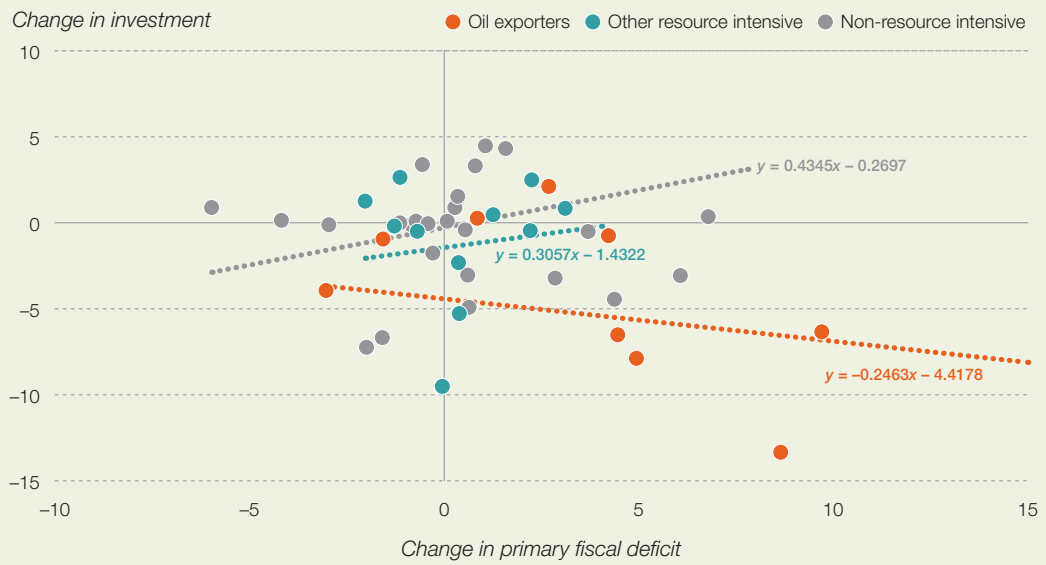
Debt vulnerabilities are elevated with deteriorating debt sustainability ratings, and more downgrades are expected as a result of COVID–19

Over the past decade, debt sustainability ratings using the Debt Sustainability Analysis (DSA) framework indicate that a large number of countries have fallen into debt distress—unable to meet their obligations—and more downgrades are expected as a result of COVID–19. Rising debt levels in the past decade have negatively affected debt sustainability ratings for low-income countries in Africa. Of 38 countries with DSA ratings available, 14 were rated as in high risk of debt distress at the end of December 2020 and another six were already in debt distress (figure 2.14).[5] Sixteen countries have moderate risk of debt distress, while two are considered at low risk. Safety margins are being eroded by COVID–19 as spending rises and revenue falls, and even countries with comfortable margins, if not properly managed, could deplete their buffers during

BOX 2.1 Debt, investment, and growth

Big-push public investment programs have been a significant source of the recent debt build-up, especially for the African Development Fund (ADF) group of countries. The positive correlation between fiscal deficit and public investment for ADF group countries is an indication that an increasing share of public debt has been used to finance ambitious investment programs in ADF countries (box figure 2.1.1). This is particularly true in the non-resource-intensive economies and non-oil resource-intensive economies, but not necessarily for oil exporters.

BOX FIGURE 2.1.1 Investment and primary fiscal deficit



Note: Period averages for 2016–19 against 2012–15.
Source: Staff calculations based on IMF World Economic Outlook database.

While some countries that have borrowed to finance investment projects have had high growth rates (such as Ethiopia, Kenya, and Rwanda), there is also evidence that the link between debt financing and the growth-enhancing role of public investment is weakened by low efficiency. To assess the impact of debt-financed public capital investment programs on growth, we use the Debt-Investment-Growth (DIG) Labor model, an open-economy, perfect foresight, general equilibrium model with three sectors, in which public investment in physical and human capital plays a complementary role in raising productivity in the different sectors.

The model uses different fiscal options to close financing gaps on big push public investments. When revenues fall short of expenditures, the resulting deficit can be financed through domestic borrowing, external commercial borrowing, or concessional borrowing. The private sectors' (firms and households) response drives the transmission and the overall impact of the government investment surges on the economy.

The model is calibrated to match the average African country and used to simulate the growth, debt, and distributional consequences of big-push investment programs with different mixes of investment in human capital and infrastructure.

The key findings are:

- Investment in physical and human capital is associated with favorable long-run effect on debt, reflected in the growth and revenue gains.

(continued)

BOX 2.1 Debt, investment, and growth *(continued)*

- Investment in human capital is much more effective than investment in infrastructure in promoting long-run economic growth.
- Investment in human capital affects labor productivity with a long lag, so it takes more than 15 years until output surpasses its counterpart in a program that invests mainly in infrastructure.

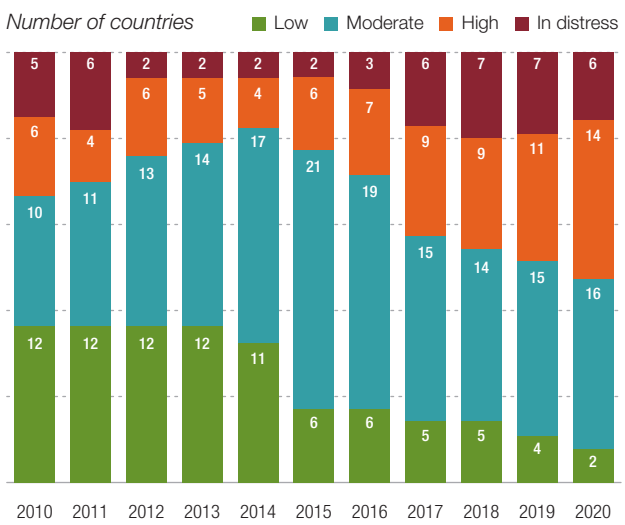
As a result, the debt-stabilizing role of growth is delayed in programs that invest in human capital compared to program that invests in infrastructure. Nonetheless, programs that invest in both human and physical capital are found to have greater payoffs than programs that invest exclusively in one because there are mutually-reinforcing effects between the two types of investment.[1] As a result, the debt-stabilizing effects might be higher.

Furthermore, estimates in the 2020 African Economic Outlook show that the efficiency of education spending is much lower in Africa—at 58 percent for primary schooling. Growth returns to debt-financed investment are also found to be lower in Africa compared to other low and middle-income economies.[2] This suggests that merely by improving efficiency and returns, African countries can maximize the outcomes of public investment without increasing spending. For instance, Africa could almost reach universal primary enrollment by closing the efficiency gap in education spending. Improved efficiency of public spending would also help stabilize debt.

Notes

1. African Development Bank 2020.
2. Morsy and Moustafa 2020.

FIGURE 2.14 Evolution of risk of external debt distress, 2010–20



Note: As of 31 December 2020.

Source: Staff calculations based on IMF Low-Income Country Debt Sustainability Analysis database.

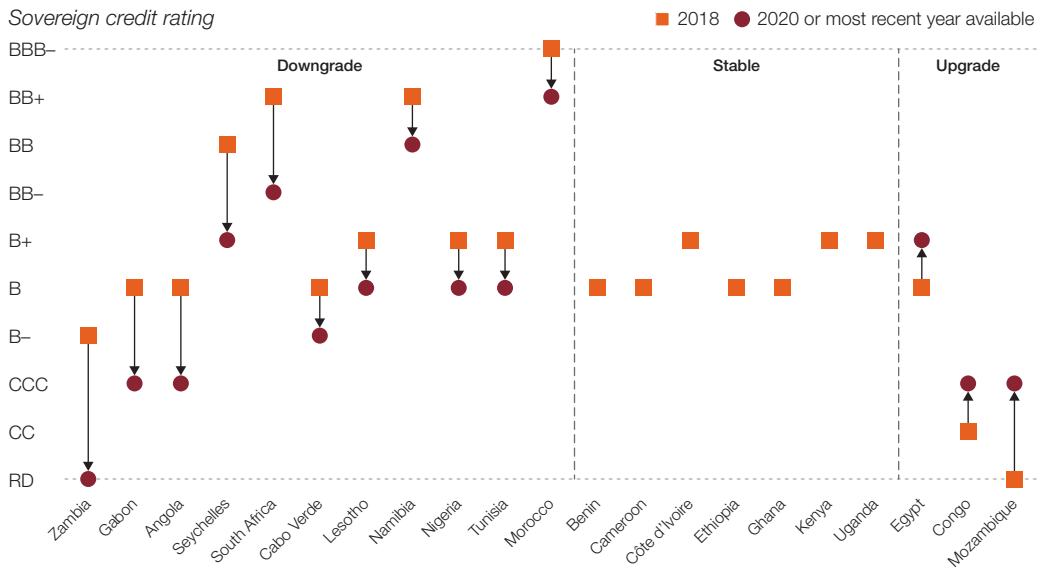
the crisis. Moreover, sovereign credit ratings are being downgraded for most countries since they made their debut in international capital markets (figure 2.15).

It is more difficult for countries to move from lower to stronger ratings—rating improvements are sticky upward while downgrades have been common. In 2010, 12 countries were rated as having a low risk of debt distress; 10 years later, only three maintain that rating. Since 2017, seven low-income countries have had downgrades in the DSA ratings, either moving from low risk to medium risk or from medium to high, but mostly from high risk to being in distress. Only three countries have managed to improve from a distress rating to a high-risk rating.

Increasing interest expenses on public debt and shorter maturities of new debt have exposed countries to higher refinancing and rollover risks

The recent increase in interest expenses as a share of revenue for many countries undermines their ability to service maturing debt obligations. A major vulnerability to the debt outlook in Africa is the diminishing liquidity available for many countries. Interest burdens are rising fast and government revenue is declining. For some countries, the interest burden has doubled in the last five years (figure 2.16). COVID–19 is expected to reduce

FIGURE 2.15 Sovereign credit ratings



Note: Fitch uses a letter system: a country rated AAA has the lowest expectation of default risk, while a country rated RD has defaulted on a payment.

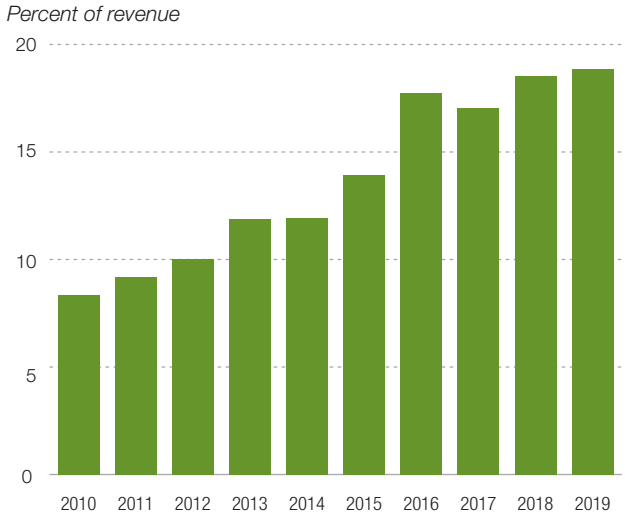
Source: Staff calculations based on Fitch ratings (as of November 2020).

government revenues further, and many countries may not have the necessary liquidity to service the debt obligations coming due in the first half of 2021 (figure 2.17). There could be widespread defaults and restructuring agreements as countries miss maturing payments.

Increased reliance on external non-concessional market financing exposes countries to higher exchange rate and rollover risks

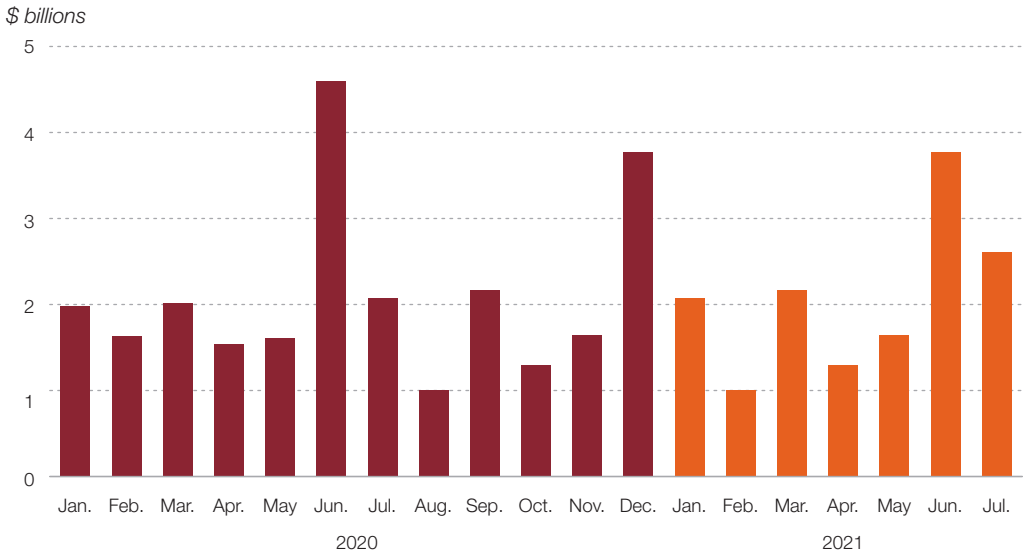
The shifting composition of Africa's debt toward non–concessional, market-financed external debt —denominated primarily in foreign currency (the US dollar and the euro)—implies that countries are becoming increasingly exposed to higher real interest rate risks (figure 2.18) and, more important, to exchange rate depreciation risks. Depreciation of the local currency causes an upward revaluation of a country's debt and also makes debt service in the foreign-currency more expensive. This currency-mismatch exposure explains a significant portion of the deteriorating debt dynamics shown by the decomposition analysis. COVID–19 has caused recent sharp swings in currency valuations for many countries, especially oil-exporting economies. The outlook for the debt ratios in these countries is expected to worsen simply because of the depreciation of their currencies. This issue would be less severe for countries that rely more on the domestic capital market for borrowing and on concessional debt with low-interest rates.

FIGURE 2.16 Interest expense in percent of revenue, 2010–19



Source: Staff calculations based on IMF World Economic Outlook database.

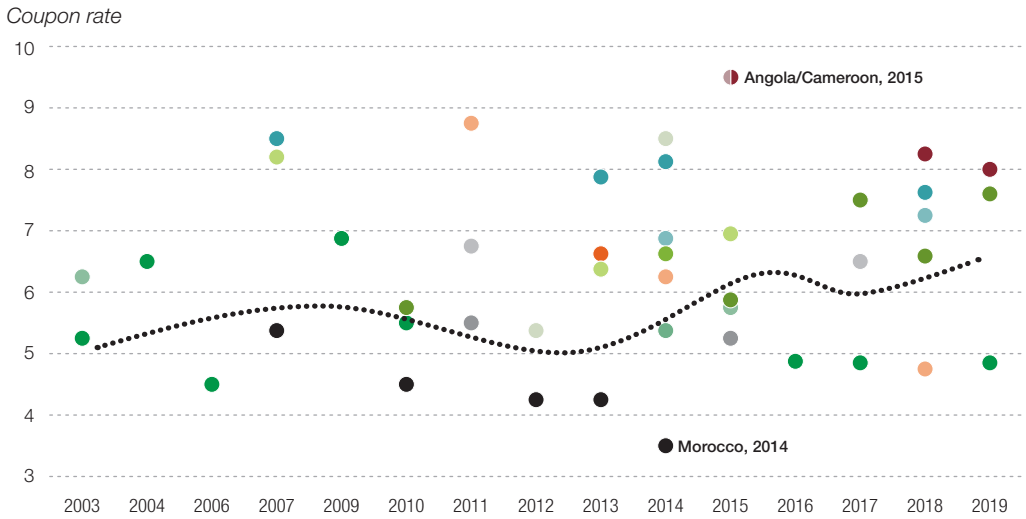
FIGURE 2.17 Short-term debt service profile for Africa



Source: Staff calculations based on data from World Bank International Debt Statistics.

Many countries may not have the necessary liquidity to service the debt obligations coming due in the first half of 2021

FIGURE 2.18 Trend of coupon rates on 10-year bond issuances, 2013–19

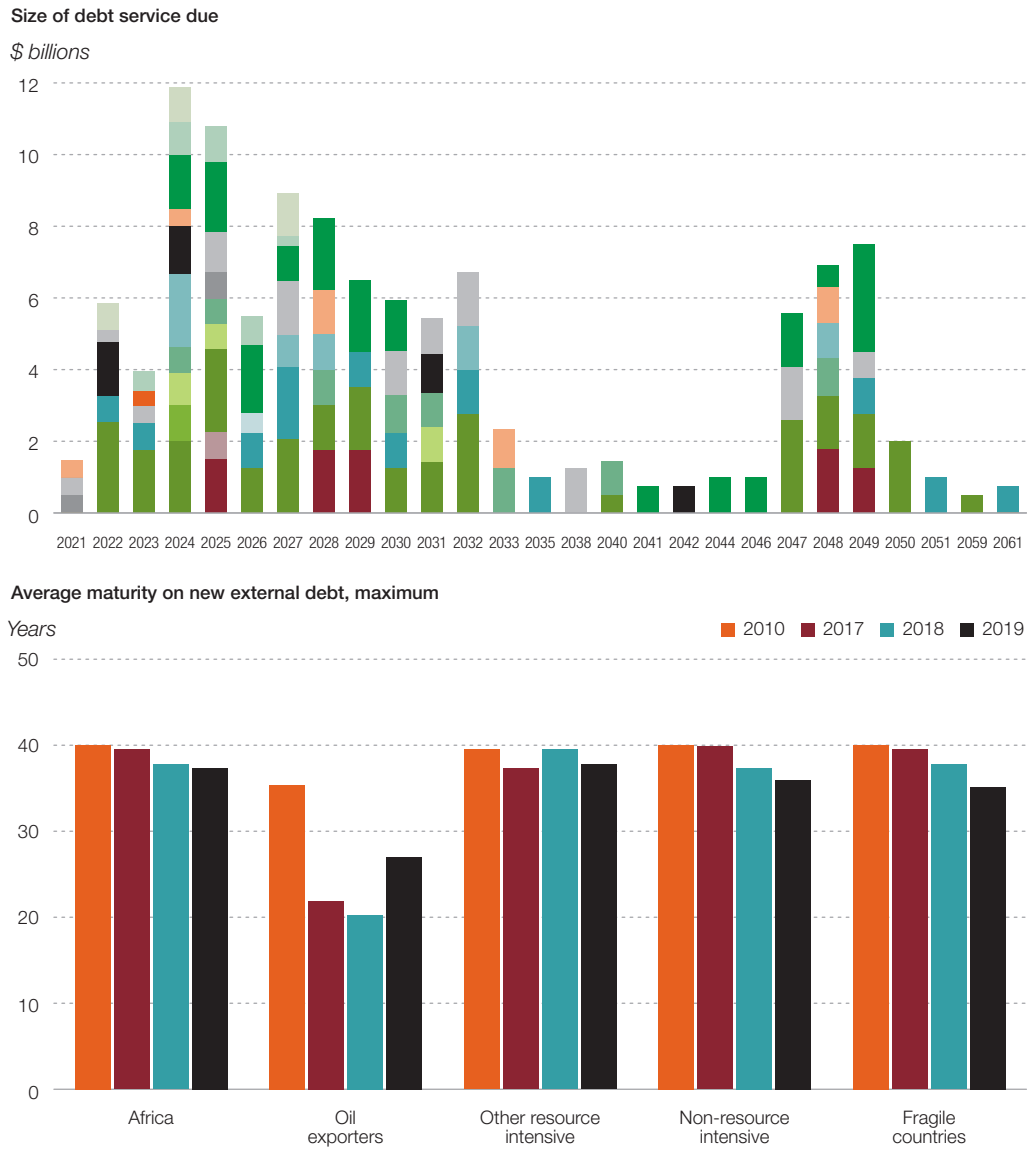


Note: Colors in the figure indicate different countries.
Source: Bloomberg database.

Shorter debt maturities have created a bunching of external loan repayments coming due in the next five years

Higher borrowing from the non-Paris Club and commercial creditors has meant shorter maturities and higher refinancing risks.[6] The surge in the issuance of 10-year eurobonds by many African countries since 2013 and the increase in non-Paris Club loans with maturities shorter than typical multilateral concessional long-term loans will cause bunching of maturing sovereign debt liabilities coming due in 2024 and 2025. That wall of liabilities will come due just as countries are expected to be recovering from the recessions caused by the COVID–19 pandemic (figure 2.19) and will elevate risks of debt distress. Affected countries need to begin debt resolution and restructuring negotiations before risks materialize. On the positive side, since 2010 maturities have

FIGURE 2.19 Debt maturity profile, 2021–61



Note: Colors in the top figure indicate different countries.

Source: Staff calculations based on the Bloomberg database and World Bank International Debt Statistics database.

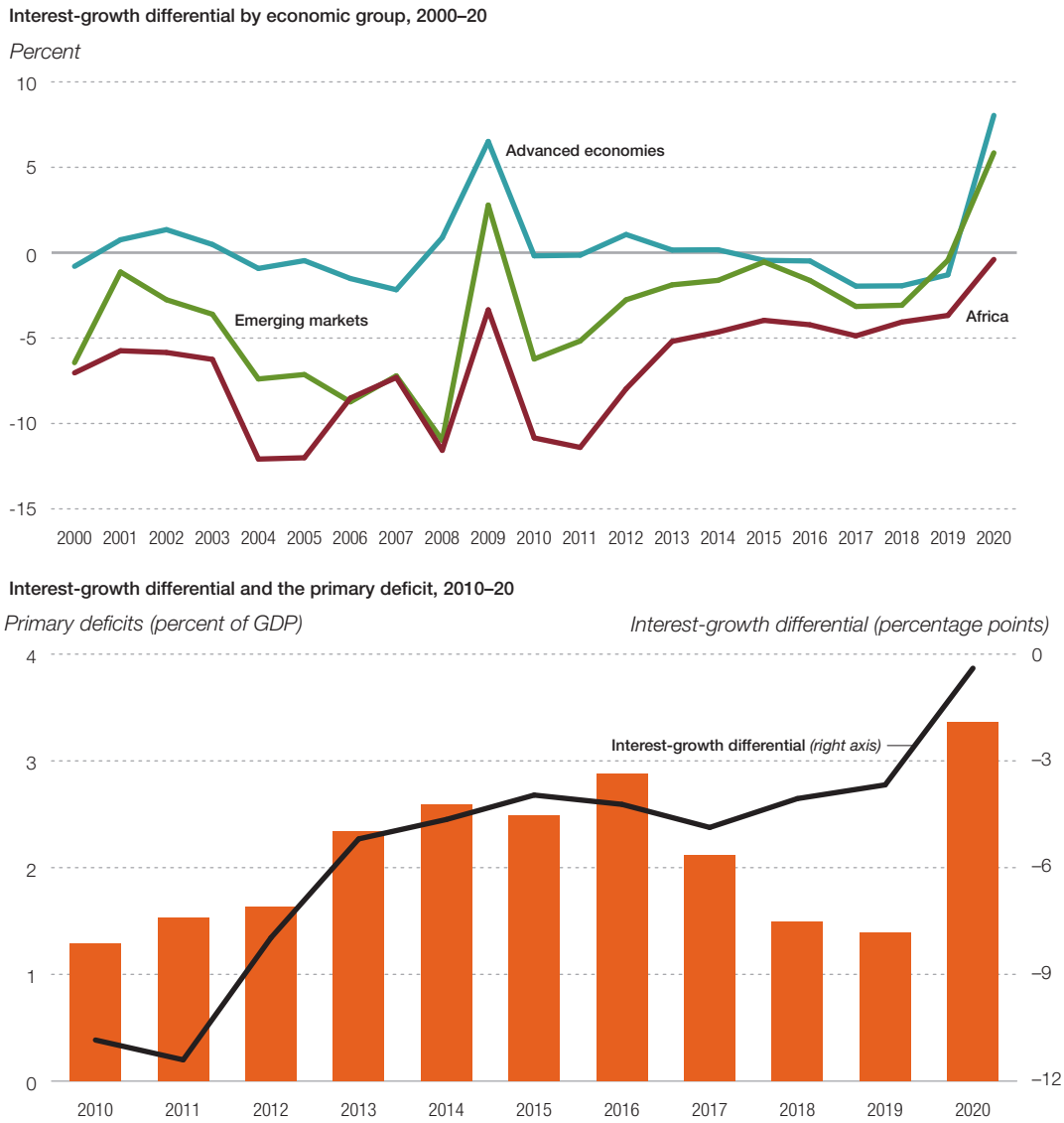
The wall of repayment liabilities will come due just as countries are expected to be recovering from the recessions caused by the COVID–19 pandemic

lengthened for several local currency debt markets from 1.75 years to 2.5 years. Ghana, Kenya, and Tanzania have issued local currency bonds at maturities greater than 15 years and Nigeria issued a debut 30-year naira bond in April 2019.[7]

Higher real interest rates and lower growth prospects imply weaker long-run debt and fiscal sustainability

While the real interest rate–growth differential has been declining for most emerging markets and advanced economies over the past two decades, it has risen in Africa (figure 2.20). Higher real interest rates imply higher interest payments to service debt. The differential has narrowed since 2011, partly due to rising interest rates from market-based borrowing, especially by African frontier market economies. It also reflects weaker-than-expected growth rates in countries such as South Africa and Nigeria. The expected slow-down in growth as a result of COVID–19 will further narrow the differential. Africa's negative real interest-growth

FIGURE 2.20 The interest-growth differential has narrowed in Africa since 2011



Source: African Development Bank statistics and IMF World Economic Outlook database.

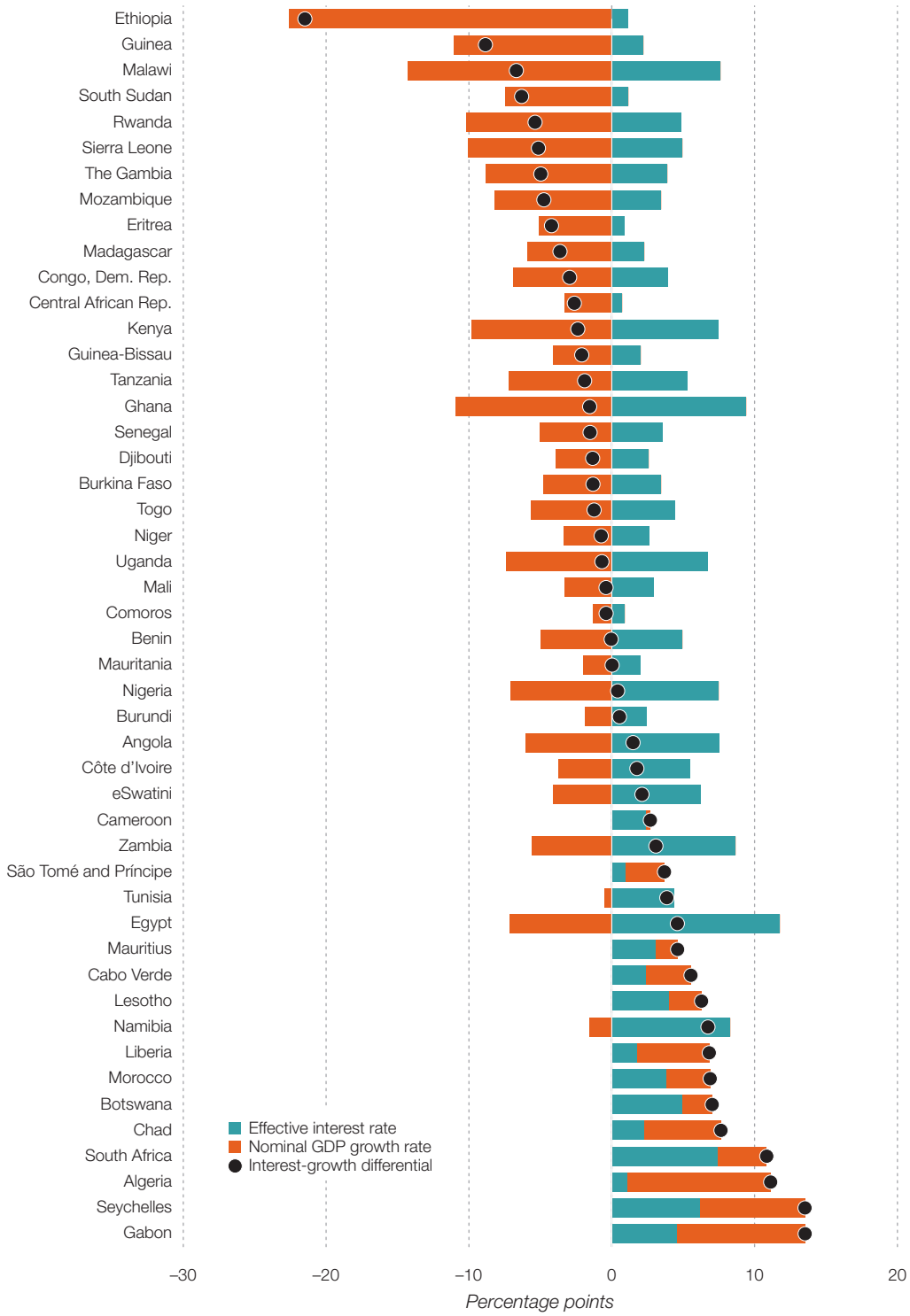
The interest-growth differential has narrowed in Africa since 2011

differential over the past years has not been sufficient to ensure declining debt ratios. The reason is that most countries have operated at primary deficits above the level needed to stabilize debt.[8] Also, low global interest rates present an opportunity to use cheap capital for high return public investments that accelerate growth on the continent.

A decomposition of the real interest–growth differential and its cross-country dispersion shows that it has been driven by nominal GDP growth. Zooming in on country groupings, the differential has been more volatile in oil-exporting and other-resource intensive economies than for other country groupings, reflecting the underlying volatility of commodity prices, which drives growth in these countries (figure 2.21). While the growth rate has been a key driver of the differential in non-resource intensive economies, the contribution of interest has been comparatively muted due to their higher dependence on concessional loans (see figure 2.21).

Most countries have primary balances well below their debt-stabilizing levels, which implies

FIGURE 2.21 Interest-growth differential by country, 2020



The differential has been more volatile in oil-exporting and other-resource intensive economies

Note: Effective interest rate defined as interest payments divided by debt stock at the end of the previous year.

Source: African Development Bank statistics and IMF World Economic Outlook database.

long-run fiscal unsustainability. Debt sustainability conditions require that debt-to-GDP ratios not exceed a certain threshold, governments do not continue service their debt by issuing new debt, and governments eventually run fiscal surpluses to pay off existing debt and interest. Some countries have seen their debt ratios stabilize and even decline in the recent past—for example, Ethiopia and Egypt—because of the favorable real interest-growth differential. However, debt ratios have not stabilized for an increasing number of African countries. Between 2017–18 and 2019–20, the number of times countries had fiscal balances above their debt-stabilizing levels increased from 48 to 63 (figure 2.22).

The "race to seniority" in debt collateralization has become an important risk factor

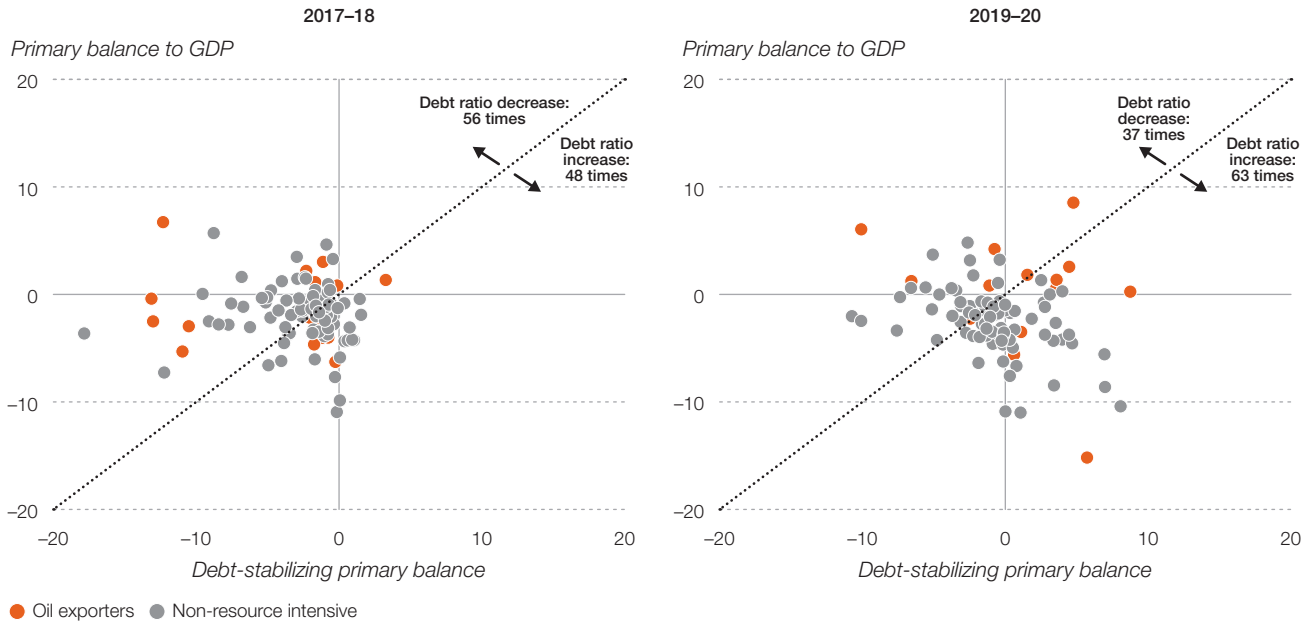
Expanding contingent liabilities, debt collateralization, and the "race to seniority" raise debt vulnerabilities

The increasing reliance on public-private partnerships, and the explicit or implicit government guarantees that accompany them, exposes African sovereigns to contingent liabilities in the event of bankruptcies of the private partner. Moreover, the "race to seniority" in debt collateralization has become an important risk factor, as creditors seek to collateralize their debt with strategic assets of the borrowing country (for example in Chad and Republic of Congo), which creates an uneven hierarchy of creditors that could complicate debt resolution negotiations (see box 2.2 and chapter 3). The risk is compounded by limited reporting on SOE debt obligations (some of which are as large as 4.5 percent of GDP in Zambia and 1.3 percent in Ghana) in sectors with systemic importance such as energy, finance, transport, and telecommunications.[9] These hidden debt obligations, when revealed, create additional vulnerabilities to the debt outlook.

Non-Paris Club creditors with less transparent loan terms complicate debt management issues

The number of Non-Paris Club creditors in Africa's creditor landscape has been increasing, by far the most important being China (figure 2.23). Many of these loans are not transparent regarding loan terms and collateralization. Most of the countries currently in debt distress or classified as being at high risk of debt distress have high exposure to Chinese loans—Djibouti (57 percent), Angola (49 percent), Republic of Congo (45 percent), Cameroon (32 percent), Ethiopia (32 percent),

FIGURE 2.22 The number of episodes with fiscal balance above debt-stabilizing levels has been rising in Africa, 2017–20



Note: Debt-stabilizing primary balance = $\frac{r-g}{1+g} d_{t-1}$, where r = effective interest rate, g = growth rate, and d = debt in percent of GDP.

Source: Staff calculations based on African Development Bank statistics.

BOX 2.2 The implications of debt collateralization in Africa

Collateralized sovereign debt refers to a sovereign loan that is secured by existing assets or future receipts owned by the government. The collateral could be commodities, future export revenues, or infrastructure use (such as electricity). Collateral lending is characterized by the fact that the lender can take control of the collateral if the loan is not repaid.

On the one hand, collateralized sovereign debt can be beneficial because it reduces the risk attached to a loan, decreasing its cost. It can allow market transactions and access to external financing that would have not been possible otherwise. On the other hand, it raises many concerns about countries' capacity for repayment —when there often is a lack of transparency on contractual terms, where it is difficult to assess the level of risk, or when transactions are unproductive and do not generate enough resources for debt repayment.[1]

Collateralized debt is often used during difficult times when countries face liquidity issues or have a risky borrower profile. Primary commodity-dependent countries are more likely to engage in collateralized borrowing, so-called commodity secured loans. For instance, countries such as Angola, Chad, or Republic of Congo—which are oil producers—use collateralized borrowing and are more sensitive to commodity price fluctuations. A decrease in oil prices leads to tensions on oil production that is used to avoid default. A major consequence is that a large share of oil revenue is used to repay loans, leading to fewer resources for governments. These are typical examples of resource backed loans that are sovereign loans in which repayments are in natural resources, from future revenues from natural resources exploitation, or when natural resources are used as collateral in debt contracts.[2]

Another concern raised by collateralized borrowing is that the creditors are given priority claims, which poses the question of seniority of sovereign debt. Collateralized borrowing affects the seniority of official creditors and multilateral creditors because debt backed by collateral is treated better than other debts. One of the consequences of debt collateralization is that it can raise hidden debt due to the race to seniority it generates. If creditors have collateralized a country's strategic assets, they may claim seniority based on that collateralization in the negotiations between a country and its creditors. These debt obligations increase debt vulnerabilities when they are disclosed for several reasons. The seniority position of sovereign debt defines the bargaining power of lenders during debt resolution negotiations, that is, who can and cannot be part of the resolution decisions. It makes debt resolution negotiations more complicated and raises concerns about repayment capacity and thus future borrowing. Collateralized loans also can create some moral hazard behavior by reducing incentives of borrowers to use and manage their debt wisely, leading to sovereign overborrowing.[3]

Notes

1. IMF and World Bank 2020.
2. Mihalyi, Adam, and Hwang 2020.
3. Bolton 2003.

Kenya (27 percent), and Zambia (26 percent)—and oil-backed loans from commodity traders.[10] Thus, any meaningful debt restructuring or resolution for African countries would require negotiating with Paris Club and Non-Paris Club official lenders, such as China. Given limited coordination among the two groups, it is not clear how this process would turn out, increasing rollover and refinancing risks for affected sovereigns.

Debt accumulation on the continent is projected to accelerate quickly from the combined effect of increased public spending and a contraction in GDP and revenue

Although the average debt-to-GDP ratio had plateaued around 60 percent in 2017 to 2019, it is expected to climb significantly to more than 70 percent in the short term. That reflects the growing

FIGURE 2.23 Chinese loans to Africa are increasing the most among non-Paris Club creditors, 2000–18

Source: Johns Hopkins SAIS China–Africa Research Initiative and World Bank Commodity Index.

The jump in debt levels is expected to be more pronounced in tourism- and resource-dependent economies

financing needs of many governments as a result of increased public expenditure to respond to the impact of the virus and shrinking revenues due to COVID–19's shocks to economic fundamentals—exports, remittances, and tourism. Debt-to-GDP ratios are projected to increase by up to 10 to 15 percentage points in the near to medium term (figure 2.24). The jump in debt levels is expected to be more pronounced in tourism- and resource-dependent economies that rely heavily on these sectors for foreign exchange earnings and government revenue.

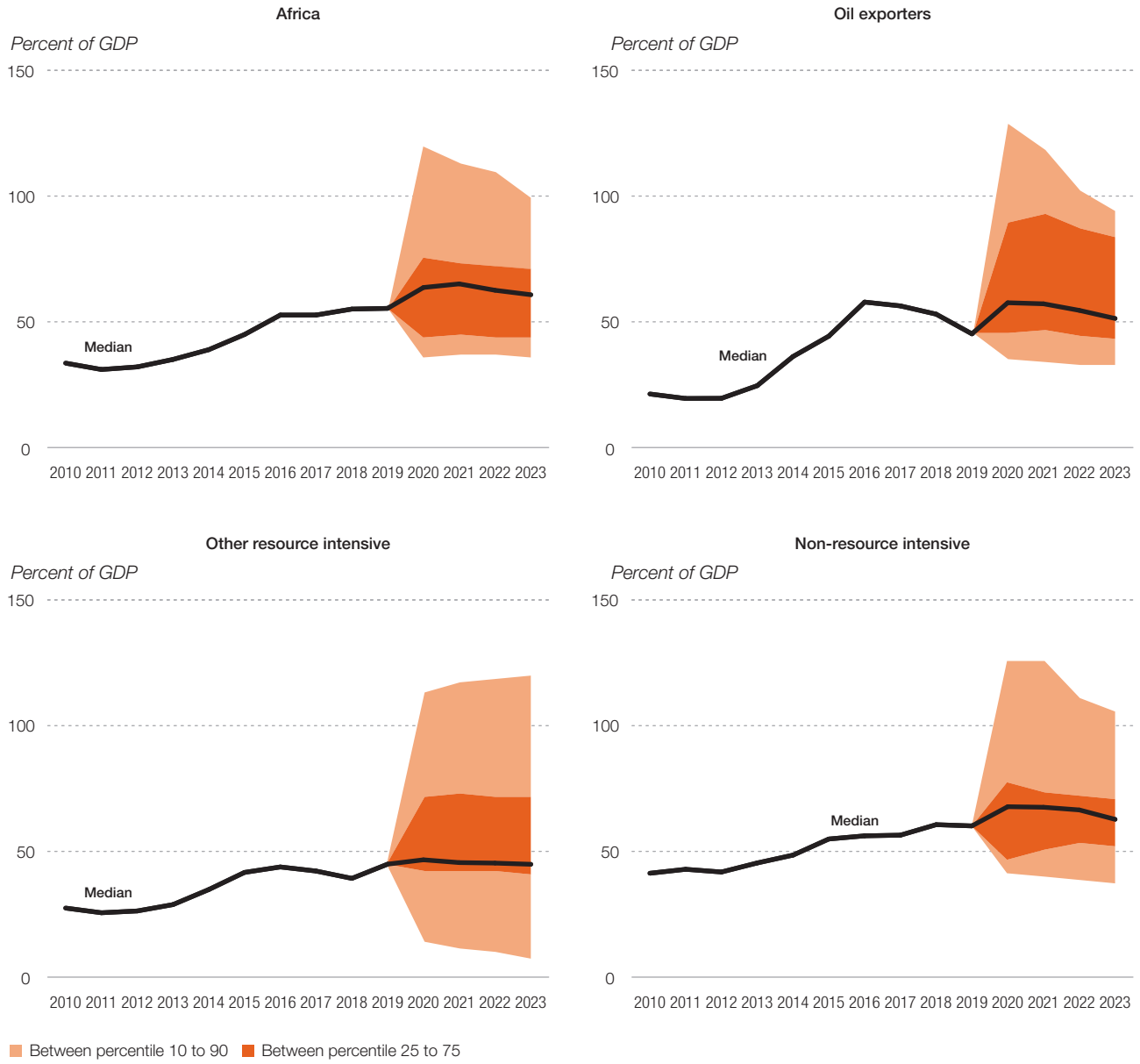
DEBT DISTRESS AND RECOVERY EPISODES IN AFRICA: GOOD POLICY OR GOOD LUCK?

Secondary market information shows that countries can recover from debt distress episodes without going into a default, depending on initial conditions

Although debt vulnerabilities are rising in Africa, countries could make appropriate policy choices to avoid events of debt default. This section seeks to identify episodes of debt distress in Africa's frontier market economies and assess the role that policies play in fostering recovery from debt distress. The definition of debt distress used goes beyond the traditional event of default or loan restructuring. Debt distress is described as an event that occurs when the spreads on sovereign debt in the secondary debt market (where loans are traded as assets by investors) exceed a critical threshold. Sovereign debt spreads commonly show market participants' perceptions of sovereign risk and therefore bear information on the external financing conditions faced by African bond issuers. Identifying bond distress episodes requires determination of the critical thresholds, the explicit definition of a time origin, unit of measurement, and the definition of the event that terminates the episode of debt distress. Duration models are used to assess the role played by the global economic environment, domestic policy, institutional factors, political events, and multilateral debt programs (by the IMF and others) in fostering recovery from debt distress episodes.[11]

Using the baseline critical value of 800 basis-point spread, 18 episodes of bond distress events are identified across 16 countries (figure 2.25). One spell involving Zambia did not finish by the end of the sample period. For the critical threshold, the distribution of the duration (the number of months) of each debt distress episode is estimated. Overall,

FIGURE 2.24 Debt-to-GDP ratios are projected to climb in the short term, 2010–23



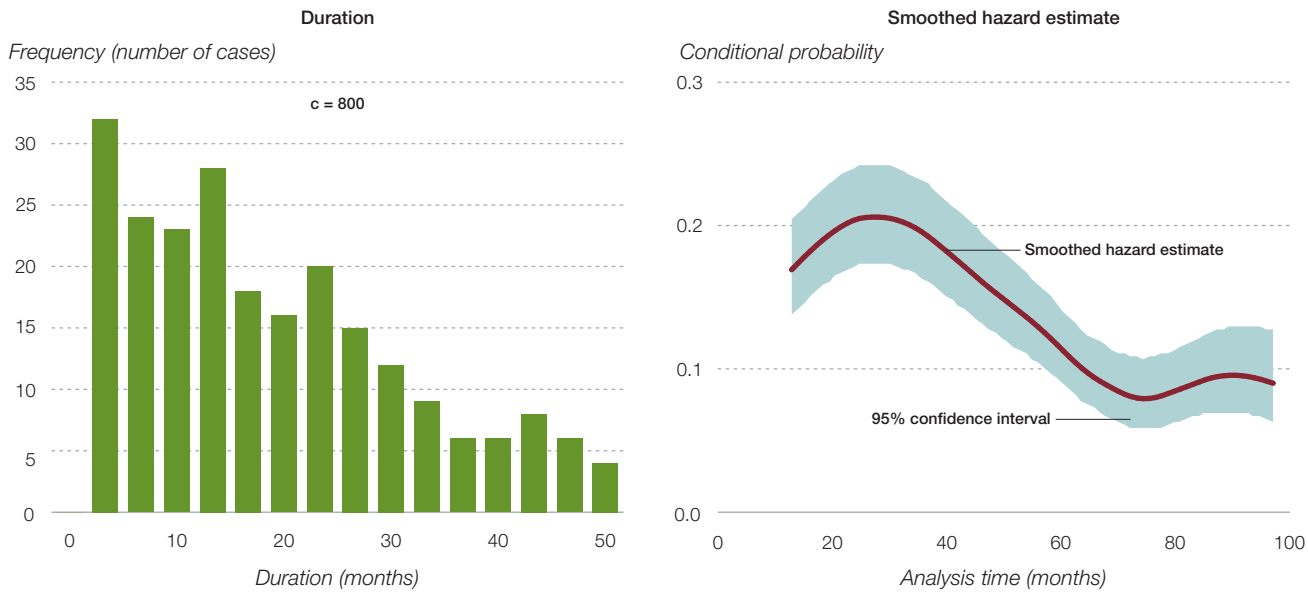
Source: Staff calculations based on IMF World Economic Outlook database.

the duration of the distress episodes remain stable over different critical threshold values considered.

