

The impact of the global economic slowdown on SSA in 2009 and the implications for equity investors

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Global growth is clearly slowing



- ◆ Global growth slowed in 2H08 and this looks set to continue in 2009. Citi's latest forecast is for global growth of -0.5% on a PPP basis in 2009. The IMF is similarly pessimistic, forecasting 0.5%.
 - A sharp fall from over 5% in 2007
 - A global recession is defined as "a rate less than 3%".
- ◆ The biggest drag on growth is the **developed world**. Citi forecasts industrial countries output will contract by 3.1% in 2009
 - Moreover, it is the speed of the contraction that is driving very negative headlines
 - Take US growth to illustrate the point. Growth has fallen from 2.8% in 2Q08 to an estimated -5.6% in 4Q08. Citi estimates it will be -5.1% in 1Q09, before returning to positive growth in 4Q09.
- ◆ Remember, unemployment is a lagging indicator

But the picture is not all bleak

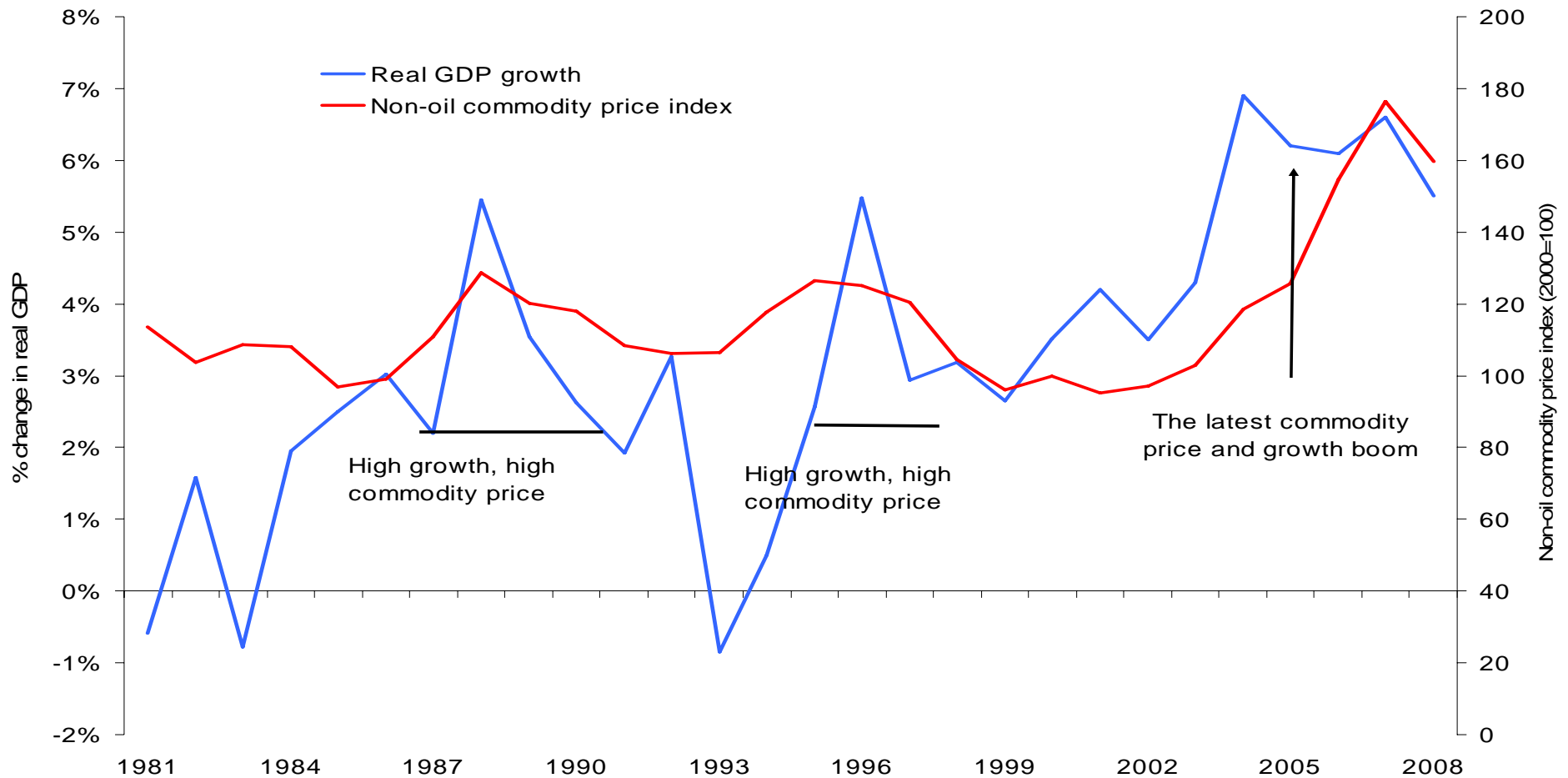


- ◆ But the outlook is not as bleak in **developing countries**
 - Citi expects “emerging markets” to grow by 1.6% in 2009. The IMF forecast growth for “all developing countries” of 3.3% in 2009
 - Down from 7-8% in recent years, but still positive. Moreover, the slowdown is clearly more pronounced in Eastern Europe and Latin America.
- ◆ The IMF forecasts growth of 5.5% for developing Asia. Citi still expects growth of 7.6% in China and 5.5% in India in 2009
 - In China, the government has helped liquidity and announced a fiscal stimulus package that should take effect in 2H09.
- ◆ The IMF forecasts growth of 3.25% for SSA in 2009, but a quick rebound to 5% in 2010
 - A tail-off compared with recent years when growth was around 6%, but good by the historical standards of the last two decades.

