SACE

FOCUS ON
The African economic miracle: This is (not) the end

Produced by the Economic Analysis and Research

The impact of the 3C Factor on the African economies and on opportunities for Italy

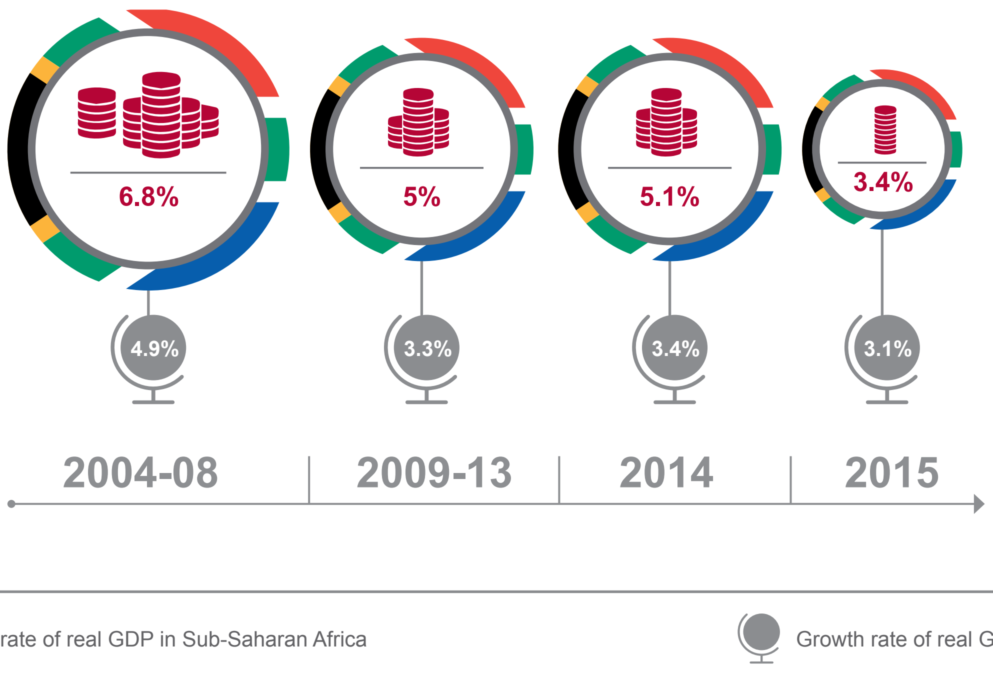
EXECUTIVE SUMMARY

- *In recent months, the news has been depicting **an African continent in difficulty**. Economic growth has been the lowest in recent years, and some old "bogeymen" like rising debt have re-emerged. Is the parable of the African economic miracle at risk?*
- *We don't think so. Never before have there been such differences among the 49 countries of the continent. And the difference is often what we might call **the 3C Factor**, to represent three variables—i.e. **Commodities, China and foreign Capital**—that affect the economic present and future of the African continent.*
- *It is no coincidence that the greatest difficulties are to be found in those countries where the 3C Factor is greatest, e.g. South Africa, Nigeria, Angola and Zambia; conversely, **the countries less exposed to the 3C Factor continue to offer interesting opportunities**, such as those in East Africa (Kenya, Tanzania and Rwanda) and West Africa (Senegal and Ivory Coast). The dynamics of Italian exports to the region follow this same dual pattern.*
- *The recent decline in the African economic situation once again underscores that venturing abroad requires a rational strategy, even when things seem to be going well. So three useful suggestions: retain **advisory services** to judge the strategic strength of a project and assess the impact of the logistical-operational difficulties in the area; accompany the commercial proposal with a **financial proposal** that lightens the burden of repayment; and secure instruments to mitigate or **cover the risk of payment default**, due to the commercial insolvency of the counterparty or possible local currency restrictions.*

IS THE PARABLE OF THE AFRICAN MIRACLE AT RISK?

In 2015 Sub-Saharan Africa set a record, a negative one unfortunately: **the GDP of the region rose 3.4%, the lowest rate since 2000** (Fig. 1). The subcontinent performed better even in 2009, the year of global recession. The latest projections for the current year leave little room for optimism, signaling a further slowdown in economic activity, around + 3%, with expectations of a recovery beginning in 2017-18[01].