The main policy-induced determinants tested in the model are grouped into:

- Domestic policy, captured by the country-specific inflation rate, economic openness, and trade balance.
- The external environment, represented by the three-month U.S. Treasury bill rate.
- The three-month Libor rate.
- The 10-year US Treasury bond rate; and global risk aversion measured by the yield spread between high- and low-rated US corporate bonds.
- Movements in gold prices; and the volatility index of the Chicago Board Options Exchange.
- Foreign exchange reserves-to-GDP to determine the level of risk premium because

FIGURE 2.25 Duration and smoothed hazard estimate



Source: African Development Bank staff calculations.

accumulation of foreign exchange reserves should reduce a country's risk.

- Civil liberties and political rights indicators from the Heritage Foundation's Index of Economic Freedom are used as a proxy for the quality of institutions.[12] Those two indicators signal a better institutional environment, which is expected to be positively correlated with shorter crises; and finally, the presence of IMF-supported programs.

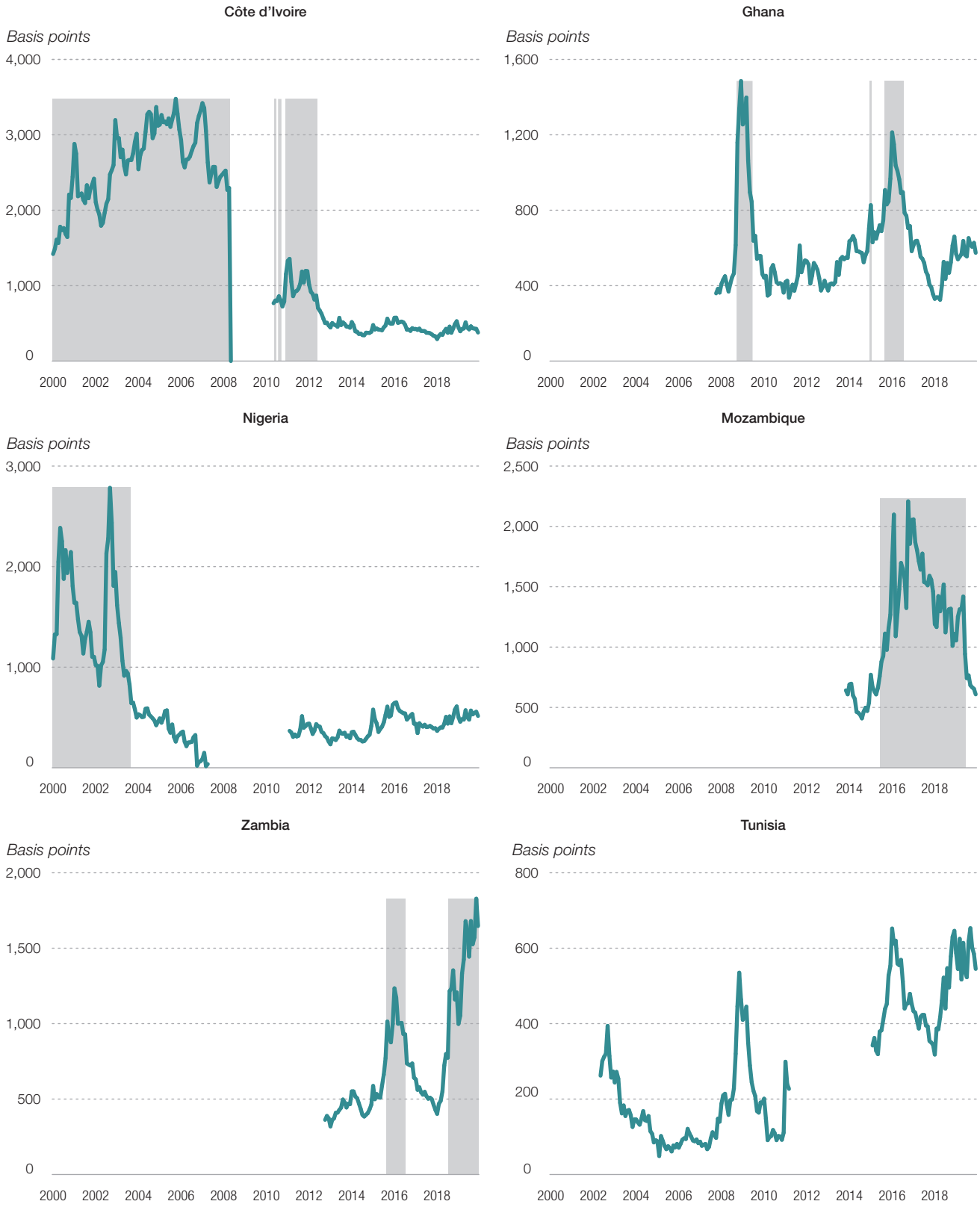
Favorable external conditions complemented by sound domestic policy and the presence of multilateral development bank programs contributes to shorter episodes of bond market distress

The findings show that the interaction between domestic policy and favorable external conditions helps to speed up the recovery from debt distress and greater openness to trade contributes to shortening debt crisis episodes. The external environment measured by risk aversion in the global market will lead to higher risk premiums in African bond markets and therefore reduce the probability of exiting from a debt distress episode. Higher interest rates on the 10-year US Treasury bond tend to extend the episode of debt distress. The presence of an IMF-supported program contributes to reducing debt distress episodes by signalling the formulation of a comprehensive policy adjustment package, which in turn catalyzes private capital flows and the provision of financial resources that support implementation of corrective measures. The intervention of the IMF in crises plays a catalytic role by making it easier for countries to exit debt crises. Also, stronger political rights have a positive impact on the probability of exiting a debt distress episode and faster reserve growth contributes to shortening the debt distress episode. Bond market debt distress and recovery episodes identified for a cross-section of countries are presented in figure 2.26.

CONCLUSION

Africa's debt trajectory is projected to accelerate quickly as a result of the surge in government spending to mitigate the socioeconomic consequences of the COVID–19 pandemic and the associated contraction in economic activity and

FIGURE 2.26 Bond market distress and recovery episodes in six frontier market economies, 2000–19



Source: African Development Bank staff calculations.

government revenue. This Chapter has shown how the changing composition and drivers of Africa's debt, with an increasing share of commercial and non-traditional sources, has elevated the continents exposure to debt vulnerabilities and created significant challenges for debt resolutions for countries with unsustainable debt burdens. The next chapter focuses on how countries can mitigate these vulnerabilities, improve the process of debt resolutions where necessary, and use policy reforms to improve debt sustainability profiles.

NOTES

1. See Chapter 1 for an assessment of the impact of the virus on macroeconomic fundamentals.
2. IMF 2020a.
3. IMF 2020a.
4. Morsy and Moustafa 2020.
5. Countries currently in debt distress are Democratic Republic of Congo, Mozambique, São Tomé and Príncipe, Somalia, Sudan, and Zimbabwe.
6. Refinancing risk is the risk of not being able to replace maturing debt with new debt.
7. IMF 2020c.
8. The debt-stabilizing primary balance refers to the level of primary deficits that stabilize debt. It is driven by the interest-growth differential and the initial debt stock. When the primary deficit exceeds this level, debt increases.
9. IMF 2020c.
10. Three African oil producers have struggled with oil-backed deals with commodity traders—Chad, Republic of Congo, and South Sudan—and ended up in debt distress in 2018.
11. This model has been widely used in the econometric literature to assess the impact of selected exogeneous drivers on the time until some kind of transition occurs (see Pescatori and Sy (2007) and Wailti and Weder (2009) among others).
12. Heritage Foundation 2007.

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3

DEBT RESOLUTION AND THE NEXUS BETWEEN GOVERNANCE AND GROWTH

KEY MESSAGES

- **Debt resolution in Africa, especially outside Paris Club processes, has often been disorderly and protracted, with costly economic consequences.** These costs have been less severe in countries that acted preemptively and collaboratively and in those where economic governance was stronger.
- **To avoid high debt resolution costs in the future, the international community needs to push for changes to the international financial architecture for sovereign debt restructuring.** The current global architecture is challenged by the emergence of new creditors, a lack of transparency that complicates burden-sharing, and a race to seniority, which may make it difficult for future debt restructuring operations.
- **African countries also need to innovate or keep abreast of innovations in financing instruments, both legal (such as collective action and aggregation clauses) and financial (such as value recovery and equity-like debt instruments).** To deal with the recurrence of debt crises, it is time to reconsider whether state-contingent debt instruments that link debt service payments to a country's ability to pay can be used extensively as a tool to minimize the possibility of future unsustainable debt dynamics. International financial institutions are in a position to partner in this effort, by providing debtor countries with incentives to own this initiative.
- **But, ultimately, only bold governance reforms will help reignite growth and put Africa's debt on a sustainable path.** Africa needs to put in place policies to reignite growth, such as those related to digitalization and enhanced competition, those to reduce leakages, and, critically, those to enhance debt transparency.

Past debt jubilees were customary after wars or dramatic events. By wiping out debts, these debt cancellations sought to avoid polarization and social tensions. Today, the massive dislocations caused by the COVID–19 pandemic provide justification for the international community to hold a modern version of the debt jubilee to deliver significant debt relief—especially for poorer countries, such as many of those in Africa.

But Africa's experience with debt resolution has historically been disorderly and protracted. For example, the Heavily Indebted Poor Countries (HIPC) initiative took more than a decade to be implemented. There are also ongoing, long-lasting litigations with external creditors over the debt of Angola, Republic of Congo, and Mozambique. Moreover, the changing composition of debt—from concessional creditors to private and nontraditional official creditors (see chapter 2 and the *African Economic Outlook 2019*)—makes even more pressing the need for changes to the international financial architecture for sovereign debt crisis resolution, especially for African countries.

The absence of orderly and successful sovereign debt resolution, especially with private creditors, makes the prospects worrisome for African economies, where debt has grown rapidly in recent years. Historically, sovereign debt restructuring has come too late and provided too little relief to facilitate a lasting exit from sovereign debt crises.[1] Anticipating debt distress should be a top priority for Africa. Failure to do so could take a critical toll on economic progress.[2]

To avoid another "lost decade" in Africa, regional policymakers and the international community must do their best to help align borrowers' and creditors' incentives, avoid disorderly sovereign defaults, and reignite growth. But African countries also need to do their share. They should chart a path forward by decisively shifting their governance systems to foster more sustainable and inclusive economic growth models.

African countries should chart a path forward by decisively shifting their governance systems to foster more sustainable and inclusive economic growth models

Against this background, the chapter first explores the international financial architecture, and describes what makes sovereign debt resolution so difficult. After describing recent sovereign debt restructuring operations in Africa and elsewhere, it discusses needed changes in the international architecture to provide timely relief. Finally, it explores complementary changes in domestic and regional governance to help the continent turn a corner and lift growth prospects.

THE ARCHITECTURE FOR DEBT RESOLUTION

The absence of formal bankruptcy procedures has created free riding and asymmetric information problems, rendering orderly sovereign debt restructuring complex to achieve

In theory, sovereign debt crises come in two ways. The crisis can be related to *illiquidity,* when there are not enough liquid assets to meet debt obligations that come due. Given adequate adjustment and sufficient official support, the country can make its debt sustainable. Alternatively, a crisis can reflect a lack of *solvency,* when there is no policy path for the country, with or without official support, that will enable it to pay back its debt.

In practice, this is often a distinction without a discernible or practical difference.[3] In either liquidity or solvency crises, a large and often uncertain amount of outstanding debt—potentially issued in multiple jurisdictions and held by different types of investors—raises coordination issues that hinder debt resolution. This is the dark side of countries' increased access to varied sources of funding. In turn, the lack of coordination among creditors can generate at least two problems. On the one hand, the difficulty of coordinating actions can engender self-defeating strategies, with individual investors deciding to pull funds from a country on the expectation that other investors will also do, turning a liquidity crisis into a solvency one. On the other hand, when debt restructuring is needed, willing countries and investors can end up in the hands of investors who prefer to stay outside of restructuring negotiations (holdouts). Investors can hold out because of a lack of interest (free riders) or to get better conditions (through a unilateral agreement or by litigating).

The fundamental difficulty with sovereign debt is that there are no formal bankruptcy procedures, as there are in corporate bankruptcies. Sovereign debts cannot be legally discharged in bankruptcy, and resolution relies on the willingness of debtors and creditors to negotiate and their ability to successfully extract repayment (through litigation or political pressure).[4]

Because there is no formal international bankruptcy mechanism for sovereigns, debt restructuring procedures have evolved over the past 40 years. The void has created free riding and asymmetric information problems, making it difficult to achieve an orderly resolution of debt default.

The existing architecture for sovereign debt restructuring places good faith negotiations between debtors and creditors at the core and has pushed a number of contractual innovations to facilitate such negotiations and reduce the likelihood that holdouts block the restructuring process. The main such innovation has been the introduction of collective action clauses (box 3.1), which removed the need for unanimity among creditors to restructure sovereign bonds and replaced it with a requirement to have only a majority of votes.

BOX 3.1 A brief history of the international financial architecture for debt resolution

Starting in the 1980s, emerging and developing countries began to dramatically change the way they addressed their financing needs. Their increasing integration in financial markets allowed these countries to reduce their almost exclusive reliance on multilateral banks, official bilateral creditors, and a handful of commercial banks, and instead start issuing bonds in international and domestic markets. The increased access to funds was supported by investors in many different jurisdictions. For investors, the development of hedging instruments (such as credit default swaps) created new opportunities for investment and risk diversification, which helped to increase the depth of sovereign bond markets and reduce financing costs. Unfortunately, rapid financial globalization also created greater vulnerability and increased the complexity of crisis resolution. The expansion and fragmentation of the creditor base complicated debt resolution, facilitating the emergence of holdout problems, which could not be addressed within the pre-existing framework, structured around the London Club, an informal group of private lenders modeled on the Paris Club of official creditors.

The debt crises in the late 1990s and early 2000s ignited a debate on how the international financial architecture should change to limit future crises. Arguments differed, depending on which problem required resolution. For some commentators, the crises were the result of failures in financial markets. For others, crises were mainly due to wrong economic policies. Those who blamed market failures believed any solution required the creation of an official financial safety net, which would function as a lender of last resort. In contrast, those who cited inappropriate economic policies believed it essential to design policies that mitigate moral hazard risks—that do not permit policymakers to take advantage of the protection of debt resolution to carry out suboptimal policies, and that do not permit investors to disregard risks when lending to sovereigns in the expectation of being bailed out. The debate focused on the intimately related nature of the reforms needed to improve crisis prevention and management. Two main approaches surfaced: one statutory-based and the other market-based. Proponents of the statutory approach argued for enacting legislation and creating an international institution with a capacity to guide situations where debt relief is necessary to restore sustainability.[1] Proponents of the market-based approach advocated solutions that involve a minimum of institutional intervention. They advocated the creation of codes of conduct and the inclusion of a voting procedure within sovereign bond contracts, in the form of a collective action clause. It is the market route that was finally chosen.

Collective action clauses (CACs) facilitate the dialog between creditors and debtors. They allow a prespecified majority of bondholders to approve the terms of a restructuring of debt and impose it on dissenting bondholders. But because these CACs did not prevent a minority of lenders from obtaining enough exposure to a single bond to block its restructuring process, they can be used to prolong resolution by rogue creditors such as "vulture funds," which typically purchase distressed debt on secondary markets at a significant discount and litigate aggressively in relevant jurisdictions.[2]

To counteract the ability of holdouts to get around CACs, an improved version of collective action clauses, which allows bundling different groups of bonds, was published by International Capital Market Association (ICMA) in October 2014, and endorsed by the IMF and the Group of 20 (G20) of the largest global economies.[3] The underlying objective of the reform was to fight holdout strategies by allowing the debtor and majority holders of one or more instruments to agree on restructuring terms and make them binding on all holders of those instruments.[4] Recently Belgium and the United Kingdom introduced antivulture legislation, intended to shield sovereign debtors from rogue creditors.

Notes

1. The institution could take the form of either an international solvency regime (Sachs 1995; Rogoff 2003) or a sovereign debt restructuring mechanism, such as the one proposed by Krueger (2002).
2. These rogue creditors can prevent the operation of CACs if they hold up to a majority of 25 percent of the bond series under consideration, in line with London and New York laws.
3. ICMA is a not-for-profit membership association. It has around 600 members in more than 60 countries. Among its members are private and public sector issuers, banks and securities houses, asset managers and other investors, capital market infrastructure providers, central banks, and law firms.
4. In addition, other modifications of contractual clauses such as pari-passu, have been introduced in sovereign bonds. Pari-passu clauses guarantee that bondholders have the same priority as other creditors.

During restructuring, the IMF often plays an important role. In fact, through its debt sustainability analysis and its lending requirement that debt be sustainable with a high probability, the IMF often acts as the gatekeeper of debt restructuring.[5] Moreover, when present, the IMF provides financing, serves as a commitment device to undertake reforms (through associated conditionality), supports negotiation, and through its macroeconomic framework, provides the relief envelope required to achieve sustainability. To minimize the potential moral hazard that authorities could use the presence of a safety net around the IMF to undertake irresponsible policies, IMF lending requires strict policy conditionality.

For the restructuring of official debt, the Paris Club—a group of 22 large official creditors—has developed a number of procedures to provide debt relief to less developed and poor countries in coordination with the IMF and the World Bank.[6] For official creditors outside the Paris Club, debt restructurings proceed ad-hoc.[7]

The longer-term costs of a poorly executed debt restructuring may be large

RESTRUCTURING SOVEREIGN DEBT

Countries have dealt with sovereign debt restructuring in different ways, depending on their specific circumstances, resulting in wide heterogeneity in outcomes across restructuring episodes

Once a sovereign debtor facing default determines that a debt restructuring is needed, it should decide:[8]

- How to announce the operation and how to treat upcoming payments.
- What liabilities will be part of the debt negotiations (the so-called debt perimeter).
- What extent and form of concessions to ask from creditors.

Different countries answer these questions in different ways, depending on their specific circumstances, which results in wildly different restructuring episodes.[9] A growing body of empirical evidence shows that considering such differences helps explain the scale of the economic benefits and costs of debt restructuring operations.

Announcing the process and managing upcoming payments

In determining how to treat payments coming due, countries can opt for preemptive negotiations, which avoid accumulating arrears, or for a postdefault restructuring, in which case the relief is felt immediately as upcoming payments are not met, and arrears build up. Accumulating arrears can allow debtors to signal their intention to achieve significant relief. Similarly, governments can engage closely with creditors, or act unilaterally.

Examining various decades of debt restructuring with external private creditors, Asonuma and Trebesch (2016) and Trebesch and Zabel (2017) find that postdefault strategies and those that treat creditors in a harsher manner result in worse growth following debt restructuring.[10] Buchheit and others (2018) note that sovereign debt restructuring can fail because it can result in debt relief that most creditors see as excessive and confiscatory or unnecessarily coercive; and that the longer-term costs of a poorly executed debt restructuring may be large. In part, these costs depend on the market's perception of how the country will behave during the crisis.

Defining what liabilities will be part of the debt perimeter

While generally, trade credits, senior or collateralized debt obligations, and treasury bills (because of the need for continued short-term financing of the government) are left out of the restructuring perimeter (that is, which borrowings are included and which are not), these unwritten rules have been repeatedly broken recently. Both collateralized (including resource-backed loans, in which natural resources can serve as payment in kind, supply an income revenue stream to make repayments, or be used as collateral) and very short-term public debt have been included recently in debt restructuring operations.

One important decision is the extent to which the relief should be granted by holders of debts governed by domestic law versus holders of debt governed by foreign law. According to the African Legal Support Facility (2019) and Buchheit and others (2018), there are several considerations at play. On the one hand, the restructuring process

differs for the two types of debt holders. Authorities can enact domestic legislation to change the terms of domestic law–governed debt, which gives the sovereign strong tools to prevent disruptive holdouts.[11] On the other hand, because local law–governed debt may be disproportionately held by local residents, including domestic banks, any restructuring could trigger a bank crisis and, through an ensuing credit crunch, worsen the prospects for restoring economic growth.[12,13]

Other important considerations include whether to involve official creditors, how to treat claims held by other public bodies (such as central banks), and whether to include debt from state-owned enterprises (SOEs).

Defining the extent and form of concessions to ask from creditors

There are three main modifications to the financial terms of sovereign debt that the authorities can propose to creditors. First, the authorities can try to obtain principal debt reductions (so that the nominal value of debt is reduced). Second, they can attempt to extend maturities (this is almost always part of debt restructuring agreements). Third, they can reduce coupons.

Evidence shows that maturity extensions and interest rate reductions, which merely smooth out and reduce refinancing needs but do not affect nominal debt amounts, are not generally followed by higher economic growth or improved credit ratings. The so-called reprofiling of maturities, where bonds maturing in the short term have their maturities extended, has received recent attention. Reinhart and Trebesch (2016) show that the macroeconomic situation of debtors improves significantly after debt relief operations only if there are principal write-offs. Using Paris Club data, Cheng, Diaz-Cassou, and Erce (2018) find that restructurings involving principal relief lead to faster GDP growth than operations involving only maturity extensions and interest rate reductions (which do not reduce the nominal value of debt, but reduce the market value of debt, delivering net present value relief). Principal debt reductions also lead to a larger reduction in poverty and inequality. The flip side is that fiscal deficits are larger following principal debt reductions.

RECENT DEBT RESTRUCTURING IN AFRICA AND BEYOND

Between 1950 and 2017, African countries have restructured privately held external liabilities 60 times and reached 149 agreements with the Paris Club

The historical record of sovereign debt restructuring in Africa is long and deep. Data from Asonuma and Trebesch (2016) show that African countries restructured privately held external liabilities 60 times between 1950 and 2017. In the same period, African countries reached 149 agreements with the Paris Club.[14] Since 1980, African countries restructured domestic debt at least 18 times.[15]

The recent period has featured intense debt restructuring activity, both with private external creditors and with China. Since 2015, four countries have restructured privately held liabilities and six have restructured Chinese debt. With a view to learning lessons for future operations, this section examines these processes, and also those outside Africa. Table 3.1 presents ongoing cases.

Principal debt reductions lead to a larger reduction in poverty and inequality, but fiscal deficits are larger

Privately held debt restructuring in Africa has been challenging due to collateralized or hidden debts

In Chad, a high-interest nontransparent resource-backed loan with a multinational trading and mining company allowed the firm to capture a large part of Chad's oil revenues. The loan proved an obstacle to achieving sufficient debt relief. In 2015, the creditor agreed to lengthen the maturity of the loan,

TABLE 3.1 Ongoing restructuring cases in Africa, September 2020

Country	Type	Announcement
Mozambique ("hidden loans" with foreign private creditors)	Post-default	Oct-16
The Gambia (private claims)	Preemptive	Jun-18
Republic of Congo (loans with commodity traders)	Post-default	Apr-18
Zambia (Eurobonds)	Preemptive*	May-20

*The Government of Zambia announced a consent solicitation in September 2020.
Source: Asonuma and Trebesch (2016), 2020 update. https://sites.google.com/site/christophtrebesch/data.

but the operation raised its net present value.[16] When Chad subsequently sought IMF support, it was required to restructure again. In an important breakthrough, the operation linked principal payments to oil prices, rendering the debt countercyclical. Other external loans remain under negotiation.

In 2016, democratic presidential elections in The Gambia resulted in a political transition to a new government. The government of The Gambia entered into negotiations with the IMF for a new Staff Monitored Program with the aim of ultimately transitioning The Gambia to an Extended Credit Facility (ECF), a medium-term lending facility to help poorer countries maintain sound policies. One of the preconditions to the 39-month ECF that The Gambia obtained in March 2020 was that the country attain "credible and specific" debt relief assurances from enough of its external creditors to ensure that the country's debt was on a sustainable path.[17]

In nearly all cases, China offered debt write-offs for zero-interest loans

In Mozambique in 2016, an IMF program went off track after hidden debts with private external contractors were uncovered. These debts led to a sharp deterioration in Mozambique's debt sustainability rating and to a protracted restructuring process. The authorities reached out to private contractors who had government-guaranteed SOE loans, eurobond holders, and China. The eurobond was swapped in October 2019, three years after it was announced. The loans with contractors remain under litigation.

The Republic of Congo has been in litigation with external private creditors since 2014, with collateralized debt posing a major obstacle. After reaching the completion point in the Highly Indebted Poor Countries debt relief initiative in 2010, Congo accumulated substantial debt with China and commodity traders. This was partly done through nontransparent deals. In 2017, previously undisclosed oil-backed contracts were discovered. Before signing an IMF program in 2019, Congo restructured its debt with China (in 2018 and 2019) and an oil company (in 2018). Congo excluded local banks and regional instruments, as stress tests showed that restructuring bank exposures would trigger a bank crisis.

In Zambia in September 2020, the government initiated a creditor engagement strategy under the auspices of the G20 Debt Service Suspension Initiative (DSSI) and entered into a memorandum of understanding with Paris Club Creditors aimed at securing immediate debt service relief (in the form of postponed payments). The government made similar requests to all external commercial creditors. Consultation between the IMF and the Zambian authorities are ongoing regarding upfront debt management measures. The government sent a solicitation of consent to its eurobond creditors for a deferment of interest payments from October 2020 to April 2021. However, this request was declined. Eurobond creditors raised concerns about lack of transparency by the Zambian authorities to ensure that all creditors were treated equitably. Based on the pressure for equal treatment of all creditors, the government chose to default on a $42.5 million eurobond coupon payment due on 13 November 2020.

Chinese debt restructuring in Africa mostly consists of write-offs for zero-interest loans

From 2015 to 2019, China rescheduled $7.1 billion of debt with Angola, Cameroon, Chad, Ethiopia, Mozambique, and Niger.[18] According to Acker, Brautigam, and Huang (2020), these operations had distinct characteristics. In nearly all cases, China offered debt write-offs for zero-interest loans. Importantly, there is no evidence of asset seizures, nor of the use of courts to enforce repayment (despite contract clauses requiring arbitration), or application of penalty rates. The technique used most was providing net present value debt relief, mainly through lower interest rates, longer grace periods, and substantially longer repayment periods.[19] While China's export-import bank is a lender in most restructuring cases, each of the multiple Chinese banks and companies that have provided credit to African governments negotiates separately.

Recent defaults outside Africa offer important lessons for the continent

Recent experience shows that both principal debt reduction and well-designed maturity extensions (reprofiling) can bring debt down to sustainable levels. Reprofiling can be less effective

when a country faces a large debt overhang—when the burden of debt is so large that a country cannot pay it back. In those situations, debt restructuring operations may simply continue to deliver too little debt relief, too late.

Following an injunction from a New York state court obtained by Argentine holdout creditors in 2012 that prevented the authorities from making payments on new bonds, litigation has been on the rise. This increasingly confrontational stance was met with various techniques to facilitate participation and avoid litigation.

Taking advantage of the local nature of their public debt, parliaments in Greece (in 2012) and Barbados (in 2018) passed legislation retrofitting an aggregation clause in all local-law bonds, to allow them to hold a single vote with holders of all bond involved. Both subsequently used the clause to avoid holdouts. Other countries (Belize, Seychelles, and St. Kitts and Nevis) successfully used collective action clauses to restructure their external bonds.[20]

Participation was further encouraged through techniques to strip holdouts of enforcement powers. These included exit consents, delisting of bonds, and cross-default clauses. Additional techniques used to buy investor acceptance included the use of creditor committees and fiscal agents.[21]

Two additional factors were critical to generating investor acceptance and preventing long-lasting negotiations and negative effects on market access. First, a high degree of good faith in negotiations by the authorities. Second, the use of innovative financing terms—such as state-contingent debt repayments, value recovery instruments, and step-up coupon structures—to help build consensus. These instruments provided investors with potential pickup in case the countries grew out of their crises, and give authorities incentives to conduct prudent fiscal policies. The nonconventional design of the instruments made them so different from other debt instruments that it drained liquidity from them. An important aspect not always considered when issuing these instruments is that their design affects future financing needs and the cyclical properties of public debt (box 3.2).

CHALLENGES WITH THE CURRENT FRAMEWORK FOR DEBT RESOLUTION IN AFRICA

While restructuring in most emerging markets has been relatively smooth, preemptive, and with high participation of creditors, some episodes, especially in Africa, have been protracted, incomplete, and nontransparent

Chad, the Republic of Congo, and Mozambique have all experienced protracted restructuring processes due to the worsening of creditor coordination problems that has accompanied the broadening of the creditor base for sovereign borrowers.[22]

Even in countries where bonds had the most recent version of collective action clauses, the negotiations proved fraught since vulture funds remained active and litigated. During 2020, Argentina and Ecuador restructured bonds, which included the latest CACs from International Capital Market Association (ICMA). While both managed to restructure using the two-limb CACs (bond-by-bond voting plus aggregation across bonds), the negotiations showed that the authorities could use the single-limb voting mechanism (aggregate voting across bonds) to their own advantage.[23] Not only did the prolonged negotiations required, despite the use of ICMA CACs, show the limits of the current contractual approach, but a significant amount of the sovereign debt has no aggregation clauses.

Another complication is that sovereigns are increasingly using collateralized and resource-backed borrowing, and the lack of transparency in those loans makes fair burden sharing more difficult and limits coordination.[24] That complicates debt restructuring negotiations.[25] This problem is most prevalent in countries where SOEs are a source of hidden debts, leakages, and corruption.

The shift in the creditor base toward new official lenders and collateralized and nontransparent debt instruments is especially concerning for lower-income African countries. Indeed, the shift to less transparent and collateralized instruments in Africa has already substantially complicated negotiations on debt resolution by making it harder to

Participation was encouraged through techniques to strip holdouts of enforcement powers

BOX 3.2 The use of state-contingent instruments during sovereign debt restructuring

The use of innovative techniques and instruments increased the likelihood of success of debt restructuring operations. As described in IMF (2020b), which focuses on the role of state-contingent debt in sovereign debt restructuring, since 2014, countries have deployed multiple features to foster investor participation. These have included more traditional value recovery instruments (VRIs), but also countercyclical and state contingent payouts (that relate debt service to a country's ability to pay), and even incentives for prudent fiscal policy.

In Greece and Ukraine, VRIs were provided in the form of GDP warrants, which provided creditors with additional payments if GDP growth exceeded preagreed limits. St. Kitts and Nevis offered a portion of future tax revenues. These VRIs increased participation in restructurings, although at the cost of encumbering future revenues. Some debt operations have built-in contingencies that make debt service obligations countercyclical (natural disaster clauses).

Other countries preferred simpler structures, such as a step-up coupon structures, in which countries start paying lower coupons and, over time, pay increasingly larger coupons. Similar to GDP warrants, step-up coupons reflect the willingness of the market to accept that a sovereign's economic prospects will improve over time. Step-up bonds are long-duration instruments and are more appealing to investors with a long investment horizon. Step-ups can help meet immediate cash flow needs, but problems can reemerge. However, the future increase in interest rates implied by the step-up can put pressure on governments.

The experience of Belize, which has restructured its public debt three times in a little more than a decade, is instructive with regard to the risks posed by these coupon structures for future debt sustainability. In the past two Belizean debt restructurings, part of the reason additional debt relief was required was that the step-up coupons were kicking in, creating an increase in financing needs unmanageable for the authorities.[1]

Note

1. Okwuokei and van Selm 2017.

The shift to less transparent and collateralized instruments in Africa makes it harder to determine the debt perimeter and the required contribution from different creditors

determine the debt perimeter and the required contribution from different creditors (box 3.3).

While the global financial architecture should address the lack of transparency of some new creditors, which may complicate future debt restructuring operations, it should also acknowledge them as an additional source of financing that African countries badly need to address structural and economic dislocations, and invest in the growth that would make debt service possible in the future.

A final, closely related, concern is that domestic arrears (accrued, say, by not paying suppliers) have become an increasing source of forced financing in some parts of Africa.[26] Figure 3.1 shows the importance of this financing mechanism, using a selection of African economies. The figure uses data on fiscal arrears reported by the Bank of England.[27] At any rate, governments and multilateral institutions such as the African Development Bank should pay greater attention to the plight of this class of creditors.

While not paying suppliers (forcing them to become creditors) may free up funds to help cover borrowing needs, it can seriously damage the productive system and delay economic recovery. IMF (2019) finds that domestic arrears have a negative impact on growth through several channels, including hurting the profitability of the private sector and stressing the banking sector.[28] Moreover, by undermining trust in government, arrears can even reduce fiscal policy effectiveness. Nevertheless, domestic arrears emerge in all debt crises, and their clearance takes a long time, preventing economic recovery. According to the IMF, domestic arrears figure prominently in

BOX 3.3 Leveraging natural resources for development financing

Resource-backed loans (RBLs) are loans provided to a government or a state-owned company, where:

- Repayment is made directly in natural resources, such as oil or minerals, or from a resource-related future income stream.
- Repayment is guaranteed by a resource-related income stream.
- A natural resource asset serves as collateral.

Resource-backed loans are primarily used for infrastructure development. They may offer cheaper financing, can be structured to mitigate volatility, and can be renegotiated if times get difficult.

Between 2004 and 2018, 30 of 52 RBLs analyzed were signed by African countries, and 22 by Latin American countries. The majority of the loans (43) were backed by oil, 6 by minerals, 2 by cocoa and 1 by tobacco. The loans totalled $164 billion, of which $66 billion went to Sub-Saharan African countries, and $98 billion to Latin American countries.

African RBLs have typically represented a higher proportion of their economies than those in Latin America. The largest in this respect is Guinea's $20 billion RBL, signed in 2017 with a consortium of Chinese companies equivalent to nearly 200 percent of the country's GDP. The second largest ratio was the Republic of Congo's 2006 RBL of $1.6 billion, or 21 percent of the country's GDP that year. Third is Democratic Republic of Congo's 2008 Sicomines infrastructure deal with China, which was USD 3 billion, or 16 percent of the country's GDP.

RBLs have been a major source of public finance risk. Of the 14 RBL recipients, 10 experienced serious debt problems after the commodity price crash of 2014, with RBLs often cited as a key contributor. RBLs are also opaque. Contract documents were public in only one case, and even basic information such as the loan's interest rate was identifiable in just 19 of 52 cases surveyed.

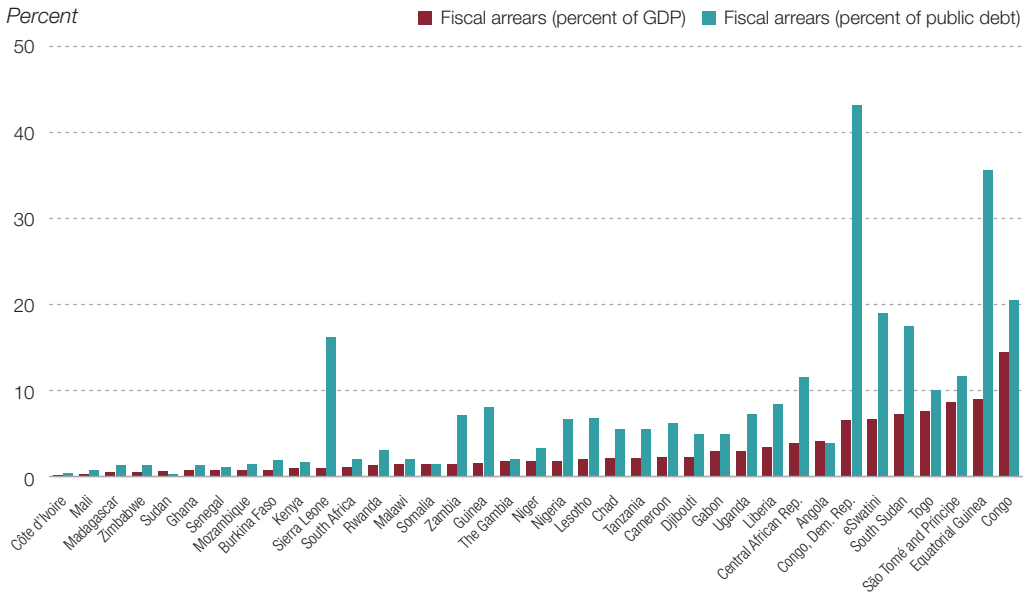
RBLs can undermine a country's ability to take part in an orderly default, because they may still need to be serviced from oil production or because of the risk of losing the collateral. This can happen even when the country is in default on other obligations and unable to pay for basic services. However, the mutual interdependence between RBL borrower and lender creates stronger opportunities to renegotiate.

For countries to better leverage RBLs for financing their development needs, there is a series of issues to be recognized:

- Recent steps taken by the Extractive Industries Transparency Initiative and others have improved transparency norms applicable to RBLs. Practice should follow so all key terms of each loan contract are promptly made public.
- Given their complex nature and importance, RBLs and the associated spending should not be executed by SOEs. Rather, they should be brought on budget, vetted by countries' ministries of finance, and made subject to parliamentary scrutiny (where applicable).
- Governments should encourage competition among RBL providers on loan terms. This will help governments secure the best possible deals when presented with alternative options.
- Using resource rights as collateral should be avoided. Rights to subsoil wealth make for poor collateral. They are hard to value appropriately, likely to be politically and legally contested, and likely worth less to a lender who will have difficulties utilizing them without government's support.
- Governments need robust institutions with the capacity to negotiate deals as complex as RBLs. This includes expertise in contracting economic modeling of loan conditions, valuation of resources used for repayments, and unbiased technical assessment of projects.

Source: Mihalyi, Adam, and Hwang 2020.

FIGURE 3.1 Domestic arrears in Africa



Source: Beers, Jones, and Walsh 2020.

The G20 DSSI initiative is too limited for the size of the debt problem

IMF arrangements. Since 2002, more than two-thirds of IMF arrangements in Sub-Saharan Africa include conditionality related to domestic arrears.[29]

INITIATIVES TO FIX THE INTERNATIONAL ARCHITECTURE FOR DEBT RESOLUTION

The international architecture for debt resolution could benefit from legal reforms, financial innovation, enhanced global coordination, and a deepening of the toolkit available to international financial institutions

To ease the burden associated with the COVID–19 pandemic, the international community has stepped in with several initiatives and enhanced international coordination. The Group of 20 (G20) has championed the Debt Service Suspension Initiative (DSSI), a relief initiative aimed at official bilateral creditors, which was recently extended until June 2021.[30] The DSSI—which includes both the 22 Paris Club creditors and nontraditional official creditors including China—has postponed tens of billions of dollars in debt payments.

The G20 DSSI initiative is positive and welcome. The inclusion of nontraditional official creditors is a significant step toward global coordination. However, it is too limited for the size of the debt problem.[31] Failure to include all actors limits the scope of any relief agreement. Indeed, although the DSSI called on private creditors to agree to provide similar terms if asked, the initiative has fallen short of including them (as in Zambia). On the one hand, debtors fear that private sector debt relief under DSSI could lead to rating downgrades, hurt reputations, trigger cross-default clauses and bring legal challenges. On the other hand, debt relief should use the contractual interest rate as a discount factor. Because market rates are currently above contractual rates, creditors have no incentive to provide relief. In addition, the initiative does not include debt problems in middle-income countries.

The rest of this section explores different proposals to facilitate debt restructuring and reduce the incidence of debt overhang.

Various reforms in contract design seek to enhance countries' ability to engage with creditors and avoid litigation

Various alternatives to the design of bond and other debt contracts that could facilitate future

debt restructuring operations are discussed below.

Legal reforms

Various legal changes could be considered to enhance the ability of countries to engage with creditors and avoid the negative implications of suffering from holdout creditors willing to litigate. Countries could consider including the ICMA Collective Action Clauses not only on their sovereign bonds, but also on bonds issued by subsovereign bodies and SOEs. Consideration could also be given to including aggregation clauses on bank loans so that they can be bundled with bonded debt.[32] Countries could also consider the use of creditor committees. While debtor countries, usually opted for informal consultations with individual creditors or groups of creditors since the 1990s, committees have reappeared more recently. This is not only because creditors prefer committees, but also because without a formal endorsement by a creditor committee, the consultations may prove ineffective and restructuring may fail.[33] Finally, along the lines of the recent recommendations of the IMF (2020a), it would be advisable that countries include negative pledge clauses in sovereign bonds that prevent sovereigns from pledging certain assets as collateral.[34] This would reduce the impact that collateralized debt can have on bond valuations during default.

Financial innovation

Despite the low-growth environment that is propelling debt distress to the forefront of Africa's policy agenda, the concept of debt restructuring for growth is remarkably absent from ongoing discussions regarding the resolution of sovereign debt crises.

Financing instruments can make debt easier to manage if their terms accommodate the appearance of shocks. This type of state-contingent instrument can be used both during debt restructuring, as a way to elicit creditor participation by offering additional recovery to creditors, and during normal times, as part of a diversified funding strategy. Their use increases a country's resilience by reducing the procyclicality of debt.

State-contingent debt as a restructuring technique. In addition to the value recovery instruments (VRIs) issued by Greece, St. Kitts and Nevis, and Ukraine during their recent sovereign debt restructuring operations (see box 3.2), other countries have ventured into designing restructured debt instruments with built-in contingencies that make debt service obligations countercyclical.[35] Barbados and Grenada included a creative growth-enhancing solution to a critical problem of countries exposed to climate risks: a standstill clause in case of a natural disaster. In Grenada, the clauses were introduced in foreign-law bonds, Paris Club debt, and debt with Taiwan's export-import bank.[36] They were designed to generate no losses when compared with market rates at the time (what in the jargon is defined as being net present value, or NPV-neutral), making them acceptable to investors. Barbados attempted to introduce the clauses in both domestic and foreign debt, which extended the negotiations, but the country only succeeded with domestic law bonds.[37] In Chad, a 2018 restructuring operation tied principal payments to oil prices so debt service now has countercyclical features. The approach followed in Chad could not only be seen as a template for other countries that may struggle to repay resource backed loans in the future, but as a lending design that could be made a regular approach to sovereign financing.

Regular state-contingent financing. The main idea behind state-contingent financing is to help sovereigns preserve policy space to undertake measures that can mitigate the economic impact of adverse shocks. By tying sovereign obligations to a variable that proxies the sovereign's capacity to pay, state-contingent financing stabilizes debt stocks and/or financing needs.

Countries such as Portugal, Germany, and the United States have successfully issued part of their liabilities linked to macroeconomic indicators, such as inflation and GDP. Emerging markets also have had experience with contingent instruments (such as Argentina's use of warrants and Mexico's use of indexation against oil prices).

Despite the risk-sharing benefits of state-contingent debt instruments, they are expensive, which discourages their use. Debt instruments, given their simple cash flow structure, are informationally less demanding than equity-like

Financing instruments can make debt easier to manage if their terms accommodate the appearance of shocks

instruments, whose payoffs depend on the success of the underlying investment and are harder to foresee. An additional issue with state-contingent financing is verifiability of the state, which might be subject to government manipulation. For these reasons, in the presence of moral hazard concerns, simple debt contracts are best to protect creditors. Moreover, state-contingent instruments are harder to price than plain vanilla bonds, which drains liquidity, further increasing their cost and reducing their appeal to liquidity investors.[38]

For state-contingent instruments to be successful, they must align the incentives of debtors and creditors. The experience with state-contingent debt suggests that the voluntarism of authorities is essential. Examples of state dependent instruments include Portugal's use of GDP-linked debt. The development of inflation-indexed bonds in the United States employed the voluntarism of US Treasury and became very successful after several attempts. Indeed, to get creditors to agree to the transformation of financing instruments from traditional debt to state-contingent instruments, a decisive change in governance systems needs to happen. In Portugal, the instruments were developed to reengage with retail investors after a period in which Portugal was absent from the market. Noticeably, despite the high quality of its GDP data, which is supervised by Eurostat, Portugal had to offer a large premium for the issuance of these instruments. Nevertheless, the Portuguese authorities have kept using them, which now amount to 10 percent of Portugal's public debt.