The impact on SSA to date

- ◆ There were few signs of a slowdown in growth in 2008
 - What Benno Ndulu refers to as the “first-round effects”
 - Growth numbers for 2008 all look solid, even where quarterly data are available, such as in Nigeria
 - However, on the downside, there has been a sharp rise in inflation.
- ◆ But there have been other areas of more visible impact
 - Falling currencies
 - Falling stock markets.
- ◆ The key questions these trends raise are
 - What will the “second-round effects” be? Uncertainty is worrying
 - When will they be felt in SSA?

Commodity prices and growth

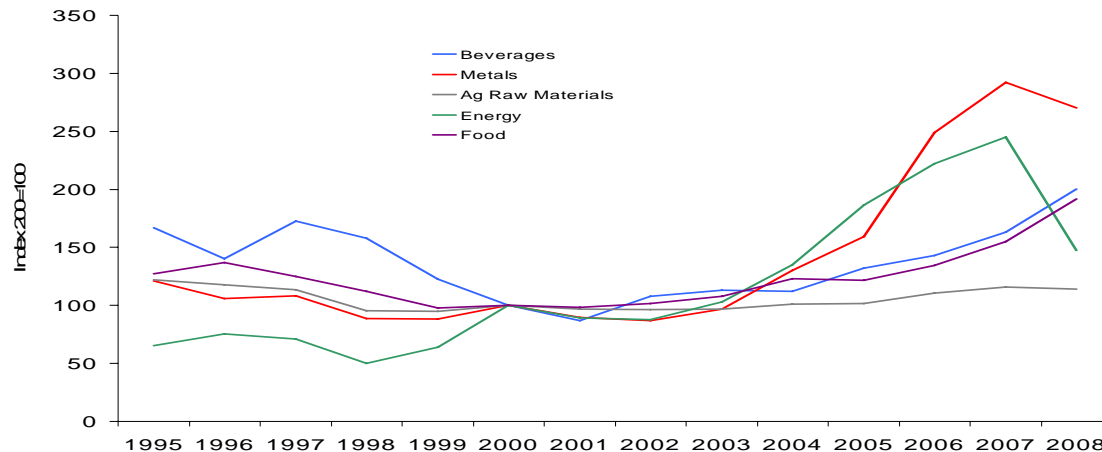


Source: IMF.

But this is only part of the story

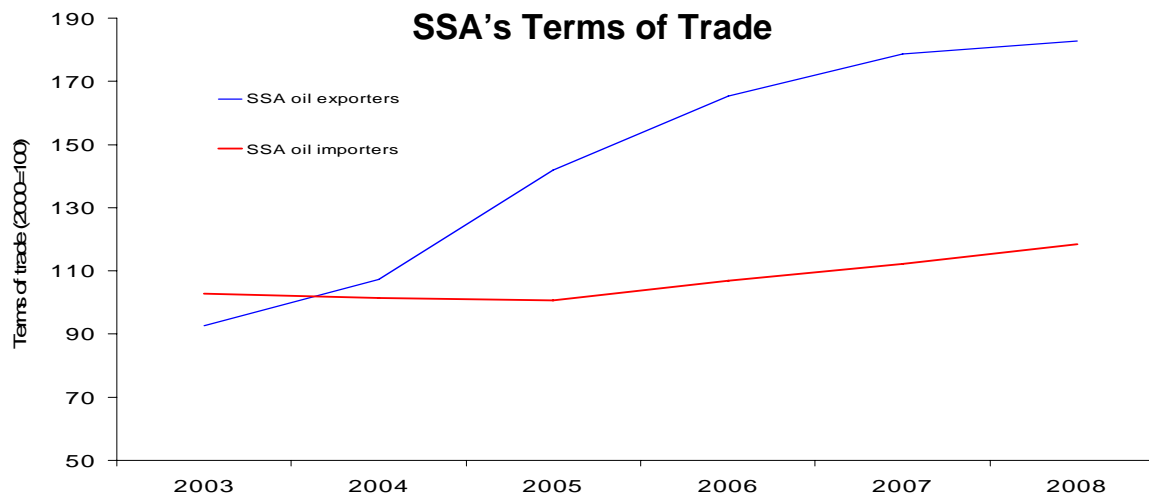


Commodity Prices



Source: IMF.

