

## **Deloitte Africa Outlook, 2016**

### **Keynote speech**

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Good Morning, ladies and gentlemen

It's a great pleasure to be here this morning – and thank you very much to Martyn and the Deloitte team for inviting me. I'd like to start by making six points – some inevitably rather bearish - but amounting, I hope, to a case for moderate and reasoned optimism about Africa's prospects.

First, a completely uncontroversial and entirely bearish point: With Chinese growth at a 25-year low and oil trading at \$28 a barrel - and because the global economy has been in the doldrums for so long and because we can't expect much improvement in 2016 - Africa is fast running out of 'policy space' for further monetary or fiscal expansion.

According to the IMF and the World Bank, 34 of the 45 countries in sub-Saharan Africa are in a worse fiscal position now than they were in 2008. On average, sub-Saharan countries had a fiscal deficit of 1.7% of GDP in 2008. The average fiscal deficit is now 3% - admittedly, hardly disastrous, but a 100% increase in the budget deficit over 6 years is not something one wants to repeat. In 21 of the 45 countries, the external balance is also weaker, with the average current account deficit having risen from 2.5% to 4% of GDP. Most worryingly, several of the larger economies – including South

Africa's – now have gross external financing needs in excess of 10% of GDP.

Of course, some people like to say that it's really a good thing when the monetary and fiscal larders are empty, because that will 'force governments to undertake structural reform.' This is over-optimistic. Governments actually have three choices in this kind of situation: In the best case, they can take vigorous – and often politically difficult - steps to make their economies more competitive. In the worst case, they can carry on spending regardless and thereby generate hyperinflation and a sovereign default. In the middle case, they can drift and tinker.

It doesn't look as if any African countries are currently on the worst path – although clearly one ought to be worried about inflation and debt sustainability in Ghana, Angola and Zambia - and so this might not be the best year for major new investments in those places. However, to quote the World Bank, average inflation across the continent is 'relatively contained' and, in general, debt levels remain at manageable levels. That leaves most of sub-Saharan Africa in our middle or 'rising star' categories.

On current evidence, both South Africa and Nigeria are middle-category countries. Nigeria has the potential to shift into rising star mode in the future, if President Buhari's reforms take hold. In the context of depressed oil revenues, the President has unveiled plans to increase government spending by about one quarter over last year's budget - but, crucially, this is to be funded by improving tax collection, cutting government costs, and clamping down on corruption. None of this will be easy, or uncontested – but the intention is sound.

In South Africa, we'll be looking to Minister Gordhan's February Budget Speech for firm evidence of fiscal discipline, and a commitment to rebuilding the country's competitiveness. However, as we all know, the National Treasury can only do so much to encourage structural change.

As the IMF said a day or two ago, South Africa's likely dismal growth rate of 0.7% this year is the result of factors including declining commodity prices, weakening business and consumer confidence, likely rate hikes, the drought, policy uncertainty and the electricity constraint. To get South Africa out of the doldrums, we would need better prices, better rains – and to see the government as a whole pulling in the same direction, which is something that isn't happening just yet. So let us say - for argument, rather than as absolutely firm prediction – that South Africa stays in the middle group. In that case sensible business leaders should do two things: First, in order to maximise profits during this difficult period, focus on resilient market segments. In South Africa, this means the established and emerging middle classes. These segments continue to do significantly better than the country as a whole, as can be seen from the facts that the VAT take has remained resilient and that personal income tax receipts have actually been growing quite strongly. In Nigeria, similarly, a short to medium-term strategy focussed on the middle class is likely to be the most successful.

Second, as I'm sure you'll agree, it would not be wise or responsible to plan to remain in this kind of defensive posture for the long term. I believe that, as corporate citizens of middle group countries, we have both a duty - and a direct commercial interest – to do what we can to promote and support faster and more inclusive growth. In

South Africa, I argue, that means doing everything we can to speed up transformation and to increase competitiveness, to improve labour relations and to strengthen institutions such as NEDLAC, and to stand up for honest and efficient management in our firms, in the SOEs and in government. Certainly, my New Year's resolution for 2016 is to spend more time and energy on all of these issues.

Among the rising stars – countries which have undertaken structural reforms to improve their competitiveness, and which have held to prudent fiscal and monetary policies – we have much of East Africa, together with the DRC, Mozambique, Côte d'Ivoire and Cape Verde. All these countries have also opened their markets to global trade and invested in large-scale infrastructure development in energy and transport. The result ? Even in the most difficult global economy in 75 years, the rising stars are expected to sustain growth of around 7% - and above – for the next several years.

Many in the rising star group are oil importers, and as such have enjoyed the benefits of lower prices, which have enabled them to lower their fiscal and current account balances. But - much more fundamentally - several of these countries, including Ethiopia, Kenya, Tanzania and Uganda, now compare favourably with non-African competitors on factors such as transport and communication costs and on their quality of institutions. They have also made good progress both on regional integration and on linking their economies into global value chains, increasing the East African region's competitiveness as an exporter of manufactured goods.

It's worth looking in a bit more detail at what Kenya has achieved. There have been major investments in infrastructure in recent years, including refurbishing the port at Mombasa, opening new industrial

parks in Mombasa and Naivasha, building a new railway that has cut cargo transit times by 90% and reduced the cost of energy by over 30%. Equally important, Kenya has also introduced an impressive set of regulatory reforms to improve the business environment. These include simplification of business registration, unified electronic land and property registration, expanded access to credit information, and better access to electricity thanks to a system that uses private sector contractors to install meters. As a result, Kenya jumped 28 places in the World Bank Doing Business indicators last year.

Smart investors are piling in. Nairobi, as we all know, is now looking like an increasingly serious rival to Johannesburg as an African headquarters for multinationals and as a financial centre.