A number of recent restructurings have featured clauses that make debt relief contingent on reform implementation

A swap market linked to GDP growth rates could appeal to market participants with assets or liabilities exposed to future economic output, such as pension funds and insurances needing to hedge GDP-linked liabilities and pension schemes. Moreover, it could be used to hedge the risk associated with GDP-linked bonds. While a GDP market for each specific country may lack sufficient demand, a commodity-linked bond and swap market would be easier to set up, given the broader appeal to global investors of the underlying asset driving the contingency.

These instruments can be valuable for African countries. While this is especially true for resource-intensive economies, even for non-resource-intensive countries, a significant fraction of imports will be linked to oil and other broadly market-traded resources.

Policy-contingent financing. A number of recent restructurings have featured clauses that make debt relief contingent on reform implementation. The objective of these clauses is to provide incentives to pursue responsible fiscal policies. The design of these clauses has varied. Some countries tied the conditions to the country's performance under an IMF program, while others tied conditions to fiscal policies. In turn, while some designs provided all the debt relief from the start and could claw it back if the targets were missed, others sequenced debt relief, making later parts conditional on meeting specific targets. Regardless of whether the clauses are designed as a carrot or as a stick, they have one major advantage and one major drawback. The advantage is that they provide incentives to conduct prudent fiscal policy. The drawback is that they can limit the authorities' countercyclical firepower, effectively inducing procyclicality. While such an effect may be unavoidable, a better understanding of the instruments can help design more effective debt restructuring operations. Another widely discussed alternative is to introduce a clause in bond contracts that automatically extend the maturity if a country requests an IMF program.

ENHANCED GLOBAL COORDINATION IS NEEDED TO FACILITATE DEBT RESOLUTION

There are several potential avenues to minimize the coordination and burden-sharing problems that plague negotiations with private creditors.

Reinforced comparability of treatment clauses

A first, straightforward way to minimize the holdout problem is to leverage the official sector to achieve private sector participation. This would amount to arranging a framework that coordinates all official creditors and can translate official commitments into binding commitments by private creditors. In fact, this is an extended version of the Paris Club. The first necessary element, a framework

including all official creditors, is in sight. During the G20 meeting in November 2020, a template for official debt restructuring was agreed to not only by Paris Club members but also by the rest of the large official non–Paris Club creditors. The second element, the binding commitment, could be modeled along the lines of the existing Paris Club comparability of treatment clause, which would ensure that official relief translates into private relief, regardless of the residence of the creditors.[39]

Although the G20 agreed on 22 November 2020 to extend a freeze on official debt service payments until mid-2021 and exhorted private sector actors to participate on equal terms, much more needs to be done, especially if deeper debt restructuring and debt cancellation becomes necessary. Without changes to the current framework, restricting and cancellation will likely prove litigious and hard to achieve. More stringent comparability of treatment clauses that force all creditors to ensure that a debtor country's agreements with other private and official creditors are similar to those reached with the G20 and the Paris Club are needed. Enforcement of such clauses would make official debt relief initiatives translate into comparable relief from private creditors more quickly.

Such a mechanism could be particularly relevant for Africa, where the contribution of commercial creditors to Africa's total external debt rose from 17 percent in 2000 to 40 percent at the end of 2019.

Other global governance reforms

At times, the international community had the appetite for a more proactive approach. For instance, a UN Security Council resolution was used in 2003 to shield Iraq's assets from creditors. Buchheit and Gulati (2020) and Gelpern and Hagan (2020) propose to replicate such an approach to resolve the debt crisis that the COVID–19 pandemic has triggered. Also, domestic legal measures in the United States and the United Kingdom—most international sovereign bonds are governed by New York state or English law—could be considered to further reduce incentives to hold out and litigate.

Additionally, there have been two recent proposals for mechanisms to facilitate the resolution of debt overhang using a centralized facility. Neither has been subject to empirical or practical validation, and both should thus be considered with extra caution.

Central credit facility

Bolton and others (2020) made a widely discussed proposal for designing a private sector standstill. They propose that multilateral institutions "create a central credit facility allowing countries requesting temporary relief to deposit their stayed interest payments to official and private creditors and borrow from it for emergency funding to fight the pandemic. Principal amortizations occurring during that period would also be deferred, so that all debt servicing would be postponed". The facility would be monitored to ensure that the payments are used only for emergency funding related to the global pandemic.

Auction-based debt buyback

Willems (2020) has proposed using an auction-based strategy to restructure sovereign debt that tailors the shape of the restructured debt stock optimally to creditor preferences, subject to debt being sustainable after restructuring. Any debt relief provided to the country gets optimally distributed among its creditors, thus minimizing the pain inflicted upon them.

DEEPENING THE TOOLKIT OF INTERNATIONAL FINANCIAL INSTITUTIONS CAN HELP MITIGATE THE NEGATIVE EFFECTS OF BELATED AND INSUFFICIENT DEBT RESTRUCTURING

Another way to reduce the deadweight loss of belated and insufficient debt restructuring is to design buffers and policies that reduce their negative effects. In fact, one important reason that restructurings occur too late and are suboptimal is the unwillingness of governments to act sooner and more forcefully out of concern for their reputation and the risk of losing access to markets.[40] Institutions directed at supporting the restructuring process, such as the African Legal Support Facility, might help overcome debtors and creditors concerns (box 3.4).

Another way to reduce the deadweight loss of belated and insufficient debt restructuring is to design buffers and policies that reduce their negative effects

BOX 3.4 The African Legal Support Facility's work in African debt restructuring and resolution

Hosted by the African Development Bank, the African Legal Support Facility (ALSF) provides legal advice and technical assistance to regional member countries (RMCs) to assist them in addressing their public debt needs and to bolster their capacities in the negotiation and structuring of complex commercial transactions, primarily in the energy, extractives and natural resources, and infrastructure/public–private partnership sectors.

Sovereign debt is at the heart of the ALSF's work. Indeed, the ALSF was founded principally in response to specific challenges heavily indebted poor countries (HIPCs), fragile states, and post-conflict countries faced in dealing with aggressive and intransigent creditors or vulture funds.

The ALSF supports RMCs with various public debt advisory needs, including for debt restructuring/refinancing/reprofiling, commercial creditor and vulture fund litigation strategy and defense, the development of debt management strategies, and the provision of advice on eurobond issuances and related hedging arrangements. Recently, the ALSF assisted RMCs in:

- Restructuring strategy development and negotiations with external commercial creditors in the context of various financing and debt relief programs.
- Restructuring negotiations in the context of a dispute settlement arrangement.
- Restructuring domestic commercial debt.
- Defending claims brought by vulture funds.
- Providing general commercial creditor litigation and litigation risk assessment support.
- Developing strategies with respect to existing and potential dispute claims.
- Structuring a currency swap hedging arrangement for a Eurobond issuance.
- Developing accounting approach to contingent liabilities for sovereign guaranties.

Specific examples of the Facility's work include assisting Guinea-Bissau in negotiating significant private debt forgiveness, which reduced the country's debt obligations to such creditors from $50 million to $5 million; supporting The Gambia in restructuring its commercial creditor debt, conducting a Debt Sustainability Analysis and developing a Medium-Term Debt Management Strategy, in each case as preconditions to an IMF financing arrangement; and assisting Somalia with its Paris Club negotiations, which resulted in debt relief in the amount of $1.4 billion and moved Somalia closer to the HIPC Completion Point.

In addition, the ALSF has a strong focus on longer-term debt sustainability and on helping RMCs address both solvency and liquidity issues. This effort has led to the creation of several capacity-building programs for RMCs aimed at bolstering their broad sovereign debt knowledge. Finally, the ALSF has developed and disseminated knowledge tools to further empower African governments to understand and effectively manage their debt, including:

- A continent-focused handbook, "Understanding Sovereign Debt: Options and Opportunities for Africa," to guide public debt managers and others involved in the public financial management of African countries.
- The ALSF Academy, a three-level capacity-building and certification program for African government officials and lawyers, which offers several courses, including on sovereign debt.

Partial multilateral guarantees were successfully deployed to facilitate buy-in by investors during a few recent debt restructurings. The first operation was for Seychelles, featuring a guarantee from the African Development Bank for part of the interest payments on the debt from a restructuring operation.[41] This was critical to generating investor acceptance of the offer. In 2011, St. Kitts and Nevis carried out a public debt exchange that also included a partial multilateral guarantee, in this case from the Caribbean Development Bank. In Greece, an exchange included a "co-financing agreement" with the European Financial Stability Facility to align the priorities of bondholders with those of some official lenders. Such policy tools could be examined with a view to adapting them to future debt crises.

International financial institutions (IFIs) can also play a key role in jumpstarting a contingent debt market. Moreover, contingent loans can be less capital-intensive, meaning that they require the lender to hold less capital to back the operation, than traditional loans. The African Development Bank and other IFIs are uniquely placed to provide state-contingent lending. Successful examples already exist, such as the lending provided by Petro Caribe and the French Development Agency, and the use of swaps to hedge currency risk by the Caribbean Development Bank. Other attempts—such as the Fight COVID–19 Social Bond of the African Development Bank and the interest rate swaps used by the European Stability Mechanism—may hold important design lessons.[42] Along these lines, the IMF (2020a) proposes to use official loans with extendable features and climate-resilient debt instruments.[43]

IFIs can also help design a more robust governance system, potentially including fiscal rules and independent and accountable fiscal councils, which will be discussed in the following section. Also, IFIs could try to obtain the right to claw back funds from officials who embezzle and commit fraud and similar crimes, and to prosecute them internationally if needed (currently this is undertaken by individual sovereigns). IFIs may be able to inject more legal strength into the recovery process—which could include criminal penalties applicable not only to individuals but to entities that support such behavior.

IFIs should also lead the way by devising instruments that support investments in low-income countries. These instruments should include the private sector through such mechanisms as public–private partnerships, debt swaps, and equity and quasi-equity investments.

GROWING OUT OF THE COVID–19 AND DEBT CRISIS: THE NEXUS BETWEEN GOVERNANCE AND GROWTH

A deep shift in the governance system coupled with reignited growth will be essential for preventing any need for a future debt jubilee

The historical record shows that debt restructuring has not delivered lasting resolution of crises and has instead left countries unreformed and unable to grow. This highlights two intertwined problems of the current framework. First, the framework fails to facilitate early restructuring and fair burden-sharing. Second, the framework fails to elicit genuine reform of economic governance.

Extensive research links governance, debt restructuring, and growth. According to Reinhart, Rogoff, and Savastano (2003), when a country goes into default, its already-weak institutions can become weaker, making the country vulnerable to further debt problems. Fournier and Betin (2018) provide robust evidence that government ineffectiveness, as measured by a broad-based perception index of the World Bank's Worldwide Governance Indicators database, is a key driver of sovereign default.[44]

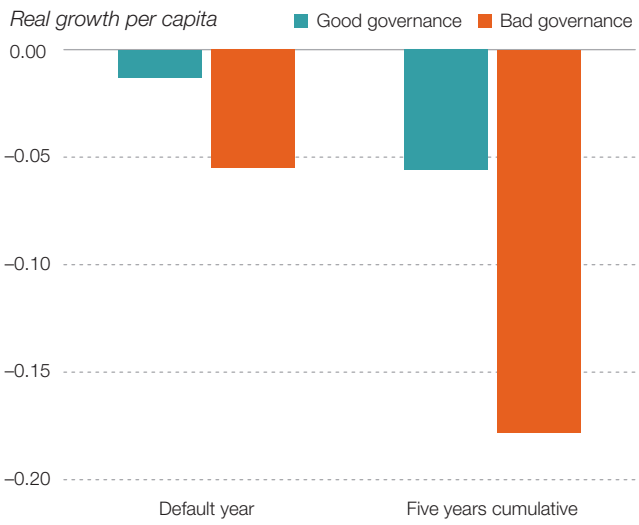
Moreover, although financing was widely available at historically low rates in the 2010s, many African countries did not take full advantage of that opportunity to support growth, because some spending was wasted or spent on investment projects with low economic and social returns. Evidence suggests that Africa has a public investment efficiency gap of 39 percent, higher than either Europe (17 percent) or Asia (29 percent).

If future investment programs are to pay for themselves, policymakers must be aware that the quality of institutions is the most important determinant of public investment efficiency. Figure 3.2 examines that link for 60 episodes of sovereign default in African countries. The data on sovereign defaults, which comes from Asonuma and Trebesch (2016), cover defaults and restructurings on privately held external sovereign debt. Governance is measured using the International Country Risk Guide (ICRG) index. The figure compares average output dynamics after a sovereign debt restructuring and shows the extent to which growth following debt restructuring depends on a country's governance structure.

Since primary deficits (excess of expenditure, excluding interest payments, over revenue) and growth are key variables in debt dynamics and sustainability analysis, the rest of this section discusses reforms needed to reduce debt vulnerabilities through better public financial management and higher and sustained growth.[45]

The current framework fails to facilitate early restructuring and fair burden-sharing and to elicit genuine reform of economic governance

FIGURE 3.2 Growth and governance in the aftermath of sovereign debt restructuring



Note: Governance is measured using the ICRG political risk index. A value of the index above 40, which corresponds to being outside the top decile of performers, is considered an indicator of bad governance.
Source: Asonuma and Trebesch (2016) for sovereign defaults and IMF World Economic Outlook for real per capita growth rates.

African countries need to do their share by eradicating all forms of leakages in public resource management

A critical governance reform should include the elimination of leakages of all forms in public resources, to ensure that the resources efficiently reach their intended beneficiaries or projects while being used efficiently, productively, and transparently. Leakages have been found to be significant in several public expenditure tracking surveys conducted in Africa.[46] Because government coffers are emptying, countries should consider aggressively eradicating leakages and curbing capital flight to create fiscal space and reignite growth.[47]

Eradicating leakages will require strengthening public financial management (PFM)—a multidimensional approach that focuses on how governments raise revenues, set spending priorities, allocate resources, and manage delivery of those resources (box 3.5). While recent public expenditure and financial accountability assessments show that the overall performance of PFM institutions has improved, there is variation across countries and within the PFM components. Upstream, budget formulation and reporting are improving, as is revenue administration and collection, but further improvement is needed in budget execution—including procurement, accounting, and control. Downstream, the key weakness is in checks and balances, especially integrity and oversight institutions (due to the dominance of the executive branch of government). Furthermore, given uneven progress in implementing PFM reforms among African countries, it is hard to assess the impact of reforms on overall PFM system quality and, in turn, on service delivery outcomes. This challenge is far more daunting in fragile states.

Successful reforms typically culminate only after a long process. Furthermore, these successes are underpinned by enhanced capacity of institutions and stakeholders to implement reforms that at times require tough choices. Conversely, uncoordinated initiatives and overly complex solutions (such as premature introduction of information management systems) have yielded unsustainable results with far-reaching implications on countries' development trajectory. This means that progress in modernizing PFM institutions within countries needs to be measured in small and incremental steps. The conventional approach to PFM reforms is to assess the functionality of PFM systems based on factors such as stability and allocative and operational efficiency. The emerging trend of reforms is to shift the focus toward four fundamental dimensions that PFM functionality should promote: prudent fiscal decisions, credible budgets; reliable and efficient resource flows and transactions; and institutionalized transparency and accountability, including in the natural resource sector.[48]

Improved governance of public finances will not only help create fiscal space in the short run to allow governments to spend on public needs, but will also pave the way for more sustainable medium-term fiscal frameworks, which will help reignite growth. Good governance and more vigorous and robust growth can also set the stage for more profound changes in the way sovereigns obtain financing, potentially enabling African countries to use state-contingent debt instruments that link repayment schedules to capacity to pay based on economic developments.

BOX 3.5 Transparent and accountable public financial management is critical for sustainable growth

Public financial management (PFM) encompasses the processes by which governments raise revenues, set spending priorities, allocate resources, and manage the delivery of those resources. It is critical to achieving public policy objectives, securing overall economic and fiscal stability, and meeting the UN's Sustainable Development Goals.

The components of public financial management include *budgeting* (both annual and multiyear), *domestic revenue mobilization* (tax regulation, management, collection, and control), *expenditure chain* administration (procurement, commitment, and then controls and payment), *cash management* (with the elaboration of cash plans and the use of a treasury single account), *public entities' accounting* (aiming to attain full accrual accounting for fiscal transparency), *public debt and assets management,* and *audit and control* (delivered by different bodies both within and alongside the central government).

The budget is often considered the financial mirror of political commitments, notably aimed at spurring development and improving socioeconomic conditions. Its credibility and satisfactory implementation are at the core of PFM.

States have coercive powers to raise money through taxation and to allocate funding to different categories of spending, both recurrent (such as wages paid to public sector employees) and capital (such as funds spent on roads and railways). However, without robust, transparent, and accountable arrangements for financial reporting and financial management, it is not possible to assess reliably whether decisionmaking by governments is in the public interest. Transparency in PFM serves as a political expression of democratic governance, giving citizens and taxpayers information to which they are entitled that could be used to hold governments accountable.

PFM transparency is also a rational and value-maximizing strategy. Beyond issues of accountability, there are indications that market access for debt is correlated with sound public financial management, in particular when specifically linked to budget transparency and reporting, debt management, and fiscal strategy.

Note: See Keita, Leon, and Lima (2019).

Improved governance of public finances will help create fiscal space in the short run to allow governments to spend on public needs, and pave the way for more sustainable medium-term fiscal frameworks

The following subsections focus on three key components of PFM— domestic resource mobilization, debt management, and budgeting—and ways to improve them.

More resources should be mobilized domestically while deepening local capital markets

Increasing government revenues through taxation and other non-debt income sources is essential to reduce vulnerabilities and allow countries to address their specific development challenges. However, the size of the informal sector in Africa limits the tax base. Informal employment in Africa accounts for 85.8 percent of total jobs, the largest percentage in the world.[49] To promote formalization, policymakers could take a broader strategic approach that seeks to register informal firms not only to tax them but to protect their rights, entitlements, and assets as entrepreneurs. The attractiveness of the formal sector can be enhanced, for example, by providing greater access to resources and information, pension schemes, social insurance, or other incentives—conditioned on registration—through intermediaries such as business associations, nongovernmental organizations, or local community groups.

Effective domestic resource mobilization (DRM) also requires a solid database that allows the identification and location of the individuals, firms, or land properties on which to levy a tax. It is essential for countries to invest in well-managed civil, business, and land registries while building

simple but efficient address systems. The creation of unique identifiers for individuals, firms, and properties in these registries will also be necessary to facilitate information-sharing among different government agencies such as tax authorities, statistical offices, and social security authorities.

In many African countries, tax laws and rules are overly complex and reduce compliance rates. Transparent and easily implementable tax regulations can help increase certainty around the application of legislation, while reducing tax enforcers' discretionary power (such as the ability to give tax exemptions, determine tax liabilities, and select firms to be audited). Digital technology offers great potential to increase DRM, particularly in the way tax administrations can improve their efficiency and help taxpayers comply. For example, in Kenya the money-transfer system M-Pesa includes an online application for taxes (the iTax System). Such an electronic filing system can save time and increase compliance by making it easier to prepare, file, and pay taxes.

Tax administration must invest in human, financial, and technological resources for improved performance

Tax administration must invest in human, financial, and technological resources for improved performance. Tax inspectors in particular need appropriate incentives to detect tax evasion and reject bribes offered by noncompliers when caught. Relying on tax inspectors' intrinsic motivation for honesty is clearly not sufficient. Unfortunately, the question of what incentive structure could motivate inspectors to conduct costly monitoring is important but unanswered. A program for mindset change such as Kaizen, the Japanese process for continuous improvement of operations, could be implemented while working to create a performance-based culture. Although kaizen originated in manufacturing, its principles and practices translate well into other work situations.

Because enforcement capacities are weak in many African countries and hard-to-tax sectors, such as informal companies, predominate, those countries should seek to promote voluntary tax compliance to increase domestic revenue mobilization. Campaigns to increase awareness of the importance of tax compliance could help. More importantly, governments should visibly use tax revenues for public welfare—by providing quality public goods and services. An important issue that is often overlooked in policy discussion is state legitimacy (box 3.6).

Finally, resource mobilization should not be restricted to tax revenue, in part because tax increases are procyclical. Resource mobilization should also include better allocation of savings to productive investments by shifting incentives for the banking system toward the core functions of payment, price discovery, information production, and intermediation.[50] That can be accomplished by a combination of better macro policies and more competition in the financial system, including by nonbank operators, which are making headway on payment systems in the continent.

There is also a need to deepen African capital markets to enable them to play their full role in mobilizing and allocating domestic savings to the real sector. To do so, authorities must address capital market structure, policy, and regulatory framework weaknesses and promote liquidity by deepening the pool of investors, with an emphasis on domestic pension funds and other institutional investors. A well-functioning local market can help to:

- Build a yield curve, which is a key element in pricing risks.
- Extend debt maturities.
- Create benchmark issuances and liquidity of secondary markets.
- Diversify the investor base while enabling the development of new financial products.

African countries should firmly embark on a credible shift to improve fiscal policymaking

African countries should firmly embark on a credible shift in fiscal policymaking by enhancing the effectiveness of fiscal rules to increase discipline and constrain government budgets, while promoting countercyclical policy, setting up fiscal councils to advise governments on tax and spending policies, and using Africa's regional economic communities (RECs) to help countries better coordinate their fiscal policies. Fiscal rules seek to put a numerical constraint on public spending (box 3.7).

Over the past two decades, an increasing number of countries have adopted fiscal rules. The 2017 IMF Fiscal Rules Dataset identifies 96 countries that adopted fiscal rules both at national and supranational levels between 2000 and 2016.

BOX 3.6 State legitimacy matters for successful domestic resource mobilization

Theory suggests that tax compliance is higher when citizens are offered valuable public goods—such as representation, public services, and infrastructure—in exchange for their tax payments.[1] Corruption, particularly embezzlement—the use of public funds by government officials for private gain—is clearly detrimental to the provision, quality, and efficacy of public goods. As a result, corruption can lead to lower tax compliance jeopardize efforts to mobilize more domestic revenues. But the link between tax compliance and corruption is often overlooked.

According to the Afrobarometer surveys from 36 African countries between 2011 and 2015, citizens are more willing to pay taxes if they perceive a low level of corruption at different levels of the executive branch (president's office, government officials, or tax authorities).[2] So, it is necessary to build legitimate and accountable states in Africa by genuinely fighting corruption to improve domestic resource mobilization.[3] Authorities are viewed as legitimate when the public sees them as having both the legal and the moral authority to tax.[4] Legitimacy enhances compliance with the law even when the likelihood of sanctions is low. In contrast, a lack of legitimacy could translate into contrary behavior, resulting in noncompliance with the law or even increased criminal behavior such as tax evasion. Governments in many developing and transition economies clearly face such legitimacy concerns.

Moreover, creating a culture of honesty among the top-rank officials would not only increase legitimacy, but also trickle down to others within the organization or society.[4] Political economy and citizen behavioral qualities must be taken into account in efforts to improve domestic resource mobilization.

Notes

1. Buchanan 1976; Moore 2008.
2. Boly, Konte, and Shimeles 2020.
3. Bird, Martinez-Vazquez, and Torgler 2008.
4. Tyler 2006.
5. Güth and others 2007; Cappelen and others 2016; Boly, Gillanders, and Miettinen 2019.

There is also a need to deepen African capital markets to enable them to play their full role in mobilizing and allocating domestic savings to the real sector

Of 25 countries in Africa using fiscal rules in 2015, 24 used debt rules; 22, budget balance rules; 9, revenue rules; and 3, expenditure rules. Some 88 percent of these African countries used at least two rules.

Despite the growing appetite for fiscal rules, they are largely ineffective. Compliance with fiscal rules in Africa is undermined by lack of clear mandates, support legislation, and institutions. Furthermore, none of the fiscal rules place emphasis on countercyclical fiscal policy, missing the opportunity to benefit from automatic stabilizers that operate when the economy deviates from the target. Temporary surges in debt during recession, for instance, will be eliminated during boom times, so the fiscal rules should be engineered to produce sufficiently large surpluses during booms to offset increased spending demands during recessions.

More than 50 percent of fiscal rules in Africa are adopted through membership in RECs, such as the West African Economic and Monetary Union, Central Africa Economic and Monetary Community, and East Africa Monetary Union. The benefits of regional commitments to enhance discipline and solidarity mechanisms are at least twofold. First, regionalization allows countries to rise above the intricacies of domestic politics. Second, regionalization offers the benefit of sharing risk. Only a few countries—including Botswana, Kenya, Mauritius, and Nigeria—are implementing national fiscal rules. While empirical evidence suggests that some degree of fiscal convergence occurs,[51] in particular in monetary zones, other evidence suggests

BOX 3.7 Enhancing the economic stabilization effects of fiscal rules

What are fiscal rules? A fiscal rule is "a long-lasting constraint on fiscal policy through numerical limits on budgetary aggregates."[1] It can act as a device that ties the hands of a government and limits fiscal discretion,[2] or flexibility, to implement proactive measures through a commitment to binding rules that ensure monetary/fiscal stability and put debt dynamics under control. A fiscal rule can also be a signaling tool that reveals the government's preferences and plans to the public and financial markets.[3] This contributes to improved credit ratings and reduced public debt costs and supports monetary policy by mitigating inflationary pressures. A good fiscal rule seeks to balance simplicity, flexibility, and enforceability. However, striking that balance can be very difficult.[4]

The main types of fiscal rules include debt rules, which set numeric limits on the public debt-to-GDP ratio, as in Liberia, which limits that ratio to 60 percent and Botswana, which limits it to 40 percent. Balanced budget rules constrain the size of the budget deficit and thus the debt-to-GDP ratio. Ghana's 2018 fiscal responsibility law, for example, establishes a 5 percent ceiling on fiscal deficits. Expenditure rules put a ceiling on the growth of public spending or its ratio to GDP, a rule instituted in Namibia. Revenue rules put ceilings or floors on revenues or determine the use of windfall revenues. Kenya, for instance, sets revenues at 21 percent of GDP. Fiscal rules are often combined.

Notes

1. IMF 2017.
2. Alesina and Tabellini 1990.
3. Debrun and Kumar 2007.
4. Eyraud and others 2018.

Establishing fiscal councils should be encouraged to strengthen fiscal policymaking in Africa

that rules in regional economic communities on the continent tend to favor procyclical behavior.[52] Supranational rules can be important in leading countries to accept fiscal discipline. However, their implementation is weakened by a lack of monitoring and sanction enforcement mechanisms, weak political commitment to impose sanctions, and limited connection with national rules.

In recent years, there has been a surge in independent fiscal councils around the globe. In general, these fiscal councils are responsible for real time implementation and surveillance of public finances rules and policies. To date, four African countries have established fiscal councils: Uganda in 2001, Kenya in 2007, South Africa in 2014, and Ghana in 2019. Empirical evidence shows that fiscal councils enhance policy compliance and transparency, reduce forecasting bias, improve government capacity to comply, and foster government commitment to fiscal discipline. Establishing fiscal councils should be encouraged to strengthen fiscal policymaking in Africa.

Enhancing debt management capabilities and transparency will reduce debt vulnerabilities

Poor and inadequate public debt management contributes to debt sustainability issues. In addition to supporting economic recovery and building resilience in the aftermath of the COVID–19 pandemic, many African countries should place priority on addressing the rising public debt burden, reducing leakages to create a more effective public sector, and promoting an environment that drives investments and private sector growth. The effective management of public resources—including control of fiscal deficits and overall debt management—is important for macroeconomic stability and the establishment of the conditions required for structural transformation.

To enhance debt management, specific attention should be given to strengthening the capability for formulating and implementing debt policies and medium-term debt strategies. Other targeted interventions can include strengthening

the organizational setup of debt offices, including the training of debt management staff, and establishing frameworks to ensure comprehensive risk management, accountability and transparency of debt, and managing the contingent liabilities of SOEs and associated risks (box 3.8). Finally, independent fiscal institutions should be created to advise governments on debt matters, and independent national auditing bodies (supreme audit institutions) should be promoted to perform regular financial and performance audits of public debt.

Debt transparency has become important because of incidents in Africa of hidden debt—financial commitments and contingent liabilities that are not publicly announced when they are made. To guard against such hidden debt, disclosure should be centralized for loan covenants in all sovereign, subsovereign, and state-owned agreements and exposures. This would apply not only to covenants and payment terms or schedules, but to collateral or other secured pledges. It will also be important to enhance the collation of debt data, and to make information on debt available and publicly accessible through regular reporting and real-time information sharing, including about the implicit guarantees and contingent liabilities of state-owned enterprises. Investments should be made in digitization and modernizing debt information management systems. Besides the long-term benefit of fostering trust in a country's public finance, full debt disclosure and transparency has

Specific attention should be given to strengthening the capability for formulating and implementing debt policies and medium-term debt strategies

BOX 3.8 Institutional framework, tools, and resources for debt management

Operational responsibility for debt management is generally separated into front, middle, and back offices with distinct functions and accountabilities, and separate reporting lines.

- The front office has the responsibility of mobilizing resources from both domestic and external sources at minimal cost and on time. It typically implements the borrowing plan based on the debt management strategy approved by the government; negotiates with creditors, liaises with market players, regularly reviews market conditions, and provides information to donors/creditors, international financial institutions, and commercial banks, among others.
- The middle office provides advice and analysis that enables the government to meet its financing needs at the lowest possible cost (for example, by prioritizing concessional borrowing over commercial borrowing) with a prudent level of risk. It monitors the front office's compliance with the chosen strategy, cost, and risk limits, and it assesses and coordinates all types of risks—market, refinancing, liquidity, credit, operational, and contingent.
- The back office typically is responsible for debt registration; handling transaction confirmations, settlements, and payments; and maintaining records of all debt contracts, disbursements, payments, debt restructuring agreements, on-lending arrangements, issued guarantees, and settlements of transactions, among other things. It is also responsible for providing projections of debt servicing to inform the budget planning process.

As part of debt management, all sovereign, subsovereign, and state-owned actors should also have compliance officers in place to ensure that operations (government, commercial, or others) comply with existing multilateral and bilateral agreements that fit within the context of the Paris Club and the London Club—an informal group of private lenders modelled on the Paris Club.

In some African countries, these offices are consolidated into a single debt management office; in others, they are fragmented across several departments within the ministry of finance; and in some, they are located in the central bank. Regardless of the organizational and governance arrangement, a well-organized debt management structure effectively integrates operation, coordination, and monitoring.

Source: African Legal Support Facility 2019.

been shown to help lower the cost of borrowing, with positive effects on countries' credit ratings.

While most African countries have a credit risk rating from one of the major rating agencies (S&P, Fitch, or Moody's), the ratings are typically below investment grade, which suggests that the countries should work to improve their credit ratings to lower borrowing costs. Specifically, countries should strive to address information asymmetries by providing investors with as much information as possible about their economic and political developments and prospects, while adopting international benchmarks, such as the International Public Sector Accounting Standards, to signal commitments to managing transparency and liabilities prudently.[53] To further lower borrowing costs, African countries and multilateral development banks should embrace innovative lending instruments, such as partial risk guarantees; promote the use of swaps, contingent loans, and nondebt finance; and establish insurance mechanisms that enable cheap access to debt from the international market through jointly issued debt facilities.

Leaders in the region must take decisive collective actions to remove roadblocks to genuine private sector development

STRUCTURAL REFORMS: DIGITIZATION AND FAIR COMPETITION AS FUNDAMENTAL LEVERS

Harnessing digital technologies and promoting free and fair competition will be fundamental in revitalizing African economies

COVID–19 and its aftermath increase the urgency for countries in Africa to not only ensure resilience (for example, by addressing deficiencies in the health sector), but also to chart a course for economic transformation. They need to break with business as usual if they are to deal with existing unemployment and create good jobs for the hundreds of millions of young people who will join the labor force in the coming decades.

With government coffers emptying, new and sustainable engines of growth must replace the large public expenditure programs that provided most jobs in the past. Leaders in the region must take decisive collective actions to remove roadblocks to genuine private sector development (such as corruption, unfair competition, lack of skills, and inadequate access to power or finance)—the only sustainable way to support growth and unleash the potential of young people and women. A regional approach through the African Continental Free Trade Area (AfCFTA) will not only make it easier to remove these roadblocks but also unleash the potential of a large single market.

Two important tasks could underlie programs to revitalize African economies. Governments must add to their quivers growth policy arrows that:

- Create large-scale economic opportunities by undertaking an all-out effort to harness digital technologies to bring their countries into the 21st century—an effort that will require an ambitious, all-in program similar to the one the United States undertook in 1961 for a manned landing on the moon by the end of the decade.
- Promote free and fair competition to end the cozy, stifling relationship between governments and well-connected firms that results in economies in which profits accrue less to genuine productive activity and more to economic rents and monopoly pricing.

Of course, before the region can embark on such an ambitious plan, it must achieve macroeconomic stability. A tendency to delay stabilization and to tolerate overvalued exchange rates has in some cases perpetuated rentier economies, with high dependence on imports and top-down, crony-dominated structures. Even achieving macro stability will not be easy. It is a task many governments have pursued—using instruments such as exchange rate devaluations, tax hikes, subsidy cuts, and the like—often with too little effect.

But even if authorities achieve a level of stability, without modernization and fair competition, the region will remain unable to reduce uncertainty and attract vital foreign direct investment. To do that will require governments to pull out new policy arrows to help revitalize the regional economic systems through technology and competition. The policies are self-enforcing and complementary. More competition will help with innovation, and more technology will help instill more market contestability—that is, make it easier for firms to enter and exit specific sectors.

Accelerated digitalization is needed to propel Africa into the Fourth Industrial Revolution and boost job creation

African countries already have the ingredients needed to jump to a much more productive service sector—and, in the process, modernize more traditional sectors such as agriculture and agribusiness. African countries have increasingly educated young men and women and the digital backbone needed to construct a widely available and affordable high-speed internet. Yet the region ranks near the bottom globally in affordability of mobile broadband and the percentage of the population that has access to it.[54]

It is time to empower a young African generation to join their global counterparts in the collaborative effort and spirit of the start-up world. Indeed, Hjort and Poulsen (2019), studying the gradual arrival of submarine internet cables on the African coasts and three datasets covering 12 countries, show positive effects (ranging from 3.1 percent to 13.2 percent) of fast internet on employment rates —including for less-educated worker groups—with little or no job displacement. Average incomes rise, and the firm-level data available for some countries indicate that increased firm entry, productivity, and exporting contribute to higher net job creation. Bahia and others (2020) show that households that had at least one year of mobile broadband coverage experienced an increase in total consumption of about 6 percent. The effects increased over time (though at a decreasing rate) and reduced the proportion of households below the poverty line. These effects are mainly due to an increase in labor force participation and employment, particularly among women.

The digital sector is characterized by a short innovation and development cycle, lower entry barriers, and high demand for human capital. Unlike the medical industry, where the development of a new drug may take more than a decade and cost up to $1 billion, the development of a piece of software or a mobile phone application in the information technology or telecommunications industries can take as little as $3,000, six weeks of development, and a working internet connection.

Governments should consider setting tight deadlines for making high-speed internet, digital, and mobile payments affordable and available to all. And not incrementally, but in an accelerated way akin to the herculean effort set in motion by the late US President John F. Kennedy to send a man to the moon, which helped unleash an extraordinary winning spirit that went well beyond the space sector that launched the lunar craft in July 1969. An accelerated digitalization would aim to propel Africa into the Fourth Industrial Revolution, which integrates technology into everyday economic activity. It would contribute to the emergence of new actors and domestic platforms—including in e-commerce, internet publishing and broadcasting, and web search portals, data processing, and hosting—and would disrupt a number of paralyzed segments of the economy, such as transport, logistics, and banking. It would also help promote a bottom-up approach to development in a region where top-down approaches have long been the rule.

The growth of platforms and additional activities will require new skills. Some of them can be learned on the job, but many will have to be taught.[55] That will require a reconfiguration of the education system to train students for the private sector, rather than for jobs in the public sector. African governments should further reduce challenges for start-ups by facilitating connection with the right partners (investors, business associates, universities, and research centers), accessing commercial opportunities (especially procurement contracts), recruiting employees with the right skills from outside if needed, and developing creative spaces—including innovation hubs, incubators, and accelerators.

Enforcing free and fair competition and investing in transparency will be key to unlocking investment, innovation, and employment

Creating a modern digital sector is not enough. African countries must also revamp their regulatory apparatus to foster fair competition. While appropriate government agricultural, industrial, and trade policies are necessary, they are not sufficient to spur sustainable and inclusive growth. Free and fair competition policy should complement the government policies, providing a framework and contributing to proper governance.

A well-designed and effective implementation of competition should enhance production efficiency—leading to lower prices, higher quality,

Governments should consider setting tight deadlines for making high-speed internet, digital, and mobile payments affordable and available to all

wider product variety, and more investment and innovation— which spell higher consumer welfare and growth. If uncompetitive markets are tasked with providing basic goods, that can significantly hurt the well-being of the poorest or most vulnerable consumers.[56] Competition policy can include legislation and advocacy. Competition legislation seeks to prevent the abuse of market power by dominant firms, to thwart agreements between firms that stifle competition (cartels), and to block mergers or acquisitions that could create dominant players, thereby weakening competition. Competition advocacy aims to promote, or create (if needed), a culture of competition.

Although most African countries and regional economic communities have adopted modern competition laws, many are not in force.[57] In North Africa, for example, the entrenched incumbency of banks has stifled the innovation needed to develop a dynamic and inclusive financial system and to advance technology.[58] In particular, incumbent banks have limited the role of nonbank operators in promoting market contestability and in developing financial technology to deliver financial service, which is growing fast, even in low-income African countries. In addition to changing the foundation of the economy, the region needs to enforce competition policy in ways that lead to actual change in the market structure of the economy to liberate investment and produce quality services, innovation, and employment.

A commitment to radical transparency would go a long way toward improving trust between the state and its citizens

At the national level, three policy actions can be considered to boost competition and promote growth: radical transparency, competitive neutrality, and the independence and accountability of competition and regulatory authorities.

The region must consider investing in transparency, by adopting and enforcing access-to-information laws for public information. A commitment to radical transparency would go a long way toward improving trust between the state and its citizens by persuading people that the state is committed to public welfare and no longer attempting to maintain a rent-seeking public sector. Yet, in many African countries, access to information is impeded by complex disclosure requirements, the discretionary disclosure power of public officials, a general lack of information about the law, and a culture of secrecy.[59]

Competitive neutrality recognizes that SOEs should be at neither a competitive advantage nor a competitive disadvantage to the private sector. The state must be able to put SOEs and existing private sector firms on the same footing when it comes to public subsidies, taxes, debt, and access to public procurement contracts. There may be situations when competitive neutrality is not appropriate—say, if it conflicts with achieving important societal goals—but such an exception must be objectively and rigorously determined.

Unless the independence, competence, and accountability of the regulatory apparatus is reinforced, economic sector reforms will not yield good developmental outcomes. In particular, privatizations would merely change public monopolies to private ones. For example, private foreign firms have entered sectors such as banking and telecom, but the expected benefits did not result because regulators failed to instill competition and tolerated collusion—tacit, or even overt. An independent and accountable regulatory apparatus balancing open markets is key if the benefits of competition are to materialize.

At the regional level, Africa needs to adopt a competition policy that makes markets work for the continent and fosters regional integration, using the African Continental Free Trade Area (AfCFTA).[60] According to Fox (forthcoming), the following policy actions should be given diligent attention:

- Creation of a regional competition/market commission, which should be directly linked with internal market commissions. It should appoint a forceful, proactive commissioner in charge of the competition/market portfolio. The competition program adopted should be manageable, credible, and have enforcement teeth.
- Adoption of laws against cartels with a significant cross-border character, including cartels facilitated by state acts. A credible hypothesis is that cross-border cartels may explain why there are no trade flows from African countries with surpluses to neighboring countries with shortages in some sectors such as cement, fertilizer, or sugar.
- Establishment of a premerger notification clearing house. It could be particularly wasteful to have each African nation (many with small

markets) to vet each merger filed, even though 95 percent of filed mergers present no competition problem.

- Establishment of high-level task forces to address specific sectors and problems, such as in banking/finance, communications (including telecoms), online commerce, retail distribution chains, energy, and big tech. A supra task force should coordinate the proper level of regulation and devolution.
- Facilitation of the work of the African Competition Forum in coordination, collaboration, and capacity-building among African nations' competition authorities.

The bottom line is that if African leaders commit to an accelerated digitalization and a promotion of fair competition, they will set the stage for a broad-based and bottom-up economic integration in an ambitious but yet-to-be-deepened free trade area. Together, African countries constitute a large domestic market, and tapping into the pent-up demand in that market by promoting a genuine private sector with regional regulatory bodies will contribute to acutely needed peace and prosperity.

CONCLUSION

The COVID–19 pandemic has led to a surge in government financing to fund COVID–19 responses in Africa and to a deterioration of credit ratings of several countries on a continent where public debt levels have been rising for a decade. Large and increasing sovereign debt burdens could pave the way for disorderly defaults and more of the lengthy resolutions that African debtor countries typically experience, with costly economic consequences. It is essential to prevent debt sustainability concerns from becoming a major obstacle to Africa's progress toward prosperity.

Today, the COVID–19 shock provides a strong rationale for the international community to deliver significant debt relief—especially for poorest African countries—to avoid another "lost decade". However, past debt relief initiatives, such as those for heavily indebted poor countries, have led to shutting Africa out of financial markets. Because both private and official debts remain legitimate and pivotal sources of financing for countries borrowing to meet their developmental needs, it is critical to mitigate potential negative consequences from debt relief on a sovereign borrower's reputation and the ability of both the sovereign and its domestic private sector to borrow at reasonable rates in financial markets.

Regional policymakers and the international actors—such as multilateral development banks, bilateral official donors, private creditors, and rating agencies—must push for changes to the international financial architecture for sovereign debt restructuring and do their best to align borrowers' and creditors' incentives to avoid disorderly sovereign defaults. A lasting solution will require a comprehensive debt restructuring and cancellation program that involves both private and official creditors, under the comparability of treatment principle. The new G20 and Paris Club "Common Framework for Debt Treatments beyond the DSSI" is a step in this direction. The promotion of legal reforms or innovations in financing instruments can provide another venue. Examples of such legal reforms include collective action clauses, aggregation clauses on bank loans, creditor committees, and negative pledge clauses. Innovative state-contingent or policy-contingent instruments (such as value recovery instruments and equity-like debt instruments) can be considered as ways to facilitate debt restructuring. Making future debt service obligations countercyclical would greatly minimize debt vulnerabilities. Additionally, African countries will need to leverage resourced-backed loans better and transparently for financing their development needs.

The Bank will continue to deploy its own critical actions and initiatives to assist regional member countries in taking and maintaining a sustainable debt path. Specifically, the Bank will:

- Try to tap into new sources of funding to lower the cost of debt.
- Strengthen countries' capability to manage their public debt transparently and productively.
- Engage in policy dialogue to raise awareness on debt sustainability at the highest political level.
- Help regional member countries in debt resolutions.

In addition to its own efforts, the Bank plans to enhance outreach and strategic partnerships

It is essential to prevent debt sustainability concerns from becoming a major obstacle to Africa's progress toward prosperity

with bilateral donors and multilateral development banks, think tanks, academia, and non-governmental organizations.

But African countries need to do their share. They should chart a path forward by decisively shifting their governance systems to foster more sustainable and inclusive economic growth models. These governance system reforms should include strengthening public financial management to eliminate all forms of public resource leakage, and to ensure an efficient, productive, and transparent use of scarce resources. There will also be a need for an accelerated digitalization and for enhanced competition (both at the national and continental level) to unlock investment innovation, boost employment, and reignite growth.

In summary, in the short term the international community needs to consider debt relief or restructuring for countries in need to preserve lives and livelihoods and maintain macroeconomic stability. In the longer term, a more conducive debt resolution architecture at the global level, combined with bold governance system reforms in Africa, would significantly help put the continent on a sustainable debt path.

