Euler Hermes Economic Research

Economic Insight

Afri-can or Afri-can't? 10 Myths to debunk on Africa

October 20, 2016

George Kibala Bauer (Junior Economist)
georgefrederic.kibalabauer@eulerhermes.com

Stéphane Colliac (Senior Economist)
stephane.colliac@eulerhermes.com

Ludovic Subran (Chief Economist)
ludovic.subran@eulerhermes.com

Executive summary

- The commodity price slump hit short-term growth prospects in many key African economies (Nigeria, South Africa) and policy-making has proved more difficult with external headwinds. Yet several African countries show resilience and interesting prospects. When excluding commodity exporters, Africa currently still grows by 4% a year, including in 2016.
- More decisively, this overcast short-term horizon should not scare investors and companies. In our 10 myths to debunk on Africa, we explore why the consumer, the business climate, the institutions, the ICT revolution *inter alia*, are major (r)evolutions.
- There is still much work to be done to create a more conducive business backdrop but a virtuous circle (business climate, tech hubs, rising FDI flows) is underway in top performing countries from Côte d'Ivoire to Kenya and Tanzania.

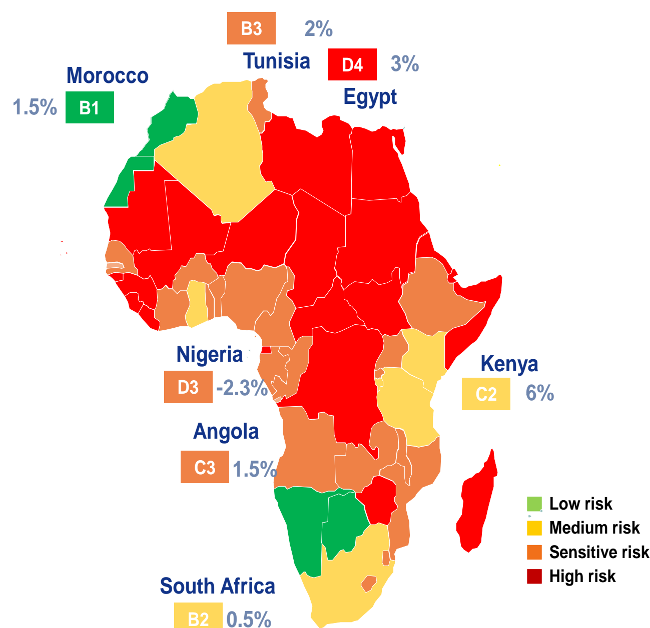
Back to reality

In 2016 Africa is expected to grow +1.3%, one of the lowest growth rates in the last 30 years. The growth bonanza, which saw African economies grow at an annual average rate of +5% annually from 2000-2010, is over. Certainly, the commodity roller coaster played an important role since it pushed Nigeria into recession and halved growth prospects in South Africa, the two largest economies of the continent (-2.3% GDP growth in 2016 in Nigeria, and +0.5% in South Africa). When excluding commodity exporters, Africa still grows +4% a year, including in 2016.

As commodity prices stabilize and emerging markets suffer fewer external headwinds, selectivity and granularity across African economies will be needed (*Figure 1*). Euler Hermes' short-term country risk indicator measures the risk of non-payment by companies in a given country. It captures elements of the business cycle as well as financing constraints such as rapidly depleting foreign exchange reserves and a necessary IMF lifeline (Ghana, Tunisia, Egypt e.g.). The overall country grade also includes political risk, the business environment and structural imbalances.

In spite of a cloudy horizon, investment and commercial opportunities do exist, particularly in economies with improving business climate and policymaking such as Cote d'Ivoire (+7.5%) and Tanzania (+6.5%).