FIGURE 1. *A slowing continent*



Source: data processing by SACE, based on IMF data

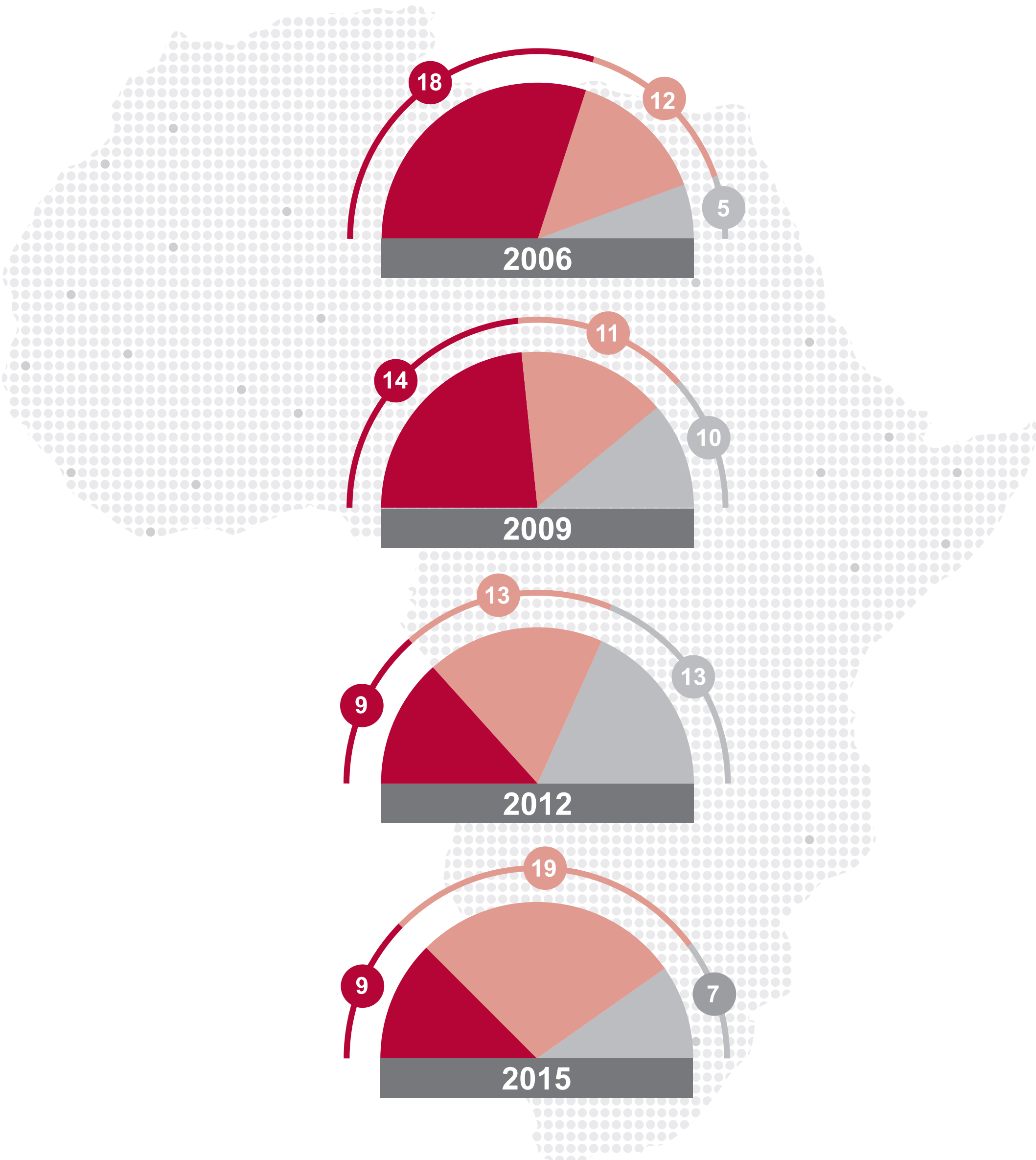
Of concern is not so much the economic deceleration (and its effects on per-capita GDP) as the **general decline in the macroeconomic situation**, especially in those countries most dependent on their production of commodities. Diminishing exports and dropping tax revenues, drained currency reserves, and pressures on the national currency: a mix of inter-related problems that has alerted the prospects of the "bogeymen" typical of the continent, such **unsustainable foreign debt**. In the recent years, numerous countries have accumulated new debt, often at less favorable conditions than in the past because it has been contracted in the international capital markets (through the issue of Eurobonds) or bilaterally (through agreements with Asian countries).