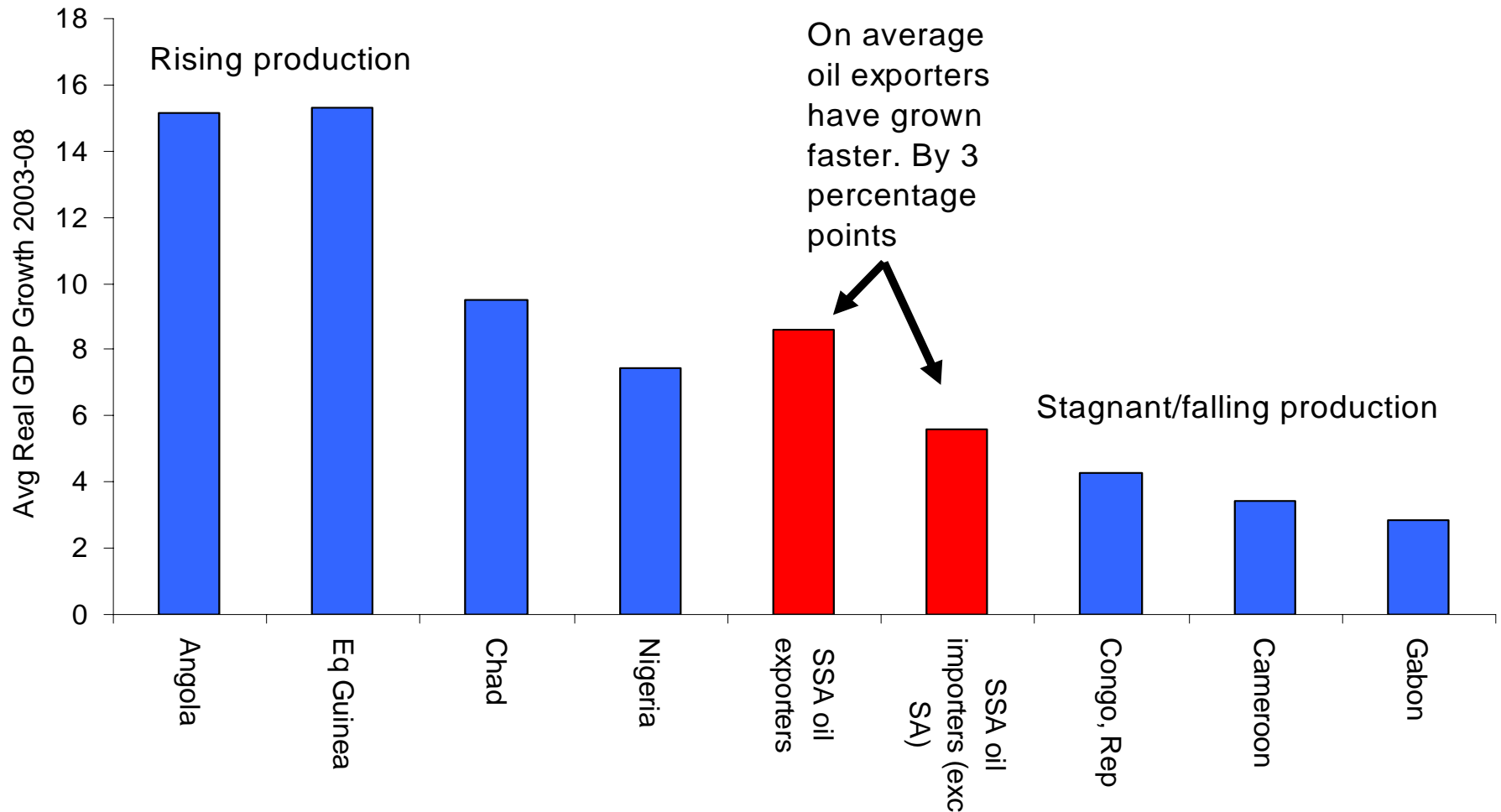
SSA's Terms of Trade



Source: IMF.