Figure 1: Africa GDP Growth-and Country Risk Forecast



Source: Euler Hermes

EULER HERMES
Our knowledge serving your success

A company of Allianz

In the context of slow global growth and increased risk aversion, capital flows from Advanced Economies to African markets have fallen and market pressures on exchange rates have increased. (*Figure 2*), particularly in countries with rising current account deficits (-8% of GDP for the gold exporter Ghana, -7% for the oil exporter Equatorial Guinea). The commodity price shock has led to falling foreign exchange reserves, one of the primary reasons for the loss of value of African currencies. Angola's Kwanza, and Uganda's shilling, depreciated 64%, and 22% respectively vis-à-vis the dollar. Additionally, import covers in Ghana, Tunisia, and Gabon declined to less than 5 months putting pressure on governments to restrict imports, and find ways to keep more foreign exchange inland. Many countries also issued dollar-denominated bonds despite increasing interest rates: Zambia (a 10-year bond for USD1bn issued at 8.6% in 2014 vs. USD 0.75bn issued at 6.5% in 2012), Ghana (a 12-year bond for USD1bn issued at 8.2% in 2014 vs. a 10-year bond for USD1bn issued at 8% in 2013), Angola (a 7-year bond for USD1.051bn issued at 7.2% in 2012); these countries now have more difficulties to attract private creditors.

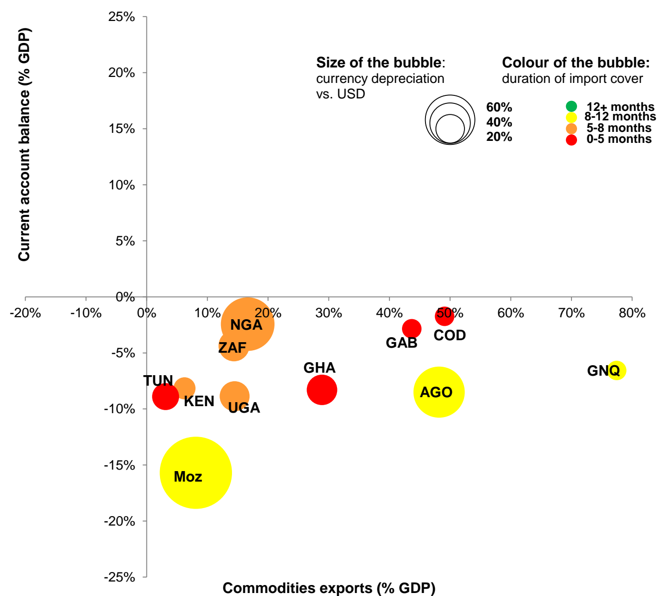
On top of existing macro vulnerabilities, uncertain policies could also affect the outlook. Nigeria and South Africa are excellent case studies. Following the drop of oil prices, the Central Bank of Nigeria was slow to let the Naira depreciate, and virtually shut down the interbank foreign exchange market fueling a large parallel market premium (*Figure 3*). Local businesses were starved off vital foreign exchange to import inputs. Though the Central Bank finally let the Naira float on June 20, and ordered banks to allocate 60% of foreign exchange to manufactures and importers of raw materials, the recession was inevitable. In South Africa, a series of government corruption scandals and frequent replacements of the country's finance minister caused Rand volatility. But the big story is that structural fiscal deficits meet private sector efforts to rebalance its balance sheet (and underinvest). As a result, structural bottlenecks explained by a too low for too long investment, are impediments to growth.

Fifty (-four) nuances of Africa

Myth #1 Africa: all the same? Wrong!