NOTES

1. IMF 2020a.
2. The cost of disorderly debt resolution can be significant to the domestic economy, including loss of access to credit markets, trade sanctions, financial sector instability, and withdrawal of foreign direct investments (Sandleris 2016).
3. Countries and markets often rely on the IMF's debt sustainability analysis (DSA). The problems with DSA are, however multiple, as described in Gelpern (2016), Corsetti (2018), and Corsetti, Erce, and Uy (2020).
4. As noted by Buchheit and others (2018), assets abroad such as embassies or consulates are typically shielded from attachment by national and international law. Only sovereign assets used for a commercial purpose will generally be in harm's way. This suggests that it is easier for creditors to get court judgments against a sovereign than to enforce payment.
5. Gelpern 2016. Various IMF policies shape decisions related to debt restructuring. IMF arrears policies require that authorities negotiate with creditors in good faith. IMF lending requires the country's debt passes the IMF debt sustainability analysis. Finally, the exceptional access policy requires "high probability" of debt sustainability as a prerequisite to enter into a program.
6. Cheng, Diaz-Cassou, and Erce 2018.
7. Despite the presence of CACs and of well-developed procedures within the Paris Club, the activity of vulture creditors proved very destabilizing during the HIPC initiative. Most HIPC countries suffered litigation from vulture funds, and a number of them agreed to repay beyond what had been agreed with the Paris Club.
8. These questions are often answered with the help of advisors. When the IMF is present, its DSA is a driving force for how countries answer these questions.
9. African Legal Support Facility 2019.
10. Asonuma, Chamon, and Sasahara (2016) show that this happens because preemptive debt restructurings, and those where the authorities act more collaboratively, attenuate the impact of default on trade, credit, and investment.
11. Traditionally, domestic debt was governed by domestic law, denominated in local currency, and locally held, while external debt was foreign law–governed, held abroad, and denominated in foreign currency. These lines are increasingly blurred.
12. According to Buchheit and others (2018), governments may also have political incentives not to restructure domestic debt, as those claims are often held by voters. Erce, Mallucci, and Picarelli (2020) compare the macroeconomic implications of foreign and domestic law default.
13. If the debt is denominated in local currency, governments can try to inflate it away and avoid default in nominal terms.
14. Cheng, Diaz-Cassou, and Erce 2018
15. Erce, Mallucci, and Picarelli 2020.
16. This happened because, in addition to the lengthening of maturities, the coupons were adjusted to provide better-than-market terms.
17. In this context, the government of The Gambia requested technical and financial assistance from the African Legal Support Facility to further the country's negotiations with its creditors, to develop a prudent and sustainable debt restructuring strategy, and to build its institutional capacity in the area of sovereign debt. In response to the government's request, the African Legal Support Facility offered its support by engaging legal and financial advisors to assist with those activities.
18. From 2000 to 2012, rescheduling with Benin, Cameroon, Seychelles, Sudan, and Zimbabwe involved $415 million.
19. Ackher and others (2020) notes that Chinese lenders tend to treat restructuring loan-by-loan and not on the basis of the entire country debt portfolio. This parallels the emphasis of the early years of the Paris Club on "development sustainability" rather than "debt sustainability" (Cheng, Diaz-Cassou, and Erce 2018).
20. Instead, in Ukraine and Greece, CACs proved insufficient to successfully restructure all foreign law bonds.
21. African Legal Support Facility 2019.
22. Other recent cases outside Africa that have shown the limits of CACs for resolving debt crises include Greece, the largest debt restructuring in history in 2012, Ukraine (in 2015), and the long litigation against Argentina and Grenada.
23. Empirical analyses have consistently found that CACs do not have an observable effect on pricing or result in significantly higher yields. Still, Fang, Schumacher, and Trebesch (2020) find that despite CACs, the higher the losses on a given bond, the

higher the share of holdouts. They also find that smaller bonds, bonds issued under foreign law, bonds with higher coupons, and more actively traded bonds tend to raise the share of holdouts. The authors' results point to the benefits of aggregation clauses.

24. Mihalyi, Adam, and Hwang 2020.
25. African Legal Support Facility 2019.
26. IMF 2019.
27. Beers, Jones, and Walsh 2020.
28. According to the IMF analysis, a 1 percentage point increase in domestic arrears is associated with a fall in real GDP per capita growth of 0.3 percentage points, and with an increase in non-performing loans of 0.3 percentage points.
29. Breaches of conditionality related to domestic arrears are commonplace during IMF programs.
30. The 40 African countries which are eligible for IDA support (of which 37 are ADF-eligible countries) can benefit from this moratorium.
31. The participation of MDBs in the initiative was heavily debated. Given concerns regarding the resulting negative impact on MDBs ratings and preferred creditor status should they agree to the proposed suspension of debt service payments, MDBs did not participate.
32. UNDESA 2017.
33. Buchheit and others 2018.
34. Kearce 2020. With a negative pledge clause, the borrower commits to not pledging or encumbering certain assets (present or future) to secure other creditors, without equally and ratably securing the lender in whose credit agreement the clause appears.
35. Bonds issued by Nigeria (among others) to commercial banks in exchange for defaulted loans as part of Brady restructuring agreements were issued with value recovery rights designed to provide additional payments in the event of an increase in the prices of commodities such as oil. Also as part of the Brady deals, Bosnia and Herzegovina, Bulgaria, and Costa Rica issued bonds containing an element of indexation to GDP. They contain warrants that increase bond payments if the debtor's GDP (or GDP per capita) rises above a certain level.
36. Anosuma and others 2017.
37. Concerned about liquidity, external creditors didn't buy the clause (*Caribbean Business Report* 2020). They only agreed to a version where enacting the clause requires majority acceptance by the committee.
38. While fixed obligation debt contracts are less informationally sensitive and have low verification cost, they engender moral hazard and a host of agency problems, including excessive risk-taking.
39. Cosio-Pascal 2008.
40. IMF 2020a.
41. African Development Bank 2009.
42. ESM 2020.
43. The IMF has exceptionally made loan disbursements conditional on economic activity. The 1986 Mexican SBA program with the IMF included a growth contingency (activated in 1998) such that, should GDP growth fall below a benchmark level, the authorities would be allowed to implement an additional public investment program, financed with loans from the World Bank and commercial banks.
44. Asonuma and Trebesch (2016) shows that where political risks are high, borrowing costs after default are higher for longer.
45. The standard debt accumulation equation suggests that the current debt ratio in a country (d_t) depends on the previous ratio (d_{t-1}), real interest rate paid on debt (r_t), real GDP growth (g_t) and primary balance (p_t): $d_t = (1 + r_t - g_t)d_{t-1} - p_t$. Note that this formula abstracts from the use of privatization proceeds, off-budget operations, gains and losses on (below-the-line) financial operations, or valuation changes due to exchange rate moves.
46. Svensson and Renikka 2004; Gauthier and Wane 2009; Francken, Minten, and Swinnen 2009.
47. Arezki and Devarajan 2020.
48. Andrews and others 2014.
49. ILO 2018.
50. Arezki and Senbet 2019.
51. Gammadigbe and others 2018.
52. Bikai 2015.
53. African Development Bank 2018.
54. Alliance for Affordable Internet 2020; ITU 2020.
55. See African Development Bank (2020) for a detailed discussion.
56. UNCTAD 2015.
57. See UNECA, AUC, and African Development Bank (2019) and Fox and Bakhoum (2019).
58. Arezki and Senbet 2019.
59. Diallo and Calland 2013.
60. Fox and Bakhoum 2019; World Bank 2020.

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COUNTRY NOTES

CENTRAL AFRICA

Cameroon

Recent macroeconomic and financial developments

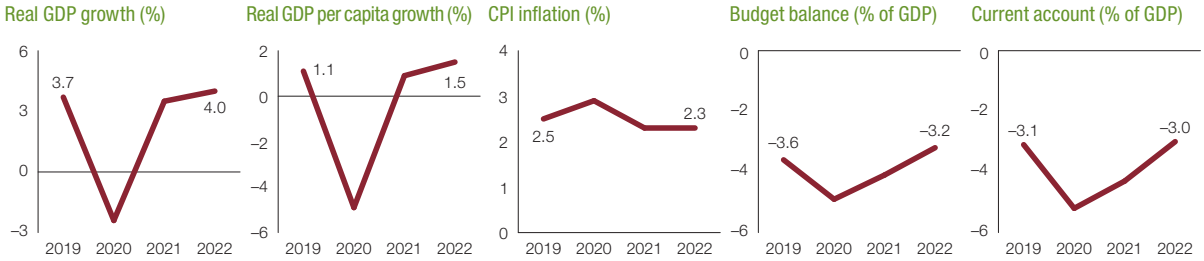
In 2020, the Cameroonian economy was strongly impacted by the combined effects of the COVID–19 pandemic, the persistence of security and political crises and the decline in world oil prices. Among Central African countries, Cameroon was the hardest hit by the COVID–19 pandemic in 2020, from a health and economic perspective. Real GDP contracted by 2.4% in 2020, compared with growth of 3.7% in 2019. This 6.1 percentage point decline in economic activity is largely explained by the fall in world oil prices. The contraction in global demand inherent in the COVID–19 pandemic and the effects of the barrier measures taken in managing the pandemic at the national level have affected the nonoil sector. The activities of the services, manufacturing, and agro-industrial export sectors, particularly trade, have thus experienced a sharp slowdown. Growth has also been affected by the persistence of the security and sociopolitical crises that the country is experiencing and the underperformance of public enterprises, particularly the National Refining Company (SONARA). Inflation has been kept below the Central Africa Economic and Monetary Community 3% convergence threshold (2.9% in 2020, compared with 2.5% in 2019). The Central Bank of Central African States took various measures in 2020 to support the economies of its member states. Thus, the interest rate (TIAO), the main instrument of monetary regulation within this monetary cooperation zone, was lowered by 25 basis points, from 3.50% to 3.25%, in March 2020. New foreign exchange regulations that took effect on 1 March 2019, made it possible to increase the country's foreign exchange reserves, which at the end of 2020 could cover 7.5 of imports, compared with 6.3 months at the end of 2019. The budget deficit increased from 3.6% of GDP in 2019 to 4.9% GDP in 2020, while the current account deficit rose to 5.2% of GDP in 2020, compared with 3.1% in 2019, mainly because oil exports and remittances declined.

Outlook and risks

Subject to the availability of a vaccine at the beginning of 2021 and the gradual extinction of the COVID–19 pandemic from the second half of 2021, the Cameroonian economy, buoyed by the recovery of the world economy and international trade, could return to prepandemic growth levels as early as 2021. Growth should reach 3.5% in 2021 and 4% in 2022. The external and internal account balances would also improve substantially. Inflation will be 2.3% in both 2021 and 2022, below the 3% standard established by Central African Economic and Monetary Community. This optimistic scenario could be undermined by a worsening of the security and sociopolitical crises at its borders and in two of its English-speaking regions, or if the pandemic does not subside by the middle of 2021, which would cripple the restart of global growth.

Financing issues and options

Cameroon's level of public debt is worrying. As a beneficiary country of the Highly Indebted Poor Countries initiative, Cameroon significantly reduced its public debt in 2006. But since then it has taken on substantial debt. The stock of public debt rose from 12% of GDP in 2007 to 45.8% of GDP (about two-third external and one-third domestic) by September 2020. Cameroon has the characteristics of a country at high risk of debt distress. China has 61.3% of Cameroon's bilateral debt, or 27.4% of its total debt, and the African Development Bank holds 30.1% of the multilateral debt, or 12.3% of its external debt. Overindebtedness could be problematic because of the need to support economic recovery in 2021 and to carry out the major structuring projects envisioned in its new national development strategy for 2020 to 2030. Cameroon is eligible for the G20 Debt Service Suspension Initiative (DSSI) announced in 2020 and benefits from a moratorium on noncommercial debt service until 30 June 2021.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Central African Republic

Recent macroeconomic and financial developments

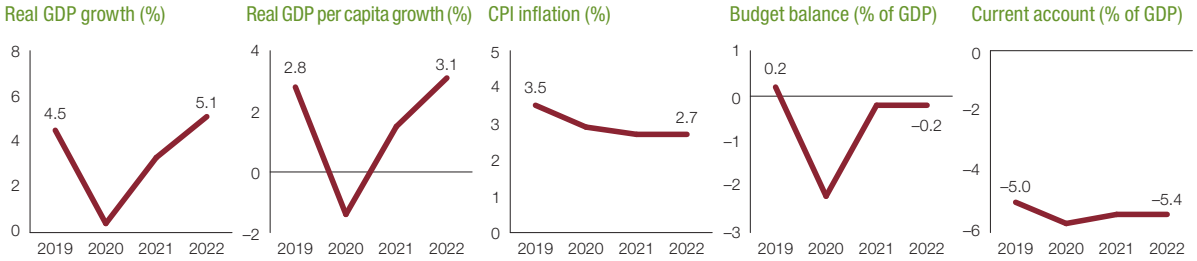
COVID–19 had a limited health effect on the Central African Republic. But its economy suffered from the pandemic—both from of weak global demand for agricultural raw materials and mining resources and the slowdown in economic activities and household demand from measures taken to contain the spread of the disease. The economy grew 0.4% in 2020, compared with 4.5% in 2019. The sectors most affected are trade, hotels, mining, and agriculture. Inflation fell to 2.9% in 2020 from 3.5% in 2019, reflecting the combined effect of improved security on the corridor from the port of Douala to the main city Bangui and the fall in demand for foodstuffs following containment measures. The budget balance slipped from a surplus of 0.2% of GDP in 2019 to a deficit of 2.2% of GDP in 2020—the result of a decline in revenue from payments, excise duties, and the value-added tax because of production disruptions and the suspension of some economic activities. The country also experienced a moderate deterioration in the current account balance, which was –5.7% of GDP in 2020, compared with –5.0% of GDP in 2019. This decline reflected a fall in exports from the deregulation of production and global demand linked to the pandemic.

Outlook and risks

The outlook should be favorable for the economy of the Central African Republic if the pandemic subsides and global demand starts to recover by mid-2021. The African Development Bank projects real GDP growth of 3.3% in 2021 and 5.1% in 2022. The rebound in growth would come from the completion of energy projects and the resumption of agricultural and mining activities. Inflation would hold steady at 2.7% over the next two years, within the limits of the Central African Economic and Monetary Community standard of 3%. Public finance reform efforts should reduce the budget deficit, at 0.2% of GDP in 2021 and 2022. The current account deficit should stabilize at 5.4 % of GDP in 2021 and 2022. The main risks to this scenario are political and institutional instability and permanent insecurity in the northern areas of the country, an extension of the COVID–19 pandemic beyond the 2nd half of 2021, and disruptions from troubled elections.

Financing issues and options

The Central African Republic is at high risk of debt distress due to its significant vulnerability to external shocks and to foreign currency risk from its high level of external debt. The stock of public debt stood at CFAF 629.3 billion ($1.1 billion) in 2019, of which 76.5% was external. The debt ratio fell from 50.3% of GDP at the end of 2017 to 47.1% at the end of 2019, below the 70% ceiling imposed by the Central African Economic and Monetary Community. The economic recovery in 2021 and the implementation of major structuring projects within the framework of the Recovery and Consolidation of Peace in the Central African Republic (2017–23) will be financed by fiscal resources, international aid, and public debt. To reduce the vulnerability of its debt, the Central African Republic should pursue a prudent borrowing policy and strengthen the management of its public debt.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Chad

Recent macroeconomic and financial developments

Although Chad has had relatively few COVID–19 cases, its economy has been hurt by the global consequences of the pandemic. In 2020 real GDP contracted by 0.6%, compared with growth of 3% in 2019 and 2.4% in 2018. The recession is mainly the result of a temporary suspension of oil production, the main engine of the economy, and the closure of borders to contain the pandemic, which caused a slowdown in trade. Inflation, which had fallen in 2019 to 1%, rose to 2.7% in 2020, following the disruption of supply chains for some basic products. The provision of budgetary grants made it possible to contain the budget deficit, despite higher spending to mitigate the pandemic. The budget deficit was 0.8% of GDP in 2020 compared with 0.3% in 2019. The current account deficit worsened from –4.9% of GDP in 2019 to –13.3% in 2020, mainly due to the suspension of oil production and exports in a period of declining oil prices. There are no recent data on poverty, but it is expected to have risen as a result of the pandemic, which disproportionately affected the most vulnerable. In the latest data, from 2018, 42.3% of the population was in poverty, of whom 49.7% were in rural areas.

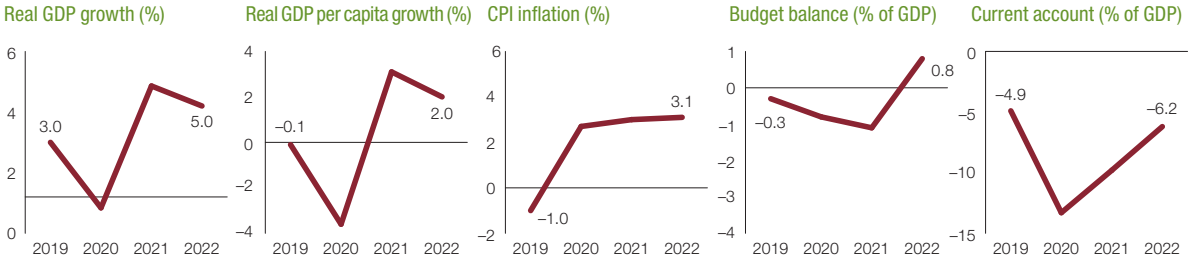
Outlook and risks

The Chadian economy should resume growth in 2021 and 2022 if the pandemic subsides to allow a global economic recovery, with increasing demand for raw materials. Growth is expected to reach 6.1% in 2021 and 5% in 2022, driven by a resumption of industrial activities—particularly in cotton ginning, oil production, and the textile industry. If the government continues to clear domestic arrears, there should be a pickup in investment and private consumption. Inflation will average 3% over the next two years.

The budget deficit is expected to worsen slightly to 1.1% of GDP in 2021, due to an increase in public investment and wage spending linked to the opening of 20,000 civil service positions and the upcoming election. However, a return to budgetary balance is expected in 2022. The current account deficit is expected to gradually narrow to 9.8% of GDP in 2021 and 6.2% in 2022 because of the resumption of oil and cotton exports.

Financing issues and options

The decline in oil prices between July 2014 and February 2016 put Chad into a debt crisis. In 2018 its main component of commercial debt (Glencore) was restructured—extending average maturity to 12 years, and reducing the interest rate from 7.5% to 2%, which, coupled with a resumption or refinery production, led to a clear improvement in debt indicators. The outstanding public debt was estimated at $4.89 million in 2019, of which 56% was external. Total debt accounted for 44.2% of GDP in 2019. About 45% of external debt was commercial, 28% multilateral, and 27% bilateral in 2018. Domestic debt was the equivalent of 19.7% of GDP in 2019, compared with 24.7% in 2017 and 8.8% in 2011. The government adopted in January 2020 a domestic debt clearance plan of $878.8 million to revive the economy.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Republic of Congo

Recent macroeconomic and financial developments

The Republic of Congo continues to experience an economic recession as a result of the underperformance of the oil sector due to the decline in production and world oil prices. In 2020, the Congolese economy contracted again by 6.8% after a 0.6% contraction in 2019. Indeed, following the fall in oil prices, Congo, like the OPEC countries, lowered its annual production goal to 110 million barrels from 140 million barrels. The nonoil sector contracted by 11%—with construction (–9.9%); trade, catering, and hotels (–18.2%); manufacturing industries (–8.2%); and other services (–15.7%) all registering serious declines in output. Domestic demand, investment, and exports also fell. Inflation remained under control at 2.4%, compared with 2.2% in 2019. Financing health response plans and providing support to the economy resulted in a drop of the budget surplus from 4.8% of GDP in 2019 to 0.6% in 2020. Declining oil exports pushed the current account into a deficit of 4.2% of GDP in 2020 after being in a surplus of 2.3% of GDP in 2019.

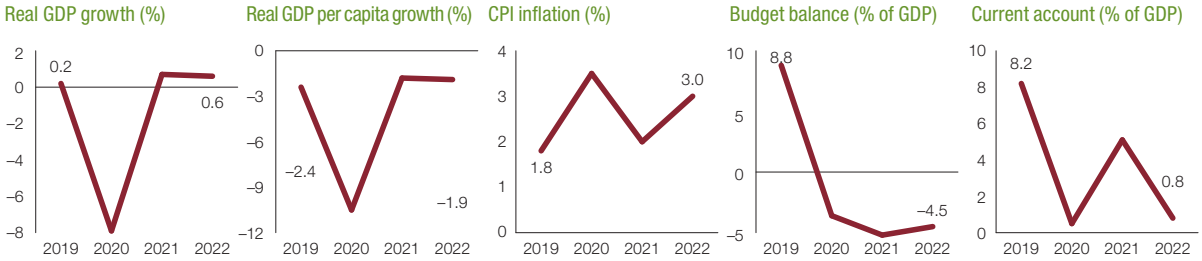
Outlook and risks

The Congolese economy is expected to rebound in 2021 and 2022 if the world economy does, which assumes a subdued pandemic. Real GDP should grow 1.2% in 2021 and 1.5% in 2022. This rebound will be driven by the increase in oil production, growth in services, and the revival of investment. Inflation is expected to be 2.6% in 2021 and 2.8% in 2022. The budget balance should show a surplus of 0.4% of GDP in 2021 and 0.7% of GDP in 2022. The current account deficit should be contained at 3.0% of GDP in 2021 and 3.5% in 2022. But a continuation of the pandemic beyond the first half of 2021 would derail this scenario by keeping oil prices down, increasing pressure on budgetary and external accounts as well as on the Congolese financial sector, which depends heavily on oil revenues.

Financing issues and options

Congo's public debt situation is worrying. The stock of public debt increased by an average of 25% a year between 2014 and 2018, in connection with public investment program initiated to accelerate municipalization of the national territory. The outstanding debt, which was 83.3% of GDP at the end of 2019, is expected to increase to 104.2% of GDP in 2020.

Because it could not agree with commercial creditors, Congo was unable to relaunch its economic and financial reform program with the International Monetary Fund, and it was suspended in 2019. As a result, Congo could not receive external financing expected from development partners. The debt ratio is expected to reach 99.8% of GDP in 2021 and slip to 94% in 2022. Debt restructuring should prove essential in the short to medium term to restore Congo's fiscal space for economic development. Economic development should be accompanied by an increased mobilization of domestic resources by broadening the tax base, rationalization of public expenditure, and implementation of the domestic debt clearance program supported by the "Brazzaville Club."



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Democratic Republic of Congo

Recent macroeconomic and financial developments

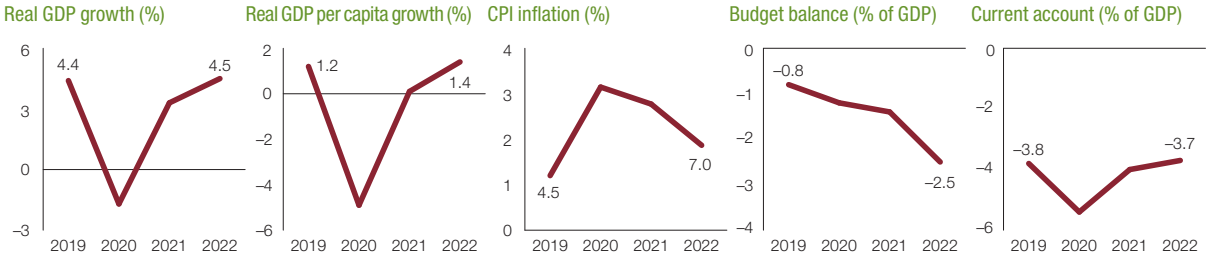
The Democratic Republic of Congo (DRC) experienced in 2020 its first recession in 18 years as a result of adverse impacts of the COVID–19 pandemic across the world. The DRC's real GDP contracted by 1.7% in 2020 after increasing by 4.4% in 2019 and 5.8% in 2018. This reflects, first, the slowdown in the extractive industries because their contribution to growth decreased from 0.28% in 2019 to 0.17% in 2020. Then, measures taken to contain COVID–19, such as lockdowns and restrictions on transport, hurt nonextractive activities whose contribution to growth collapsed from 4.1% in 2019 to –1.9% in 2020—such as manufacturing, buildings and public works, commerce, and market services. This led to the closure of several companies and weakened local demand. Despite high prices for mining products, the current account deficit deteriorated from 3.8% of GDP in 2019 to 5.4% of GDP in 2020. Social spending to mitigate the effects of COVID–19, combined with reduced tax revenue led to a slight worsening of the public deficit from 0.8% of GDP in 2019 to 1.2% of GDP in 2020. To combat inflation and the depreciation of the Congolese franc against the US dollar, the central bank raised the policy rate from 7.8% to 18.5%. Still, inflation rose from 4.5% in 2019 to 13% in 2020 as a result of the containment measures and monetization of the budget deficit. The Congolese franc depreciated 12.4% against the US dollar between 2019 and 2020.

Outlook and risks

The economic outlook for the DRC for 2021 and 2022 is favorable if the pandemic is brought under control and global demand recovers. Real GDP is expected to grow by 3.3% in 2021 and 4.5% in 2022, driven by higher prices for major mining products, such as copper, and recovery in both consumption and investment. The pursuit of public and monetary financial reforms should help bring inflation down to an average of 11.7% over 2021–22, due to the facilitation of imports and better supply to urban centers. The recovery in the extractive sector is expected to boost mining exports and to improve export earnings. However, the current account would remain structurally in deficit, averaging 4.0% of GDP over 2021–22. The 2023 elections are expected to result in increased public spending. As a result, the budget deficit should deteriorate to 1.4% in 2021 and 2.5% in 2022. The current account deficit is projected to narrow to 4.0% of GDP in 2021 and 3.7% in 2022. In sum, real GDP per capita growth is expected to rise by 0.1% in 2021 and by 1.4% in 2022 after falling by 4.9% in 2020 due to the drop in production and demographic pressure. This scenario could be upended by a continuation of the COVID–19 pandemic well into 2021, security and sociopolitical unrest, falling commodity prices, and declining world demand for minerals.

Financing issues and options

With a debt-to-GDP ratio at 21.2% in 2020, or $10.175 billion, the DRC is among the least indebted countries in Africa. But it has significant financing needs. External debt represents two-thirds of public debt and is mainly contracted with multilateral donors. The domestic portion is mainly budget arrears. The financing gap was estimated at $631 million in 2020. The participation of the DRC in the G20 debt moratorium, African Development Bank budget support, and other donors' resources should reduce that financing gap and provide an alternative to the prohibited monetization of the public deficit, as agreed by authorities as of 18 August 2020.



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Equatorial Guinea

Recent macroeconomic and financial developments

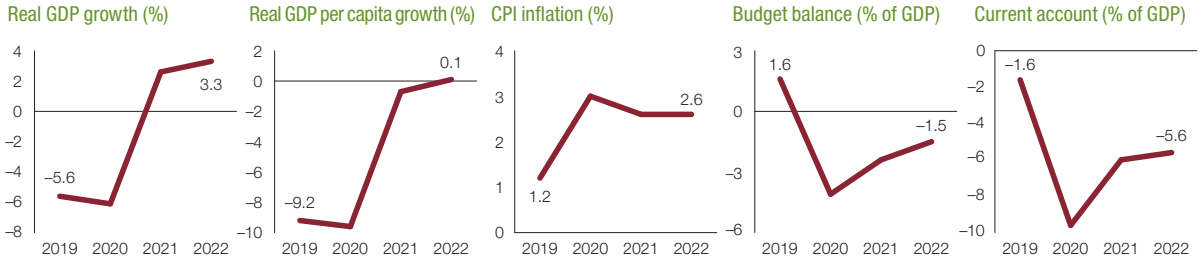
Equatorial Guinea's economy has suffered from the effects of the COVID–19 pandemic. The drop in global demand and oil prices occasioned by the crisis coupled with the drop in household consumption and the slowdown in business activities due to measures to contain the spread of the disease exacerbated the country's already serious growth problems. Real GDP shrank 6.1% in 2020, compared with 5.6% in 2019. It was the eighth consecutive recession year due to growth problems in both the oil (–7.2 %) and nonoil sectors (–4.7%). On the demand side, investment contracted by 35%. But even though output fell, prices rose. Inflation was 3% in 2020, up from 1.2% in 2019, the result of a pandemic-spawned decline in the terms of trade and a worsening monetary situation. As a result, the Bank of Central African States gave up trying to reduce liquidity in the banking system and proposed a series of measures to support the economies in the Economic and Monetary Community of Central Africa (CEMAC) by cutting the policy interest rate and the marginal lending facility rate (from 3.5% to 3.25%, and from 6% to 5%, respectively). The country faced a budget deficit estimated at 4.7% of GDP in 2020, despite the fiscal consolidation the country has been carrying out under a 2017 agreement with the International Monetary Fund (IMF). The fiscal consolidation helped generate a budget surplus of 1.6% of GDP in 2019 and 0.5% in 2018. The current account deficit widened to 9.9% of GDP in 2020, compared with 5.9% in 2019, because of the deterioration in the terms of trade and a 41.5% drop in oil exports.

Outlook and risks

The economy is expected to grow 2.6% in 2021, a projection based on the successful completion of a large gas project and the recovery of the world economy by the second half of the year. But the country is expected to return to recession in 2022, with a real GDP decline of 4.4%. The inflation rate is expected to settle at 2.9% over the next two years, remaining within the CEMAC limit of 3%. The budget is expected to be in a deficit of 2.4% of GDP in 2021 and 1.5% of GDP in 2022. The current account balance is expected to remain in deficit at 6% of GDP in 2021 and 5.6% the following year. The country's main risk factor, beyond the persistence of the pandemic, remains the lack of diversification of its oil-based economy, to which is added the structural weakness of inadequate human capital. Indeed, the country has a capacity deficit, particularly in terms of public finance management and governance, that hinders effective implementation of its economic and social transformation policy.

Financing issues and options

Equatorial Guinea's external debt remains low at around 11.1% of GDP in 2019. However, significant domestic arrears have accumulated since the onset of the commodities crisis, resulting in a public debt-to-GDP ratio of 41.1% in 2019, up from 12.6% in 2014. China is the main external creditor of Equatorial Guinea, holding about 75% of the external public debt. The stock of public debt is mainly linked to domestic arrears, but the increase in external debt is likely to exacerbate the country's future vulnerability. The government is committed to improving public debt management practices. Under the reform program supported by the IMF, the country's debt strategy will essentially consist of not contracting any new guaranteed loans or new guaranteed loan facilities for three years. The additional financing contracted in the fight against COVID–19 will increase the amount of public debt to 54.6% of GDP in 2020. That should fall to 48.7% of GDP in 2025.



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Gabon

Recent macroeconomic and financial developments

The Gabonese economy was hit hard by the global economic slowdown linked to the COVID–19 pandemic. Real GDP contracted 2.7% in 2020, after growing 3.9% in 2019—reflecting a 21% drop in national oil production, a fall in oil prices and a slowdown in nonoil sector activity that resulted from measures to contain the spread of COVID–19. Inflation increased to 3% in 2020 from 2% in 2019, largely due to supply disruptions. The deterioration of the economic situation caused a decline in public revenues, and the pandemic boosted spending on health and social protection expenditures. As a result, the country had a budget deficit of 5.2% of GDP in 2020, compared with a surplus of 1.4% in 2019. The current account deficit widened to 9.5% of GDP in 2020 from 0.3% due to falling oil prices and disruptions in supply chains.

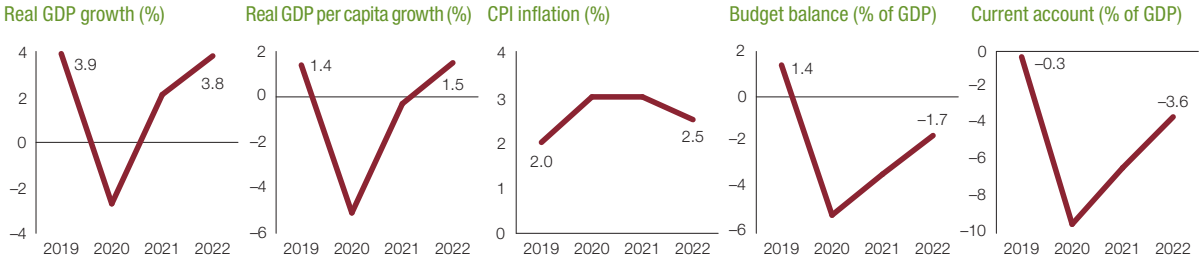
Outlook and risks

The Gabonese economy should rebound if the pandemic improves in the second half of 2021. Real GDP is expected to grow 2.1% in 2021 and 3.8% in 2022. The recovery would not be inflationary, with the inflation rate at 3% in 2021 and 2.5% in 2022.

Better mobilization of nonoil revenue and control of current expenditure will lead to a decrease in the budget deficit to 3.4% of GDP in 2021 and 1.7% in 2022. The current account balance should remain in deficit at 6.4% of GDP in 2021 and 3.6% in 2022. This optimistic scenario could be undermined if the pandemic continues beyond the third quarter of 2021, which would retard the global economic recovery, put significant downward pressure on raw materials prices, and affect growth, public accounts, and the current account.

Financing issues and options

Gabon's public debt is mainly medium to long term and 66% is external. Gabon's debt-to-GDP ratio in 2019 was 58.7%, down from 60.6% in 2018, thanks to public finance reforms and prudent debt management. But the increased financing needs caused by the pandemic will boost the debt ratio to 74.7% of GDP in 2020. Debt service, which represented 37% of public revenue in 2019, will be 88.5% in 2020 as the country repays just over half of the outstanding eurobond 2024. Public debt remains broadly viable in 2020 but is vulnerable to interest and currency risks. After 2021, a decrease in borrowing is programmed to contain the increase in public debt aggregates, with an anticipated debt level for 2021 of 70.5% of GDP.



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EAST AFRICA

Burundi

Recent macroeconomic and financial developments

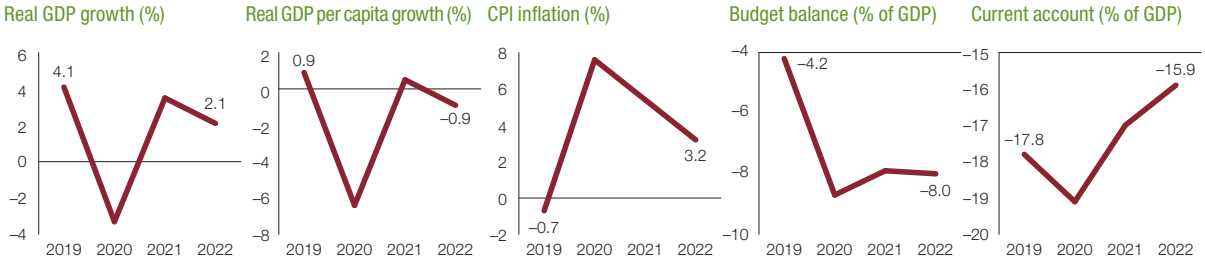
Burundi fell into a recession in 2020, largely the result of the effects of the COVID–19 pandemic. Real GDP contracted by 3.3%, after growing 4.1% in 2019. The pandemic hit hardest at industry, which saw a 4.5% decline in output, and services, whose output fell 1.8% compared with 2019. On the demand side, investment fell by approximately 3%. A decline in agricultural production combined with rising prices of imported products resulted in a sharp rise in prices. Inflation rose by 8.5 points to 7.6% in 2020, compared with –0.7% in 2019. The budget deficit doubled to 8.7% of GDP in 2020, compared with 4.2% in 2019, as current expenditures shot up about 4%. Because weak global demand caused a 4.4% decline in coffee export prices and a 10.4% decline for tea, trade and current account deficits deteriorated. The current account deficit was 19.1% of GDP compared with a deficit of 17.8% in 2019. That resulted in a reduction in foreign exchange reserves, which could cover less than 30 days of imports at the end of 2020. The exchange rate between the Burundian Franc and the US dollar fell by 3.8% between May 2019 and May 2020.

Outlook and risks

If the pandemic is under control by the second half of 2021, an economic recovery could occur with projected growth rates of 3.5% in 2021 and 2.1% in 2022. Inflation would come down to 5.4% in 2021 and 3.2% by 2022 from 7.6% in 2020. Thanks to measures to increase tax revenue in the 2020–21 Finance Law and the prospect of a drop in current spending, the overall budget deficit is expected to decrease to 7.9% of GDP in 2021 from 8.7% in 2020 However, the current account will continue to run a large deficit due to the pressure on prices on agricultural raw materials and the revival of imports linked to the economic recovery. The risk factors that could disrupt this scenario include a possible drop in global demand that would hurt coffee and tea exports as well as a decrease in foreign aid grants from donors. Moreover, given the limited size of the formal sector, there are also risks to achieving tax revenue increases.

Financing issues and options

Burundi's public debt is 70% domestic and has risen sharply since 2015, when civil unrest caused external funding to dry up. In 2020, public debt represents around 63.7% of GDP. External debt is 18.4% of GDP in 2020 compared with 36% in 2012, when Burundi satisfied the criteria for the full amount of debt relief available under the Heavily Indebted Poor Countries initiative (HIPC). Due to the structural trade deficit and the continued increase in domestic debt linked to the persistent budget deficits, Burundi's risk of debt distress remains high. The implementation of a comprehensive reform of public finances aimed at achieving a balanced budget over time is a key priority for public debt sustainability.



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The Comoros

Recent macroeconomic and financial developments

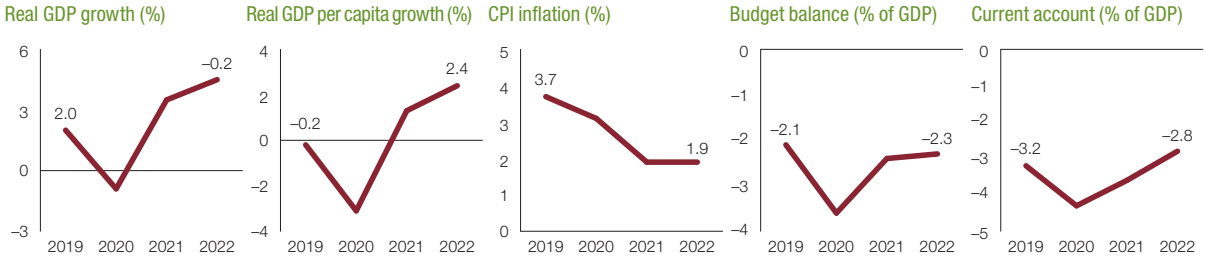
The economy of the Comoros was hit hard by the adverse effects of the COVID–19 in 2020 after being hit hard in 2019 by Cyclone Kenneth. The country chose a noncontainment strategy but closed its borders and instituted a curfew. The archipelago's economic isolation led to a decline in real GDP of –0.9%, compared with 2% growth in 2019, due to a drop in exports of cash crops and tourism. The service sector, which represents more than 50% of GDP, was strongly affected because of restricted international travel. On the demand side, the growth in the investment rate fell to 1.8% in 2020 from 10.5% in 2019, while consumption generally stagnated. Comoros has a high propensity to import, so pegging the Comorian franc against the euro made it possible to stabilize inflation at 3.1% in 2020, compared with 3.7% in 2019—despite an increase of 1.4% in the money supply between December 2019 and June 2020. The Comoros managed to maintain a high level of foreign exchange reserves, enough to cover 6.2 months of imports. The budget deficit amounted to 3.6% of GDP in 2020, compared with 2.1% in 2019, due to lower tax revenues and increased public spending linked to the COVID–19 crisis. Thanks to remittances, which grew by 73.8% between the first half of 2019 and the first half of 2020, and the support of development partners, the current account deficit should widen slightly to 4.3% of GDP in 2020, compared with 3.2% in 2019.

Outlook and risks

The Comorian economy should grow 3.5% in 2021 and 4.5% in 2022 if the pandemic subsides enough to permit the reopening of borders, remittances continue strong, the prices of export products recover and the support of development partners continues. The country intends to continue its monetary policy under its membership of the Franc Zone, which should reduce the inflation rate to 1.9% in both 2021 and 2022. A recovery should allow consolidating public finances to reduce budget deficits to 2.4% of GDP in 2021 and 2.3% in 2022. The expected return of external resources and financing should gradually reduce the current account deficit to 3.6% of GDP in 2021 and 2.8% in 2022. This outlook would be undermined if the pandemic were to extend beyond the first half of 2021, delaying the restart of the global economy.

Financing issues and options

In 2012, the Comoros achieved the full reduction in debt it was eligible for under the Highly Indebted Poor Countries initiative, which enabled to reduce public debt from 40.3% of GDP in 2012 to 18.7% in 2013. Public debt rose to 26.5% of GDP in 2019, largely because of increased bilateral borrowing to finance public infrastructure and support state-owned enterprises. Public debt grew by 1.5% between June 2019 and June 2020. However, the risk of debt distress is considered moderate. The country should optimize its financing prospects by strengthening the mobilization of domestic resources, improving the governance of state-owned enterprises (which hold part of the public debt), further developing the financial sector, continuing to supervise the flow of remittances from the diaspora, and further improving the business environment.



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Djibouti

Recent macroeconomic and financial developments

Djibouti has not faced as severe an outbreak of COVID–19 as some countries. After the first reported case, measures to curb the spread of COVID–19 were taken by the government, including a curfew, a lockdown, a broad range of social distancing, and a mass testing campaign. These measures yielded positive results that led to the lifting of the lockdown and opening up of the country. The government maintained minimum security measures such as social distancing, mask-wearing, and systematic testing at entry points into the country.

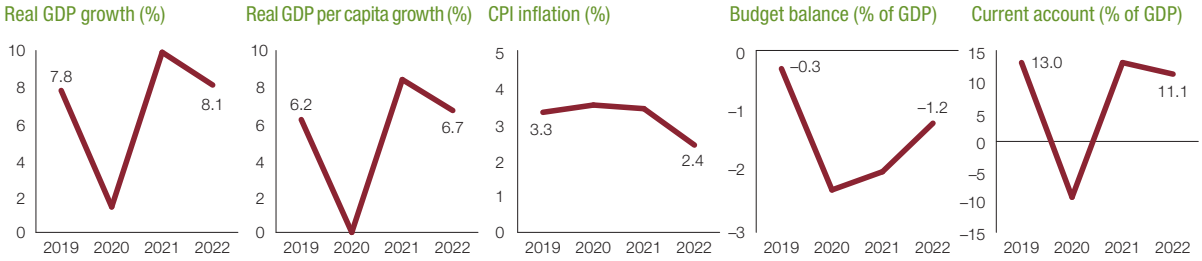
Overall, its economy has suffered from the pandemic's weakening of global demand, which caused a sharp slowdown in re-export activities from the Doraleh terminal—Djibouti's main growth engine. Real GDP growth slowed to 1.4% in 2020 from 7.8% in 2019. Total revenues, excluding grants, fell from 19.4% of GDP in 2019 to 17.5% of GDP in 2020, which led to a widening of the budget deficit to 2.3% of GDP from 0.5% of GDP in 2019. The value added by the services sector, which usually generates nearly 70% of Djibouti's growth, increased only 2% in 2020, compared with 8.2% in 2019. The COVID–19 crisis has also resulted in a sharp deceleration of investments, which increased by only 10.3% of GDP in 2020 after growing by 26.3% of GDP in 2019. Inflation remained stable at about 3.5% in 2020, despite steps by the central bank to foster growth—including an exceptional overdraft mechanism and temporary easing of bank capital requirements, which resulted in money supply growth of 9.39% from September 2019 to September 2020. A decline in foreign direct investment (FDI) and port revenues weakened the current account balance, which showed a deficit of 9.2% of GDP in 2020, compared with a surplus of 13% of GDP a year earlier.

Outlook and risks

The Djiboutian economy should recover well—with projected real GDP growth rates of 9.9% in 2021 and 8.1% in 2022—if the global pandemic subsides. Djibouti's growth prospects are supported by a rapid recovery of port activities as international trade and world demand perk up. Free zones and the expected return of FDI would also support the economic recovery. This return to activities and investments with the support of development partners should bring Djibouti's economy back to its precrisis situation, with decreasing budget deficits projected at 2.0% of GDP in 2021 and 1.2% in 2022. The current account is projected to be in surplus by 13% in 2021 and 11.1% in 2022. Pursuit of monetary policy based on pegging the national currency to the US dollar should lead to low and stable inflation of 3.4% in 2021 and 2.4% in 2022. However, should the pandemic persist beyond the second half of 2021, this scenario could be delayed or compromised.

Financing issues and options

Because the country makes public investments in major infrastructure projects, Djibouti's public debt has increased sharply—from 50.2% of GDP in 2015 to an expected 72.9% in 2020—and could become a potential vulnerability for the country. Financing the economy could be boosted by greater fiscal discipline, strengthened domestic resource mobilization, improved management of state-owned enterprises, and diversifying its external financing sources.



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Eritrea

Recent macroeconomic and financial developments

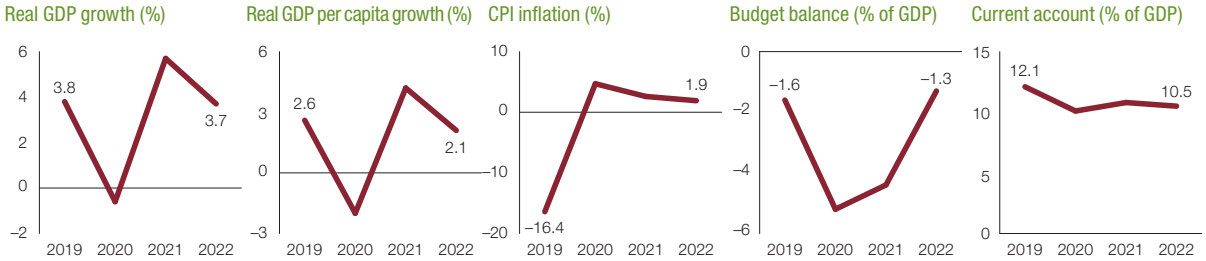
Eritrea was affected by a locust invasion and the COVID–19 pandemic, which combined to impede economic activity in 2020. Real GDP is expected to decline by 0.6%, compared with growth of 3.8% in 2019. Pandemic-related disruptions of supply chains and working hours, and containment measures such as travel restrictions hurt growth. Subdued private consumption and investment, together with reduced net exports, also contributed to the decline in GDP. After deflation of 16.4% in 2019, prices rose 4.7% in 2020—in part because of COVID–19-induced disruptions in regional and global supply chains. The fiscal deficit widened to 5.2% of GDP in 2020, compared with 1.6% in 2019. The deterioration was due to increased public spending to mitigate the impact the pandemic at the same time that revenues fell. The fiscal deficit was financed by drawing down government deposits with the central bank and concessionary borrowing. The current account surplus decreased to an estimated 10.1% of GDP in 2020 from 12.1% in 2019, reflecting a narrowing savings–investment gap, as savings dropped in line with subdued economic activity. The excess savings relative to investments reflects in part a business regulatory environment that has not been conducive to investment and job creation. Poverty remains pervasive, as the working poor (with incomes below $3.10 a day at purchasing power parity) are estimated to account for 75.2% of total employment.