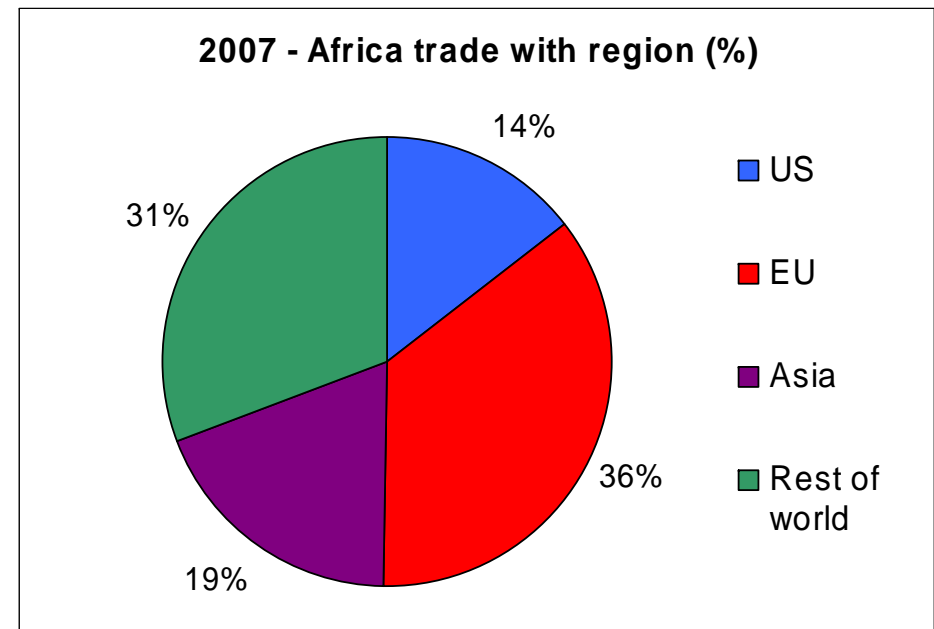
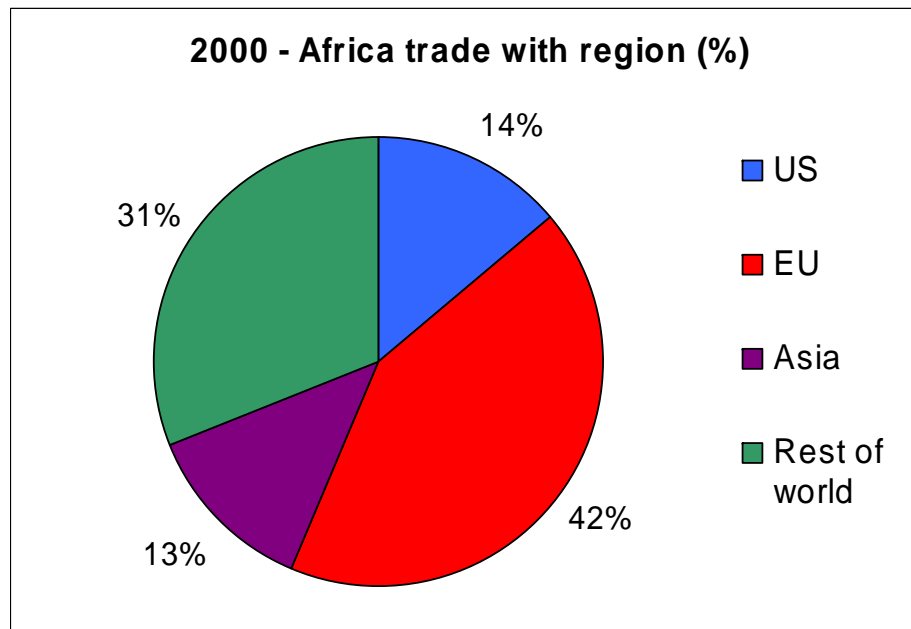
- ◆ Oil and metal prices rose significantly faster than prices of beverages and agricultural raw materials
- ◆ The impact of the commodity price boom depends on the country's precise export/import composition
- ◆ Because oil prices have been rising so rapidly, the overall impact of the commodity price boom on the terms of trade is insignificant for non-oil exporters
- ◆ Ghana – oil imports have risen from US\$1,129 mn in 2005 to an estimated US\$3,233 mn in 2008

Oil exporters show the complexity



Source: IMF.

Changing trade patterns



Source: IMF.

Source: IMF.

- ◆ The EU has become less important as a trading partner, while Asia, led by China, has become more important as a trading partner
- ◆ Provisional data show trade between SSA and China and India grew in 2008
- ◆ Some disengagement, but mainly in marginal mines. China is still making a long-term play into infrastructure development

Key links - remittances

- ◆ According to World Bank/official data, remittances to SSA were only US\$4.6 bn in 2000. They have risen sharply since - the latest World Bank estimate is that they were US\$20.4 bn in 2008
- ◆ But a large part is rising Nigerian remittances. Up spectacularly from just over US\$1.4 bn a year from 2000-04 to over US\$9.5 bn a year in 2007-08
 - Around 6% of GDP in Nigeria vs 2.4% for SSA as a whole
 - Other countries with a high dependence – Cape Verde 9.2%, Senegal 8.5%, Togo 8.4%, Uganda 7.2%, Zambia 6.1% and Kenya 5.9%.
- ◆ A crucial inflow, as money flows directly to individuals and households and is directly spent on consumption and investment
 - Around 75% of SSA remittances are from the US and EU and will therefore be adversely affected by the global slowdown
 - But the World Bank argues that flows are generally resilient/counter cyclical. Estimates they will only fall by between 1% and 7% in 2009

Key links - tourism



- ◆ Visitors still largely from the EU. As the EU slips into recession, this should have an impact
 - UN data show that during 2004-08 the number of tourist visitors rose by around 7% a year, and around 4% in SSA
- ◆ To some extent, SSA tourism has tended to be at the “high end of the market”, which may prove marginally more immune – Seychelles, Botswana and Namibia
- ◆ But may be more pronounced in Cape Verde, The Gambia, Ghana and Senegal, which do not necessarily operate at the high end of the market
- ◆ Early signs of slowdown in East Africa – Mauritius, Kenya and Tanzania – bookings are reportedly down
- ◆ The UN estimates that world tourism numbers will fall by 2% in 2009

Key links - investment



◆ FDI

- According to World Bank data, FDI into SSA was only US\$6.8 bn in 2000. FDI flows rose to over US\$17 bn a year in 2005-07
- Partly commodity driven, and therefore likely to slow down
 - Two mechanisms - prices and financing
- But rising production from past investment will likely drive growth
- And also non-resource FDI – phones/retail/transport/financial

◆ Portfolio

- Difficult to get accurate data, but has clearly risen
- Probably over 60% of the total stock has left – mainly that in government bonds
- But on the equity side we feel SSA is a long-term investment play