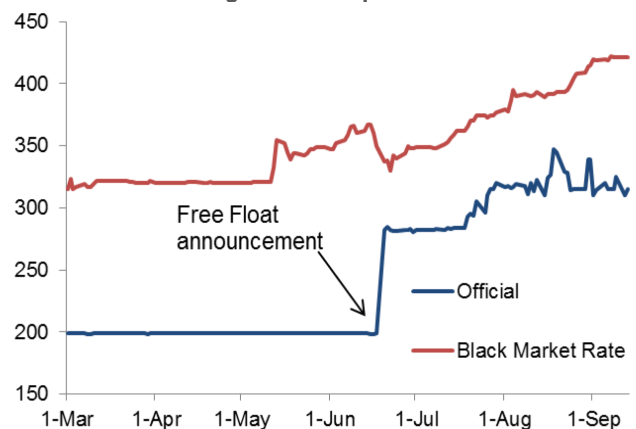
Despite short-term strains, there are still opportunities in Africa. In many places, the business climate is still far from good, and there are few diversified economies (the left-hand cluster in *Figure 4*). However, economic growth and strong will for reforms is spreading across the continent: Kenya, Ethiopia, Tanzania, Rwanda, Senegal and Cote d'Ivoire are epitomes of future African powerhouses. Attractiveness (and confidence) will help diversify the economy towards new sectors and grow at above +6%, a rate competing with emerging Asia's top performers (middle cluster in *Figure 4*). Another cluster includes economies trapped in their overreliance on commodities as a wealth engine. Consumption has grown there, but it was underpinned by oil-driven fortunes. Now, the model has proven unsustainable *(right-hand cluster)*.

Figure 2: Exchange Rate Vulnerability



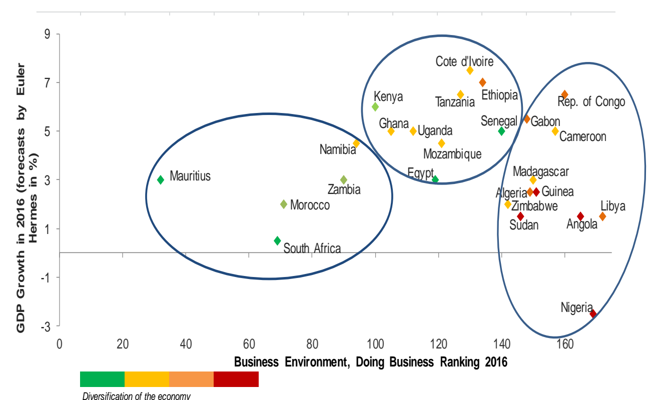
Sources: IHS, Euler Hermes

Figure 3: Official vs. Black Market exchange rate Nigerian Naira per USD



Sources: Bloomberg, Aboki, Euler Hermes

Figure 4: Growth and Doing Business



Sources: World Bank, Harvard CID, Forecasts by Euler Hermes

Myth #2 Africa is only about natural resources. Wrong!

The primary sector has been the African bonanza. Yet, growing the manufacturing sector looks like a necessary step to both rebalance growth prospects and offer jobs to millions of Africans. Growth stability requires diversification, and diversification requires an enabling environment. One encouraging trend in this regard has been the increase in Research & Development expenditure in several African countries (*Figure 5*). Kenya, whose R&D expenditure (% of GDP) increased from an average 0.3% from 2001-2007 to 0.9% in 2015, is placing increasing emphasis on innovation and ICT. It is also a leading centre for Africa's growing network of tech-hubs: 150 new companies can trace their origins to Ideas incubated in iHub, one of Kenya's 11 tech-hubs. Investment in R&D is important not only due to high social returns, but also because it can create unique growth opportunities for businesses.

Myth #3 There is no decent infrastructure. Wrong!

The growth of the African private sector requires an infrastructure shock therapy. If we take France as a benchmark, Nigeria's infrastructure gap is USD1900bn (*Figure 6*). Most African countries are ranked in the bottom half of the World Bank's Logistic Ranking, while countries such as Uganda and Kenya are benefitting from improving regional infrastructure and coastal access. The African Development Bank estimates that the opportunity cost of Africa's infrastructure gap to 2% of annual GDP growth. Meanwhile private investment flows into infrastructure tends to prefer telecommunications, which receives 64% of total infrastructure investment in Africa, while private investment in hard infrastructure is lacking.