Outlook and risks

The outlook is positive, with real GDP growth projected to recover to 5.7% in 2021 before moderating to 3.7% in 2022. Economic recovery will be driven by a rebound in metal exports following a gradual improvement in global demand and prices. A recovery in private consumption and increased investment demand are expected to support growth in 2021. The ongoing civil disturbance in the Tigray region of neighboring Ethiopia, climate change shocks, and limited financial inflows constitute the main downside risks to growth. Inflation is projected at 2.6% in 2021 and will decline to 1.9% in 2022, as domestic production continues to expand. The fiscal deficit is projected to narrow to 4.4% of GDP in 2021 and to 1.3% in 2022, as domestic revenues grow in tandem with the economic recovery. The current account surplus is projected to increase to 10.8% of GDP in 2021 before moderating to 10.5% in 2022, driven by fluctuations in national savings. Poverty and income inequality are expected to worsen because the services sector, which accounts for 30.3% of total employment, was most affected by the COVID–19 containment measures. A global economic recovery will boost remittance inflows, a key source of livelihoods in Eritrea, and mitigate the severity of poverty and income inequality.

Financing issues and options

Eritrea's gross public debt reached 189.2% of GDP in 2019, up from 185.8% in 2018, and the country is in debt distress. The growth in gross public debt was driven by primary deficits and high real effective interest rates, with real GDP growth partially offsetting the buildup in public debt. Gross public debt is projected to decline to 185.6% of GDP in 2020 and 165.7% in 2022, due to government efforts to accelerate debt servicing. Strong policy adjustments, notably fiscal consolidation will be beneficial, but debt restructuring is necessary to ensure a gradual return to debt sustainability. The Quality of Policies and Institutions score, as measured by the Country Policy and Institutional Assessment, is less than 2.69, reflecting weak capacities, including debt management. In this context, high economic growth involving greater participation of the private sector and fiscal reforms—notably domestic resource mobilization, fiscal consolidation, and institution strengthening—should be an integral part of policy measures to ensure debt sustainability.



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Ethiopia

Recent macroeconomic and financial developments

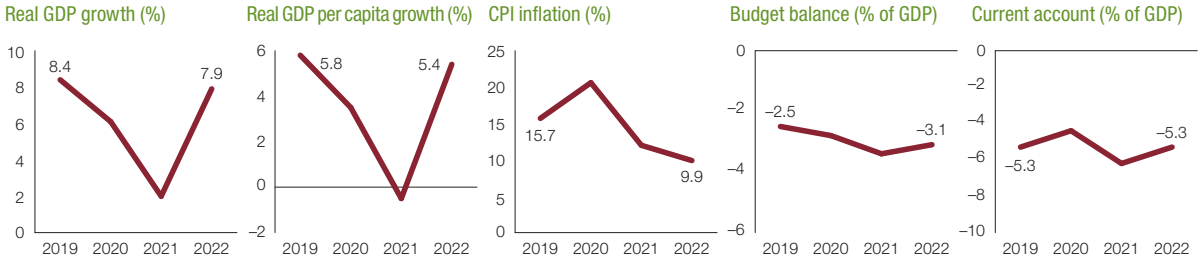
Ethiopia's economy grew by 6.1% in 2020, down from 8.4% in 2019, largely because of the COVID–19 pandemic. Growth was led by the services and industry sectors, whereas the hospitability, transport, and communications sectors were adversely affected by the pandemic and the associated containment measures to prevent the spread of the virus. The fiscal deficit, including grants, increased slightly during 2020, financed mainly by treasury bills. Tax revenue increased by 16%, but the tax-to-GDP ratio declined to 9.2% in 2020 from 10% in 2019 due to delayed implementation of tax reforms. Total public spending remained stable, in line with the country's fiscal consolidation strategy. In 2020 inflation reached 20.6%, well above the 8% target, due to pandemic-induced supply chain disruptions and expansionary monetary policy. In November 2020, the official exchange rate was devalued by about 8% to 35.0 birr per US dollar. Export revenues increased by 12% in 2020, as exports of gold, flowers, coffee, and chat increased while imports declined by 8.1%. This helped narrow the current account deficit to 4.4% in 2020 from 5.3% in 2019. Service sector exports declined by about 6%, mostly because of lower revenue from Ethiopian Airlines. Foreign direct investment (FDI) fell 20% to 2.2% of GDP, and personal remittances declined by 10% to 5.3% of GDP. Poverty was projected to decline from 23.5% in 2016 to 19% by end of 2020. But pandemic-driven job losses, estimated at as many as 2.5 million, will impede poverty reduction.

Outlook and risks

The medium-term economic outlook is contingent on the resolution of the COVID–19 crisis, the pace of the economic recovery, and such other shocks as civil strife and climate change. Real GDP growth in 2021 is projected to fall to 2%, then recover to about 8% in 2022, led by a rebound in industry and services. Monetary policy is expected to remain flexible in response to the government's financing requirements. Increased use of open-market operations is expected to reduce inflation gradually. The fiscal deficit is projected to increase as tax policy reforms are delayed due to COVID–19. The current account is likely to deteriorate in 2021 before improving in 2022 as service exports gradually pick up. The key downside risks to the economic outlook include low investor confidence, in part due to sporadic domestic conflicts, weakness in global growth, and climate change.

Financing issues and options

Ethiopia's financing requirements are significant given its large physical and social infrastructure needs and low tax-to-GDP ratio, which averaged 10% from 2017 to 2020. The primary deficit plus debt service was estimated at nearly 4% of GDP. As of June 2020, total public debt was about 57% of GDP, slightly more than half of which was external. Since 2017, Ethiopia has been classified at high risk of public debt distress due to weak export performance coupled with increased import-intensive public infrastructure investments. The International Monetary Fund's 2019 debt sustainability analysis estimated the net present value of debt-to-exports at 247.6% and debt service-to-exports at 24.6%; the highest sustainable levels are 180% and 15%, respectively. Ethiopia benefited from the G20 Debt Service Suspension Initiative, and the government is taking measures to contain the debt burden as part of the so-called Home-Grown Economic Reform agenda, which includes fiscal consolidation, expanding public financing sources, a moratorium on nonconcessional borrowing, harnessing grants and concessional loans, and debt restructuring. Gross reserves amounted to $3.1 billion in 2020, or 2.5 months of imports and are unlikely to provide an alternative source of development financing in the short term. Expansion of public debt in the context of large public expenditure requirements could constrict the fiscal space and lead to repayment risks, especially since $1 billion in eurobonds come due in December 2024. Further reforms in public finance and investment management are needed to improve the efficiency of public expenditures.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Kenya

Recent macroeconomic and financial developments

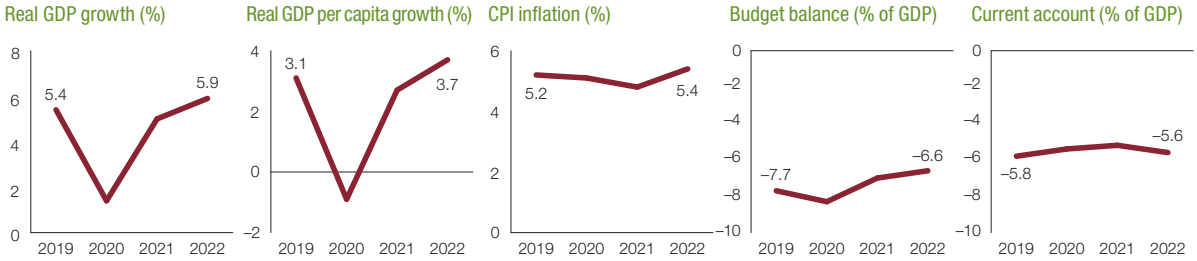
Kenya's economy has been hurt by the COVID–19 pandemic. In 2020, GDP growth is expected to decelerate to 1.4% from 5.4% in 2019. Growth is supported by agriculture, while weaknesses in services and industry have had a dampening effect. Domestic demand is subdued while external demand has neither helped nor hurt growth. Expansionary fiscal, monetary, and financial policy measures were introduced to mitigate the impact of the pandemic on businesses and households. Inflation is expected to ease to 5.1% because of lower aggregate demand. The fiscal deficit is expected to widen to 8.3% of GDP—the result of revenue shortfalls and pandemic-related spending increases to deal with health issues and to mitigate the damage to household income and businesses. The current account deficit is expected to narrow to 5.4% of GDP, supported by a sharp reduction in the oil import bill. Foreign exchange reserves declined to $7.8 billion (4.8 months of import cover) at the end November 2020 from $8.96 billion (5.6 months of import cover) at the end November 2019. The local currency weakened by 8.9% to KSH 110 to the US dollar at the end November 2020 from KSH 101 to the dollar a year earlier. The financial sector was affected by spillover effects from major sectors; the capital market was the hardest hit. The Nairobi Securities Exchange share index fell 20% between 30 September 2019 and September 2020, and market capitalization fell 2% over the same period. The pandemic did serious social damage. Nearly 2 million people are estimated to have fallen into poverty, and nearly 900,000 lost their jobs.

Outlook and risks

The growth outlook is positive. The economy is projected to grow by 5.0% in 2021 and 5.9% in 2022. The rebound assumes that economic activity will normalize due to a full reopening of the economy, the Economic Recovery Strategy being successfully implemented, and Kenya capitalizing on an expected improvement in external liquidity and benefiting from initiatives to meet its external financing needs. The external initiatives could include debt refinancing, restructuring and debt service relief, and additional concessional loans. Inflation is projected to remain within the Central Bank of Kenya's target range of 2.5% to 7.5%, and fiscal and current account deficits are forecast to narrow as a result of improved revenue collection and exports. Downside risks to the outlook could emanate from delays in the full reopening of the economy, failure to secure external financing to execute the budget, a slowdown in global growth, and disruptive social conditions during the run-up to the 2022 elections.

Financing issues and options

Public debt surged to 72% of GDP in 2020 from 61% in 2019, driven mainly by public investment in infrastructure, debt management–related challenges, and the COVID–19 crisis. Kenya is now in high risk of debt distress as determined by the International Monetary Fund. Addressing the emerging fiscal and debt vulnerability risks would require growth friendly reforms, soliciting external financial assistance, concessional credit, and debt refinancing and restructuring. The growth–friendly reforms could entail revenue-related steps to improve tax compliance, widening the tax net by reviewing the list of tax-exempt and zero-rated items, formalizing the informal sector, ensuring that public expenditures reach their intended targets, and deepening the domestic financial market to support private and public sector credit growth.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team. Data on the budget balance correspond to Kenya's fiscal year, which runs from July 1 to June 30.

Rwanda

Recent macroeconomic and financial developments

Real GDP in Rwanda was estimated to contract by 0.4% in 2020 due to the COVID–19 pandemic, after growing 9.4% in 2019. Trade, transportation, and tourism services have been the sectors most affected by the global pandemic. COVID–19 also hurt investment and exports. Rising food prices, stoked by disruptions to regional and domestic supply chains, contributed to a 6.6% increase in inflation in 2020. That was far higher than the 2.4% in 2019 and breached the central bank's 5% policy target. The National Bank of Rwanda reduced the key policy rate to 4.5% in April 2020 from 5.0% in 2019 to stimulate growth, but private sector credit remained subdued, expanding by 10.2% in 2020, compared with 12.6% in 2019. Low tax yield and elevated health and social protection spending caused the fiscal deficit to grow to 8.3% of GDP in 2020, compared with 7.3% in 2019. The deficit was financed by COVID–19 budget support loans and grants from cooperating partners. Low exports and reduced foreign direct investment resulted in a current account deficit equivalent to 16.5% of GDP in 2020, compared with 9.3% in 2019. Gross reserves shrank. In 2020 they could cover 2.4 months of imports, compared with 4.5 months in 2019. Low external inflows contributed to a 4.6% depreciation of the Rwandan franc against the US dollar. The financial sector remains stable and well capitalized, with a capital adequacy ratio of 23.7% in June 2020, above the 15% regulatory threshold.

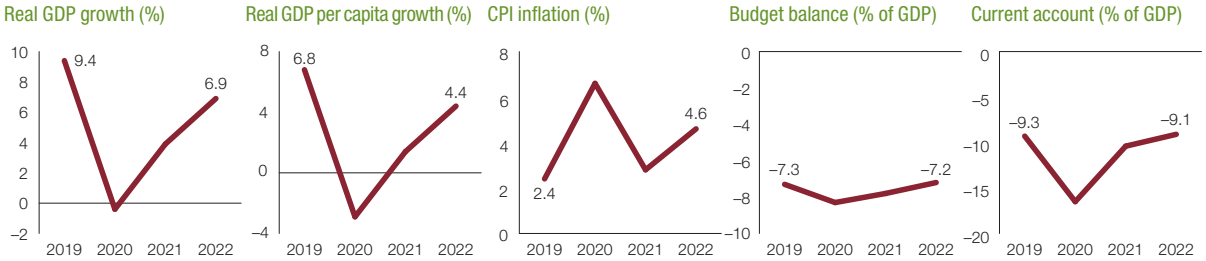
The latest available data show an unemployment rate of 22.1% in May 2020, compared with 15% a year earlier. Unemployment growth reflects the virtual shutdown of such major industries as transport, food, and hospitality during the lockdown and is like to increase the poverty rate —which was 38.2% in 2017, the most recent data available.

Outlook and risks

Growth is projected to rebound in 2021 and 2022, supported by high infrastructure spending on Bugesera airport and a pick up in the tourism sector as the effects of the pandemic dissipate. The implementation of the African Continental Free Trade Area is expected to boost intraregional trade, which will support growth—especially if Rwanda increases its share of intraregional exports. Inflation is expected to abate to within the policy target as reopened borders increase the food supply and domestic containment measures ease further. The fiscal deficit is projected to narrow to 7.8% of GDP in 2021 and to 7.2% in 2022 due to a planned fiscal consolidation in the 2021/22 fiscal year. The current account deficit is projected to narrow to 10.4% of GDP in 2021 and further improve to 9.1% in 2022, mainly because a rollout of COVID–19 vaccines should trigger a rebound in tourism and foreign direct investment. The downside risks to the outlook include trade disruptions due to simmering regional political tensions, a decline in the fiscal space due to a rising debt burden, and a resurgence of the COVID–19 virus.

Financing issues and options

Rwanda's public debt was 58% of GDP in 2019 due to elevated spending on key infrastructure investment and a decline in aid flows. The COVID–19 crisis caused an increase in health-related spending and a decline in tax revenues, resulting in an increase in public debt to 66% of GDP in 2020, which is expected to reach 72% of GDP in 2021, above the safe debt ratio of 65%. In anticipation, the country's debt distress was raised from low to moderate by the International Monetary Fund and World Bank, effective in June 2021. An urgent fiscal adjustment to a safe debt ratio of 65% of GDP is required to avoid the risk of slipping into high debt distress. The planned transition to private sector–led growth, the use of blended finance and derisking strategies to fund infrastructure projects, drawing on reserves, and renegotiating debt will help avoid overburdening the public balance sheet. Capacity building in the management of fiscal risks from private-public partnerships should be prioritized to support a fiscal consolidation strategy.



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Seychelles

Recent macroeconomic and financial developments

The economy of Seychelles will contract by an estimated 12% in 2020, after growing 4.7% in 2019. The contraction was the result of the COVID–19 pandemic, which significantly damaged both tourism earnings and fisheries because of disruptions to supply chains and weaker external demand. Growth was also affected by reduced household consumption and investment performance due to the pandemic. Pandemic-induced supply disruptions pushed inflation to 4.1% in 2020 from 1.8% in 2019. Tax collections were estimated to decline in 2020 at the same time that social expenditures increased to mitigate the impact of the pandemic. As a result, the tax-to-GDP ratio declined to 27%, below the average of 32% over the previous five years. That made for a fiscal deficit of 5.0% of GDP, compared with a surplus of 4.5% in 2019. Lower export and tourism earnings contributed to a widening of the current account deficit to 32.3% in 2020 from 15.9% in 2019. The reduction in tourism revenues was also expected to lead to a decrease in foreign exchange reserves to $563 million in December 2020 from $580 million in 2019. The pandemic also caused downward pressure on the exchange rate, which depreciated from an average rate of SCRs 13.8 to the US dollar in 2019 to 21.2 in December 2020. Seychelles' financial sector is reasonably well developed and capitalized. Asset quality, as measured by the ratio of non-performing loans to gross loans, has improved over time reaching 3.5% in 2018. As businesses could find it difficult to pay their debts due to the pandemic, non-performing loans could rise in 2020, but problem loans are also likely to be mitigated by government measures, including a moratorium on loan payments by businesses.

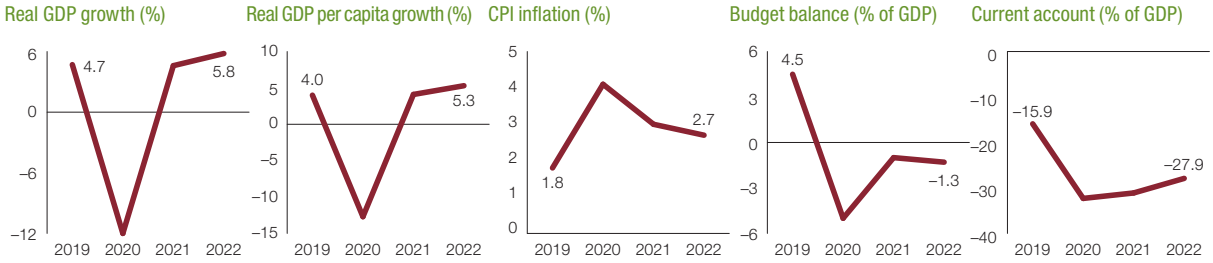
Poverty and social indicators are among the best in Africa. Extreme poverty, living on less than $1.90 in purchasing power parity per day, was 1.1% in 2019. However, because the unemployment rate rose to 4.8% in the first quarter of 2020 from 2.3%% in the last quarter of 2019, the poverty rate is also likely to rise.

Outlook and risks

The medium-term economic outlook is positive. Real GDP is projected to grow 4.6% in 2021 and 5.8% in 2022 as economic activity increases and tourist arrivals rebound. Investor confidence is likely to be strengthened by the smooth transition to a new leadership after the opposition won in the October 2020 elections, which bodes well for the country's medium-term economic outlook and its ability to sustain its recently acquired high-income status. The fiscal and current account deficits are projected to narrow to 1.0% and 31.1% respectively in 2021 and to 1.3% and 27.9% in 2022. Insufficient economic diversification and vulnerability to external shocks (more than 25% of GDP comes from tourism) and climate change pose the main risk to the outlook.

Financing issues and options

After defaulting on its international debt payments almost a decade ago, the country started a debt restructuring that aimed reaching a debt-to-GDP ratio below 50% by 2021, from 150% at the peak. The country was on track until the pandemic, when it had to increase borrowing to offset a loss in domestic revenue. Its debt stock was estimated at about 85% of GDP in 2020, a sharp increase from 57% in 2019, suggesting the likelihood of debt distress. The country received support from cooperating partners, including the International Monetary Fund ($31.2 million), the World Bank ($15 million), and the African Development Bank ($10 million). A renewed and strengthened focus on debt management is key to ensuring continued growth and avoiding a repeat of debt-related macroeconomic risks. Policy actions should include first, further expenditure rationalization by focusing on critically needed areas and revenue mobilization by widening the tax base (30 companies account for 80% of total tax collection), and second, economic and market diversification and improvements in the business environment to attract investment, accompanied by a renewed focus on debt management and restructuring.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Somalia

Recent macroeconomic and financial developments

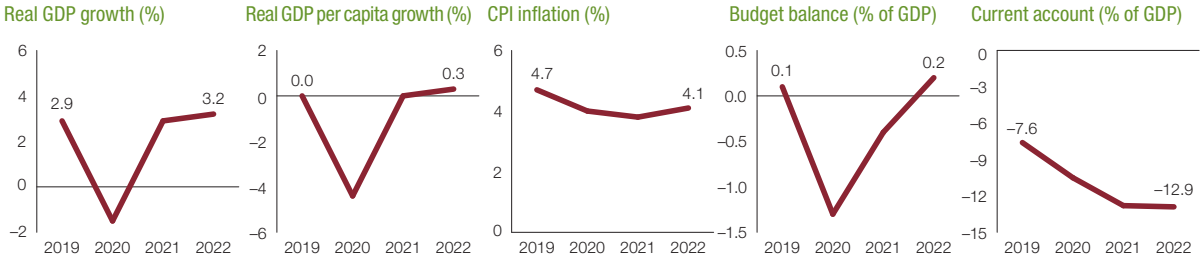
Somalia was affected by several shocks during 2019 and 2020—drought, floods, locust invasions, and the COVID–19 pandemic. As a result, real GDP, which grew 2.9% in 2019, shrank by 1.5% in 2020, mainly because of COVID–19 containment measures such as travel restrictions and supply and value chain disruptions. Growth has also been affected by reduced foreign direct investment, as investors shied away during contentious elections that were postponed, a shrinkage in remittances because of the global recession, and bans on livestock exports by the Gulf countries. Financial sector development is still nascent and there is no scope for monetary policy because of dollarization and currency counterfeiting. Annual inflation was estimated to decrease to 4% in 2020 from 4.7% in 2019, due to tax relief on food essentials and improved food supply. The Somali shilling remained relatively stable, depreciating by less than 1% between January and November 2020 as widespread dollarization reduced the supply of counterfeit currency. A structural trade deficit persists; exports continue to lag imports. Lower exports and reduced net financial inflows are expected to aggravate the current account deficit in 2020, estimated at 12.8%. Seven of 10 Somalis survive on less than $1.90 per day, and the COVID–19 crisis has likely increased poverty, as the 4.4% decline in real per capita income would suggest.

Outlook and risks

The economic outlook is clouded by uncertainty about the pandemic's course, which will require a strategic approach to reopening the economy. Containment measures are gradually being relaxed, but social distancing is likely to become more difficult as people seek to restore livelihoods and businesses return to normal operations. Growth is expected to recover to 2.9% in 2021 and 3.2% in 2022, which is still below pre-COVID–19 projections. A recovery in household expenditures and agriculture, especially livestock exports, will drive growth if other Gulf countries follow Saudi Arabia's move to lift a ban on imports of livestock from Somalia. The key downside risks include the climate and a decline in financial flows, notably development assistance and remittances, due to COVID–19. Inflation is projected to remain below 5% because of an improved food supply. While a balanced fiscal position is expected, due to conditions imposed for debt relief under the Heavily Indebted Poor Countries (HIPC) initiative, the current account deficit is projected to widen to 12.8% in 2021 and 12.9% 2022. Poverty and unemployment are expected to increase due to reduced remittances, which will disproportionately affect women, youth, and displaced persons.

Financing issues and options

Somalia became eligible for interim debt relief under the HIPC initiative in March 2020, which set the country on a course to sharply reduce its debt levels. The International Monetary Fund's 2020 debt sustainability analysis indicates that even with the interim debt relief, Somalia will remain in debt distress, as its debt will still be about 43.3% of GDP in 2024, above the 30% sustainability threshold. Somalia's debt was 55.3% of GDP when it became eligible for HIPC interim debt relief. It largely fulfills its financing requirements from donor contributions. Domestic revenues were 3.9% of GDP in 2018 and 4.6% in 2019 and financed an average of 71% of the national budget during those two years. Considering Somalia's debt distress rating and the expectation that it will start honoring due debt repayments by 2024, the HIPC negotiations on debt restructuring should aim for comparability of treatment by non-Paris Club creditors to allow Somalia to secure a 9% debt-to-GDP ratio in 2024 when it is expected to reach the completion point of the HIPC initiative. Domestic revenue mobilization efforts and implementation of the new Public Financial Management framework are expected to expand the fiscal space for pro-poor spending. Gross reserves were low at 1.4% of GDP in 2020, equivalent to less than one month of imports, and are therefore not expected to complement the public financing sources in the short term.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

South Sudan

Recent macroeconomic and financial developments

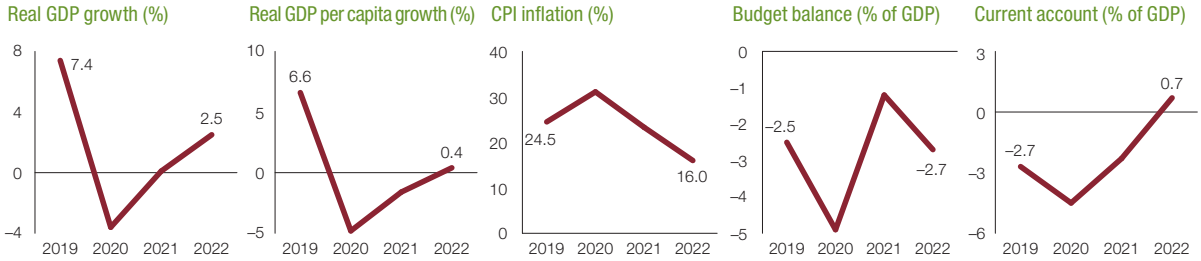
South Sudan's nascent economic recovery—driven by the 2018 Revitalized Peace Agreement, rising oil prices, and a resumption in oil production—was derailed in 2020 by locust invasions, floods and the COVID–19 pandemic. Economic activity was disrupted by measures to contain the spread of COVID–19—social distancing, and restrictions on movement and business operating hours. The service sector, which accounts for 6.1% of GDP, was particularly hard hit. Floods and locusts hammered the agriculture sector, which accounts for 15% of GDP and employs 80% of the population. The oil sector, which accounts for 70% of GDP and more than 90% of public revenues, was damaged by the collapse of global oil prices. Public and private consumption, the key growth drivers on the demand side in 2019, were also hurt by COVID–19. As a result, real GDP growth is expected to decline by 3.6% in 2020 after expanding by 7.4% in 2019. Supply shocks induced by flooding, locust invasions, and COVID–19 disruptions coupled with monetization of the government budget deficit and currency depreciation, increased inflation to an estimated 31.1% in 2020 from 24.5% in 2019. The South Sudan pound depreciated by 10% in November 2020 relative to the same period in 2019, to SSP 176 per US dollar. Falling global oil prices have reduced government revenues by 40%, increasing the fiscal deficit to 4.9% of GDP in 2020 from 2.5% in 2019. Reduced oil export receipts and a slowdown in financial inflows, mainly remittances and foreign direct investment, widened the current account deficit to 4.5% of GDP in 2020 from 2.7% in 2019. Banking, which dominates the financial sector, has been affected by the COVID–19 containment measures. Credit to the private sector, which fell by 20% in 2019, dropped another 40% in 2020, reflecting subdued economic activity and the high cost of finance. The economic slowdown is also expected to aggravate poverty and unemployment, with disproportionate effects on youth and women.

Outlook and risks

A peace dividend and the projected rebound in oil production and exports will support partial economic recovery, with real GDP expected to grow by 0.1% in 2021 and 2.5% in 2022. Inflation is expected to drop to 23.3% in 2021 due to the easing of containment measures, especially the reopening of borders with Kenya and Uganda, which will facilitate imports of food and other essentials. Public financial management reforms and the recovery of global oil prices will reduce the fiscal deficit to 1.2% of GDP in 2021, with external borrowing expected to bridge the public financing gap. The current account deficit is expected to fall to 2.3% of GDP in 2021 because of improved global oil prices. A breach in the peace accord, oil price fluctuations, and climate change, are the main downside risks to the growth outlook.

Financing issues and options

South Sudan's debt risk rating improved from debt distress to high risk in October 2020, due to the restructuring of the country's commercial debt with Qatar National Bank, which accounts for 46% of external debt. Debt restructuring and the clearance of arrears owed to Sudan also helped reduce external debt to an estimated 28.3% of GDP in 2020 from 38% in 2019. Commercial loans accounted for 81% of the total external debt as of June 2020, followed by multilateral (8%) and bilateral (11%) loans. While focusing on domestic resource mobilization is important, the government should also expand the fiscal space by enhancing fiscal transparency, accountability, and reporting. Improving the transparency of resource-backed loans and building the capacity to design and implement prudent macroeconomic policies will support debt sustainability in the medium to long term. Reforms to accelerate economic diversification and reduce reliance on oil are equally important. Institutional and capacity limitations are the key challenges to implementing such reforms. Gross reserves were equivalent to less than one month of imports in 2020 and so too low to be an alternative source of financing in the short term.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team. Data on the budget balance correspond to South Sudan's fiscal year, which runs from July 1 to June 30.

Sudan

Recent macroeconomic and financial developments

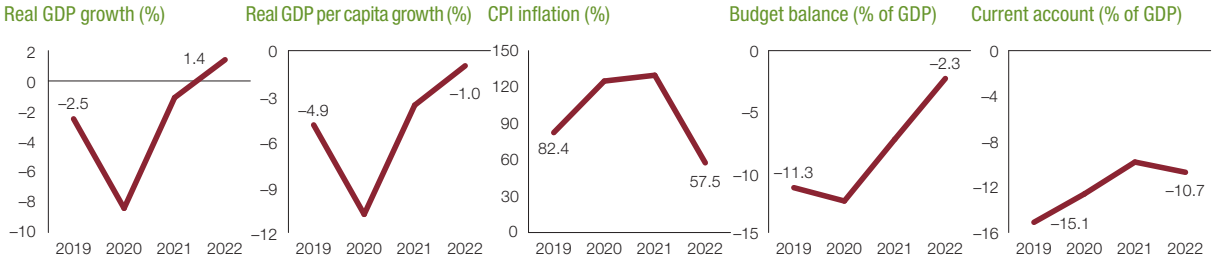
Real GDP was estimated to have shrunk by 8.4% in 2020 after shrinking by 2.5% in 2019. The COVID–19 pandemic's effect on commodity prices, trade, travel, and financial flows contributed to subdued economic activity. Reduced private consumption and investment as well as disruptions in value and supply chains also affected growth. Containment measures such as lockdowns took their toll on the service sector, with 58% of GDP, and the industrial sector, with 22%. Inflation escalated to an estimated 124.9% in 2020, compared with 82.4% in 2019, mainly due to a 118% currency depreciation and monetization of the fiscal deficit. Public revenues decreased by 35% in 2020, while the pandemic spurred a big increase in spending, worsening the fiscal deficit to 12.4% in 2020, compared with 11.3% in 2019. The fiscal deficit, which accounted for 40% of government revenues in 2019, has primarily been financed by advances from the central bank. Reduced demand among Sudan's major trading partners in the Persian Gulf lowered exports, but imports also declined. As a result, the current account deficit narrowed to 12.6% of GDP from 15.1% in 2019. Private sector credit as a percentage of GDP dropped by 4 percentage points during first half of 2020, reflecting the pandemic-related economic slowdown. In July 2020, the government adopted an accommodative monetary policy by reducing the cash reserve ratio, boosting credit to private sector to an estimated 12% of GDP at the end of 2020, still below the 14% of GDP it reached in 2019. While non-performing loans decreased from 3.5% in 2019 to 3% in 2020, returns on assets decreased to 1% from 1.8%, reflecting reduced profitability due to the sharp economic contraction. Subdued economic activity increased poverty from 48.3% in 2019 to an estimated 56% in 2020.

Outlook and risks

Sudan's economy is projected to remain in recession in 2021, with a return to modest growth expected in 2022. Agriculture and mining will drive growth on the supply side, and private consumption and investment on the demand side. The improved political outlook and Sudan's recent removal from the States Sponsor of Terrorism List (SSTL) by the United States will stimulate financial flows, benefiting growth. Poverty is projected to come down by 0.5 percentage points in 2022, reflecting the improved economic outlook. Reduced foreign exchange from remittances and foreign direct investment is expected to lower imports, including fuel and food supplies, and increase inflation in 2021. However, the prioritization of public spending and tighter monetary policies will reduce inflation from 129.7% in 2021 to 57.5% in 2022. Fiscal and current account deficits are expected to improve because of planned reforms to accelerate the economic recovery. The key downside risks include low public revenues, which may trigger further monetization of the deficit, and further depreciation of the local currency.

Financing issues and options

The 2020 debt sustainability analysis conducted by the International Monetary Fund and World Bank found that Sudan was in debt distress. Total public debt reached 201.6% of GDP in 2019, of which 80% was external. The share of total external debt in arrears increased to 85% in 2019 from 80% in 2017. The bulk of external debt in 2019 was owed to bilateral creditors ($41.5 billion, or 76% of total external debt), about equally divided between Paris and non-Paris Club creditors, followed by commercial (14%) and multilateral (10%) lenders. Sudan's removal from the SSTL is expected to accelerate the country's eligibility for Heavily Indebted Poor Countries (HIPC) initiative relief, and discussions are under way on the possibility of debt relief. However, repayment of the country's commercial debt obligations has constrained the fiscal space for growth-generating public investments. This lack of fiscal space necessitates urgent reforms to broaden the tax base by rationalizing tax exemptions and improving tax administration. Improvements in governance are also necessary to crowd in private investment and finance. Gross reserves were low at $1.1 billion in 2020, representing about 2 months of imports and are thus not expected to augment public financing sources in the short term.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Tanzania

Recent macroeconomic and financial developments

Growth slowed to 2.1% in 2020 from 6.8% in 2019 because of COVID–19. Growth was driven mainly by construction and manufacturing on the supply side and investments on the demand side. Monetary policy has been accommodative to support credit and economic growth, with a reduction in the policy rate from 7% in August 2018 to 5% in May 2020, where it remains. Inflation fell to 3.3% in 2020 from 3.5% in 2019, due to a steady decline in food prices. Exchange rates remained stable, partly due to the Bank of Tanzania's interventions to ensure stability in the foreign exchange market. The government's fiscal consolidation has helped to reduce recurrent expenditures, but the adverse effect of COVID–19 on revenues increased the fiscal deficit slightly from 2.0% of GDP in 2019 to 2.3% of GDP in 2020—which still is lower than the government target of 5%. The deficit was financed largely by domestic borrowing. The current account deficit improved slightly to 3.2% of GDP from 3.4% in 2019 due to better export performance, particularly gold exports. The non-performing loans ratio increased from 9.8% in December 2019 to 11.0% in April 2020, mainly because of liquidity constraints in the private sector, in part due to COVID–19.

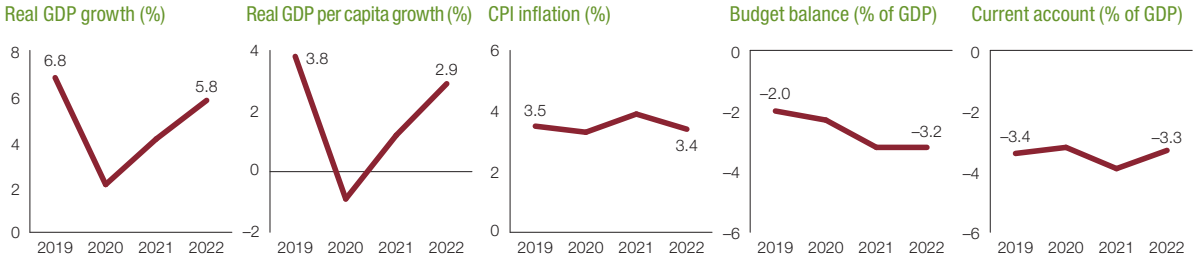
The number of Tanzanians living below the poverty line has increased as the pandemic caused weakness in sectors with high employment potential, notably agriculture and manufacturing. It was estimated that the pandemic could push an additional 500,000 Tanzanians below the poverty line. Inequality is also likely to have widened further during the pandemic.

Outlook and risks

The economic outlook is positive, with real GDP projected to grow 4.1% in 2021 and 5.8% in 2022, due to improved performance of the tourism sector and the reopening of trade corridors. Energy and fuel price increases are expected to persist in 2021, raising overall inflation to 3.9% in 2021 and 3.4% in 2022. Spending on large infrastructure projects and depressed revenue performance are expected to widen the fiscal deficit to 3.2% of GDP in both 2021 and 2022, financed mainly by external borrowing. The current account deficit is projected to grow to 3.9% of GDP in 2021, due to the lingering effects of COVID–19 on merchandise exports and increased imports of capital goods for large infrastructure projects. It is expected to narrow to 3.3% of GDP in 2022. The major downside risks to the outlook include business regulatory bottlenecks that constrain private sector activity and uncertainties regarding the pandemic. Poverty and unemployment are expected to remain high due to depressed private sector activity.

Financing issues and options

Tanzania's total public debt stood at 39.2% of GDP in October 2020, with external debt accounting for 73.0% of the total. Domestic public debt increased slightly from 26.1% of the total in October 2019 to 27% in October 2020, partly because of increasing financing needs. Increased public spending requirements and a reduction in grants increased the financing needs from 1.8% of GDP in 2018 to 2.8% of GDP in 2020, and they are projected to further increase to 3.2% and 3.4% of GDP in 2021 and 2022 respectively. Large financing needs increased nonconcessional debt from 1.2% of GDP in 2018 to 1.7% of GDP in 2020, and it is projected to reach 2.0% of GDP in 2022. The risk of external public debt distress is low, but the pandemic is likely to increase vulnerabilities caused by reduced public revenues and decreased capacity for concessional borrowing. Maintaining debt sustainability will require keeping debt financing costs low, increasing exports, and improving domestic resource mobilization to substitute for expensive commercial debt. Furthermore, the government can benefit from innovative development financing mechanisms such as equity financing of public investments, creation of an asset class for public projects, and increased use of public-private partnerships. Gross reserves at $4.8 billion, or 5.6 months of imports in November 2020, were below the Southern African Development Community target of 6 months and are thus not expected to cover short-term financing needs.



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Uganda

Recent macroeconomic and financial developments

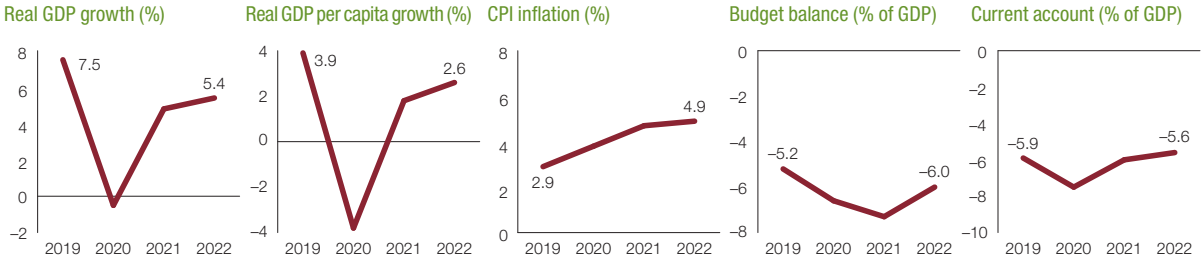
The COVID–19 pandemic and subsequent lockdowns to prevent the spread of the virus damaged Uganda's economy. Real GDP declined by 0.5% in 2020, after growing 7.5% in 2019. Tourism and hospitality were severely hurt by global travel restrictions and local containment measures. Other sectors that were adversely affected include manufacturing, retail and wholesale trade, and education. The Bank of Uganda reduced the policy rate in April to 8% and then in June to 7%, to provide stimulus to businesses. Nevertheless, the central bank kept inflation at 3.8%, well under the 5% medium-term target. The fiscal deficit widened to 6.6% in 2020 from 5.2% in 2019 as the government directed spending towards public health, including increased testing and cross-border surveillance of COVID–19. The government also provided support to business, but overall, the economy remained subdued, reducing tax revenues. Government borrowing increased to cover revenue shortfalls. The debt-to-GDP ratio rose to 40.8% in June 2020 from 35.9% a year earlier. The financial sector has come under increasing pressure as a result of the decline in economic activity. Nonperforming loans rose, and private sector credit slowed. Non-performing loans increased to 6.0% of gross loans in 2019–20 from 3.8% a year earlier. Between May and October, credit expansion grew 8%, compared with 15% between January 2018 and May 2019.

Outlook and risks

Uganda's economic outlook is challenging. However, a pickup in the global economy in 2021 could boost Uganda's exports, and if COVID–19 containment measures are less stringent, household consumption would recover. The rise in demand is already improving business activity, as evidenced by the rise in the Purchasing Managers Index to above 50, the threshold for improving business activity. Tourism will remain subdued, but manufacturing, construction, and retail and wholesale trade should rebound in 2021—though they are likely to remain below pre-COVID–19 levels. The budget deficit will remain elevated at 7.3% in 2021 but is projected to decline in the medium term, reaching 6.0% in 2022. The need for investment in infrastructure, including roads, power, and water, will continue to drive the deficit. The finance minister has indicated a potential funding gap of 1.6% of GDP in 2021. Key domestic risks stem from a flare-up in COVID–19 cases, low tax revenue mobilization, weak implementation of public investment, and a rise in uncertainty after the January 2021 elections. External risks include continued weakness in the global economy and a rise in regional insecurity.

Financing issues and options

Although debt levels have been rising since the multilateral debt cancellation in 2006, Uganda has prudently managed its debt, currently classified as low risk of debt distress. However, with the slowdown in the economy in 2020, the government increased its financing needs. Gross financing needs are projected to reach 11.4% of GDP ratio in 2021. The African Development Bank projects that the rising financing needs will drive the debt-to-GDP to 48.8% by June 2021 and to just above 50% in June 2023. These levels are sustainable but leave little room to accommodate adverse shocks. Relatively strong foreign reserves of 4.9 months of imports cover could be deployed to support short-term financing needs. A key concern is the rise in interest payments, 22% of domestic revenue in 2020–21, driven by an increase in nonconcessional borrowing. To maintain debt sustainability, Uganda must prioritize concessional financing, and limit nonconcessional financing to high-return projects. In the medium term, authorities will need to strengthen domestic resource mobilization and continue to improve the business environment to make the country attractive to foreign and local investors. If the economy does not provide the required upswing, the authorities should cut spending to reduce the primary deficit, estimated at 4.5% of GDP in 2021, to a sustainable level.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team. Data on the budget balance correspond to Uganda's fiscal year, which runs from July 1 to June 30.

NORTH AFRICA

Algeria

Recent macroeconomic and financial developments

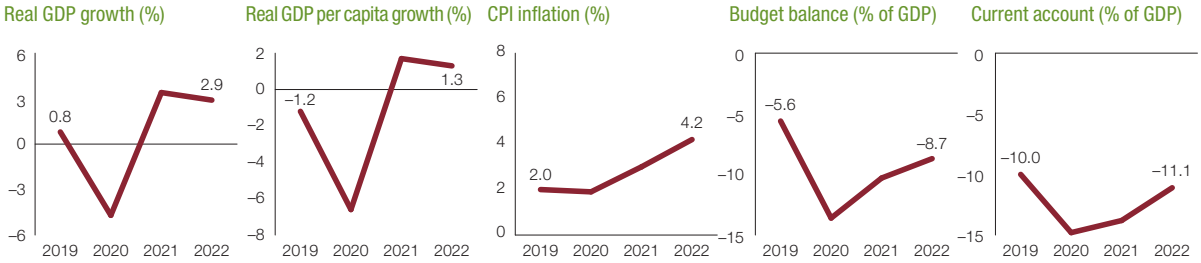
The COVID–19 pandemic had a strong effect on Algeria in 2020. In addition to the health toll, the pandemic added to other adverse developments, mainly the fall in oil prices, and plunged the Algerian economy into recession. Real GDP shrank by 4.7% in 2020, after growing a paltry 0.8% in 2019. The measures put in place to contain COVID–19 had serious consequences for the service and construction sectors, cut many jobs. The fall in revenues from oil and gas exports contributed to a further widening of the public and external deficits. The budget deficit more than doubled in 2020 to 13.6% of GDP from 5.6% in 2019 under the combined pressure of a drop in hydrocarbon revenues, which constitute a large share of public revenues, and high public spending to mitigate the economic effects of the health crisis. The current account deficit widened to 14.8% of GDP in 2020 from 10% in 2019 due to the country's heavy dependence on hydrocarbon exports and structurally high imports. As a result, the level of foreign exchange reserves has gradually declined, sufficient to cover only 12 months of imports at the end of 2020, compared with 13.6 months at the end of 2019. To provide banks with additional liquidity to finance the economy, the Bank of Algeria sharply lowered the reserve requirement ratio to 3% in September 2020 from 12% in February 2019. In 2020, inflation was 2.4%, compared with 2% in 2019. However, if the government resorts to monetary financing of the budget deficit, it could, over time, impede the monetary policy objective of limiting inflationary surges.

Outlook and risks

Growth could return as soon as 2021 if vaccines lead to global control of the pandemic, which would revive the global economy. In this scenario, a substantial rebound in real growth, estimated at 3.4% of GDP, would take place in 2021 and continue in 2022. A return to a high level of growth would allow a substantial reduction in the overall budget deficit to 10.3% of GDP in 2021 and 8.7% in 2022. The trend would be similar for the current account deficit, which would shrink to 13.8% in 2021 and 11.1% in 2022. However, Algeria should deepen the measures to widen the tax base initiated in the 2021 finance law and set up a program to diversify its economy with a view to limiting domestic public debt. Otherwise, the Algerian economy's heavy dependence on hydrocarbons will continue to hamper its medium-term development prospects.