[01] *FMI, World Economic Outlook, April 2016.*

We are certainly not at pre-2000 levels, with several countries on the brink of default, but there is no doubt that meeting foreign debt deadlines has become more difficult, due to the depreciation of national currencies (Fig. 2).

FIGURE 2. *The countries at risk of debt distress are increasing*

(Trends in debt distress risk in the **35 low-income countries** *of Sub-Saharan Africa)*



High risk countries | **Moderate** risk countries | **Low** risk countries

Source: data processing by SACE, based on IMF data and World Bank

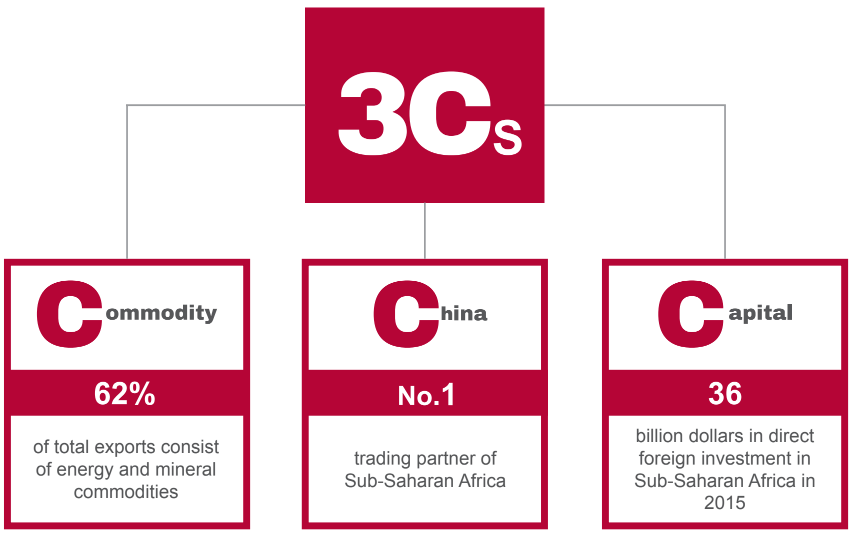
This situation presents **three negative constraints on the activity of Italian exporters and investors** in the Sub-Saharan region:

- In the case of commercial agreements or financial partnerships not yet signed, there may be **delays or postponements in negotiations** with both the public sector (government ministries or state-owned companies) and private counterparties (banks and companies), especially when non-strategic sectors are involved.
- If the contracts are already in force, African customers may **encounter greater difficulty in honoring payments terms**, considering the economic downturn and the limited availability of hard currency.
- The shortage of currency will also affect the activities of Italian investors, who may encounter **delays and restrictions on the conversion and transfer of their foreign profits.**

Therefore there may be some basis for recent talk of the end to the African economic miracle and the fears of companies to continue viewing the African subcontinent as the new business frontier. We feel that these two conclusions have some basis in truth but must be examined in detail. In fact, not all 49 Sub-Saharan countries are suffering from the same problems: **one key of interpretation** may help distinguish the riskier markets from the safer ones. The risks need not compromise the search for opportunities in those countries: **a rational internationalization strategy** and a few suggestions may help companies to mitigate these problems and continue to operate profitably in the region.