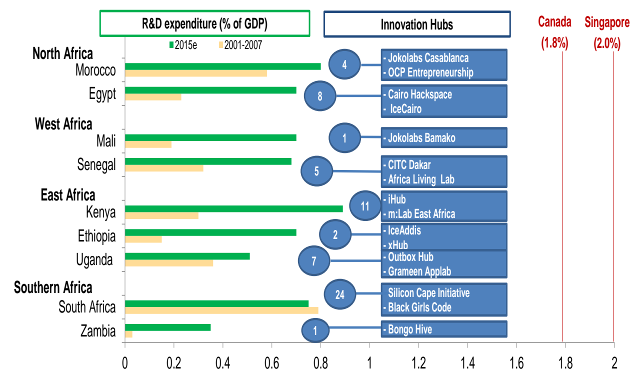
To measure better to understand better

Africa's economic growth is taking place in the context of a multipolar world with globalized value-chains, and disruptive technological changes. Many accounts of Africa's economic transformation fail to take this reality into account.

Myth #4 Africa is isolated from the world. Wrong!

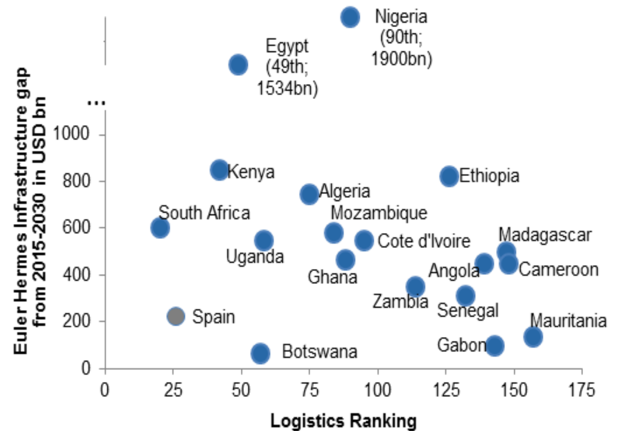
This is exemplified by the case of Africa's openness to trade. We estimate that by 2025, the rise of African trade will be driven by Africa's economic heavyweights Nigeria (+USD210bn exports/+ USD150bn imports), South Africa (+USD140bn exports/+ USD180bn imports) (*Figure 7*). Though African exports contracted in value by USD12bn in 2016 due to lower export prices, exports are expected to expand by +USD30bn in 2017. Exports to China, Africa's main export destination (27%), are still mostly natural resources (93%), but China's rebalancing is going to create space for more light-manufacturing, and agricultural exports (currently at 7%). Intra-African trade, driven by improved regional integration efforts, has increased from 10% of total trade in 2000 to 16% in 2014, a boon for Africa's diversification efforts as 60% of intra-African trade is in manufacturing.

Figure 5 : Africa, Land of Innovation



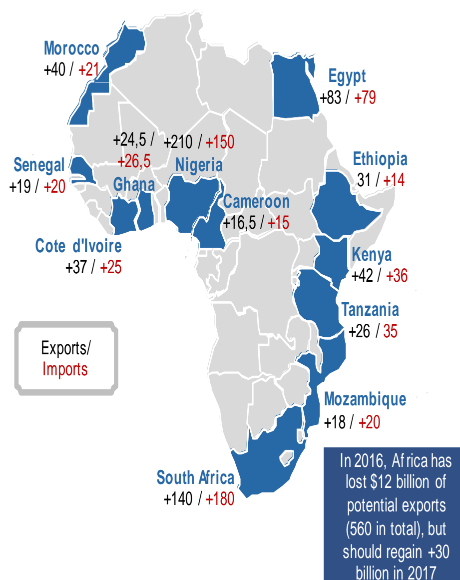
Sources: World Bank, United Nations, Euler Hermes

Figure 6: Quality of Logisitics and Infrastructure Gap



Sources: World Bank, Euler Hermes.
Note: The estimated infrastructure gap covers the investment needs in electricity, the roads network, internet, and mobile phone lines in order to reach the same level of infrastructure of France today in 2030.

Figure 7: Cumulative trade gains (USD billion) by 2025



Sources: Euler Hermes

Myth #5 African institutions are not working. Wrong!