Key links - aid and debt relief



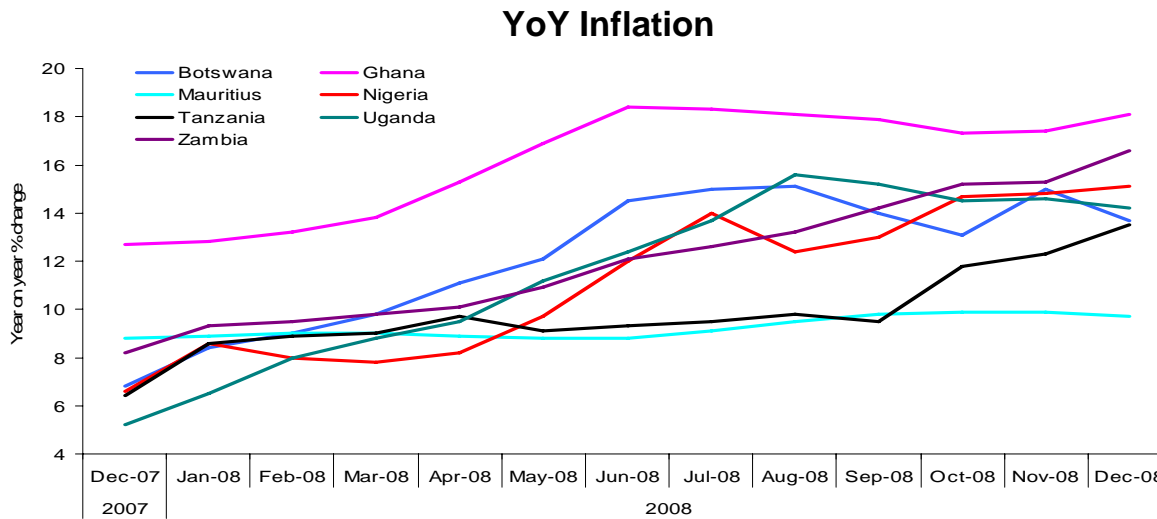
- ◆ Impact of aid on growth is still the subject of much academic debate
 - Donors will probably be reluctant to commit new money – and therefore unlikely to meet the UN’s target of 0.7% of GDP - but unlikely to cut back significantly
 - But the real question is: which countries will get funds? And what will happen if governments fail to meet performance targets?
- ◆ Part of the recent rise in aid inflows is debt relief, not traditional project aid. HIPC reductions have only had a modest impact on the stock of external debt in most countries. Total SSA debt stock in 1999 was US\$215.1 bn, roughly the same as the US\$216.3 bn in 2005
 - The impact of debt relief only came with the MDRI initiative/Nigerian buy-back. By the end of 2006 the stock of external debt fell to US\$173.5 bn
 - Has since risen, but may become important now

Policy response is crucial

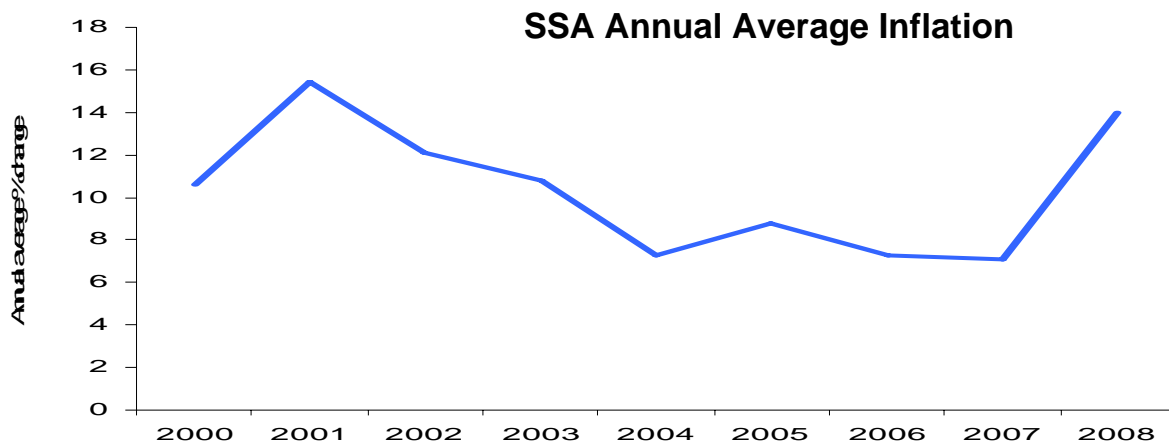


- ◆ In general, governments are in a much better position to respond to a negative external shock, such as a global recession
 - Strong growth, robust foreign exchange reserves, relatively low inflation, low domestic debt, external debt write-offs and so on
- ◆ In particular, low domestic debt levels, and for some, external debt write-offs, mean that they can boost spending and borrow more to offset the slowdown in growth
 - Also, some countries have sought to make progress on tackling the infrastructure constraints to growth
- ◆ Inflation is likely to be an issue for some time. Lower world oil prices should help, but prices are sticky
 - Central banks may have to maintain tight monetary policies to help bring inflation firmly under control