FROM A(NGOLA) TO Z(IMBABWE): THE 3C FACTOR AS A KEY OF INTERPRETATION

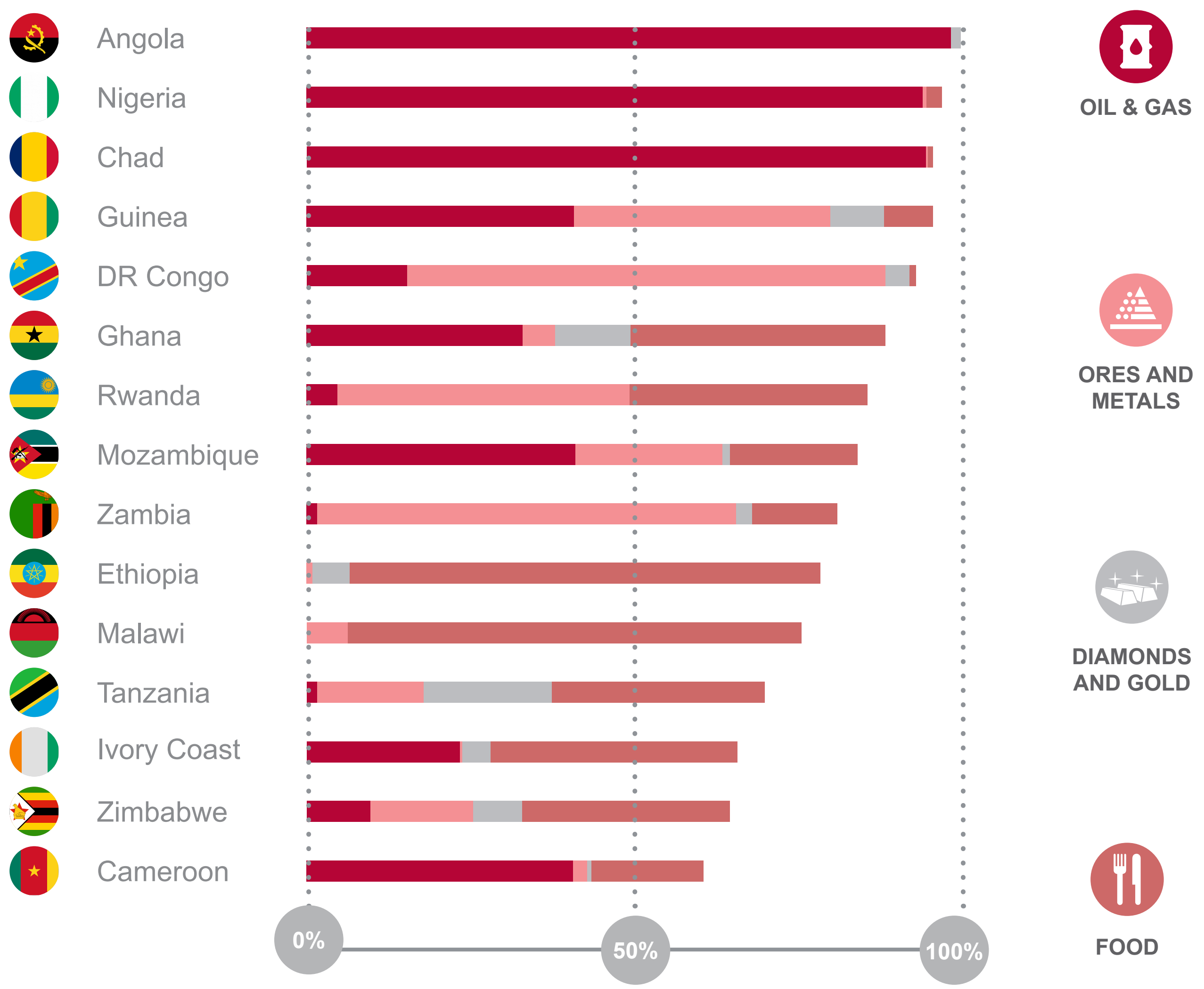
The difficulties in Sub-Saharan Africa may be traced to three closely related elements: Commodities, China and foreign Capital. These may be grouped under the title of the **3C Factor**, not only using the common first letter but also to point out the positive role these factors played in the recent past. And, conversely, they will be negative factors in the present and the near future.



