

African Economic Outlook 2021

HIGHLIGHTS

From Debt Resolution
to Growth: The Road
Ahead for Africa



AFRICAN DEVELOPMENT BANK GROUP



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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



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

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.

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

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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.

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

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

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 hold-out 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.

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 a digital moonshot—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.

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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 a digital moonshot 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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