Financing issues and options

Because authorities decided against borrowing externally, Algeria's public debt is essentially domestic. It has increased sharply since 2016 to finance a deficit born of rising spending and falling hydrocarbon prices. At the end of 2019, while the external public debt represented less than 1% of the GDP, domestic debt, including guarantees, was a little more than 46% of GDP and could further increase in the years ahead.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Egypt

Recent macroeconomic and financial developments

Egypt's economic growth has been strong and resilient since the economic reforms initiated in 2016. It is one of the few African countries expected to record a positive growth in 2020, at 3.6%, despite the adverse impact of the COVID–19 pandemic. The economy grew at a slower rate than in 2019 (5.6%) but did not enter a recession, thanks to high domestic consumption. The tourism sector—which accounts for about 5.5% of GDP and 9.5% of employment—was shut down from mid-March to 1 July 2020. Despite pandemic-related expenditures and revenue shortfalls, the fiscal balance excluding the cost of government debt is expected to remain positive, at 0.5% of GDP. This fiscal buffer, a consequence of the fiscal consolidation reforms, helped keep the overall deficit broadly unchanged at 8% of GDP in 2020—compared with a 7.9% deficit in 2019 that benefited from a primary surplus of 2%. Public debt was estimated to increase to 90.6% of GDP in 2020 from 86.6% in 2019, reversing three years of continuous decline. During the first half of 2020, exports dropped by 6%, while imports fell 21%, which helped narrow the current account deficit to 3.1% of GDP in 2020 from 3.6% the year before. The smaller current account deficit also reflected the strength of remittances, estimated at 8% of GDP in 2020.

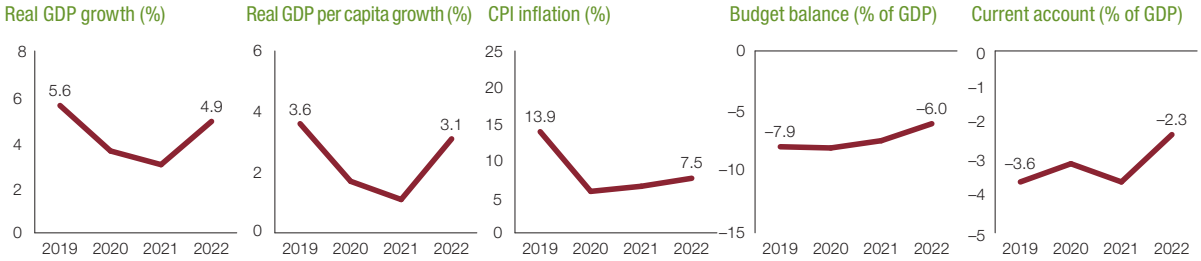
Following the move to a flexible exchange rate regime in 2016, Egypt experienced a period of double-digit inflation, but inflationary pressures have been trending downward since the summer of 2017. In 2020, price pressures were muted, especially on food products, and inflation declined to 5.7%, from 13.9% in 2019, which allowed monetary policy to be accommodative. To stimulate economic activity, the bank of Egypt cut the overnight lending rate by 300 basis points on 16 March 2020, another 50 basis points on 24 September, and to 9.25% on 12 November.

Outlook and risks

Real GDP growth is expected to slow to 3% in 2021 because of continued weakness in net exports, mainly tourism receipts. Tourism earnings, which totaled 25% of exports in 2019, are likely to have declined in 2020 due to the closure of international airports and restrictions on local travel. The outlook for tourism in the short term remains weak. Overall, exports, which decreased in 2020, should remain subdued in 2021 due to the weak external environment, especially in Europe, which accounts for 35.5% of Egypt's exports and is the main source of tourists. Similarly, private investment could remain subdued in 2021 but benefit from the improved investment climate over the medium term. Private consumption will remain the main growth driver. Egypt must maintain its reform momentum to dynamize the private sector and enhance inclusive growth. Monetary policy should remain accommodative in 2021, as inflation is expected to increase only moderately.

Financing issues and options

Liberalization of the capital account in 2016 attracted foreign investors to the domestic debt market. But the pandemic caused a significant reversal of capital flows, which put pressure on reserves and the current account. The pandemic also exacerbated Egypt's already large refinancing needs, with 60% of the country's public debt at a maturity of one year or less. To bridge the financing gap, Egypt accessed funding from COVID–19-related facilities. It received $8 billion from the International Monetary Fund ($2.8 billion from the coronavirus rapid financing initiative and $5.2 billion in a one-year stand-by arrangement). The African Development Bank provided $300 million, and the World Bank $450 million. On 21 May 2020, the country also tapped the international capital market, issuing a $5 billion bond, its largest issuance to date, that was largely oversubscribed. Credit facilities from international financial institutions and bond issuances boosted foreign exchange reserves to $40.06 billion at the end of 2020. External debt rose to 36% of GDP, but the new borrowing helped lengthen the average debt maturity. Total public debt is projected to increase to 90.6% of GDP in 2021 before steadily declining to 77.2% by 2025. Egypt must further lengthen the maturity of its debt and diversify its investor base to manage its refinancing risk and mitigate its rollover risk. Moreover, the country needs to continue implementing structural reforms to catalyze private sector development and enhance domestic resource mobilization.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team. Data in the figure correspond to Egypt's fiscal year, which runs from July 8 to July 7.

Libya

Recent macroeconomic and financial developments

Libya's real GDP was estimated to shrink by 60.3% in 2020 in the face of multiple shocks. The country experienced an intensification of the civil war, including a blockade of major oil fields from January to early October 2020, a decrease in oil prices that reduced income from already depressed oil production and the rapid spread of COVID–19, which further damaged the country's fragile economy and health system. The closure of the oil fields led to a sharp decline in exports that, coupled with low oil prices, resulted in an estimated $10 billion or more in lost revenues. Libya's fiscal and current account balances dramatically deteriorated in 2020 to deficits equivalent to 73.8% of GDP and 59.8% of GDP, respectively, wiping out the fiscal and current account surpluses recorded in 2019. Foreign exchange reserves also decreased, from $77 billion to $63 billion in June 2020, the lowest level since 2016 (equivalent to 58 months of imports).

The Central Bank of Libya decided to endorse a new exchange rate starting on 3 January 2021 to harmonize itself and the parallel market exchange rates. This implies a sharp depreciation of the Libyan dinar, from LYD 1.35 per US dollar to LYD 4.48 per dollar, which is expected to push up prices. The banking system, dominated by state-owned banks, has suffered recurrent liquidity crises since 2014 due to the loss of confidence in the formal system.

With a population of around 6.8 million—including 585,000 migrants and refugees and 400,000 internally displaced persons—and a political conflict that has divided the country into east and west, Libya finds it increasingly difficult to ensure a coordinated and inclusive developmental approach. Access to basic services is hindered by continuous fuel shortages, electricity, and water cuts, and a poor health system.

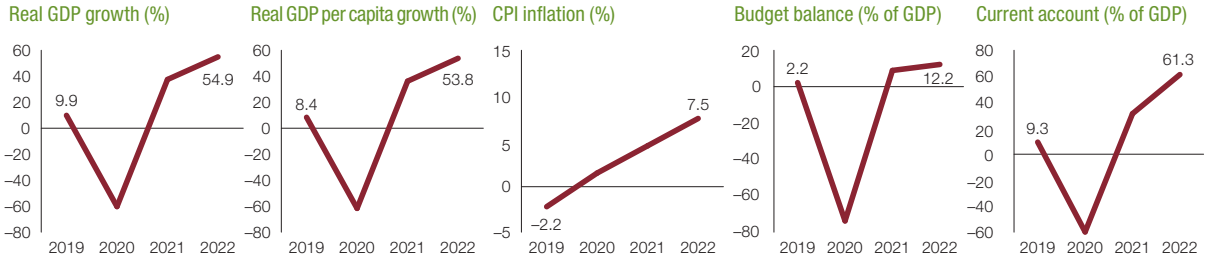
Outlook and risks

The political and security situation remain fragile and volatile, despite a ceasefire agreement in October 2020 between the warring factions. Without a significant improvement in the security situation, a sound economic recovery is difficult to achieve in the short to medium term. Despite the easing of the oil blockade, Libya remains vulnerable to low international prices and demand for oil, should the COVID–19 pandemic persist. In such an environment, foreign exchange reserves could decline further, and the domestic financing capacity of the country could be severely impaired.

However, Libya's economic prospects for 2021 are slightly more upbeat than in 2020, with the resumption of oil production in November 2020, and could mitigate the effect of low prices. The economy is projected to grow by 37.5% in 2021 and 54.9% a year later. Fiscal and current account balances are also expected to improve at 8.9% of GDP in 2021 and 31.2% of GDP in 2022, thanks to the projected increases in oil revenues and exports in 2021. Inflation is projected at 10.5% in 2021, due to the depreciation of the national currency and persistent supply constraints.

Financing issues and options

While Libya's external debt is among the lowest in the world, estimated at 5.8% of GDP in 2017, domestic debt has increased significantly over the recent years, reaching 155% of GDP in 2020. Historically, Libya had limited need for external borrowing, thanks to its abundant foreign earnings and reserves from hydrocarbons. However, the political and security crisis significantly reduced government revenue, and foreign direct investment (FDI) has not flowed into the country since 2014. Consequently, the stock of FDI has not changed since 2013, at $18.5 billion. The ministry of finance representing the government of national accord covers its financing needs borrowing from the Central Bank of Libya. However, continuous borrowing from the central bank combined with the depletion of foreign reserves, is not sustainable and carries potentially serious macroeconomic consequences. A strong debt management policy should be implemented to handle the recent increase of public domestic debt.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Mauritania

Recent macroeconomic and financial developments

The deterioration of the global economy in 2020 from the COVID–19 pandemic caused real GDP in Mauritania to contract by 3.6% in 2020, after growing 5.9% in 2019. The budget fell into a deficit of 4.1% of GDP in 2020, after being in surplus the year before, because of a significant drop in tax revenues during an economic slowdown, a decline in export revenues, the easing of taxes on some necessities, and a significant increase in health spending to fight COVID–19 infections. The slowdown in the world economy not only affected foreign trade but also foreign direct investment in Mauritania, which fell from a forecast $937 million to $594 million. The current account deficit reached a record 17.6% of GDP, due to a one-third drop in iron ore exports and a halt in exports of fishery products. Official foreign exchange reserves remained stable in 2020 at $1.135 billion, enough to cover 5.1 months of imports. Inflation, estimated at 2.7% in 2020, remained below the target of 4% set by the monetary authorities, but slightly higher than the 2.3% rate in 2019.

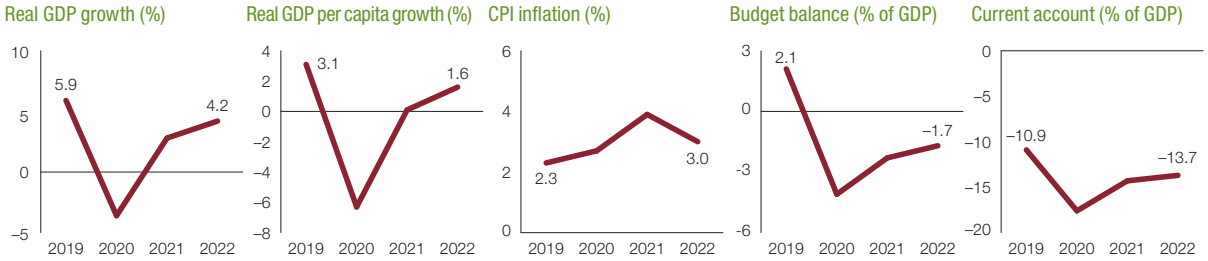
Outlook and risks

Growth is projected to return in 2021, assuming the global pandemic subsides and the global economy revives. That would mean a recovery in global demand for iron, which is Mauritania's main engine of growth. Real GDP is forecast to grow 2.8% in 2021 and 4.2% in 2022, underpinned by the resumption of public and private investment and structural reforms.

The public finance situation should gradually improve as economic activity resumes and emergency measures to fight the pandemic are lifted. The budget deficit should gradually decrease to around 2.3% of GDP in 2021 and 1.7% of GDP in 2022. The current account deficit should also narrow—to 14.3% of GDP in 2021 and 13.7% in 2022—because of an increase in exports. The development of the Grand Tortue/Ahmeyim (GTA) offshore gas field during 2021–22, which is projected to begin production in 2023, should also buoy the short-term economic outlook. However, this outlook could be undermined if the pandemic continues beyond the second half of 2021, if metal and oil prices fall, and if there are climate shocks.

Financing issues and options

A primary surplus of 3.5% of GDP in 2018 and 1.7% in 2019 made it possible to reduce Mauritanian public debt to 62% of GDP in 2019 from 65% in 2018. Debt solvency ratios also improved in 2019—for example, debt service fell to 14.1% of export revenue in 2019 from 17.4% in 2018. However, total public debt, almost exclusively external, remains high and vulnerable to external shocks. The debt includes arrears to Kuwait (estimated at 12.8% of GDP), which the authorities have tried to settle for several years. According to the debt sustainability analysis conducted by the International Monetary Fund, the risks of external and public debt distress are high in Mauritania. Public external debt as a percentage of GDP is expected to rise to 69% in 2020 and 70% in 2021, and to decline slightly to 68% in 2022—well above the 40% of GDP that is considered sustainable.



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Morocco

Recent macroeconomic and financial developments

The economy of Morocco has suffered dire consequences from the COVID–19 pandemic, experiencing its first recession in more than two decades in 2020. Real GDP declined by –5.9% in 2020, after growing 2.5% in 2019. The economy also is vulnerable to poor rainfall, so on top of damage from a strict three-month lockdown to contain the spread of COVID–19, a drought also hurt rural incomes, which further reduced domestic demand. Unemployment rose to 12.7% at the end of September 2020 from 9.2% at the end of 2019.

The disruptions of global value chains and the sudden slowdown in Morocco's main trading partners (Spain, France, Italy, and Germany) also reduced demand for exports, which fell by 10.1% over the first 10 months of 2020. During the same period, lower domestic production and consumer demand reduced imports by 16.6%. However, remittances increased by 1.7% over the first ten months of 2020. Nevertheless, the current account deficit was expected to widen to 7.6% in 2020 from 4.1% in 2019, mainly due to lower tourism receipts. Tourist arrivals dropped by 78% through September 2020. Lower tourism earnings, coupled with subdued domestic demand, reduced tax revenues at the same time the government incurred high pandemic-related expenditures. The fiscal deficit nearly doubled, reaching about 8% of GDP in 2020, from 4.1% in 2019. The need to finance the deficit increased borrowing, pushing government debt to 76.9% of GDP in 2020 from 65.8 % in 2019. Public debt was already high prior to the pandemic, mainly as a result of borrowing to finance government's ambitious infrastructure investment program over the past decade.

Inflation is expected to remain low. On 9 March 2020, Moroccan authorities widened the fluctuation band of the dirham to increase the ability of the economy to absorb external shocks and improve competitiveness. The Bank Al-Maghrib has hardly intervened in the foreign exchange market despite decreasing its benchmark interest rate by 25 basis points in March 2020 and by another 50 basis points to 1.5% in June 2020.

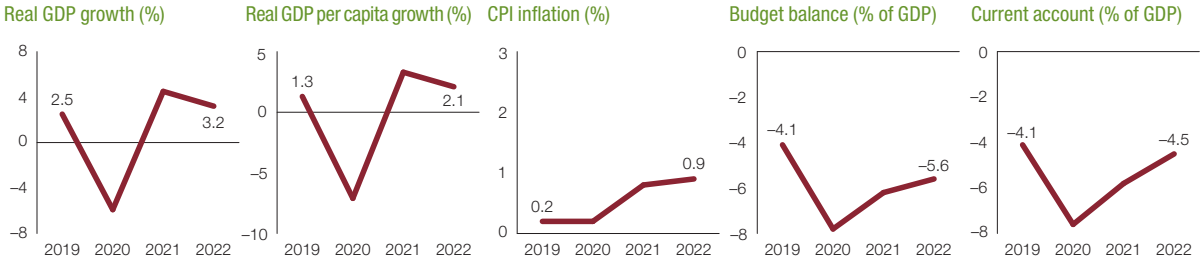
Over the past decade, Morocco improved by more than 50 places its position in the World Bank's Doing Business ranking. In 2020, Morocco ranked 53rd of 190 countries.

Outlook and risks

Real GDP growth is projected to rebound to 4.5% in 2021 as the economy recovers from a severe contraction and agriculture thrives. During the third quarter of 2020, exports of automotive parts and phosphate and derivatives rebounded and are expected to strengthen more in the near term as global demand improves. This is likely to offset any continued weakness in the tourism, hotels, and restaurants sector. Consequently, the current account and fiscal deficit are expected to narrow, while inflationary pressure should remain subdued. Still, the country battles significant social and regional development disparities as well as youth unemployment. Rethinking the development model to enhance inclusive growth is the mission of a special commission named by the king.

Financing issues and options

Morocco has rapidly accessed emergency funding from donors, including $3 billion from the International Monetary Fund and $460 million from the African Development Bank to mitigate impact of the pandemic. In September 2020, Morocco also issued a 1 billion Euro bond. These inflows bolstered foreign exchange reserves, which are sufficient to cover around 8.1 months of imports and three times the debt due in the short term. In 2019, the total debt of the treasury was MAD 650 billion (about $73.1 billion) and the public external debt was MAD 346 billion (about $39 billion). General government debt carries a maturity of more than six years, and more than half of Morocco's external debt is owed to multilateral institutions. Consequently, the refinancing risk of the kingdom is minimal, and starting in 2021, the debt-to-GDP ratio is expected to decline steadily, reaching 70% by 2025.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Tunisia

Recent macroeconomic and financial developments

COVID–19 has infected many Tunisians and severely damaged the economy in this North African nation, which is heavily dependent on Europe. Real GDP contracted by 8.8% in 2020, after growing 1% the year before, due to the general decline in economic activity and the hardening of financing conditions designed to fight inflation. Production fell in all sectors except agriculture and fishing. The service sector (including tourism), which traditionally drives growth, has been hit hard by the consequences of the pandemic. But the biggest shock from the pandemic was a sharp drop in investment and exports. Inflation, however, declined in 2020 to 5.9%, from 6.7% the year before, because of a slowdown in domestic demand and a sharp drop in energy prices. The budget deficit grew to 13.1% of GDP, compared with 3.5% the year before because of a strong increase in spending to deal with the pandemic while at the same time revenues fell. The pandemic-related revenue decline put an end to a fiscal consolidation effort under a 2018 program with the International Monetary Fund. After being in deficit by 8.5% of GDP in 2019, the current account stabilized at a deficit of 8.1% of GDP in 2020, due to a sharp drop in imports and remittances.

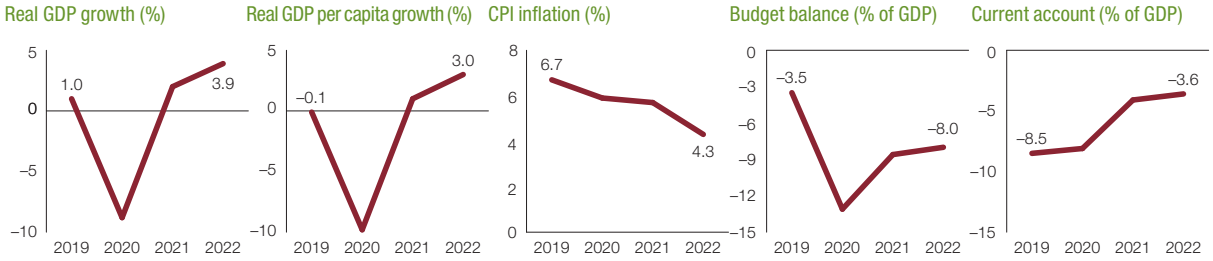
Outlook and risks

Tunisia's real GDP should rebound and grow 2% in 2021 and 3.9% in 2022, if the pandemic recedes and allows a restart of the global economy, especially in Europe, upon which Tunisia relies heavily. Inflation is expected to continue to decline over the medium term to around to 5.7% in 2021 and 4.3% in 2022, due to prudent monetary policy. The budget deficit is expected to improve to 8.6% of GDP in 2021 and 8% in 2022.

The current account deficit is also expected to narrow over the medium term to 4.1% in 2021 and 3.6% in 2022 as the recovery continues. The major risks to this scenario are a third wave of the pandemic, political instability at the national and regional level, an increase in popular protests against social conditions, insufficient access of companies to financial resources, and a slower-than-expected recovery of European economies on which Tunisian exports depend heavily.

Financing issues and options

The Tunisian public debt, 70% of which is external, will reach 90% of GDP in 2020, continuing the worrisome upward trend that began in 2011, when it was about half as big. Tunisia is vulnerable to exogenous shocks, mainly to currency risk because of the high concentration of external debt. The cost of servicing the debt absorbs around 28% of the budget, at the expense of development spending necessary to improve Tunisia's long-term competitiveness. The financial difficulties of public establishments and enterprises is another area of concern. At the end of 2019, the debt of public enterprises represented 13% of GDP. However, the recent external debt sustainability analysis conducted by the IMF concluded that Tunisia's debt is sustainable because a large portion of it is concessional and the portfolio has relatively long maturities.



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SOUTHERN AFRICA

Angola

Recent macroeconomic and financial developments

Angola's oil-driven economy has been in recession since 2016, leading to an increase in its debt-to-GDP ratio from 57.1% in 2015 to an estimated 120.3% in 2020. To promote macroeconomic stability, private investment, and a more diversified economy, major reforms were introduced over the past two years—including a value-added tax, a fiscal responsibility law, a liberalization of the exchange rate regime, and a private investment and privatization law. However, the COVID–19 pandemic has unwound some gains from these measures. Real GDP was estimated to contract by 4.5% in 2020, compared with pre-COVID–19 estimates for 2020 that indicated the end of a long recession with 1.2 GDP growth. Reduced oil exports, Angola's main revenue source that accounts for about 95% of the country's exports, caused the fiscal deficit to widen to an estimated 4.5% of GDP. Lower oil export earnings will increase the current account deficit to an estimated 2.1% of GDP from a surplus of 6% in 2019. Inflation, estimated at 24.6% in 2020, was driven by a cumulated 36% devaluation of the currency through mid-December.

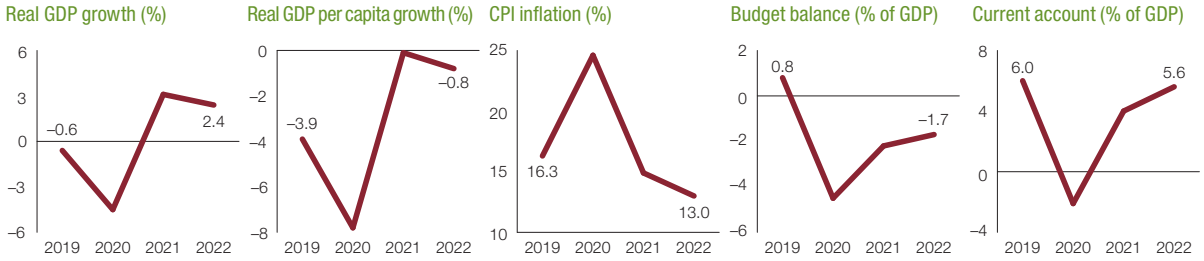
The pandemic sped efforts to implement the country's first cash-transfer program, KWENDA, which aims to reach 1.6 million poor families. However, lower oil revenues hampered the government's capacity to fully protect livelihoods from the effects of the pandemic. As a result, the socioeconomic situation worsened. The unemployment rate rose to 34.0% in the third quarter of 2020 compared with 30% a year before, with youth unemployment rising to a high of 56.4% from 54.2% in the third quarter 2019. The pandemic is expected to exacerbate the 2019 official poverty incidence of 40.6%.

Outlook and risks

The change to a flexible exchange rate regime in 2019 helped mitigate the impact of lower oil prices on international reserves. The major prepandemic reforms might contribute to a V-shaped recovery in 2021; GDP is projected to grow 3.1%, assuming the private nonoil sector performs better. In addition, the recovery in the Brent oil price from about $30 per barrel in March 2020 to more than $50.40 per barrel in mid-December 2020 will increase fiscal revenues. Inflation was estimated to drop to 14.9% in 2021 following the monetary easing needed during the crisis, which also put pressure on inflation. The major risk associated with the Angolan economy is low oil prices in 2021; however, if the oil price recovery persists, the budget deficit could narrow to 2.2% of GDP, and the current account could return to a surplus position of 4.0% of GDP in 2021.

Financing issues and options

The recent exchange rate depreciation was the main contributor to changes in Angola's public debt, about 80% of which is denominated in foreign currencies. However, the major macroeconomic reforms implemented before the COVID–19 pandemic increased the resilience of the country to external shocks and, as a result, the International Monetary Fund, after the reprofiling of interest and principal payments under the G-20 Debt Service Suspension Initiative, considers that the debt is sustainable.



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Botswana

Recent macroeconomic and financial developments

Botswana's economy contracted by an estimated 8.9% in 2020, after growing by 3.0% in 2019, as the COVID–19 lockdown and other movement restrictions constrained economic activity. On the supply side, mining output declined significantly, mainly due to falling global demand for diamonds. Nonmining output also shrank, from both the pandemic-induced domestic restrictions and weaker global markets. The subsectors most affected were trade, construction, manufacturing, hotels and restaurants, and transport. Subdued aggregate demand also hurt investment and consumption.

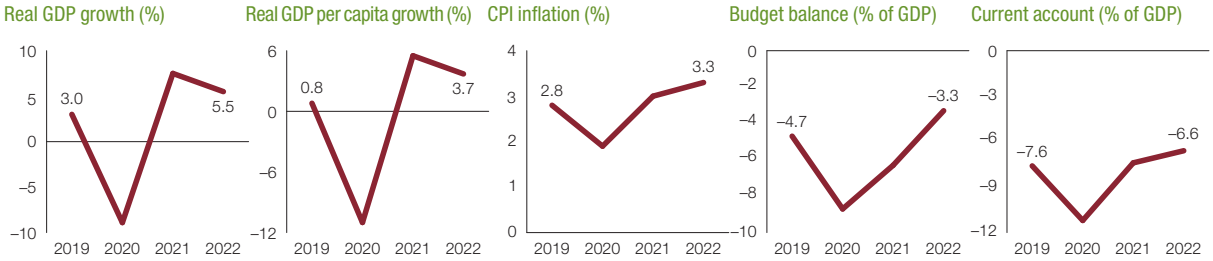
Monetary policy was accommodative to support growth, taking advantage of the prevailing low inflation. Lower demand and fuel prices contributed to a reduction in the annual inflation rate from 2.8% in 2019 to 1.9% in 2020, below the Bank of Botswana's target range of 3%–6%. The central bank reduced its policy rate to 3.75% in October 2020, after maintaining it at 4.25% from April to September 2020 and at 4.75% from September 2019 to March 2020. The fiscal deficit was estimated to widen to 8.7% of GDP in 2020 from 4.2% in 2019, as COVID–19-related spending rose and tax revenues fell due to reduced economic activity and imports. The deficit is being financed through domestic and external borrowing and a drawdown in reserves. Botswana's public debt, estimated at 17% of GDP in 2020, is low and sustainable. The current account deficit widened to 11.2% of GDP in 2020 from 7.6% in 2019, mainly because of the fall in diamond prices and reduced Southern African Customs Union (SACU) revenues. International reserves declined to a still relatively high $5.3 billion at the end of November 2020 (enough to cover 10.9 months of imports), from $6.2 billion in December 2019.

Outlook and risks

Real GDP growth is projected to recover to 7.5% in 2021 and 5.5% in 2022, based on a revival in domestic demand as the effects of the pandemic recede and a rebound in commodity prices as economies reopen globally. Upside risks to the growth outlook hinge on the steadfast implementation of business environment reforms and government interventions against COVID–19, including the Economic Recovery and Transformation Plan (ERTP). Downside risks include lower diamond demand if the global economic recovery is weakened by renewed waves of infection. There are also threats from persistent drought and the adverse effects of poor economic conditions in South Africa on Botswana's exports and SACU receipts. The fiscal deficit is projected to narrow to 6.3% of GDP in 2021 as domestic revenues pick up. The current account deficit could improve to 7.4% of GDP in 2021, depending on how fast the diamond and tourism industries revive. Inflation is expected to be within the central bank's medium term 3%–6% target range, but could be higher if the recovery in global commodity prices is faster than anticipated and the constraints on aggregate supply are sustained by the potential reinstatement of worldwide lockdowns. Reverting to this form of extreme social distancing could dampen economic activity and aggregate demand and keep inflation lower than projected. Growth prospects continue to be clouded by Botswana's relatively high poverty, unemployment, and inequality, particularly among youth and female-led households, both likely to be disproportionately affected by the pandemic.

Financing issues and options

The estimated cost of the ERTP is $1.3 billion (7.6% of GDP) over two and a half years. Because of its low debt levels, Botswana can fund the plan from both domestic and foreign sources. On the domestic side, the government has increased its bond issuances by 50%. Other options include increasing domestic revenue mobilization and reprioritizing public expenditure. The government also has the fiscal space to borrow externally.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team. The fiscal years start in the named April and conclude the end of March in the following year.

Lesotho

Recent macroeconomic and financial developments

The Lesotho economy was estimated to contract by 5.2% in 2020 from modest growth of 0.6% in 2019. This reflects measures to mitigate the COVID–19 pandemic and low external demand, which adversely impacted the mining and manufacturing industries. Estimates of growth in the mining industry (textiles and clothing, construction) and services were revised downwards by 34.5, 29.3 and 9.9, and 4.2 percentage points in 2020, respectively.

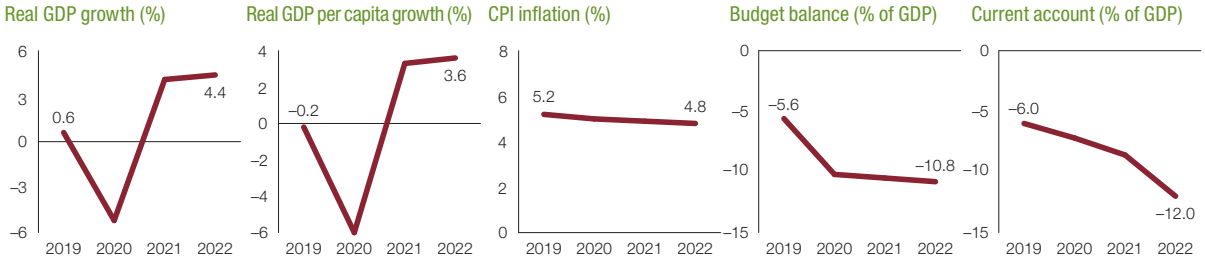
Lesotho's economy is closely linked to South Africa's with imports from South Africa, mainly foodstuffs, constituting about 80% of its total imports. The decline in imports from South Africa contributed to food shortages in Lesotho, fueling inflationary pressures. Hence, inflation was estimated to decline only marginally, to 5.0 % in 2020 from 5.2 % in 2019. The fiscal deficit was estimated to widen to 10.2% of GDP in 2020 from 5.6% in 2019, largely driven by a 25 % increase in government expenditures mainly on the wage bill and government spending on health care to fight the pandemic. Much of the financing gap is expected to be met through foreign borrowing unless the government undertakes substantial fiscal adjustments to curb the widening fiscal deficit and the associated accumulation of foreign debt, which could threaten debt sustainability. External debt stood at 36.1% of GDP in 2020, well below the convergence criterion of 60% of GDP set by the South African Development Community (SADC). The decline in exports to both South Africa and the United States and reduced investments from China and South Africa, coupled with dwindling incomes and transfers, led to a deterioration in the current account, deficit from 6.0% of GDP in 2019 to 7.2% in 2020. The widening current account deficit also reflected a 26.6% decline in diamond exports and a 21.2 % decline in textile exports. It will be financed by a drawdown in foreign reserves. The banking sector remains stable with non-performing loans declining marginally from 3.2% in 2019 before increasing to 4% in the second quarter of 2020.

Outlook and risks

Lesotho's growth trajectory and recovery are highly dependent on the path of the pandemic in South Africa given the close economic ties between the two countries. The economy is projected to grow by 4.1% in 2021 and 4.4% in 2022, owing to mining and construction associated with the second phase of Lesotho Highlands Water Project. Inflation is projected to decline further to 4.9% in 2021 and 4.8% in 2022, owing to subdued demand arising from the second wave of the pandemic in neighboring South Africa, the main trading partner. The fiscal deficit is projected to remain elevated at more than 10.0% of GDP in the medium term, owing to massive health-related spending if the crisis continues in 2021 and the revenue allocation from the Southern African Customs Union declines due to weak economic activity in the region. The current account deficit is projected to deteriorate further to 8.6% in 2021 and 12% in 2020, reflecting low external demand and dwindling incomes and transfers from migrants in South Africa.

Financing issues and options

Total public debt is projected to increase to 62.8% of GDP in 2021 due to the pandemic, breaching the SADC convergence criterion of 60% of GDP. Lesotho's risk of external debt distress has, therefore, been revised from low in 2019 to moderate. Going forward, Lesotho needs capacity strengthening for domestic resource mobilization, drawing down reserves, renegotiating debt, attracting concessionary financing, deploying remittances for infrastructural development, and fiscal consolidation to reduce the wage bill from its current level of 24% of GDP (three times the average for sub-Saharan Africa). The textile industry needs to source inputs from alternative countries to alleviate overdependence on China.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team. Data on the budget balance correspond to Lesotho's fiscal year, which runs from April 1 to March 31.

Madagascar

Recent macroeconomic and financial developments

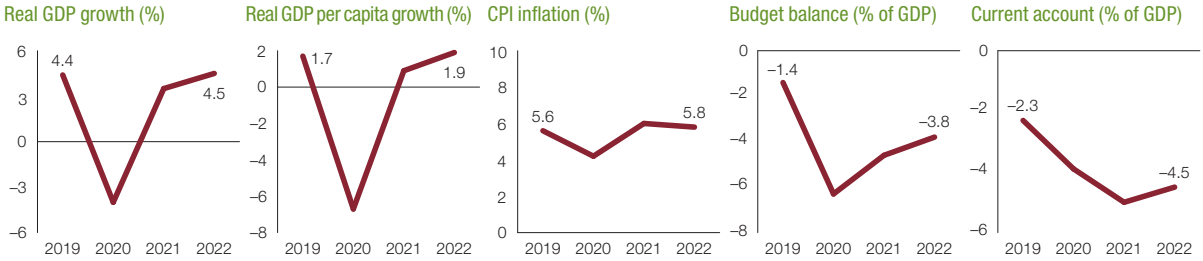
The COVID–19 pandemic put a brake on Madagascar's four years of economic growth. After real GDP growth of 4.4% in 2019, the country went into a recession in 2020, with real GDP declining 4%. Manufacturing, mining, and services were hardest hit because of containment measures, while agriculture performed well. The crisis also put pressure on the financial sector, prompting the central bank to inject liquidity into the system. But prices were contained. Inflation was 4.2% in 2020, compared with 5.6% in 2019. The current account deficit deteriorated to 3.5% of GDP in 2020, compared with 2.3% in 2019, because of a drop in exports, an abrupt halt in tourism, and a decline in foreign direct investment. The pandemic hurt public finance. Tax revenues fell, while spending increased significantly as the government took steps to mitigate the COVID–19 crisis. As a result, the budget deficit deteriorated to 6.3% of GDP in 2020 from 1.4% in 2019.

Outlook and risks

If the pandemic subsides during the first half of 2021, the outlook is favorable for a return to growth, with real GDP projected to grow 3.5% in 2021 and 4.5% in 2022. But the impact of the crisis will continue to be felt in public finances in 2021. The financing needed for economic recovery was estimated at $820 million in 2021, resulting in a budget deficit of 4.6% of GDP in 2021, which would narrow to 3.8% in 2022. On the demand side, the recovery should be supported by a rebound in both public and private investment and a resumption of exports—nickel, cobalt, and vanilla—as the global economy and international trade recover. However, the current account deficit is expected to remain high at 5% of GDP in 2021 and 4.5% in 2022. Job losses estimated at 27% in the formal sector are expected to gradually decline in 2021 as the economy recovers. The main risks to the outlook are a new wave of COVID–19 infections and weather shocks, such as drought, cyclones, and floods.

Financing issues and options

Debt sustainability indicators worsened in 2020 because of the COVID 19 crisis. The debt-to-GDP ratio deteriorated to 44.8% in 2020 from 38.7% in 2019. In 2020, public debt was mainly external. Madagascar owed foreign creditors an amount equivalent to 32.6% of GDP, while domestic debt was 12.2% of GDP. Slightly more than three-quarters of the foreign debt was owed to multilateral institutions, 19% was bilateral, and about 5% was commercial. Domestic debt was mostly in treasury bills. With a low ratio of tax revenues to GDP, Madagascar may need to focus on increased mobilization of public revenues to support the financing of economic recovery and to preserve the long-term sustainability of its debt.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Malawi

Recent macroeconomic and financial developments

Growth in Malawi's economy decelerated in 2020 to 1.7% from 5.7 % in 2019. The slowdown in GDP growth was driven by the outbreak of COVID–19, which necessitated a partial lockdown of the economy, resulting in subdued economic activities—mainly in tourism, the accommodation and food subsectors, transportation, and agriculture. Other sectors affected by disruptions from the COVID–19 pandemic disruptions were manufacturing and mining and quarrying. Weak global demand hurt Malawi's tobacco and other agricultural exports, and inflows of foreign direct investment (FDI). The fiscal deficit was an estimated 7.7% in 2020, a deterioration from 4.7% deficit in the previous year. The deterioration was driven by $345 million in spending to respond to the pandemic, interest payments amounting to 5.3% of GDP, and a rerun of the 2019 presidential election. The fiscal deficit pushed the debt-to-GDP ratio to 65% in June 2020 from 62% in 2019 and was financed by borrowing and budget support.

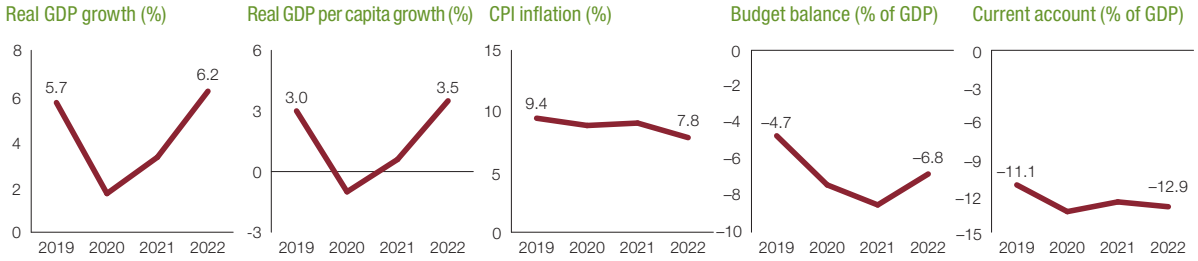
Monetary policy was accommodative to support recovery from the pandemic. The policy rate was reduced to 12% by November 2020 from 16% at the start of the year. Although the foreign exchange market experienced some pressures caused by COVID–19, average annual inflation decreased to 8.8% in 2020 from 9.4% in 2019, mainly because of reduced fuel prices implemented as part of COVID–19 response measures. The current account deficit worsened to 13.3% of GDP ($1.64 billion) in 2020 because of a decline in exports, tourism receipts, and investment inflows. International reserves stood at 3.1 months of imports in 2020, supported mainly by budget support receipts. The financial sector remained stable and capitalized, with the ratio of non-performing loans improving marginally to 5.4% in June 2020 from 5.6% in December 2019. Private sector credit growth declined to about 16.9% in October 2020 from 17.7% a year earlier.

Outlook and risks

Real GDP growth is projected to grow at 3.3% in 2021 and 6.2% in 2022. The prospect for a recovery to the prepandemic level is not expected until 2022, mainly because of the uncertain effect of COVID–19 infections. The projected growth will be driven by recovery in the tourism and agriculture sectors, exports, FDI, and public investments in infrastructure (airport, roads, energy). The downside risks to the projected recovery relate to a potential second wave of COVID–19 infections, bad weather, and fiscal overruns due to revenue underperformance. The fiscal deficit is projected to widen to 10.2% in 2021, raising the debt-to-GDP ratio to 66% in 2021. The current account deficit is forecast to narrow to 12.5% of GDP in 2021 as exports rebound, then tick up to 12.9% in 2022. A rebound in domestic economic activity and a projected increase in oil prices may have pushed inflation from 8.8% in 2019 to an estimated 9% in 2020, but improved food production should help bring it down to 7.8% in 2022.

Financing issues and options

Traditionally, the domestic debt market has covered government financing needs. Since 2012, Malawi has experienced frequent weather-related shocks, including cyclone Idai in 2019, and the COVID–19 pandemic, resulting in persistent fiscal imbalances and elevated public debt levels. The emerging financing gap of $243 million (2.9% of GDP) in October 2020, combined with the COVID–19 financing needs of 3.9% of GDP, will be financed from external sources, domestic debt, and official reserves—also projected to improve to 3.3 months of imports in 2021 from 3.1 months of imports in 2020. The government is prioritizing fiscal consolidation, including strengthening domestic resource mobilization through the 2017–22 public financial management reforms program.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team. Data on the budget balance correspond to Malawi's fiscal year, which runs from July 1 to June 30.

Mauritius

Recent macroeconomic and financial developments

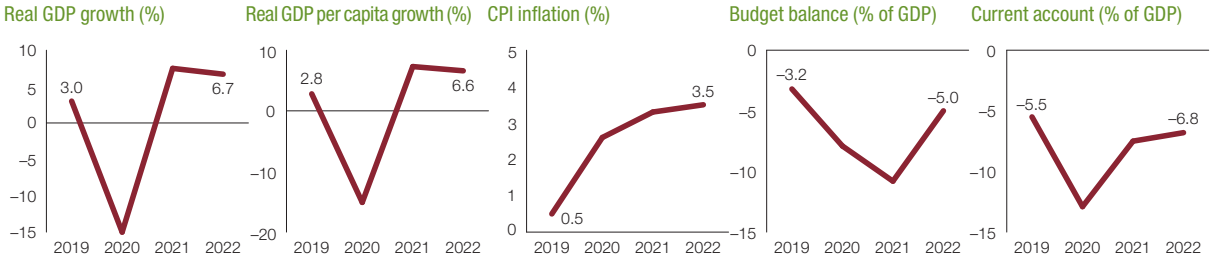
Drastic and fast action by the government of Mauritius to lock down and isolate the island allowed the country to record only 315 cases and 10 deaths from COVID–19 between January and December 2020. But the protocol that allowed the island nation to escape the worst of the pandemic entailed a very high cost for the economy. In just one year, Mauritius lost 18 percentage points of growth. Real GDP was estimated to contract by 15% in 2020, against positive real GDP growth of 3% in 2019. The tourism and hospitality industry, which traditionally contribute around 24% of GDP and account for 22% of employment with significant spillover effects on the whole economy (transport, agriculture, wholesale and retail trade, and administrative and support services), incurred an estimated 75% loss in value added. At the same time exports of seafood, textiles and apparel, and sugar were hurt by disruptions in global demand. Only the information and telecommunication sector grew, supported by heavy use of technological and teleworking services during the lockdown. The financial services sector also registered a positive growth of 1.1%. An increase of 53% in public expenditure targeted at social and economic safety nets, coupled with lower tax receipts because of the economic downturn, led to a more than doubling of the fiscal deficit to about 8% from 3.2% in 2019. The current account deficit widened to 12.9% due to the decline in export and tourist receipts. Inflation more than tripled, to 2.5% in 2020 from the prepandemic low of 0.5%. Inflation was fueled by increase in prices of imported products and the depreciation of the rupee. As a result of the economic downturn, unemployment doubled in the third quarter of 2020 to 10.9% from 6.7% a year earlier. Poverty remained contained because the government decided to increase the level of existing social protection schemes, with priority given to the most vulnerable segments of the population.

Outlook and risks

The medium-term outlook is for a strong recovery with real GDP growth projected to average 7.1% over the next two years. Still, the fiscal deficit is projected to widen to 10.8% of GDP in 2021, fueled by high public investment and continued support to businesses and jobs. The deficit will narrow in 2022 to 5.0%, with economic recovery supporting growth in tax revenues. The current account deficit is projected to improve starting in 2021 because of improvement in the trade balance and a gradual recovery in tourist receipts as air links resume between Mauritius and Europe, the main source of tourists. Inflation is projected to rise, averaging 3.4% over the medium-term as domestic demand increases. economy. The main risk to the outlook stems from a potential second or a third wave of COVID–19 in key tourism markets.

Financing issues and options

Mauritius' public debt trajectory raises concerns. After a substantial decrease in public debt to 48.6% of GDP in 2013 from 63.7% in 2008, Parliament established a statutory debt limit of 60% of GDP through the Public Debt Management Act. However, staying below that level has proved challenging. Domestic debt represents 88% of the country's public debt and is mainly held in government bonds by the banking sector. Public external debt (12%) is limited to multilateral creditors on concessional terms with long maturities. The high concentration of domestic public debt ensures some protection against foreign exchange risk. Over the short to medium-term, the pandemic could worsen Mauritius' public debt profile due to elevated spending. Public debt is projected to be 76.1% in 2021, against 64.6% in 2020. To achieve the statutory public-sector debt target of 60% of GDP would require a significant fiscal consolidation and improvement in revenues. Despite signs of deterioration, public debt remains sustainable, and the debt service moderate (9% of budget in 2020/2021). Debt restructuring may not be an option for the government in the short term. Projected growth recovery in the next two years will allow containing debt at levels compatible with sound economic development.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Mozambique

Recent macroeconomic and financial developments

The onset of the COVID–19 pandemic caused a sudden stop to Mozambique's good economic performance. Real GDP contracted by an estimated 0.5% in 2020, the first decline in 28 years, after growing 2.2% in 2019. A slowdown in construction, tourism, and transport, and a decrease in demand for commodities exports were the main drivers of the deceleration. Economic activity was also hurt by the escalating conflict in the northern province of Cabo Delgado, which has displaced more than 250,000 people and resulted in more than a thousand deaths. The economic contraction was expected to drag 850,000 people below the international poverty line in 2020, an increase of 1.2 percentage points to 63.7% of the population, according to the World Bank, while GDP per capita was expected to contract by –3.4% in 2020.