In first place are **commodities**, since energy and mineral resources and metals account for two-thirds of total exports from the region, compared to 16% manufactured goods and 10% agricultural products[02]. Oversupply, uncertain demand in the principal emerging markets, and a stronger dollar continue to depress commodity prices (Fig. 3). The repercussions particularly affect the African countries that export oil and gas, especially Nigeria and Angola, due in part to the negative effects of currency restrictions on the private sector; not to mention other oil-exporting countries such as the Republic of the Congo, Gabon and Equatorial Guinea. Other countries of southern Africa (Botswana, South Africa and Zambia, for example) and West Africa (Guinea, Liberia, Sierra Leone) have had to deal with declining resources of the non-energy mineral resources they export, such as iron ore, copper, diamonds and platinum.

FIGURE 3. *Dependency on commodity exports: not just oil & gas*

Commodity exports as a % of total exports

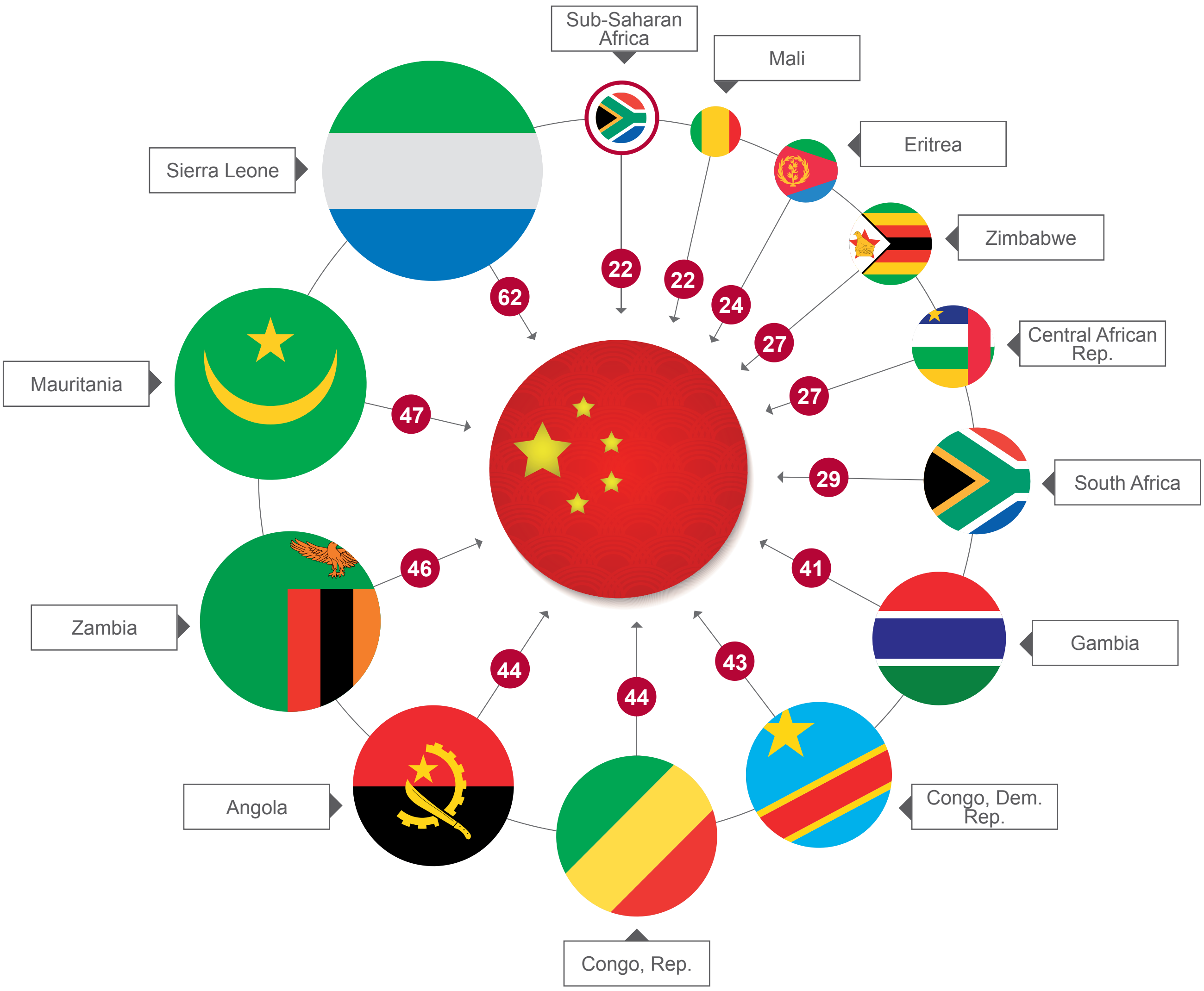


Source: data processing by SACE, based on UNCTAD and Deutsche Bank