My third point is that gloom about the effects of China's slow-down on Africa can be overdone. There's no question that the short-term trade picture is bleak. Standard Bank's economists think that the value of Africa-China trade could be down by as much as 25% year-on-year for 2015. But this follows 15 years in which China-Africa trade grew by over 2000%, from around \$5 billion in 2000 to about \$220 billion in 2014. This trade explosion has changed both Africa and China profoundly. Many Chinese firms are now deeply invested in Africa, and increasingly look to this continent for growth opportunities that are getting harder to find at home. In 2014, for instance, Chinese sales to Africa increased by 14% - twice as fast as the overall growth rate of Chinese exports. Africa also presents attractive opportunities for the Chinese construction and manufacturing firms that are most vulnerable to China's re-balancing. After all, a lot of Africa now looks like China did when it began its take-off: lots of potential, but far too little infrastructure.

Further, some African countries could benefit from a weaker yuan that would cut the cost of the Chinese goods and services they import. Countries such as Ethiopia, Kenya and Mozambique have posted trade deficits in recent years owing to high import volumes of Chinese capital goods. A weaker yuan will mean more heavy equipment and more infrastructure at a lower cost.

Lastly on China – and I don't think enough people know this yet - China's switch from an investment-led to a consumption-based growth model is actually good news for Africa in the longer term. The World Bank's modellers think that, over the next 15 years, the negative impacts will be far outweighed by the positive changes. The net effect of the evolution of the Chinese economy towards consumption will be to add 4.7% (\$181 billion) to Africa's GDP by 2030 compared to China's current growth path, with Kenya, Botswana and Nigeria the biggest winners, and only Zambia experiencing a small net loss.

My fourth point is about currency depreciation. Yes, it's uncomfortable – especially for the middle class – and feels undignified. But the evidence suggests that it has its advantages. Enjoyable foreign travel, admittedly, is not one of them, but if appropriately managed, depreciation supports national competitiveness and makes structural reform easier.

South Africa actually handles depreciation very well. As the Reserve Bank has frequently stated, it doesn't seek to manage the external value of the currency, preferring to use it as a shock-absorber. A rapid depreciation is not a pleasant experience. But it is better than the alternatives, which would include very steep interest rate hikes, or running down our international reserves – or both.

Countries that have tried to defend their currencies have burned through billions of dollars which could almost certainly have been better spent on infrastructure and public services. Nigeria has spent about 2% of its GDP on shoring up the naira, and Angola about 6% of GDP on the kwanza.

Further, in most African economies, depreciation has rather small effects on local inflation. On average, a 10% depreciation will cause domestic prices to rise by only 1.3 percent - not percentage points. In South Africa, the pass-through to inflation may be a bit higher – at about 1.6% a year for every 10% depreciation, or 6.4% as a result of the Rand's 40% depreciation last year. Even this dramatic fall is unlikely to create a lot of inflation – it's likely to push up CPI by only about 30 basis points. Therefore, if South Africa can avoid another period of frequent load-shedding or major strikes, depreciation has relatively low costs to the economy as a whole, gives exporters a boost, and may create opportunities to undertake longer-lasting reforms to our labour and product markets - it is always easier to operate on a relatively healthy patient.

Fifth, another bullish point: As we all know, Africa already leads the world in mobile payments, and we can expect that Africa's digital revolution will continue. By 2021, we can expect the continent to have over a billion feature and smart phones in use. Every single African, in other words, will have a phone and an internet connection. We shouldn't let ourselves get blasé about this – the economic, social and political effects of a fully digital Africa will be enormous and, I think, almost all positive. Looking just at the financial sector, Africa's lead in electronic payment is being rapidly supplemented by mobile-based insurance, savings and micro-credit

services. And since Kenya is my poster child for this morning, I can't resist mentioning two new Kenyan apps: M-Farm, which – provides farmers with up-to-date information on crop prices and Safari Tales, which teaches children to read using African stories, in indigenous languages.

Finally, a point I've made many times in recent years – as African populations become steadily healthier, better educated and more urbanised, African economies are increasingly able to generate their own internal growth. World Bank research published in 2014 showed that 'overall economic growth in recent years in sub-Saharan Africa is largely due to increases in:

1. Capital accumulation, driven by the inflow of FDI, particularly into resource rich countries
2. The rising population share of the working age population – in other words, an improvement in dependency ratios as fertility rates come down,
3. Total factor productivity growth, which the World Bank attributes to reduced political instability, and economic diversification from agriculture to other sectors over the past two decades. I'd argue that it's also very likely supported by improvements in education and better health.

Of these three, FDI flows are inevitably vulnerable to the decline in commodity prices. But improved dependency ratios are not, at least in the short and medium terms. And nor is total factor productivity growth, which essentially measures the quality of governance and of the business environment.



In other words, the steps that Africa has taken to get its own house in order – improved governance, major regulatory reforms in the rising star countries, better education and health care - are reaping rewards for the continent that are substantially independent from international commodity prices. And note that these developments are self-reinforcing. Healthier and more prosperous parents are better able to care for and educate their children. The educated middle class both supplies and demands better governance and better regulation, and produces most of the entrepreneurs to take advantage of these. It is for these reasons that Africa will continue to grow at between 4 and 5% a year for the next five years – not quite as fast as we would like, not quite as fast as emerging Asia – but still far better than the world average, whatever the price of oil.

Many commentators have already consigned the ‘Africa rising’ narrative to history. But - as is always the case – the picture is a lot more nuanced than the news headlines would suggest. The continent continues to offer excellent investment opportunities – if you know where to look for them, and if you have a good understanding of likely risks and trends, not just in the next year or two, but over the next ten to 15 years.

Thanks.