Despite negative growth, a slight increase in inflation was expected for 2020, from 2.8% in 2019 to 3.1%, pushed by a 21.7% depreciation of the metical against the US dollar. The Monetary Policy Committee reduced the policy interest rate by 250 basis points from March through August, to 10.25%, to ensure liquidity and minimize potential credit crunches in the private sector. Nevertheless, non-performing loans, which were already high at 10.2% in 2019, increased to 12.6% in June 2020 as businesses struggled to meet their obligations.

Both the fiscal and external balance deteriorated. The fiscal deficit was estimated to reach 7.0% of GDP in 2020, larger than the 2.7% deficit in 2019, pushed by lower revenues from tax relief and the economic slowdown and increasing public debt, which already was high at 108.4% of GDP in 2019. The current account deficit was estimated to widen to 30.8% of GDP in 2020 from 19.9% in 2019, mainly because of lower export earnings. International reserves remained at 7 months coverage of imports until November 2020, excluding megaprojects, the same as in December 2019.

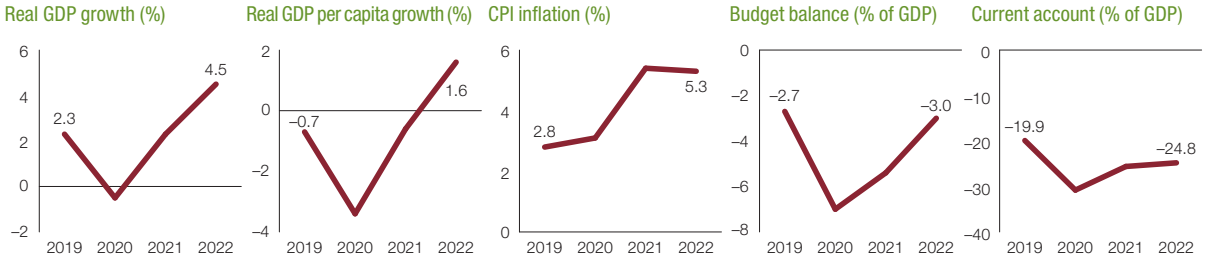
Outlook and risks

Growth prospects are more positive for the medium-term, with GDP expected to grow by 2.3% in 2021 and 4.5% in 2022, when it will surpass the prepandemic level on the back of gas investments. Inflation is expected to average 5.3% during 2021–22, pushed mostly by domestic demand during an economic recovery. Higher domestic growth and international demand for commodities are expected to generate more tax revenues and support resumption of the fiscal consolidation process. The budget deficit will narrow to 5.4% in 2021 and to 3.0% in 2022. The current account deficit will fall to 25.6% in 2021 but will remain elevated at 24.8% in 2022, above the prepandemic level of about 20%. Poverty would fall to 63.1%.

The main risks to such a recovery are climate shocks, low commodity prices, and increasing military disturbances in the center and north of the country—which could increase military expenditures, disrupt regional commerce, and limit creating local content and jobs associated with the megaprojects value chain.

Financing issues and options

The already constrained national budget and the high levels of public debt offer limited fiscal space to stimulate private sector–led growth and leverage social programs to increase the coverage of vulnerable groups to minimize the short and medium term impacts of the pandemic. To open room for such policies, the country should pursue financing options backed by donors' grants or highly concessional loans to reduce the impact on the budget during the crisis, while allowing for the resumption of fiscal consolidation in the medium term. Debt service reductions from the G20 debt moratorium should be used to offset the loss in tax revenues. In the medium-term, the country should explore fiscal and tax policies to stimulate the domestic nonextractive sector to foster job creation and reduce the economy's vulnerability to commodity shocks.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Namibia

Recent macroeconomic and financial developments

The COVID–19 pandemic hit Namibia's economy hard —it is expected to shrink by 7.9% in 2020 because of declines in tourism, retail, trade and investments, health, and education. That followed poor performances in previous years; the economy contracted in 2019 and 2017 and registered anemic growth in 2018 because of poor performance in construction and mining, persistent drought, and weakening demand for Namibian exports.

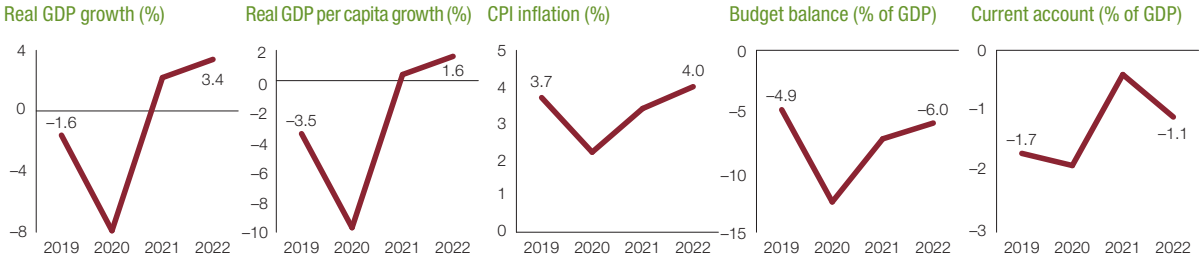
The Bank of Namibia has maintained an accommodative policy stance to support a revival of the domestic economy. It reduced the policy rate by a cumulative 275 basis points to 3.75% in 2020.Inflation was on a downward trend during the 2016–20 period, reflecting steady decline in housing prices and transport costs. The fiscal deficit was estimated to widen to 12.5% of GDP in 2020 from 4.9% in 2019, due to a surge in pandemic-related spending and lower revenues. The increased expenditure in 2020 and subsequent fiscal deficit will require large public debt financing, with the public debt-to-GDP expected to rise substantially in financial years 2020/21 and 2021/22. The current account deficit narrowed from 3.4% of GDP in 2018 to 1.7% of GDP in 2019, before widening slightly to 1.9% of GDP by the end of 2020. The country's reserves could cover 4.5 months of imports as at mid-2020, compared with 3.9 months in 2019, and are expected to remain at that level in the short to medium term.

Outlook and risks

The economy is projected to grow by 2.6% in 2021 and 3.3% in 2022, on the back of a steady recovery in financial services, tourism, retail and wholesale trade, and the mining industries—combined with an improvement in the regional and global economic environment. But the economy still faces substantial risks and challenges in the short to medium term. For instance, if the pandemic continues, the revival of critical sectors such as tourism, agriculture, and retail and wholesale trade would be slower than anticipated. Furthermore, sluggish global economic growth would hold down exports and foreign direct investment inflows. The fiscal deficit and public debt levels are expected to remain elevated as the government implements its ambitious economic recovery program of NAD 8.1 billion ($0.5 billion), and limits the fiscal space needed for infrastructure and human capital investment. Inflationary pressures are expected to rise in 2021 and 2022 with anticipated increases in prices of housing, utilities, and food and nonalcoholic beverages, coupled with a steady depreciation of the Namibian dollar, which fell by 7% against the US dollar during 2020. Furthermore, the negative net exports will continue to weigh on aggregate demand despite the anticipated narrowing of the current account deficit in 2021. Other factors that risk eroding Namibia's economic outlook include high unemployment levels and widening income inequality, which have been exacerbated by the pandemic.

Financing issues and options

The fiscal deficit is likely to be largely financed by local debt issuance in the medium term. This will push total public debt to 67.5% of GDP in 2020 and 68.4% in 2021, up from 58.4% in 2019. Domestic debt and guarantees already account for approximately 72% of total debt. Namibia's highly liquid financial sector provides a large resource pool, particularly through pension funds and insurance companies, whose assets amount to the equivalent of 120% of GDP. The financial sector has the potential to develop long-term innovative financing instruments to fund national development projects and programs. The government established dollar- and South African rand-denominated sinking funds, with proceeds initially set aside to fund the redemption of eurobonds maturing in 2021 and 2025. However, with funds from those sinking funds subsequently prioritized to fund the post-COVID–19 economic recovery program, government is in discussions with investors to roll over the 2021 eurobond for another 10 years. Moreover, there are also plans to establish a sovereign wealth fund in 2021 to contribute to socioeconomic development.



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São Tomé and Príncipe

Recent macroeconomic and financial developments

The economy of São Tomé and Príncipe contracted by an estimated 6.4% in 2020, after growing by 2.2% in 2018 and 1.3% in 2019. The contraction in output, for the first time in a decade, is attributed to a sharp decline in tourism and service sectors, which were severely hurt by weak external and domestic demand and COVID–19 containment measures. Subdued aggregate demand also hurt the hotels and restaurants, transport, construction, and manufacturing sectors, while cocoa exports were disrupted by widespread international border closures.

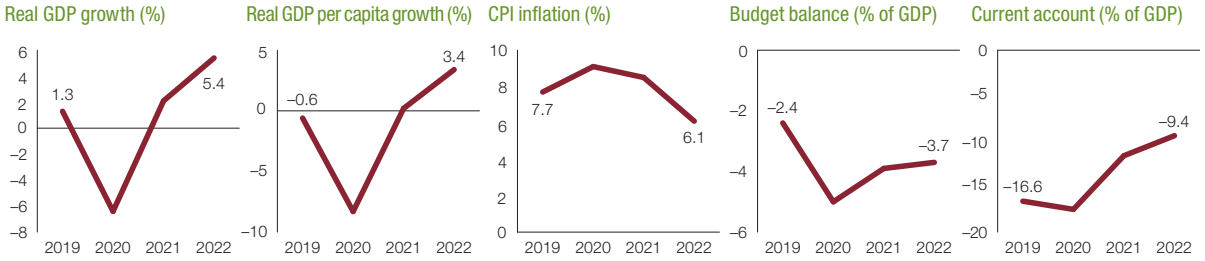
Monetary policy was accommodative to support growth. To help bank lending to a distressed private sector, the central bank reduced the minimum reserve requirements—from 21% in 2019 to 17% in 2020 for foreign-currency denominated accounts and from 18% to 14% for domestic currency accounts. Annual inflation increased to 9.1% in 2020 from 7.7% in 2019 due to pandemic-related shortages of food and other essential goods. The fiscal deficit was estimated to widen to 5.0% of GDP in 2020 from 2.4% in 2019, as spending related to COVID–19 increased and tax revenues fell. The deficit is being financed through external borrowing. Public debt rapidly rose to 104.9% of GDP in 2020 from 94.8% in 2019. The current account deficit widened to 17.5% of GDP in 2020 from 16.6% in 2019, mainly due to the reduction in tourism and cocoa receipts. Nonetheless, official reserves improved to four months of import cover from three months in 2019, boosted by budget support inflows. The banking sector remained stable, but non-performing loans increased to 28% in June 2020 from 26.7% a year earlier, as weak economic activity caused by the pandemic put pressure on borrowers' ability to repay their loans.

Outlook and risks

The economy is projected to grow by 2.1% in 2021 and 5.4% in 2022, underpinned by increased export demand for cocoa, chocolate, and palm oil and the resumption of tourism as global economic conditions improve. Growth will also be helped by an uptick in the service sectors as domestic demand strengthens. Improvements in export receipts and tourism earnings will help narrow the current account deficit and bolster international reserves in 2021. Furthermore, the government is implementing macroeconomic and structural policy reforms—such as fiscal consolidation and strengthening the central bank's independence. It is also committed to continue investment in public infrastructure to improve the business environment. Nevertheless, the economy is likely to face significant headwinds, including a potentially longer shock from the COVID–19 pandemic and a sluggish global economic recovery. This could slow recovery of the tourism sector and dampen the demand for the country's exports. The medium-term growth outlook could also be weighed down by accelerated fiscal consolidation, as the government pursues measures to improve the macroeconomic environment. Lastly, growth prospects will be clouded by an increase in poverty due to job losses triggered by the pandemic.

Financing issues and options

The country's public sector debt is high, driven mainly by oil imports for power generation, accounting for 22% of total imports in 2020. According to the International Monetary Fund's 2020 Debt Sustainability Analysis, the country is classified as being in debt distress due to prolonged unsettled external arrears, but public debt is deemed sustainable in the long term. Public debt is projected to decrease to 100.2% of GDP in 2021 and 96.4% in 2022 due to ongoing investment in alternative power sources and fiscal reforms, which could reduce external borrowing to cover oil imports. The introduction of a value-added tax of 15% in 2020 will improve revenue collection and bolster the fiscal position, which, in turn, will create fiscal space for investment in public infrastructure.



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South Africa

Recent macroeconomic and financial developments

South Africa's real GDP growth was 0.2% in 2019. The pandemic and the containment measures to curb the spread of the virus further damaged the economy. Real GDP contracted by 8.2% in 2020, the result of a decline in construction, transport and communication, manufacturing, and mining. On the demand side, all components declined, with the largest contraction, 32.4%, recorded in investment. The Reserve Bank of South Africa cut the policy rate by a cumulative 300 basis points in 2020, from 6.5% to 3.5%, to support businesses and households affected by the pandemic. Inflation was estimated to decline to 3.4% in 2020, within the reserve bank target of 3%–6%. The budget deficit was estimated to widen significantly to more than 14% of GDP, mainly due to spending pressures to contain the economic impact of the pandemic. The country will, however, record its first current account surplus in 2020, estimated at about 1% of GDP, because of the high price of the gold it exports, a low bill for fuel imports, and increased agricultural exports.

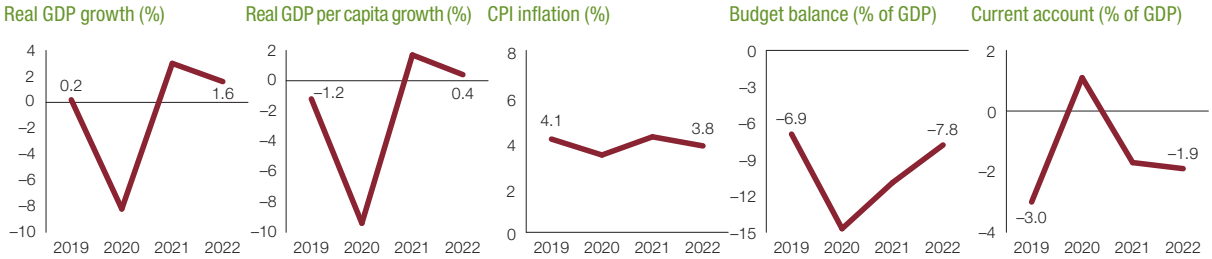
Despite the pandemic, the South African banking sector remains sound, with a capital ratio of 16.3%, which is above the 10% regulatory requirement. Domestic credit to private sector reached $280 billion in November 2020, an increase of 3.5% from December 2019, when it was 139% of GDP. Lingering economic weaknesses prompted the three major credit rating agencies to downgrade South Africa's local and foreign currency credit rating to subinvestment grade. Nevertheless, real private investment expanded by 33.2% in the third quarter of 2020. Social indicators are likely to remain weak due to the severity of the pandemic and legacy issues of low human development. About 2.6 million people have lost their jobs since March 2020, bringing the unemployment rate to 30.8% in September 2020 from 23.3% in December 2019.

Outlook and risks

Real GDP growth is projected to rebound to 3.0% in 2021, but the pace of the recovery will slow to 1.6% in 2022 due to continued structural constraints such as unreliable electricity supply and job regulations. The inflation rate is projected at 4.2% in 2021 and is expected to stay within the reserve banks' target range of 3%–6% for 2022. The current account surplus is expected to erode, since a recovery in oil prices could raise the import bill. Public debt could reach more than 90% of GDP in the medium term, with projections that it will stabilize at 95% in 2026. The 2020 Medium Term Budget Policy Statement (MTBPS) in October 2020 projected a significantly larger budget deficit and slower debt consolidation in the medium term. These projections will raise risks due to the high debt-service costs and deteriorating balance sheets of state-owned enterprises and the continued weaknesses of the financial position of municipalities.

Financing issues and options

The 2020 MTBPS proposed steps to reduce the public service wage bill and investment driven by state-owned companies in order to narrow the fiscal deficit and stabilize the debt-to-GDP ratio over a five-year period. The treasury expects to reduce the wage bill—the major driver of the fiscal deficit—by nearly $1.8 billion through 2023–24. The proposal has already raised the risk of widespread strikes by the 1.3 million public sector workers. Also, calls for debt guaranteed by the government to support higher levels of capital investment will be discouraged. This could push South African Airways into liquidation and the electric utility Eskom to adopt tariffs that reflects its costs, which would be efficient but unpopular. In 2020, the South Africa government committed itself to investment in public utilities through strong private sector participation. South Africa's gross international reserves increased slightly from $52.4 billion at the end of March 2020, covering 6.9 months of imports, to $53.8 billion at the end of November 2020, covering 8.3 months of imports. This progress mainly reflects foreign borrowings received on behalf of the government from multilateral banks, including the African Development Bank, to cope with the pandemic crisis.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team. Data on the budget balance correspond to South Africa's fiscal year, which runs from April 1 to March 31.

eSwatini

Recent macroeconomic and financial developments

eSwatini's economy contracted by an estimated 3.2% in 2020 after growing by 2.2% in 2019. Manufacturing declined sharply as export-oriented industries were constrained by temporary business closures, disruptions in global value chains, and weak demand. Construction dropped as the COVID–19 pandemic upended input supplies. Investment weakened, and consumption, a key driver of aggregate demand, retreated, crippling the performance of key services such as wholesale and retail, tourism, and hospitality. However, information and communication services performed well, due to increased demand for online services. Agriculture also posted marginal gains, thanks to favorable weather and continued investments.

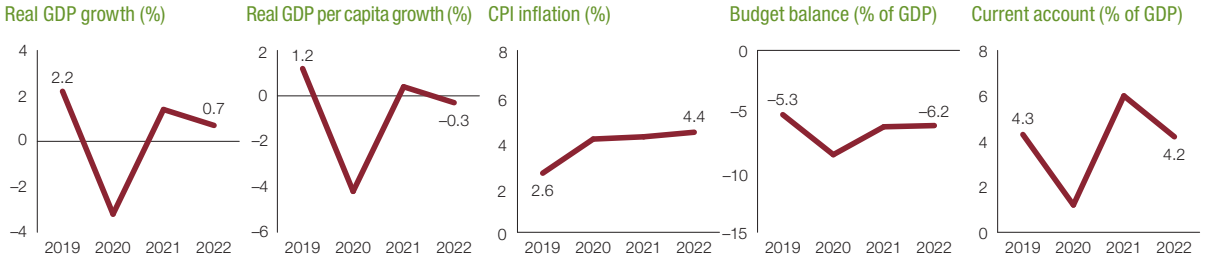
The fiscal deficit worsened to 8.6% of GDP in 2020, from 5.3% in 2019, prompting the government to approach international financial institutions for budget support. Gross public debt, which includes domestic arrears, rapidly rose to nearly 48% of GDP from 38% in 2019, well above the government's threshold of 35% of GDP. Authorities are committed to clearing domestic arrears, which remain high at about 5% of GDP. The current account surplus declined to 1.2% of GDP in 2020, but official reserves improved to four months of import cover, boosted by budget support inflows. Monetary policy was accommodative to support growth during the pandemic. The discount rate was gradually lowered from 6.5% in March 2020 to 3.75% in July. Inflation increased from 2.6% in 2019 to around 4% in 2020, stoked by supply constraints, elevated food prices, and a weakening domestic currency—which hit its lowest exchange rate to the US dollar in April 2020, having depreciated by 22% since January 2020. The banking sector remained stable and adequately capitalized, but non-performing loans increased, and year-on-year private sector credit fell by 0.4%.

Outlook and risks

The economy is projected to grow by 1.4% in 2021, underpinned by a modest recovery in all sectors. Agriculture, manufacturing, and construction are expected to lend greater impetus to recovery, while an expected strengthening of domestic demand will reignite services growth. Planned reforms to make it easier to do business, along with the clearance of domestic arrears, should stimulate private investment. Risks to recovery include a longer pandemic, inadequate progress on a COVID–19 vaccine, and external developments. Medium-term growth is expected to be tepid, weighed down by accelerated fiscal consolidation and a decline in projected Southern African Customs Union (SACU) receipts. As a result, the fiscal deficit will slightly decline but remain elevated. According to the International Monetary Fund's 2020 Debt Sustainability Analysis, if eSwatini implements its 2021–23 fiscal adjustment plan (totaling 6.5% of GDP), public debt will rise to about 50% of GDP in 2021, reach a high of 53% of GDP in 2023, then gradually decline. The current account surplus and international reserves are expected to improve as export demand recovers. Upside inflation risks include higher food prices and increases in water and electricity tariffs. The projected appreciation of the lilangeni/rand to near prepandemic levels is expected to minimize the pass-through effect of oil price increases on inflation.

Financing issues and options

eSwatini's public debt level is largely driven by a persistent fiscal deficit. Government has increasingly relied on the domestic market to finance the deficit and has accrued significant domestic arrears. External financing is mainly limited to capital project loans. Continued implementation of public financial management reforms, including fiscal consolidation and strengthening domestic revenue mobilization, are crucial to achieving fiscal sustainability, increasing fiscal space, and stabilizing public debt. Increased access to long-term concessional financing can further improve the fiscal position and ease government's liquidity constraints. A fiscal rule that imposes a ceiling on annual spending of SACU receipts while saving excess revenue could help insulate the budget from volatility of SACU transfers and bolster external buffers.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team. Data on the budget balance correspond to eSwatini's fiscal year, which runs from April 1 to March 31.

Zambia

Recent macroeconomic and financial developments

The economy of Zambia fell into a deep recession due the adverse impact of the COVID–19 pandemic. Real GDP contracted by an estimated 4.9% in 2020, after growing by 4.0% in 2018 and 1.9% in 2019. The output contraction is the result of an unprecedented deterioration in all the key sectors of the economy. Manufacturing output fell sharply as supply chains were disrupted, while the service and tourism sectors were hurt as private consumption and investment weakened due to measures taken to contain the spread of COVID–19. Mining output, which declined initially due to falling global demand for copper, is recovering amidst production disruptions in South America. Sustained commodity price increases beyond the current forecast could lead to lower economic contraction.

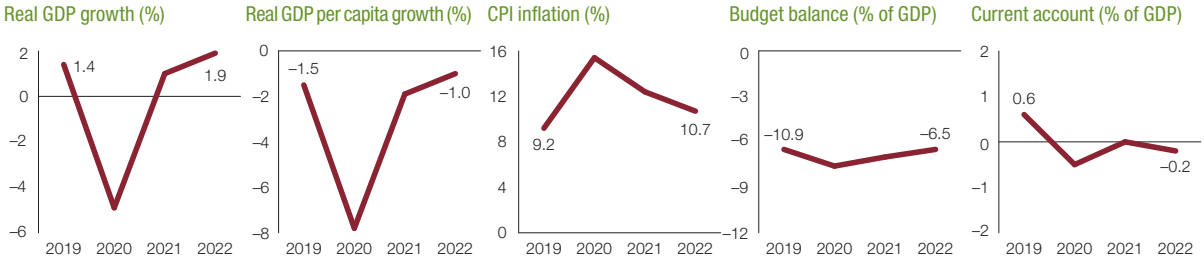
Even before the pandemic, the economy was experiencing serious macroeconomic challenges, such as high inflation, widening fiscal deficits, unsustainable debt levels, low international reserves, and tight liquidity conditions. Price levels and the financial sector have not stabilized, despite government efforts to deploy monetary easing in 2019 and 2020. Inflation has been rising, mainly driven by the pass-through effects of the depreciation of the kwacha and elevated food and transport prices. Following the outbreak of COVID–19, inflation rose to 17.4% in 2020 and is projected to remain above the target range of 6%–8% in 2021. The external position also worsened in 2020, with dwindling reserves (averaging 1.6 months import cover), and will remain depressed in 2021 due to copper price and output fluctuations, rising public debt payments, and elevated nonoil imports. The government's pursuit of expansionary fiscal policy for public investments, despite falling revenues, has resulted in widening fiscal deficits (8.3% of GDP in 2019 and 11% of GDP in 2020). The expansionary fiscal policy, mainly financed by external and local borrowing, caused Zambia's public and publicly guaranteed debt to hit 91.6% of GDP in 2019 and 104% in 2020. It will remain elevated in the medium term.

Outlook and risks

The economy is projected to grow by 1.0% in 2021 and 2.0% in 2022, underpinned by recovery in the mining, tourism, and manufacturing sectors. The recovery in international demand and copper prices are positive developments, while a reduction in COVID–19 cases will boost activity both in manufacturing and tourism. However, the economy faces substantial risks that a second wave of the pandemic will impede global economic recovery and stifle demand for copper. A second wave could also undermine the revival of such critical sectors as tourism and manufacturing. Failure to effectively implement the Economic Recovery Programme, which is intended to resolve most of the critical economic constraints—such as debt sustainability and stabilization of the macroeconomic environment—could also pose a high risk to Zambia's economy. In the banking sector, the ratio of non-performing loans is expected to increase and contribute to a drying up of bank liquidity, dampening private sector activity. Against this backdrop, poverty is expected to increase due to significant job losses in the service sector (on average, 30.6%), manufacturing (39%), personal services (39%), and tourism (70%).

Financing issues and options

Zambia's stock of public debt increased to an unsustainable 104% of GDP on 30 September 2020 and is expected to rise slightly in 2021 before decreasing in the medium term because of improved coordination between fiscal and monetary policy, as espoused in the Economic Recovery Programme. To attain debt sustainability, Zambia must stop accumulating new external debt, increase domestic revenues, curb runaway public spending, and create a stronger institutional public financial management framework. To avoid a severe liquidity crunch, the government has initiated a creditor engagement strategy aimed at securing immediate debt service relief with its external creditors.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Zimbabwe

Recent macroeconomic and financial developments

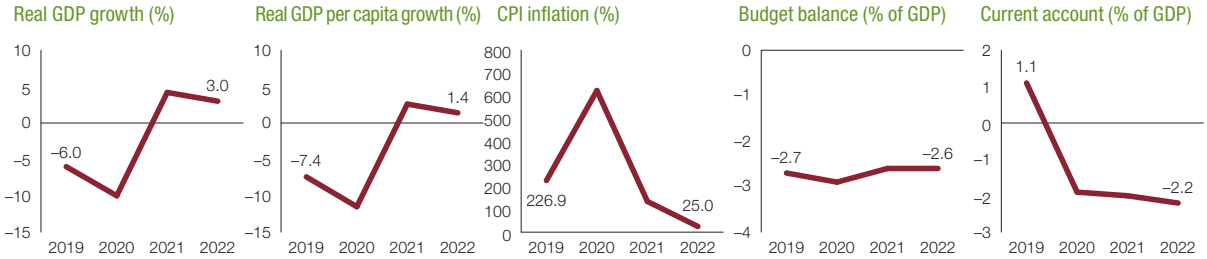
Before the COVID–19 pandemic, Zimbabwe's economy was already in recession, contracting by 6.0% in 2019. Output fell because of economic instability and the removal of subsidies on maize meal, fuel, and electricity prices; suppressed foreign exchange earnings; and excessive money creation. The onset of the COVID–19 pandemic and continued drought led to 10% contraction in real GDP in 2020. Inflation soared, averaging 622.8% in 2020, up from 226.9% in 2019. Foreign exchange reforms were instituted in June 2020, which dampened an inflation that raged an annual rate of 838% in July. Fiscal and current account deficits also recovered after July, but both deteriorated for the year as a whole. The budget deficit rose from 2.7% in 2019 to 2.9% in 2020, while the current account went from a surplus of 1.1% of GDP in 2019 to a deficit of 1.9% in 2020. The exchange rate depreciated ZWL2.5 in February 2019 and stabilizing around ZWL82 to the US dollar in December 2020. Poverty stood at 70.5% in 2019 while unemployment remained high at over 21%. The banking system is stable. Banks have some room to increase credit. The loan-to-deposit ratio was 38.8% in 2020 against a benchmark of 70%. Non-performing loans are at 3.23%, well under the regulatory benchmark of 5%. The capital adequacy ratio is more than three times the regulatory requirement of 12%.

Outlook and risks

Modest economic recovery is projected in 2021, if effective measures are taken to stabilize foreign exchange and avoid excessive money creation. But the outlook is clouded by a number of factors. The pandemic and government policies to contain the disease will affect production levels across all sectors—although a partial easing of border closures may help. The industrial and mining sectors are equally faced with reduced competitiveness, low commodity prices, and interruptions in electrical service that disrupt output. The problems are exacerbated by debt distress and arrears, and low international reserves that can cover less than one month of imports. Zimbabwe's economic situation will remain challenged in 2021, although the foreign exchange reforms, especially the weekly Forex auctions, introduced in June 2020 could create price stability and create room for modest economic recovery.

Financing issues and options

Zimbabwe's total public debt is $11.1 billion (53.9% of GDP), of which 95.6% is external. including $6.4 billion in arrears to international financial institutions, bilateral, and private creditors. Zimbabwe has been in default since 2000. A Staff Monitored Program with the International Monetary Fund to help Zimbabwe implement economic policies from May 2019 to March 2020 collapsed in September 2019. The government and the Fund have not agreed to a new arrangement, which would be aimed at helping Zimbabwe clear its arrears. As a result, the country will have to continue to rely largely on domestic resource mobilization and borrowing from non-Paris Club members like China. The international financial institutions will not resume lending until debt arrears are cleared.



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WEST AFRICA

Benin

Recent macroeconomic and financial developments

From a health perspective, Benin seems to have fared better than many other countries during the COVID–19 pandemic. But the economic effects of the pandemic have been significant in a country considered among the best-performing in Africa. Benin's real GDP growth was estimated to have slowed to 2.3% in 2020, following 6.9% in 2019 and 6.7% in 2018. The slowdown in growth on the supply side reflects the underperformance of commerce, transport, agriculture, and hotels and restaurants—the sectors most affected by the pandemic. On the demand side, the slowdown in growth in 2020 is linked to lower investment and private consumption. Inflation doubled from –0.9% in 2019 to 2% in 2020, mainly because of higher food prices. Tax revenue fell 6.5%, and spending increased 14.3% in 2020 due to the slowdown in economic activity and higher health and social spending. The budget deficit was 3% of GDP in 2020, compared with 0.5% in 2019. The current account deficit improved slightly to 4.0% of GDP in 2020 from 4.7% in 2019—due to a 4.6% decline in the value of imports.

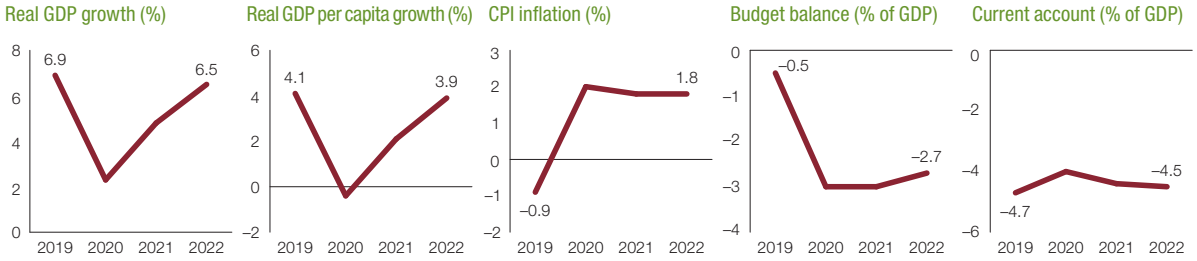
Outlook and risks

If COVID–19 is brought under control by the middle of 2021, the global economy could restart, which would allow Benin's growth rate to recover to 4.8% in 2021 and 6.5% in 2022—driven by trade, transport, and agriculture. Inflation is expected to be 1.8% in 2021, below the 3% convergence criterion of the West African Economic and Monetary Union.

The fiscal balance is expected to improve to 3% of GDP in 2021 and 2.7% the following year. The current account balance should deteriorate slightly to 4.4% of GDP in 2021 and 4.5% in 2022, because of an expected 11.5% increase in imports over those two years.

Financing issues and options

The outstanding public debt is 46.1% of GDP in 2020, compared with 41.4% in 2019, and is expected to average 40.9% of GDP over 2021–22. Benin is expected to have additional financing needs equal to 3% of GDP in 2020. External debt accounts for 55.54% of total debt in 2020—56% of which is owed to multilateral lenders (mostly on concessional terms), 12.7% is bilateral, 17% is commercial, and 14.2% is in eurobonds. China holds more than half of Benin's bilateral debt. The risk of debt distress will be moderate through 2022. To hold down debt risk, the country should strengthen the mobilization of domestic resources by broadening the tax base, prioritizing treasury bonds with longer maturity, and seeking concessional external resources.



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Burkina Faso

Recent macroeconomic and financial developments

Burkina Faso's real GDP contracted by 0.2% in 2020, compared with an increase of 5.7% in 2019, caused mainly by a slowdown in activity in trade, transport, tourism, and hotels, much of it the result of measures taken to contain the spread of COVID–19. The inflation rate rose to 1.4% in 2020, mainly due to higher food prices, after falling to –3.2% in 2019. An increase in public spending, combined with lower revenue, led to a deterioration in the budget deficit of 5.4% of GDP in 2020 after a deficit of 3.5% of GDP in 2019. The current account balance recorded a surplus of 1.2% of GDP in 2020 after being in a deficit of 3.4% of GDP in 2019. This performance is the result of an increase of 21% in the value of gold exports and 13% in cotton exports while the import value of petroleum products fell by 20% because of the drop in economic activity.

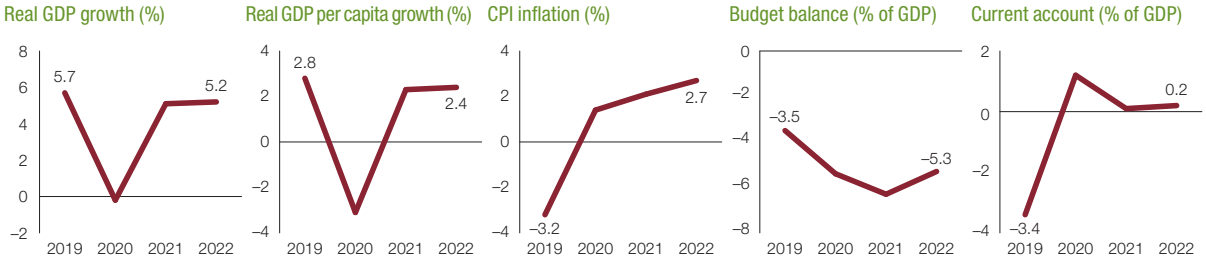
Outlook and risks

If the pandemic is brought under control by the beginning of the second half of 2021, permitting the global economy to restart, real GDP would grow by 5.1% in 2021 and 5.2% in 2022, as the service sector recovers and public investments increase. The inflation rate is expected to increase to 2.1% in 2021 and 2.7% in 2022 due to an increase in food prices. The budget deficit would continue to deteriorate, to 6.3% of GDP in 2021, because of an increase in public investment to stimulate post-COVID–19 economic recovery and security spending, before decreasing to 5.3% in 2022.

An expected recovery in imports would worsen the current account balance, but the balance would remain in surplus in 2021 and 2022. The two main risk factors to this optimistic scenario are a deterioration in the security situation—there is terrorist activity in the country—as well as a continuation of the pandemic into the second half of 2021, which would retard a global economic recovery.

Financing issues and options

Burkina Faso continues to present a moderate risk of debt distress. The financial resources needed to deal with current economic, health, and security issues will increase total public debt to 50.1% of GDP by the end of 2021, compared with 46.4% of GDP in 2019. External debt would increase from 22.0 % of GDP in 2017 to 25.0% of GDP in 2020. Domestic debt will grow to 25.1% of GDP in 2020 from 15.5% of GDP in 2017 due to increased issuances of treasury bonds. Public debt service stood at CFAF 345.1 billion in 2019, up 34.8% from 2018. Domestic debt service represents 76.7% of total debt service. About 30.4% of the debt portfolio is denominated in floating currencies, particularly the US dollar, which exposes Burkina Faso to the risk of exchange rate volatility. Debt sustainability indicators are likely to deteriorate if the country does not urgently adopt a strategy to extend the average maturity of its domestic debt. Moreover, with a tax-to-GDP ratio of only 15.5% of GDP in 2020, increased mobilization of domestic resources remains a central issue for the country, if it is to finance the infrastructure of development. Finally, reforms to contain and put the wage bill on a sustainable path are very important. The upward trend in the wage bill, which was estimated at 62.4% of tax revenue in 2020, risks considerably reducing the fiscal space needed to finance domestically investments.



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Cabo Verde

Recent macroeconomic and financial developments

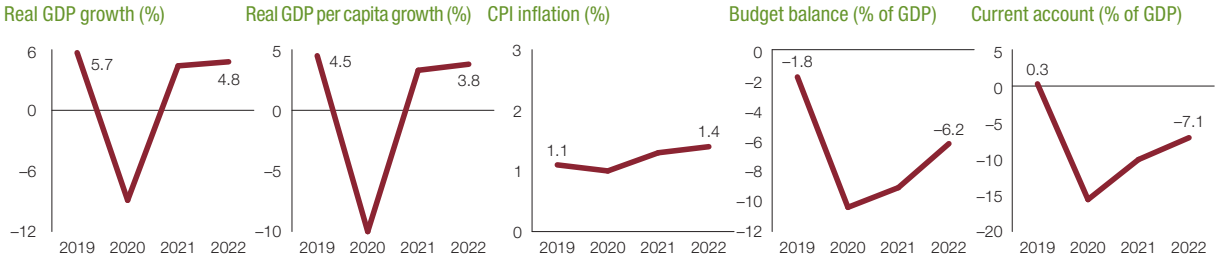
Containment measures and disruptions in global and regional supply chains due to the COVID–19 pandemic combined to cause Cabo Verde's economy to shrink by 8.9% in 2020. That was a sharp contrast to the 5.7% growth in 2019, which was driven by transport, tourism, construction, and retail trade. The government adopted fiscal and monetary stimulus measures and enhanced social protection and employability programs to mitigate the impact of pandemic. But they were insufficient due to the severity of the shock to key economic sectors. Inflation dropped by 0.1 percentage point between 2019 and 2020, mainly due to an exchange rate peg to the euro and lower energy costs. However, revenue shortfalls caused the fiscal deficit to widen to 10.4% of GDP in 2020 from a 1.8% deficit in 2019. The estimated 69% drop in tourism revenues caused the current account to be in a deficit of 15.6% of GDP in 2020, reversing a surplus of 0.3% the previous year. The high ratio of non-performing loans to gross loans, at 12%, diminishes the quality of banking sector assets and heightens risks—which erodes financial sector stability. Nearly 20,000 jobs were lost in 2020, and the unemployment rate is projected to double to 19.2%, with joblessness highest among young people (41%). Poverty was estimated at 35.5% of the population in 2020, compared with 29.3% in 2019.

Outlook and risks

Growth is projected to average 4.6% during 2021 and 2022—as economic conditions improve and fewer global supply chain disruptions combine to drive private consumption and investment in transport, tourism, energy and information and communications technology. Tax revenue losses are likely to remain high, and although the fiscal deficit is projected to narrow, it will remain elevated at 9.1% of GDP in 2021. A reduction to 6.2% in 2022 is projected on the back of improved revenues, as economic recovery gains pace. The major threats to the outlook emanate from fiscal risks ahead of the March 2021 presidential elections and the possibility of another wave of COVID–19 infections in Europe. Inflation is projected at 1.3% in 2021 and is expected to remain broadly low in the medium term, mainly because of low fuel prices and subdued aggregate demand. The effect of the pandemic restrictions on economic activity could exacerbate non-performing loans as firms struggle to service their borrowings. Exports could recover but will remain below pandemic levels, and remittances will remain subdued in the near term. The current account deficit is projected to narrow but remain high at 10.1% of GDP in 2021, with a further reduction to 7.1% in 2022.

Financing issues and options

Rising public investment spending and support to state-owned enterprises (SOEs) has raised public debt. Cabo Verde's public debt was estimated at 152.4% of GDP in 2020, compared with 124.2% in 2019. External debt accounts for 72%, and domestic debt 28%, of the total. Public external debt is highly concessional, with an average maturity of 22 years and an average interest rate below 1%. Major creditors are multilateral (46.2%) and bilateral (24.2%) donors, while commercial loans represent 29.6% of public borrowing. Although public debt is assessed as sustainable, both external and total debt are at high risk of distress. Measures aimed at increasing domestic revenue mobilization, rationalizing expenditures and limit additional support to SOEs, should be a main component of the government's fiscal consolidation strategy. Priority should be on obtaining more new loans on concessional terms, seeking other financing options such as exchanging debt for development and multicreditor debt swaps, and exploring options for debt renegotiation and concessional loans while the authorities seek debt relief under the G20 Debt Service Suspension Initiative to ensure sustainability of public debt.



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Côte d'Ivoire

Recent macroeconomic and financial developments

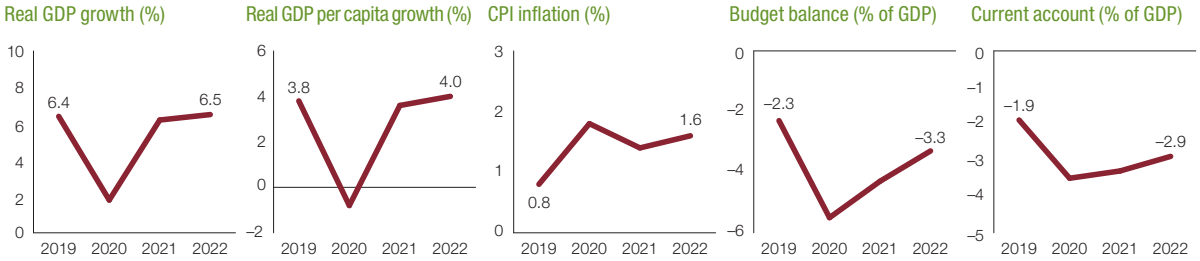
Real GDP rose 1.8% in Côte d'Ivoire in 2020, well below its 6.4 growth in 2019, as the effects of COVID–19 disrupted most sectors of the country's economy. Weakened global demand hit Côte d'Ivoire's export sectors hard: export agriculture (which contracted by 2.2%), agro-food industries (–1.3%), forestry (–16.5%), mining (–4.8%), petroleum products (–26.9%), and transport (–1.8%). Inflation rose from 0.8% in 2019 to 1.8% in 2020, on the back of higher food and transport prices in a country that suffers one of the highest COVID–19 infection rates in West Africa. Financing extra health spending and economic support led to a doubling of the budget deficit from 2.3% of GDP in 2019 to 5.5% of GDP in 2020, mainly financed by loans, projects and programs, and borrowing from the regional financial market. The current account deficit has nearly doubled from 1.9% of GDP in 2019 to 3.5% in 2020 due to rising imports and falling exports.

Outlook and risks

The 2021–22 outlook will be conditioned by the global control of the COVID–19 pandemic by the second half of 2021 and the implementation of the National Development Plan (PND) 2021–25, which aims to maintain a stable sociopolitical environment and increase the mobilization of domestic resources. The Ivorian economy should rebound strongly with real GDP growing 6.2% in 2021 and 6.5% in 2022, driven mainly by agriculture, construction, petroleum products, transport and trade, investment, and consumption. At the same time, inflation is expected to ease to 1.4% in 2021 and tick up to 1.6% in 2022. The budget deficit is expected to be reduced to 4.3% of GDP in 2021, then to 3.3% of GDP in 2022, under the effect of the economic recovery. The current account deficit is expected to narrow slightly to 3.3% of GDP in 2021 and to 2.9% in 2022 as exports pick up. The main risk factors to this optimistic scenario are a continuation of the pandemic into the second half of 2021, the deterioration in the internal sociopolitical situation and in the prices of the country's main export products, and a poor mobilization of internal and external resources.

Financing issues and options

The stock of total public debt increased by an average of 14% per year between 2015 and 2019, in line with the financing needs of the public investment program of the PND 2016–20. Outstanding public debt, which was 37.9% of GDP at the end of 2019, is expected to grow to 41.7% of GDP in 2020 and stabilize at an average of 42.5% of GDP during 2021–22, well below the 70% threshold set by the West African Economic and Monetary Union. In 2019, 65.7% of public debt was external —half of it consisted of $1 billion in eurobonds issued in April 2020, and a quarter of it is owed to multilateral institutions. Slightly less than 20% is bilateral, with the rest commercial. The risk of overindebtedness appears moderate over 2020–40, both for external debt and for total public debt. The capacity to cope with large external shocks, however, remains limited. With little access to concessional resources, the authorities should favor semiconcessional financing over commercial financing, while strengthening domestic resource mobilization efforts by broadening the tax base.