[02] *World Bank, Africa's Pulse, April 2016*

The second C is **China**, an important figure in the economic fate of Sub-Saharan Africa: China became the no. 1 trading partner of the region back in 2011, and Sino-African trade today is worth 200 billion dollars, a level comparable with the trade between the Sub-Saharan Africa and the European Union and four times that with the United States. These numbers clearly indicate the potential repercussions of a Chinese slowdown on African growth. The push of Beijing for internal growth linked more to consumer spending and services, in fact, has resulted in a decline in imports from the African subcontinent, particularly energy and mineral resources. This has impacted those economies that by choice or necessity depend on the Chinese market for much of their sales, with rates greater than 40% of national exports, like Angola, Sierra Leone, Mauritania, Zambia and Democratic Republic of the Congo (Fig. 4).

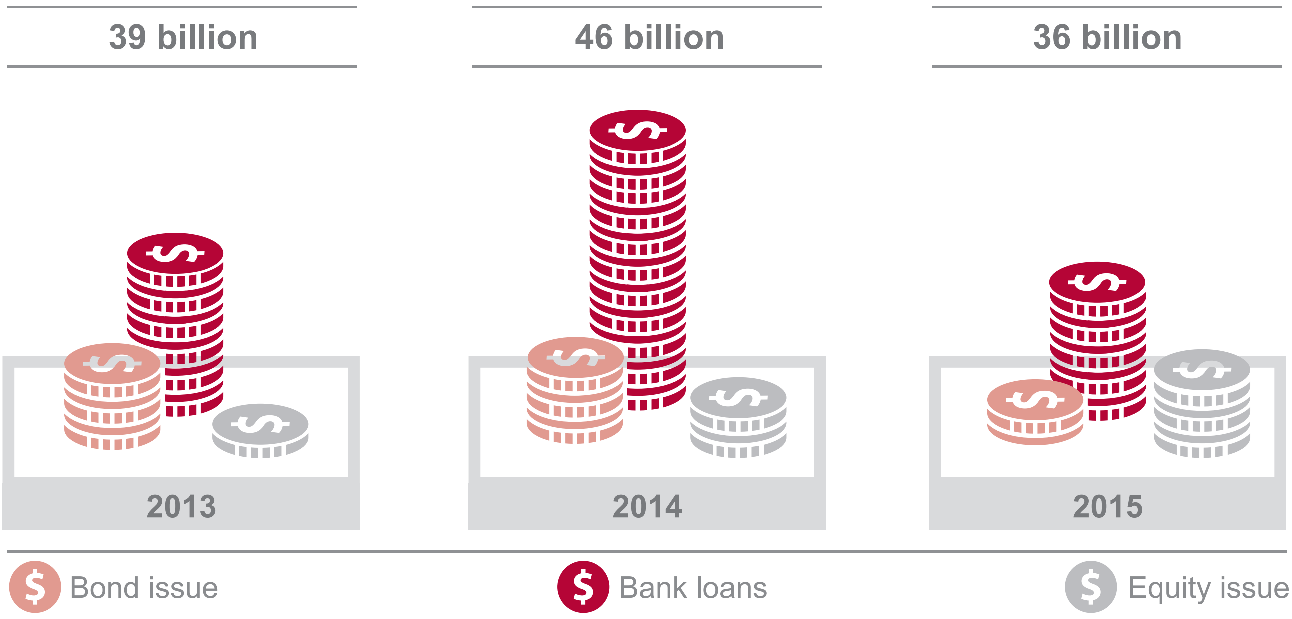
FIGURE 4. *The importance of China as principal trading partner for Africa*
(Exports to China as a % share of total exports, average 2010-14)