Rising inflation



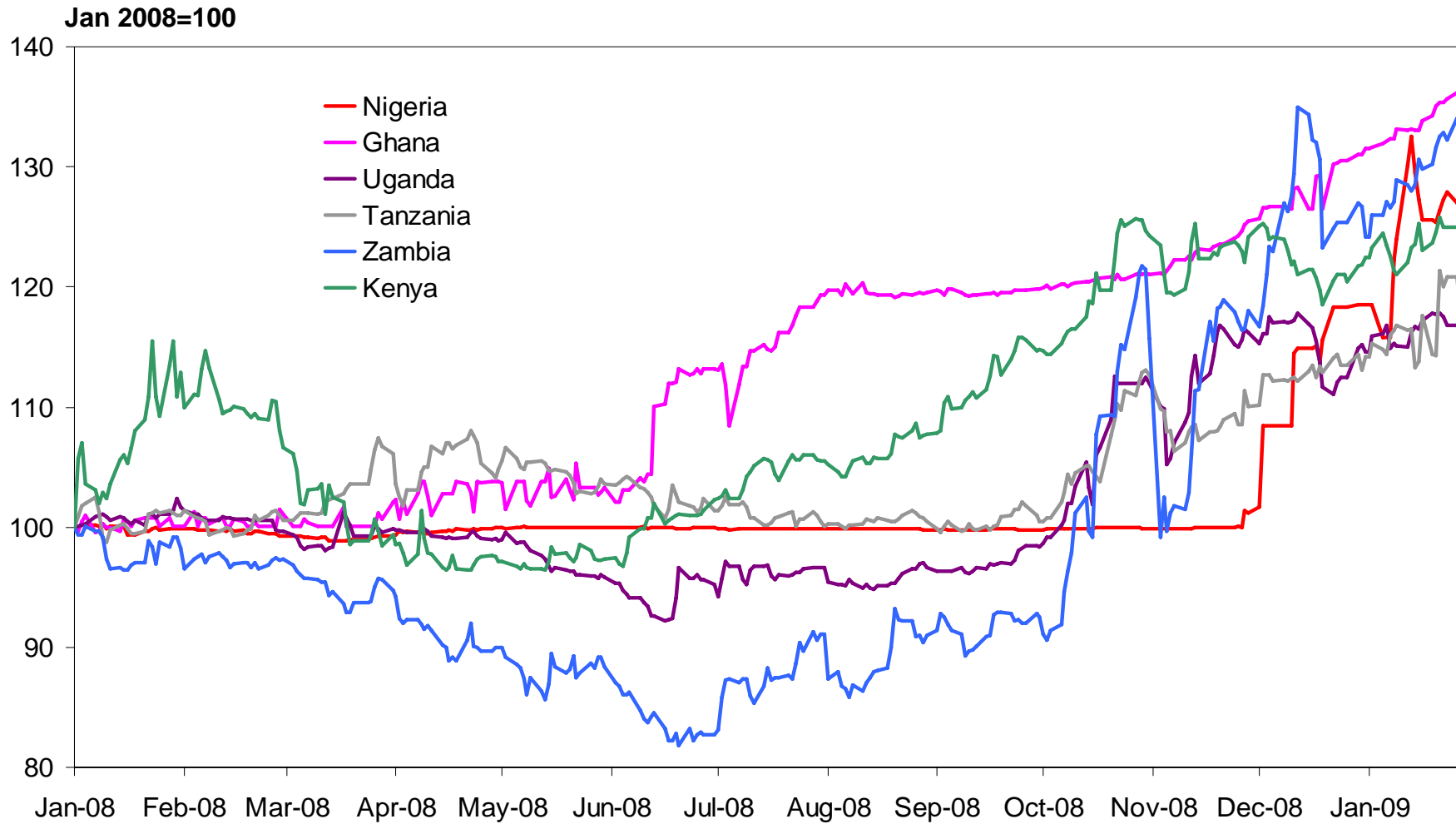
Source: IMF.



Source: IMF and Citi estimates for 2008.

- ◆ Inflation started to rise sharply in 2008 in a number of SSA countries
- ◆ Rising prices have become a big “political issue”
- ◆ Many governments have claimed it is the result of rising world food and fuel prices. Partly true. But the food price element is overplayed. Most SSA food is domestically supplied
- ◆ The IMF estimates that a 10% rise in the world oil price will add 0.4 percentage points to the inflation rate
- ◆ The main cause may be domestic. Rising money supply growth since 2005/loose monetary policy

Falling African currencies



Source: Reuters.