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The Gambia

Recent macroeconomic and financial developments

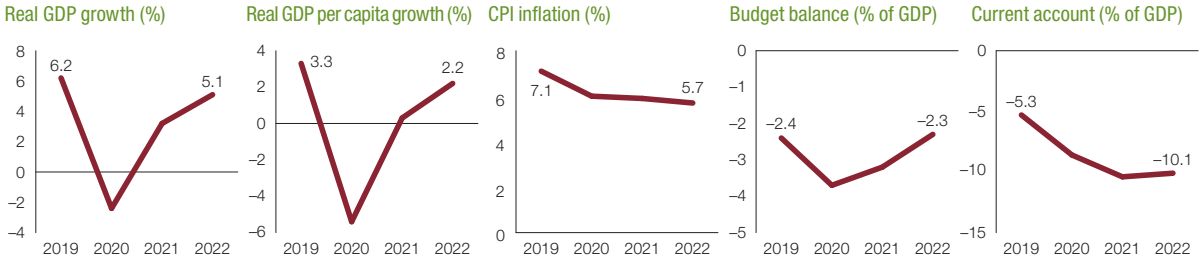
Containment measures introduced to limit the COVID–19 pandemic helped cause The Gambia's GDP to contract by an estimated 2.4% in 2020, after growing 6.2% in 2019. On the supply side, the tourism and trade sectors were the most affected, while on the demand side, subdued domestic and external demand hurt the economy. The government responded with expansionary fiscal policy—health spending increased by 0.5% of GDP and food assistance increased by 0.7%. Monetary and financial policies were also eased—the policy rate was cut by 200 basis points to 10% to boost liquidity. Subdued aggregate demand pushed down inflation to an expected 6% in 2020 from 7.1% in 2019. The fiscal deficit widened to 3.7% of GDP in 2020 from 2.4% in 2019 as a result of increased spending amid a shortfall in revenue collections. The decline in remittances and tourism receipts widened the current account deficit to 8.6% of GDP from 5.3% in 2019. Foreign exchange reserves expected to drop by $10 million in 2020 to $258 million (3.7 months of import cover) while the foreign exchange rate stabilized at GMD 51 to the US dollar throughout the year. Public debt increased to 83.1% of GDP in 2020 from 81% in 2019—because of large fiscal deficits and government efforts to prop up state-owned enterprises (SOEs). The financial sector, although well capitalized and liquid, remains vulnerable to spillover effects of the pandemic on the ability of firms in the tourism, trade, and real estate sectors to service their loans. These three sectors account for 54% of total credit and one-third of non-performing loans. The pandemic has hurt social indicators. An estimated 20,000 jobs were lost in 2020, the unemployment rate was about 40%, and the poverty level was estimated at 48.6%.

Outlook and risks

The outlook is positive, if the economy reopens, good rains aid agriculture, global demand improves, structural reforms are instituted on non-performing SOEs, monetary policy is accommodative, and negotiations to restructure public debt continue as a complement to fiscal consolidation efforts. Real GDP is projected to pick up gradually—growing by 3.2% in 2021 and 5.1% in 2022. Inflation is projected to decline marginally to 5.9% in 2021 and 5.7% the following year. The fiscal deficit is projected to narrow to 3.2% of GDP in 2021 and 2.3% in 2022, while the current account deficit will widen to 10.4% of GDP in 2021 and 10.1% in 2022. Downside risks to the outlook emanate from possible spending pressures during the 2021 presidential election. Failure to secure external assistance and a delay in reopening economies are other potential downside risks.

Financing issues and options

The Gambia's efforts to lift growth to its precrisis level could be constrained by adherence to stricter fiscal rules under an International Monetary Fund program and National Development Plan provisions for fiscal austerity. Therefore, The Gambia should explore external assistance to support its post-COVID–19 growth recovery. In this regard, The Gambia could capitalize on its past and ongoing debt restructuring and debt service deferment experiences. The G20 Debt Service Suspension Initiative, deferred payments, and debt restructuring of bilateral and multilateral credits have helped improve The Gambia's debt distress rating to high risk from being in debt distress. The Gambia could also immediately introduce growth-friendly revenue enhancement measures—such as broadening the tax base, improving tax compliance, and streamlining exemptions. In the short to medium-term, the country could pursue deepening the financial sector to support private sector credit growth. Priority should be on obtaining new financing on highly concessional terms, seeking other financing options such as exchanging debt for development and multicreditor debt swaps, and exploring options for debt renegotiation to bring public debt onto a sustainable path.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Ghana

Recent macroeconomic and financial developments

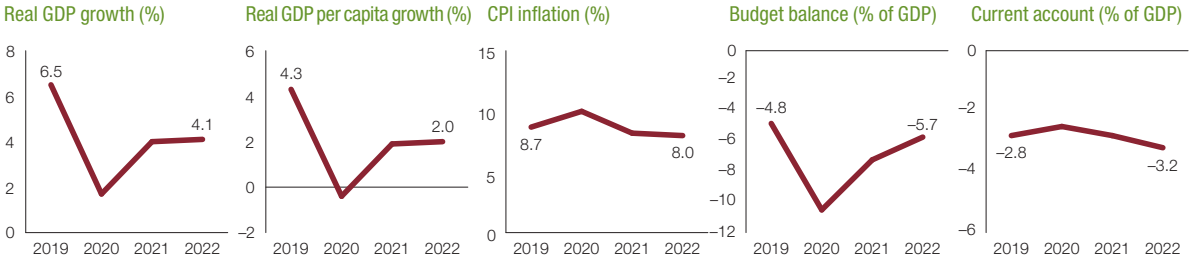
The COVID–19 pandemic significantly curtailed Ghana's economic growth momentum. Real GDP growth was estimated to decelerate from 6.5% in 2019 to 1.7% in 2020, due to the slump in oil prices and weakened global economic activity. Nonetheless, growth will be sustained by a budding recovery in construction and manufacturing sectors, combined with favorable gold and cocoa prices. Inflation is expected to reach 10% in 2020 from 8.7% in 2019 due to pandemic-related interruptions in supply chains and expansionary monetary policy aimed at mitigating the economic impacts of COVID–19. The fiscal deficit is expected to widen to 10.5% of GDP in 2020 from 4.8% in 2019 due to revenue shortfall from weak economic activity and unanticipated increased health expenditure. The current account deficit is expected to narrow to 2.5% of GDP in 2020 from 2.8% in 2019 because of reduced demand for imports. Foreign exchange reserves maintained the previous year's level of 4.0 months of import cover as of October 2020. The Ghana cedi depreciated by 3.1% in 2020, compared with a 10% depreciation in 2019. Ghana remains at high risk of debt distress in the International Monetary Fund's 2019 Debt Sustainability Analysis because of solvency and liquidity risks. The public debt-to-GDP ratio reached 71% in September 2020 from 63% a year earlier. A banking sector reform, including recapitalization of banks and liquidation of insolvent financial institutions, has enhanced the overall resilience of the sector. Firm and household surveys reveal that during the partial lockdown, about 770,000 individuals experienced reduced wages, and 42,000 lost their jobs.

Outlook and risks

The economic outlook is good in the short to medium term, contingent on an increase in demand for Ghana's exports, improved business confidence, and successful implementation of the Ghana COVID–19 Alleviation and Revitalization of Enterprise Support program. Growth is projected to increase to 4% in 2021 and 4.1% in 2022. Inflation is expected to ease to 8.2% in 2021 and 8%, in 2022—in the midpoint of the Bank of Ghana's target band of 6%–10%. The fiscal deficit is projected to narrow to 7.2% in 2021 and 5.7% in 2022, driven by an expected increase in revenue collection in a recovering economy. However, the current account deficit is expected to widen to 2.8% of GDP in 2021 and 3.2% in 2022 as import volumes resume their prepandemic levels. Downside risks to the outlook emanate from a possible second wave of the virus and heightened fiscal and debt pressures.

Financing issues and options

Ghana's ability to push economic growth to its precrisis level is expected to be constrained by fiscal and debt risks. The country is only expected to return to its fiscal responsibility budget deficit threshold of 5% of GDP in 2024. The public debt as at the end of 2019 had cost escalation risks because almost 50% of external debt was commercial. It also showed refinancing and foreign exchange rate risks, since 90% of the domestic debt has short- to medium-term maturities, and 70% of the foreign currency debt was denominated in US dollars. To overcome these risks, domestic resource mobilization needs to be complemented with external financial assistance, including concessional loans. While maintaining the foreign exchange reserves buffer, government should actively engage its creditors in exploring other financing options including renegotiating and restructuring debt, and debt service suspension.



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Guinea

Recent macroeconomic and financial developments

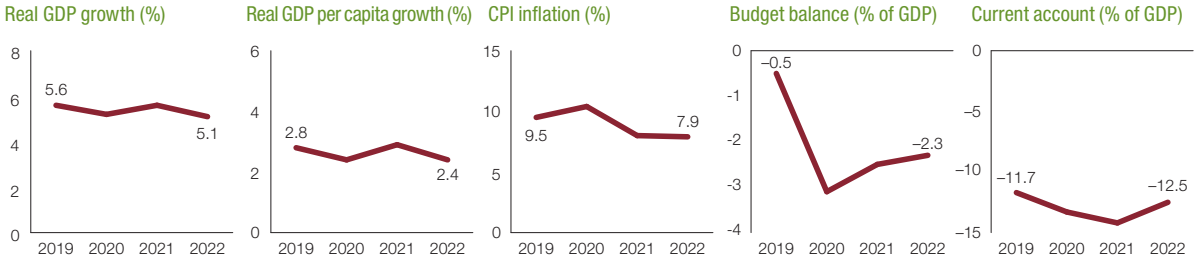
The Guinean economy has been resilient in the face of the global pandemic. Real GDP grew 5.2%, only slightly less than 5.6% in 2019 and far more than the 1.4% forecast at the start of the pandemic. This remarkable performance is linked to the strong 18.4% increase in mining activity in 2020, compared with 8% in 2019, the result of a recovery in Chinese demand for bauxite and aluminum, of which Guinea has been the major supplier since displacing Australia in 2017. But the pandemic hurt nonmining sectors, whose growth fell to 2.5% in 2020 from 5.1% in 2019, largely because of delays of major projects and the temporary closure of borders and measures to contain COVID–19, which disrupted agricultural, manufacturing and service activities. Those disruptions also led to an increase in inflation to 10.4% in 2020 from 9.5% in 2019. The central bank narrowed the differential between the official and parallel exchange rates to limit the inflationary impact of imported capital and consumer goods. A fall in tax revenues and spending increases to mitigate the effects of pandemic combined to raise the budget deficit to 3.1% of GDP in 2020, compared with 0.5% in 2019. It will be financed through advances from the central bank and the issuance of treasury bills. The massive importation of capital goods for major projects and the reduction in exports are expected to widen the current account deficit from 11.7% in 2019 to 13.3% in 2020. It would be financed by foreign direct investment in mining.

Outlook and risks

Medium-term growth is expected to reach 5.6% in 2021 and 5.1% in 2022, stimulated by a substantial energy supply from the new 450-megawatt Souapiti dam, new mining projects, and higher infrastructure spending. The budget deficit should gradually shrink to 2.5% in 2021 and 2.3% in 2022, the result of rationalization of public expenditure, a reduction of subsidies on electricity tariffs, improved taxation more suited to the nonmining sector, a broadening of the tax base and the strict application of the fiscal provisions of the mining code. New mining production should increase exports, and starting in 2022, reduce the current account deficit currently financed by foreign direct investment. The level of international foreign exchange reserves is expected to improve to cover more than 4 months of imports in 2021 and 2022, compared with 3.8 months in 2020.

Financing issues and options

Guinea's debt is sustainable, with a moderate risk of external debt distress. In 2019, the total public debt outstanding represented 36.5% of GDP, about 53% of it domestic. In 2020, the outstanding amount could reach 40.2% of GDP, about 60% it external. This moderate level of indebtedness should make it possible to undertake new concessional borrowing to finance priority spending and new investments in the country's national strategy to combat COVID–19. The authorities should focus on a prudent external borrowing policy in the future, while enhancing the effectiveness and efficiency of public investments.



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Guinea-Bissau

Recent macroeconomic and financial developments

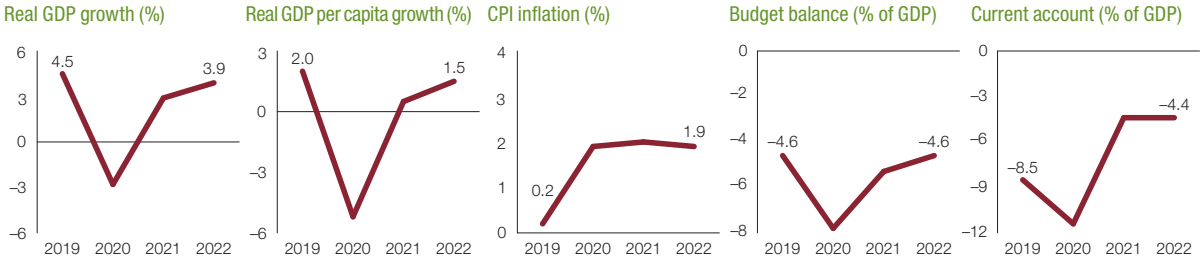
The containment measures introduced to limit the spread of the COVID–19 pandemic have retarded Guinea-Bissau's growth momentum. Real GDP is expected to contract by 2.8% in 2020, reversing a steady acceleration since 2015. The 2020 rate is below the 4.5% recorded in 2019 and the lowest since the coup d'état in 2012, when the economy contracted by 2.0%. Lower cashew nut prices and sales are the main factors behind the reversal in growth—Guinea-Bissau's agriculture-based economy is dependent on cashew nut exports, which suffered from lockdowns and closure of borders. Inflation is expected to rise to 1.9% in 2020, because of a pandemic-related supply shock to the prices of essential items. However, the inflation in 2020 is still below the 3% West African Economic and Monetary Union (WAEMU) convergence criterion. Guinea-Bissau's fiscal position in 2019, at –4.6% of GDP, is projected to worsen to –7.8% of GDP in 2020, mainly because the cashew trade is an important source of revenue. Trade restrictions will also worsen the current account deficit to 11.4% of GDP in 2020, from deficits of 8.5% in 2019, and 1.6% in 2018.

Outlook and risks

Growth is expected to rebound to 2.9% in 2021 and 3.9% in 2022, an outlook based on large-scale vaccination against COVID–19 and a resumption of trade activities. Political stability will be crucial to attract investment and stimulate private sector engagement. Inflation is expected to remain stable—at 2% in 2021 and 1.9% in 2022. A slight improvement will be observed in in both the budget deficit—at 5.3% of GDP in 2021 and 4.6% in 2022—and the current account balance, which will be in a deficit of 4.4% in both years.

Financing issues and options

Guinea-Bissau has very limited fiscal space to respond countercyclically to an economic downturn and needs to reprioritize expenditures toward critical public health services. The public debt situation has deteriorated rapidly, with estimates at end-2019 showing that total public debt had climbed sharply to 69% of GDP from 50.9% of GDP in 2018. External debt stood at 25% of GDP at end-2019, compared with 12% of GDP in 2018. The impact of the pandemic on public finances is likely to further increase the country's indebtedness, putting more pressure on the sustainability of its debt. The most recent audits of domestic debt suggest that arrears accumulated from 1974 to 1999 amounted to CFAF 14.3 billion (1.7% of GDP), and arrears from 2000–07 were CFAF 88.7 billion (10% of GDP). On external debt, international financial institutions are the main creditors. Authorities need to address tax policy administration and strengthen the national tax framework to raise domestic revenues. Guinea Bissau's tax-to-GDP ratio, estimated at 9.4%, is below the WAEMU average of 15%.



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Liberia

Recent macroeconomic and financial developments

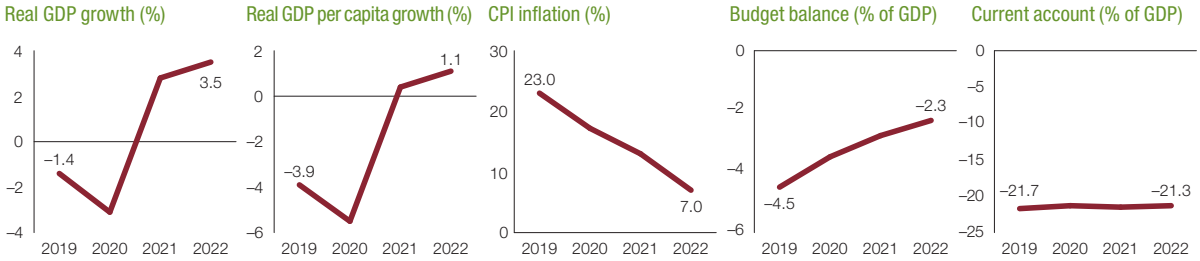
Real GDP was estimated to contract by 3.1% in 2020, its third year of decline in the past five. The 2020 result reflects a pandemic-induced reduction in external demand for its major exports. Domestically, the service sector, particularly wholesale and retail trade, and the hospitality industry were the hardest hit. Inflation was estimated to decline to 17.2% in 2020 from 23% in 2019 on account of subdued aggregate demand caused by pandemic-related containment measures. The fiscal deficit was estimated to narrow to 3.5% of GDP in 2020 compared with 4.5% in 2019 as the government limited expenditures to available budgetary resources in line with International Monetary Fund's (IMF's) Extended Credit Facility (ECF) program. The current account deficit was estimated to narrow to 21.3% of GDP from 21.7% because of a lower oil import bill. Gross official reserves declined to 2.3 months of import cover at the end of June 2020 from 2.4 months a year earlier. Declining reserves prompted a 2.6% depreciation in the exchange rate from LRD 193 per US dollar in June 2019 to LRD198 per dollar in June 2020. Public debt increased to 49% of GDP at the end of September 2020, compared with 38% of GDP in September 2019—an increase attributed to government borrowing from the Central Bank of Liberia (CBL). Since December 2019, Liberia has been implementing the IMF's ECF program, which aims to create a sound macroeconomic policy environment and to address underlying structural bottlenecks.

Outlook and risks

In 2021, real GDP growth is forecast to rebound to 2.8% due to increased demand for Liberia's key exports of iron ore, gold, diamond, and rubber—assuming major importing countries in Europe and Asia cope with the COVID–19 pandemic. Inflation is projected to decline to 13%, the exchange rate to stabilize, the fiscal deficit to remain below 5% in the medium term, and the current account deficit to narrow on the back of continued adherence to fiscal discipline and tight monetary policy that is aligned with the IMF's ECF program. Downside risks to the outlook could emanate from high vulnerability to external shocks and prolonged COVID–19 pandemic.

Financing issues and options

As part of the ECF program, the government has committed to debt rules, which among other things, limit external borrowing to concessional terms and require reduced domestic borrowing from the central bank. This approach is supported by the ongoing implementation of Domestic Resource Mobilization Strategy, which aims to increase domestic revenues by expanding the revenue base and minimizing tax losses, and to financial deepening and capital market development. These efforts may not be enough to create the fiscal space needed to support a resilient recovery. Policy options for increasing fiscal space could include anchoring fiscal policy on debt sustainability, deepening the financial market to enhance private financing, and seeking external assistance in debt relief, debt service suspension, debt restructuring, and concessional loans in the immediate term to create fiscal space.



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Mali

Recent macroeconomic and financial developments

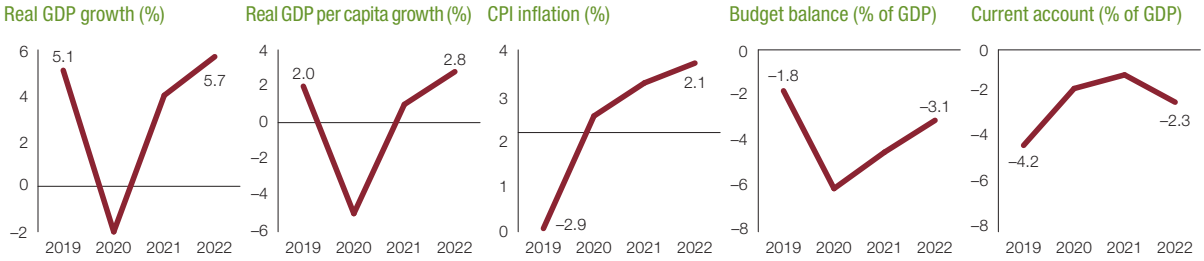
The COVID–19 pandemic, combined with a military coup d'état in August 2020, drove the economy from strong growth of 5.1% in real GDP in 2019 to a recession in which real GDP shrank by 2% in 2020—a loss of 7.1 percentage points. This recession was driven by a contraction of 3.5% in the secondary sectorand of 5.5% in the tertiary sector, a falloff in net exports because of weak global demand, and a contraction in public investment as public program resources were diverted to social sectors. The recession was also attributable to a decline in private investment and private consumption. Inflation, which fell by 2.9% in 2019 due to record cereal production, is expected to rise by 0.5% in 2020 because of supply disruptions. The budget deficit deteriorated sharply from –1.8% of GDP in 2019 to –6.1% of GDP in 2020, mainly because of lower tax revenue. The financing need for 2020 will be covered at 97.3%—through budget support from the International Monetary Fund at 40%, the World Bank at 42%, the African Development Bank at 9.8%, and the West African Development Bank at 5.5%. The current account deficit, however, improved from –4.2% of GDP in 2019 to –1.7% of GDP in 2020, mainly because of a massive drop of 14% in imports and a tiny decrease of only 0.3% in exports.

Outlook and risks

Assuming a gradual extinction of COVID–19 at the start of the second half of 2021 related to the availability of a vaccine in early 2021 would allow the recovery of the global economy, real GDP in Mali would grow by 4.0% in 2021 and 5.7% in 2022. Growth would be driven by a resumption of activities in the secondary and tertiary sectors and, a rebound in exports, domestic demand, and bank credit. Rising oil prices would boost the inflation rate to 1.5% in 2021 and 2.1% in 2022. The budget deficit would narrow to –4.5% of GDP in 2021 and –3.1% of GDP in 2022, with tax revenue revived by the resumption of economic activity and reforms. The current account deficit would improve to –1.1% of GDP in 2021 due to the recovery in exports supported by the recovery of the extractive industries but would deteriorate to –2.3% of GDP in 2022 due to an increase in the oil bill and a rise in imports associated with public development investments. Terrorist activity also remains a key downside factor.

Financing issues and options

Public debt is 56% external and 44% internal. Domestic debt consists of 81% of government-issued securities and 19% of loans. External debt is 73% from multilateral institutions, and 27% bilateral. Public debt is expected to increase from 40.5% of GDP in 2019 to 44.8% of GDP in 2020 in response to the health and political crises, but with a moderate risk of debt distress. The action plan of the 2020–22 Transition Roadmap should maintain this increase at 46.2% of GDP in 2021 and 47.2% of GDP in 2022. Tax revenues are low, at 13.3% of GDP in 2020 compared with a regional standard of 20%, which offers plenty of space for reforms to broaden the tax base. The restructuring of domestic debt initiated in 2019, due to the high concentration of debt maturity, must be completed to reduce the pressures on public finances.



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Niger

Recent macroeconomic and financial developments

Niger was able to manage the health aspects of COVID–19, but the pandemic slowed the economic dynamism that the country has displayed in recent years. Real GDP grew 1.2% in 2020 after growing 5.9% in 2019 and 7% in 2018. Security issues, such as terrorist activity, and the closure of borders hurt growth. On the supply side, the service and extractive industry sectors were most affected by the health crisis. On the demand side, consumption and foreign investments (from China and Europe) declined sharply. Because of supply disruptions, the inflation rate was 2.8% in 2020, compared with a 2.5% deflation in 2019. The budget deficit increased further to 5.7% of GDP in 2020, as the COVID–19 crisis triggered increased health spending and already low tax revenues fell. The current account deficit rose to 12% of GDP in 2020 from an already high 12.5% of GDP in 2019, mainly because of lower export earnings.

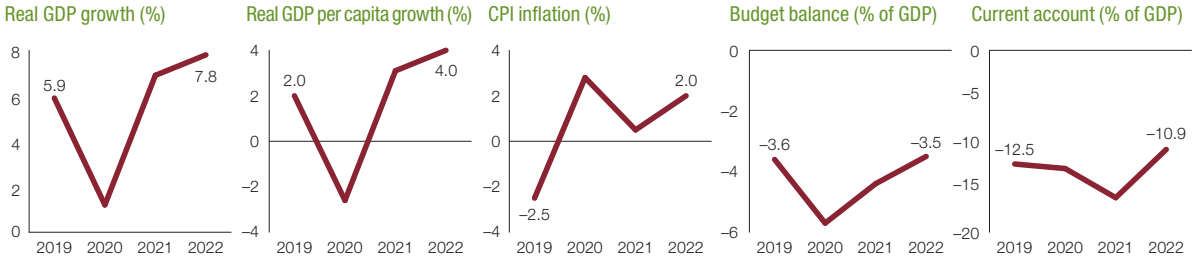
Outlook and risks

If the global pandemic is brought under control in the first half of 2021, the world economy will strengthen, and Niger's real GDP could grow 6.9% in 2021 and 7.8% in 2022. This return to strong growth would be underpinned by control of the pandemic at the local level, continuation of major infrastructure projects, and especially the exploitation of new oil fields. Inflationary pressures are expected to be contained—with a 0.5% inflation rate projected for 2021 and 2% for 2022.

The budget deficit would gradually decline—to 4.4% of GDP in 2021 and 3.5% in 2022—mainly due to additional tax revenues from increased economic activity. On the other hand, the current account deficit should deteriorate markedly in 2021 to 16.2% of GDP because of an increase in imports for investment projects before falling significantly in 2022 to 10.9% of GDP as oil production from the new fields increases exports. However, presidential and legislative elections early in 2021 and the continued fragile security situation put the optimistic economic forecast at risk.

Financing issues and options

Niger's public debt increased significantly between 2014 and 2017, going from 22.2% of GDP to 39.6% of GDP, then stabilizing at around 39% between 2017 and 2019. But the effects of the pandemic drove public debt to nearly 50% of GDP in 2020, which presents a moderate risk of debt distress. External public debt, about 25% of GDP, is largely concessional and held by multilateral creditors. Niger has also recently reduced its more expensive domestic short-term debt in favor of longer-term and less expensive external financing. Niger should pursue reforms to improve public debt management, while giving priority to concessional financing. The country should also strengthen measures to mobilize more domestic public resources, while examining the possibility of improving the taxation of the extractive sector.



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Nigeria

Recent macroeconomic and financial developments

Nigeria's economy entered a recession in 2020, reversing three years of recovery, due to fall in crude oil prices on account of falling global demand and containment measures to fight the spread of COVID–19. The containment measures mainly affected aviation, tourism, hospitality, restaurants, manufacturing, and trade. Contraction in these sectors offset demand-driven expansion in financial and information and communications technology sectors. Overall real GDP is estimated by the Bank to have shrunk by 3% in 2020, although mitigating measures in the Economic Sustainability Programme (ESP) prevented the decline from being much worse.

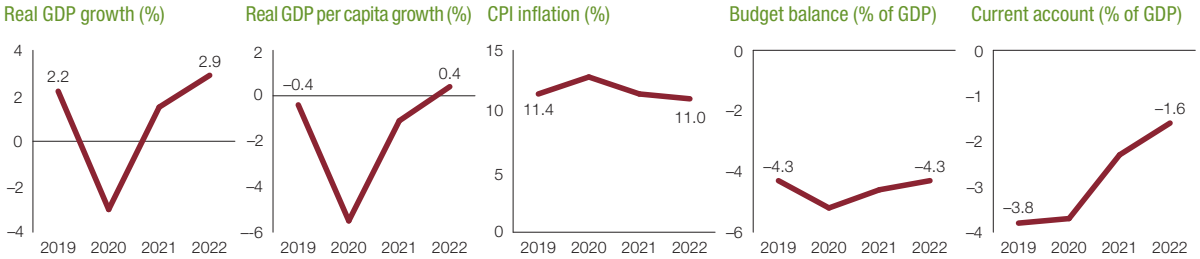
Inflation rose to 12.8% in 2020 from 11.4% in 2019, fueled by higher food prices due to constraints on domestic supplies and the pass-through effects of an exchange rate premium that widened to about 24%. The removal of fuel subsidies and an increase in electricity tariffs added further to inflationary pressures. The Central Bank of Nigeria cut the policy rate by 100 basis points to 11.5% to shore up a flagging economy. The fiscal deficit, financed mostly by domestic and foreign borrowing, widened to 5.2% in 2020 from 4.3% in 2019, reflecting pandemic-related spending pressures and revenue shortfalls. Total public debt stood at $85.9 billion (25% of GDP) on 30 June 2020, 2.4% higher than a year earlier. Domestic debt represented 63% of total debt, and external debt, 37%. High debt service payments, estimated at more than half of federally collected revenues, pose a major fiscal risk to Nigeria. The current account position was expected to remain in deficit at 3.7% of GDP, weighed down by the fall in oil receipts and weak external financial flows.

Outlook and risks

The economy is projected to grow by 1.5% in 2021 and 2.9% in 2022, based on an expected recovery in crude oil prices and production. Stimulus measures outlined in the ESP and the Finance Act of 2020 could boost nonoil revenues. Improved revenues can narrow the fiscal deficit to 4.6% and the current account deficit to 2.3% of GDP in 2021 as global economic conditions improve. Reopening borders will increase access to inputs, easing pressure on domestic prices and inflation, projected at 11.4% in 2021. Downside risks include reduced fiscal space, should oil prices remain depressed. In addition, flooding and rising insecurity could hamper agricultural production. Further depletion in foreign reserves from $35 billion (7.6 months of import cover) could lead to sharp exchange rate depreciation and inflationary pressures. A potential relapse in COVID–19 cases could exacerbate these risks. High unemployment (27%), poverty (40%) and growing inequality remain a major challenge in Nigeria.

Financing issues and options

Nigeria's public debt is relatively sustainable at 25% of GDP. But debt service payments are high, and the country's ability to attract external private financial flows is hurt by macroeconomic imbalances and policy uncertainty. During the first half of 2020, Nigeria received $7.1 billion in foreign investment. This was half the amount it received in the corresponding period of 2019. Nigeria's financing requirements require improved domestic revenue collection. Currently, nonoil revenue collections are equivalent to 4% of GDP. The revenue yield in 2020 from an increase in the value-added tax rate to 7.5% from 5% was less than projected because of subdued economic activity. Broadening the tax base could strengthen Nigeria's fiscal buffers, if structural reforms to enhance compliance are supported and illicit financial flows are tackled. Remittances and sharia-compliant sukuk bonds also offer potential financing options. In 2019, remittances totaled $23.8 billion (5.3% of GDP), but the effect of the COVID–19 pandemic in key source markets could reduce this figure. The third issuance of sukuk bonds of 150 billion naira ($395 million) in June 2020 attracted 669.1 billion naira, of which 162.5 billion naira was allotted to finance 44 critical road projects. Use of foreign reserves as a financing option in the medium term is impaired by lower oil receipts, the main source of foreign exchange.



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Senegal

Recent macroeconomic and financial developments

The COVID–19 pandemic hit Senegal hard, leading a once robust economy to fall into recession. After increases of 6.7% in 2018 and 5.3% in 2019, real GDP contracted by 0.7% in 2020—due to a slowdown in tourism (–17.0%), transport (–8.8%), and trade (–0.6%), as well as a decline in investment and external demand. Inflation rose to 1.9% in 2020 from 0.9% in 2019 due to the restrictive measures to contain COVID–19 and the continued easing of monetary policy. The crisis hit fiscal position from both sides. Tax revenue fell and health spending rose, resulting in a deterioration of the fiscal deficit to 6.0% of GDP in 2020 from an average of 3.7% in 2018–19. The fall in external demand led to a deterioration of the current account deficit from 7.9% in 2019 to 10.3% of GDP, which was financed by donors because of the low level of foreign direct investment and the decline in remittances.

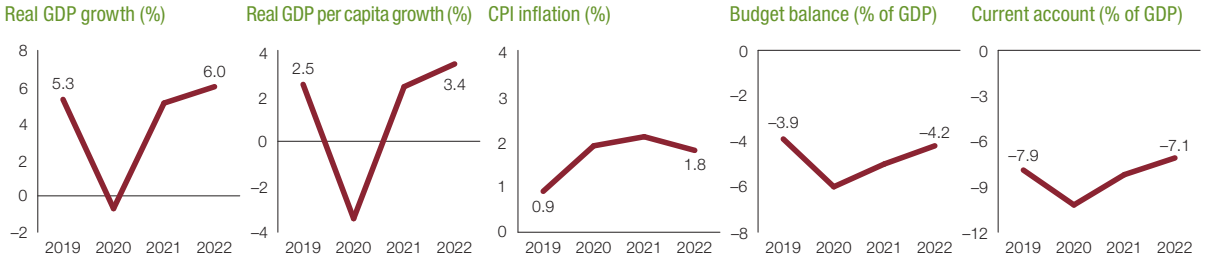
Outlook and risks

If the pandemic is brought under control in the first half of 2021, growth is expected to rebound to 5.1% in 2021 and 6.0% in 2022, driven by the resumption of public investments and the hydrocarbon sector in tandem with the resumption of global growth. Even so, inflation will be stable—at 2.1% in 2021 and 1.8% in 2022.

Senegalese authorities remain committed to rationalizing public spending and mobilizing domestic revenue to reduce fiscal deficit to 5% of GDP in 2021 and 4.2% in 2022. Similarly, the current account deficit will fall to 8.2% in 2021 and 7.1% in 2022, as exports resume and remittances pick up. This scenario could, however, be called into question if the COVID–19 pandemic persists as observed in December 2020.

Financing issues and options

The pandemic led to a slowdown in domestic revenue mobilization, which declined from 17.5% of GDP in 2019 to 16.5% in 2020, driving an increase in debt to 68.6% of GDP in 2020 compared with 64.1% in 2019 and 61.4% in 2018. Nearly 83% of total debt is external—30% of it owed to commercial lenders, 42% to multilateral institutions, and 28% to bilateral lenders. However, the risk of debt distress remains moderate. To ensure fiscal sustainability, the authorities have launched the Medium-Term Revenue Mobilization Strategy and will rely on concessional borrowing while reforming the debt management institutional framework. Total public debt stock is projected at $9.8 billion in 2021, 8.2% more than in 2020, and will represent 65.3% of GDP, below the convergence threshold of the West African Economic and Monetary Union.



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Sierra Leone

Recent macroeconomic and financial developments

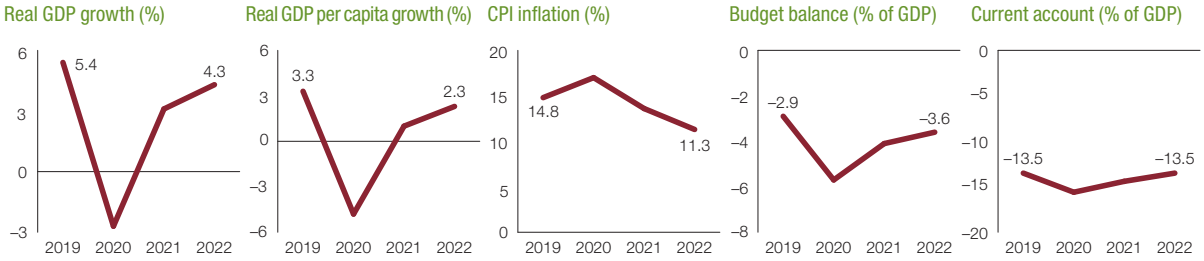
Sierra Leon's economy has been hurt by the COVID–19 pandemic. Real GDP was estimated to contract by 2.7% in 2020 after growing by 5.4% in 2019. The decline was attributable to weak external demand for major exports, particularly diamonds, and to declines in the mining, transport, trade, and tourism sectors. Inflation was estimated to pick up to 17% in 2020 from 14.8% in 2019, because of supply chain disruptions and transportation restrictions. The budget deficit was expected to widen to 5.7% of GDP from 2.9% in 2019, because of a revenue shortfall arising from lower economic activity. The decline in exports caused the current account deficit to widen to 15.6% of GDP from 13.5% in 2019. At the end of September 2020, foreign exchange reserves were $565 million (4.2 months of import cover), compared with $506 million (3.5 months of import cover) in 2019. The exchange rate remained stable at SLLs 9,845 to the US dollar at the end of 2020. The stock of public debt increased to 77% of GDP as of 30 November 2020 from 70% in 2019 a year earlier. Sierra Leone's debt is classified as being at high risk of debt distress, largely due to heightened solvency and liquidity risks arising from the COVID–19 pandemic. The country is implementing an Extended Credit Facility (ECF) arrangement with the International Monetary Fund. The ECF plans to support the government's reform agenda of creating fiscal space to finance policy priorities of the National Development Plan (NDP).

Outlook and risks

Upside risks to the outlook are predicated on the assumption that the economy would fully reopen, the ongoing policy and structural reforms supported by the NDP be implemented, the economic stimulus program continue, and external financial assistance in grants, concessional loans, debt service suspension, and restructuring be secured. In that scenario, growth is projected to accelerate to 3.1% in 2021 and 4.3% in 2022. Inflation is projected to ease to 13.6% in 2021 and to 11.3% in 2022; the fiscal deficit will narrow to 4.1% of GDP in 2021 and 3.6% in 2022; and the current account deficit will be reduced to 14.4% of GDP in 2021 and 13.5% in 2022. Downside risks to the outlook emanate from delays in the full reopening of the economy, a potential slowdown in global demand, and weak international assistance to supplement growth recovery efforts.

Financing issues and options

The high debt burden coupled with limited fiscal and monetary policy space could constrain Sierra Leone's effort to increase growth to its precrisis level in the near term. The ECF program, which was introduced prior to the pandemic, continues to guide policy and budgeting in Sierra Leone. In particular, the 2020 budget was anchored on the NDP. Despite credits and grants from international financial institutions in 2020 to help the country meet urgent balance of payments and fiscal needs from the pandemic, the country needs increased external financial assistance to support a resilient recovery. External assistance could aim to create fiscal space through debt relief, restructuring, suspension of debt service payments, and concessional lending. In the medium to longer-term, the country should also complement ongoing domestic revenue mobilization efforts by deepening ongoing financial sector reforms to support domestic credit market growth.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

Togo

Recent macroeconomic and financial developments

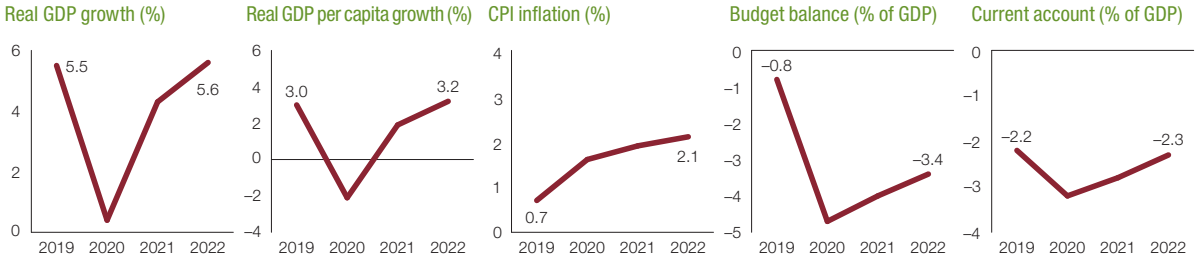
Togo did not feel the brunt of COVID–19 infections, but the effects of the pandemic halted its dynamic economic performance. Real GDP, which grew 5% in 2018 and 5.5% in 2019, grew only 0.4% in 2020, because of a decline in foreign direct investments, portfolio investments, and migrant remittances and the slowdown in global trade. Despite a prudent monetary policy, inflation more than doubled, from 0.7% in 2019 to 1.6% in 2020, mainly due to the supply disruptions. The budget deficit grew sharply, from 0.8% of GDP to 4.7% of GDP, as tax revenue fell and health spending increased as the government sought to fight the pandemic. The current deficit grew slightly, from 2.2% of GDP in 2019 to 3.2% in 2020. The current account deficit was kept from rising more because of a slowdown in imports.

Outlook and risks

The Togolese economy will recover soon if the pandemic subsides and global economic growth resumes. Real GDP will grow 4.3% in 2021 and 5.6% in 2022, driven by the agricultural sector and the resumption of investment in transport, energy, and the manufacturing sector. Inflation would remain high, compared with prepandemic levels, at 1.9% in 2021 and 2.1% in 2022. The budget deficit will only improve slowly because the government will maintain public expenditure to support investment and the revival of economic activity. The budget deficit will be 4% of GDP in 2021, and 3.4% in 2022. The deficit will be financed by a greater effort to collect taxes efficiently and more monitoring of exemptions and the tax base, among other things. The current account deficit should decline to 2.8% of GDP in 2021 and 2.3% in 2022 as exports increase.

Financing issues and options

The risk of debt distress is moderate. Fiscal consolidation from 2017 to 2019 and debt reprofiling to extend loan maturities made it possible to reduce the debt-to-GDP ratio from 80% in 2016 to 68.67% in 2019. Domestic debt represents 65.8% of outstanding public debt. Other technical adjustments and a further extension of maturities with some creditors because of the pandemic reduced the debt-to-GDP ratio to 57.8% in 2020. The recovery of the economy and public investment, as well as the payment of deferred maturities, will increase the debt ratio to 60% of GDP in 2021 before it stabilizes at around 57% of GDP over 2022–25. Recent debt sustainability analysis by the Togolese government indicates a moderate risk of external debt distress but a high risk of overall public debt distress due to the high level of domestic debt.



Source: Data are as of December 2020 and are from domestic authorities; figures for 2020 are estimates and figures for 2021 and 2022 are projections by the African Economic Outlook team.

ABBREVIATIONS

ADF	African Development Fund
AEO	African Economic Outlook
AfCFTA	African Continental Free Trade Area
ALSF	African Legal Support Facility
CAC	Collective action clauses
CEMAC	Central African Economic and Monetary Community
COVID-19	Coronavirus Disease of 2019
CPIA	Country Policy and Institutional Assessment
DIG	Debt-Investment-Growth
DRM	Domestic Resource Mobilization
DSA	Debt Sustainability Analysis
DSSI	Debt Service Suspension Initiative
ECF	Extended credit facility
EMBI	Emerging Markets Bond Index
ERI	Economic Resilience Index
EVI	Economic Vulnerability Index
FDI	Foreign direct investment
G20	Group of 20
GDP	Gross domestic product
HIPC	Heavily Indebted Poor Countries initiative
ICMA	International Capital Market Association
ICRG	International Country Risk Guide
IDA	International Development Association
IFI	International financial institutions
IMF	International Monetary Fund
IPI	Industrial Production Index
LP	Local projections
NPV	Net present value
ODA	Official development assistance
PFM	Public financial management
PISA	Program for International Student Assessment
PPP	Public–private partnership
RBL	Resource-backed loans
REC	Regional economic communities
RMC	Regional member countries
SME	Small and medium-sized enterprise
SOE	State-owned enterprise
UAE	United Arab Emirates
UN	United Nations
VIX	The Chicago Board Options Exchange Volatility Index
VRI	Value recovery instrument
WAEMU	West African Economic and Monetary Union

Real GDP in Africa is projected to grow by 3.4 percent in 2021, after contracting by 2.1 percent in 2020. This projected recovery from the worst recession in more than half a century will be underpinned by a resumption of tourism, a rebound in commodity prices, and the rollback of pandemic-induced restrictions.

Macroeconomic fundamentals have weakened as a result of the pandemic. Although counterbalancing forces kept average headline inflation stable at 10.4 percent in 2020, core inflation has risen in many countries. Fiscal deficits are estimated to have doubled in 2020 to a historical high of 8.4 percent of GDP, leading to increased debt burdens. A gradual consolidation process is expected in 2021 and beyond.

The adverse effects of COVID-19 will reverse hard-won gains in poverty reduction in Africa. About 30 million Africans were pushed into extreme poverty in 2020, and about 39 million more could fall into extreme poverty in 2021. The monetary cost of lifting the new extreme poor to the $1.90 a day poverty line is estimated at $4.5 billion for 2021—about $90.7 million on average per country.

Although lockdowns have been effective at mitigating the spread of COVID-19 in Africa, they have had severe economic consequences. Evidence shows that African countries with more stringent lockdown restrictions have experienced fewer COVID-19 cases than those with less restrictive policies.

Policy priorities to support economic recovery and build resilience include continuing support for the health sector to consolidate gains in the fight against the pandemic; sustaining monetary and fiscal support; expanding social safety nets and making growth more equitable; minimizing the long-term implications of the pandemic on human capital accumulation; accelerating structural transformation through digitalization, industrialization, and diversification; and strengthening regional and multinational solidarity.

Fiscal stimulus packages by African governments to contain the pandemic have had direct implications for public debt levels. The average debt-to-GDP ratio in Africa is projected to increase by 10 to 15 percentage points by 2021. Moreover, Africa's debt continues to shift from traditional lenders towards private and commercial debt with significant vulnerabilities.

Debt resolution in Africa has often been disorderly and protracted with costly economic consequences. The current international financial architecture makes orderly sovereign debt restructuring complex to achieve. To avoid high debt resolution costs and limit the likelihood that debt crises re-emerge, the international community needs to push for enhanced global coordination. African countries need to adopt legal and financial innovations that facilitate debt restructuring.

Strengthening the nexus between governance and growth is required to get out of the COVID-19 crisis and avoid a looming debt crisis. African countries must eradicate all forms of "leakages" in public resource management and pursue digitization and fair competition to re-ignite growth.

Two important strategies could revitalize African economies: Launching an accelerated digitalization, an all-out effort to harness digital technologies to propel Africa into the Fourth Industrial Revolution and boost job creation—and promoting free and fair competition and investing in transparency to enhance production efficiency.

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