Source: data processing by SACE, based on World Integrated Solutions (WITS)

Last, but not least, is the C of **foreign Capital**. In past years, commodities and positive financial returns attracted the big multinationals and international investors to Sub-Saharan Africa. Today, at a time of low commodity prices and a gradual strengthening of the dollar, the flows of international capital to Sub-Saharan Africa are gradually waning (Fig. 5). This can be explained in part by greater reluctance on the part of European banks to operate in the region but also by a drop in the issues of Eurobonds by the African countries, down to 9.2 billion dollars from the 12.9 billion in 2014. The number of issues has declined in light of conditions that have become more costly if not prohibitive: the spreads on yields have come to exceed 9% (as in the case of Zambia in July 2015 and Angola in November 2015) and as much as 10% (Ghana in October 2015). The international capital markets thus perceive greater risk that the African countries will not honor their obligations, as indicated by recent news on the Ematum case in Mozambique. It is no coincidence that there have been no issues of Eurobonds by Sub-Saharan countries since the start of 2016.

FIGURE 5. *Direct capital flows in Sub-Saharan Africa is declining*
(Capital flows to Sub-Saharan Africa, in USD billions)



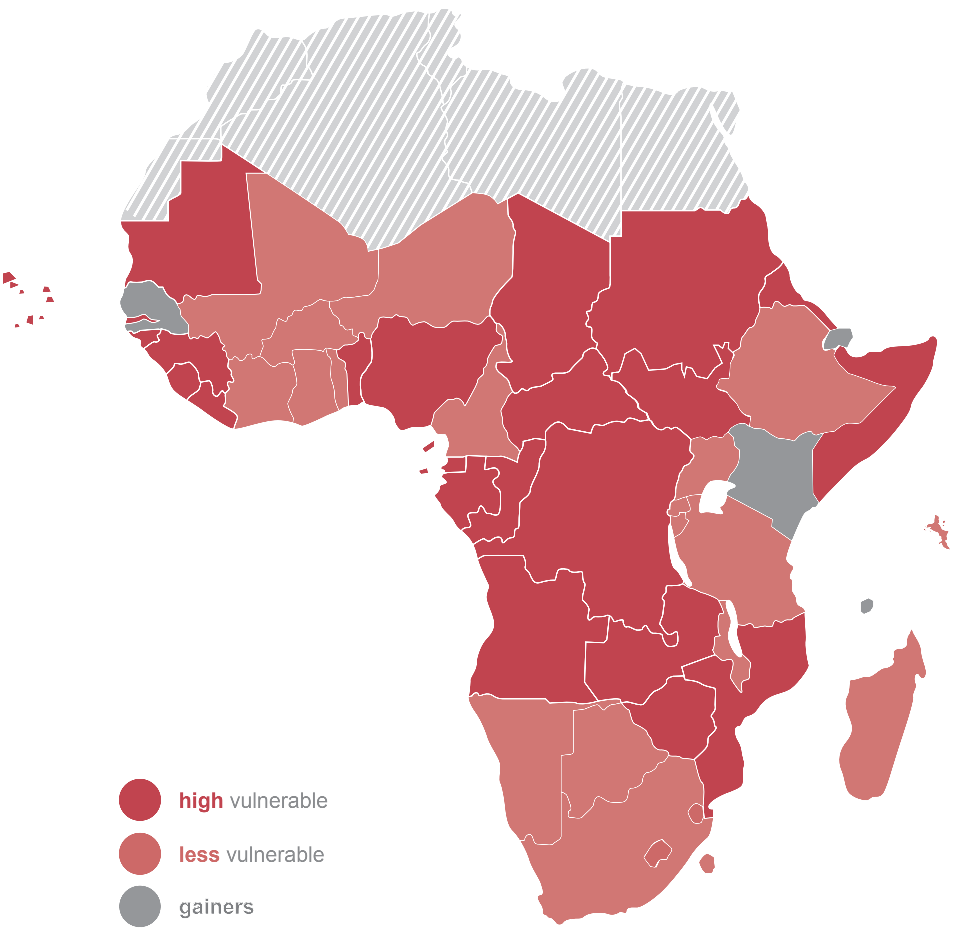
Source: data processing by SACE, based on Dealogic