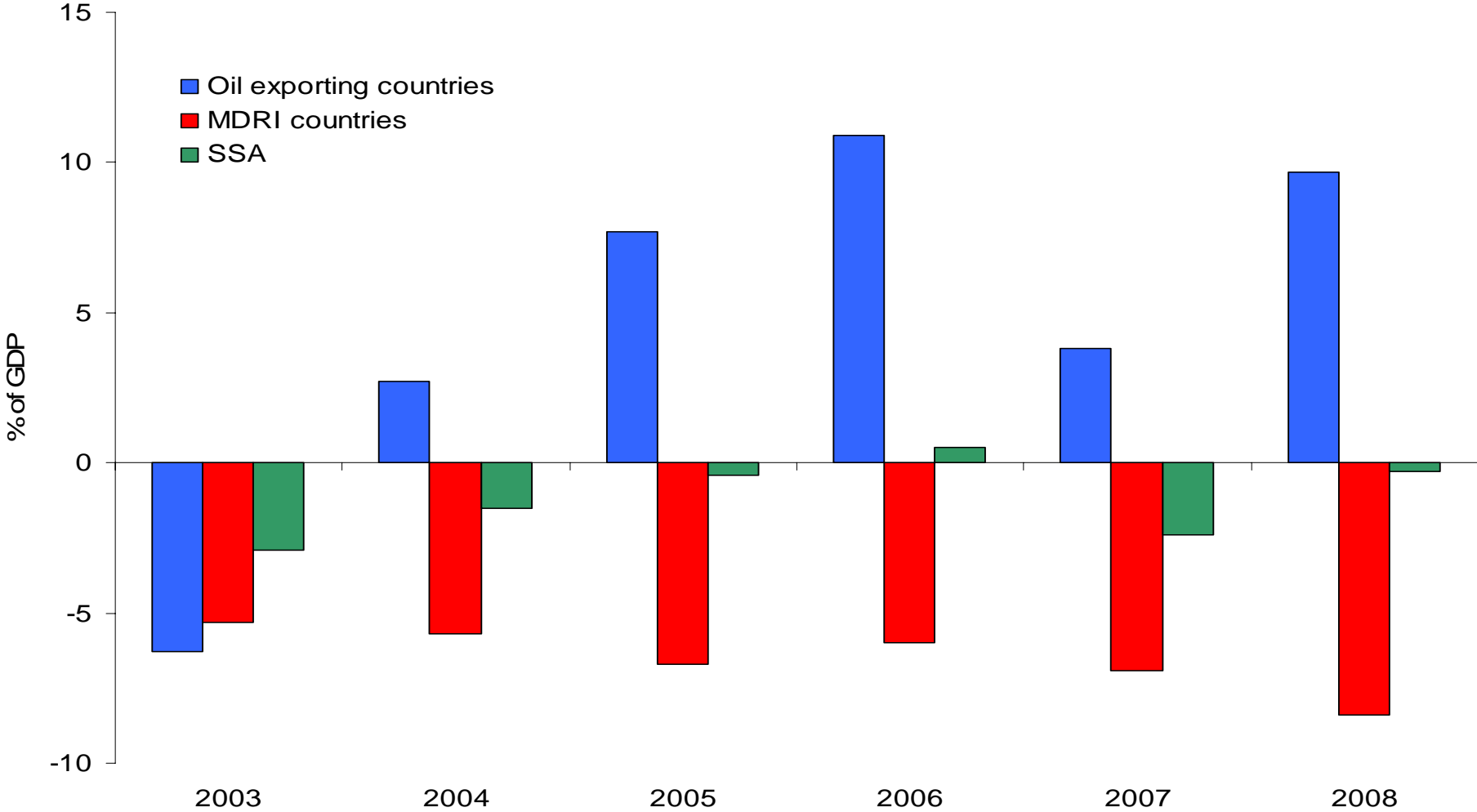
Why are they falling?

- ◆ The initial trigger may well have been portfolio investment outflows from investors in government securities
- ◆ Compounded by the strengthening of the US dollar on world markets in September and October 2008
- ◆ But we think it has now switched to “speculative “ domestic demand
 - Holding money locally has little attraction, domestic interest rates are low. In fact, often negative in real terms
 - Individuals/corporates with spare cash seek to buy foreign exchange as a hedge against further devaluation
 - People delay exchanging remittances into local currency
 - Bunched up demand, or purchases are moved forward
- ◆ Think about Nigeria. If there are 10 million people, with US\$10,000 each = US\$100 billion
- ◆ Return of informal dollarisation

Longer-term currency outlook

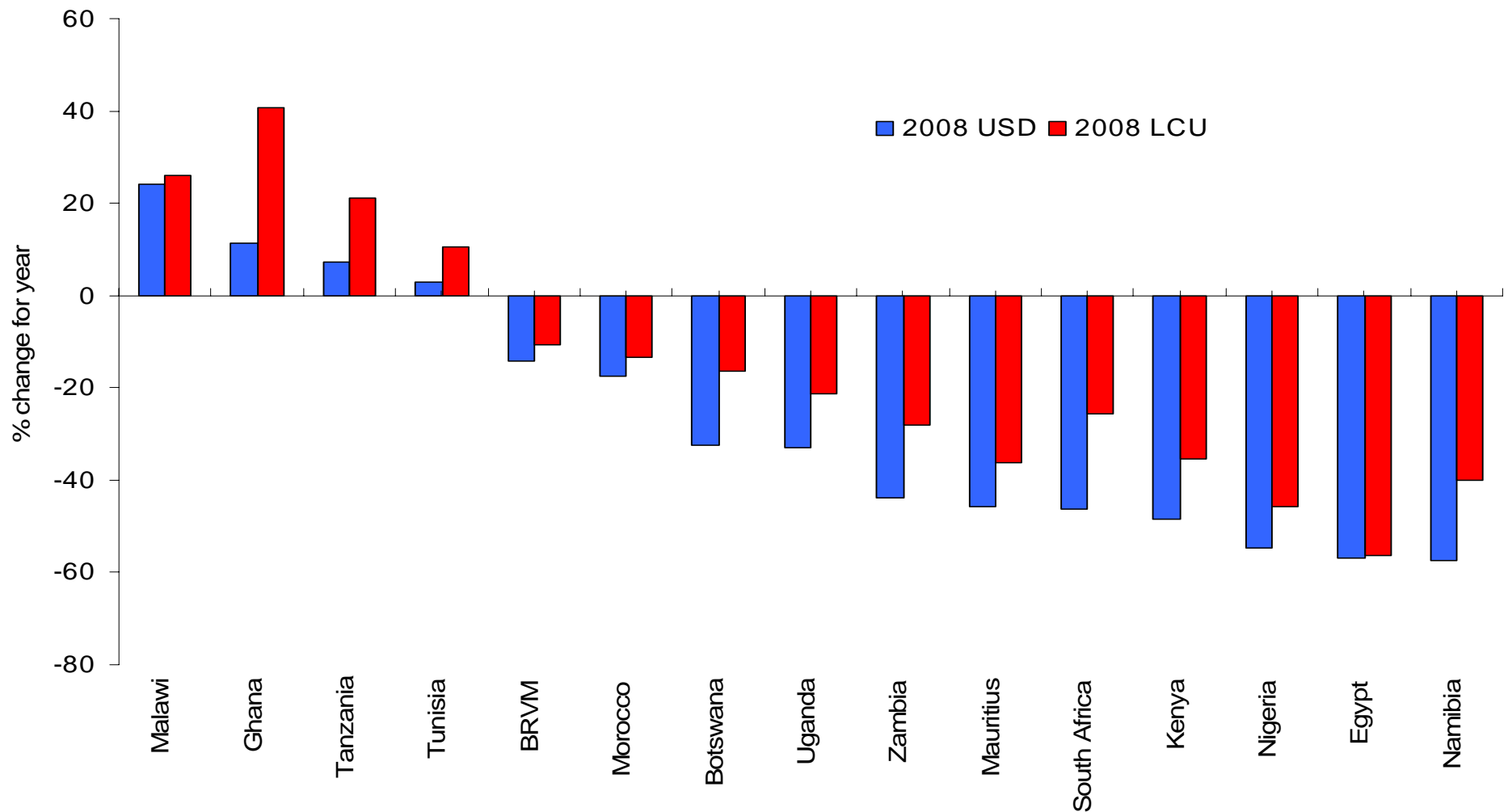
- ◆ But remember, the fall is also a positive adjustment
- ◆ In the longer term, the main impact on the currency outlook will remain current account deficits – supply and demand
 - Crucially, how these current account deficits can be financed
- ◆ Annual patterns may also re-assert themselves
- ◆ Future taxation of mineral revenues may also be important
 - Zambia has led the way. Tanzania may well follow. The IMF, for example, estimates that of gold exports worth US\$2,667 m in 2008, only US\$149 m accrued to the government in tax.
 - Oil revenue inflows – Ghana and Uganda
- ◆ Policy stance will also matter. Overall attitude and capital/exchange controls

Current account deficits



Source: IMF.

African equity markets 2008



Source: Databank and Reuters.

Trends in 2008

- ◆ Year of two halves, with the fall in 2Q08 substantial, but still considerably less than for other emerging markets
- ◆ The fall was much worse in US dollar terms for most exchanges, reflecting the currency weakness in 4Q08
- ◆ Within Africa, the fall was greatest in Southern Africa and economies more exposed to the global economy
 - Reflects - greater exposure to foreign investors, led by Southern African investors? JSE cross listings? Global concerns?
- ◆ But domestic factors were still by and large the main factors driving falls
- ◆ Market valuations may look much better now than a year ago
- ◆ No real trends by sector
 - Financials did badly in Nigeria and Kenya

Trends in 2008 - Nigeria



- ◆ Three triggers to the Nigerian stock market collapse in 2H08
 - Foreigner investor withdrawal. But should not overstate. At a peak market capitalisation of around US\$85 bn, only 15% was held by foreigners. Many long-term players
 - Banking sector issues – some stocks have fallen 70%
 - Common end of year financial deadline
 - Margin lending problems. CBN estimates costs at around US\$6 bn for banks, or around 20% of outstanding loans
 - Erosion of confidence – a classic asset price bubble in an emerging economy. Lack of local buyers on the way down to help slow the fall

Possible trends 2009

- ◆ Market valuations may look much better now than a year ago in many markets – but this could quickly change
- ◆ Stick to the “3 Cs” – cash, be conservative and choose companies where consumer demand will hold up
 - Basic consumer products, construction and perhaps death?
- ◆ Pick companies that are using the “cooling off period” to invest
- ◆ Infrastructure – Eurobond road shows
- ◆ Be picky. Don’t buy into whole sectors. Nigerian banks, some good, some not so good
- ◆ Mobile phone listings – will these take off?
- ◆ Resource company listings – towards the end of 2009 to raise money
- ◆ Slowdown in IPOs

Conclusion

- ◆ Growth will slow in 2009 and into 2010, but moderately in larger economies
 - DRC, Kenya, Senegal, South Africa and Zambia will probably be worse hit
- ◆ Inflation should slowly ease
- ◆ Currencies will likely remain under pressure, but a big adjustment has occurred already

But

- ◆ Domestic issues are still probably the more important factor adversely affecting SSA growth
 - Governments need to fix structural constraints to development
 - Find the appropriate policy response to the slowdown
 - If they get it wrong, the impact could be greater
 - Harder to get policy right in a more challenging international environment



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