OPPORTUNITIES AND SUGGESTIONS FOR ITALIAN COMPANIES

The economic slowdown in Sub-Saharan Africa has also impacted the commercial activity of our companies in the region. In 2015, Italian exports to the area totaled € 5.7 billion, down 7.9% from the previous year. This negative figure is particularly significant because it comes on the heels of the historical record set in 2014, and especially because it was the first setback since the economic crisis on the continent in 2009-10. Our projections indicate another but lighter decline in Italian exports to the region in 2016.
The African markets with the greatest decline in the demand for Italian goods are those with a high 3C Factor.

Declines of 25 to 40% in Italian exports, particularly capital goods, have been registered to the African economies most closely tied to petroleum, such as Nigeria, Angola and the Republic of the Congo. But it is also interesting to note that a lower 3C Factor also corresponds to rapidly growing Italian exports. In 2015, in fact, our exports grew by double digits to those economies less dependent of the three Cs, such as Ivory Coast (with + 59% it became our no. 3 importer in all of Sub-Saharan Africa), Kenya and Senegal.

FIGURE 6. *Impact of the 3C Factor*
(degree of country vulnerability)[03]



Source: data processing by SACE, based on UNCTAD

[03] *The degree of vulnerability of countries to the 3C Factor refers to an assessment based on the average impact of the following variables: export of commodities as a % of total exports; exports to China as a % of total exports; inflows of FDIs as a % of national GDP. Sources: UNCTAD, WITS database.*

This second group of countries now represents a new engine for African growth, less dependent on factors outside the continent. These are the new opportunity markets Italian companies must target, in part to offset the decline in sales to the larger economies, but without forgetting that these emerging economies, though less tied to the 3C Factor, present significant internal problems. For this reason, companies **must adopt a rational internationalization strategy** to seize the opportunities offered by the African markets, even when things seem to be progressing well. The following suggestions may therefore be useful:

1. Use **advisory services**. A thorough knowledge of the counterparties and the target foreign markets is essential for assessing the strategic nature of a project (avoiding wasting time on commercial initiatives that may be blocked by financial difficulties of the buyer) and to assess the impact of operating difficulties in the area (e.g. in logistics and distribution channels, which are often inadequate in most of the African countries). Last, but not least, an advisory service can help create the conditions for a "chain" action abroad, with the objective of going beyond the "piecemeal" sales level (not attractive for those wishing to purchase from Italy with a single, integrated project).

2. Accompany the commercial proposal with a **financial proposal** that facilitates payment conditions for the foreign customers. In the recent months, several African countries have raised interest rates to fight inflation and attract foreign capital, but at the same time they have made it more costly for local companies to obtain credit to pay for foreign imports. Offering multi-year payment conditions is one way to "finance" the foreign customers at conditions better than those available in the local market.

3. Acquire **instruments to mitigate or cover the risk of payment default**. The slowdown in the African economies is having an inevitable impact on the solvency of both the private and public sectors. The adoption of currency restrictions by the local monetary authorities may also compromise access to strong currencies to pay for the foreign purchases of local companies and banks, often resulting in nonpayment to Italian suppliers. And companies should not forget the advisability of covering purely political risk, such as acts of expropriation or political violence, events that are still likely in several countries of the African region.

CONCLUSIONS

Despite the difficulties that most countries of Sub-Saharan Africa are experiencing, we are at the beginning of an African economic miracle. The commodities boom has lost steam; China is providing less thrust to African growth; foreign capital may be channeled toward returns now offered by safer destinations. But Sub-Saharan Africa is now an economic reality that should not be overlooked. It has a population of 1.2 billion people, and according to United Nations projections one person in four will be living on the subcontinent by 2050[04]. In coming years South Africa, Nigeria and Angola will continue to represent over 50% of Italian exports to the region, but the expected growth in other emerging African economies, particularly those less tied to the 3C Factor, and the increasing activity of Italian companies in this region, are the conditions necessary for pursuing the African economic miracle.

[04] *The Economist, Special report on Business in Africa, 16-22 April 2016.*

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