Governance has seen decisive improvements in certain countries, and is increasingly shaped by the technological advances. Countries such as Ghana and South Africa rank better than Brazil, a comparative emerging country in most traditional Governance Indicators, while Rwanda surpasses both Italy and Brazil in the control of corruption. These achievements are underpinned by reforms such as speeding up of judicial processes in Ghana, or the creation of a national anti-corruption commission in Rwanda. However, African governments with limited public resources, amid growing demands from a larger, urban population, are also finding ways to leverage the internet to deliver better services (*Figure 8*). In South Africa entrepreneurs can take free online-classes in accounting, and management, while in Rwanda, a business can be registered within 6 hours online.

Myth #6 Nobody wants to finance Africa's growth. Wrong!

African countries could be a very attractive destination for high-impact FDI. The average of Africa's net FDI inflows as a share of GDP from 2005-2015 at 2.9% is above OECD average of 2.8%. Zambia, Guinea, Tanzania, and Uganda have been especially successful in attracting FDI with an average of more than 4% of GDP (*Figure 9*). Though the strong performances of mineral-rich Zambia and Guinea indicate that FDI in Africa is still highly concentrated in natural resources, construction, manufacturing, and services sectors are also attractive. Besides traditional investors such as France, the UK, and China, new investors are adding new value. Turkey's FDI inflows created the most jobs (16593) out of all investing countries in 2014, and the UAE led the way in M&A purchases (1543) in 2015. Attracting FDI is especially important for countries with large current account deficits such as Rwanda (14%), or Mali (9%). However, in order to raise sufficient funds for economic transformation, domestic resource mobilization needs to improve. Though countries such as South Africa (30%), or Algeria (26%), already have high government revenue to GDP ratios, Africa's overall tax to GDP ratio of 14.5% is very low compared to the OECD average of 30%.

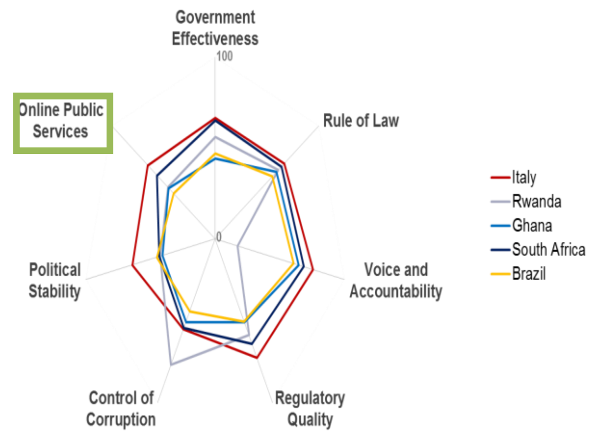
The advantages of backwardness

Leapfrogging will unleash Africa's growth potential.

Myth #7 The African consumer is not bankable. Wrong!

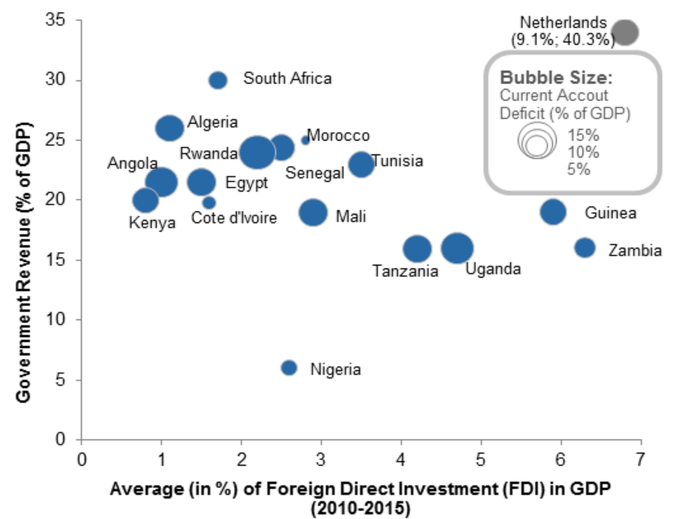
We designed a proprietary Consumer Market Potential Index using as urbanization (to capture volume), consumption growth (value), and internet access (leapfrogging). By 2024, Africa's urban areas will grow by 24 million inhabitants against 9 million in China, and 11 million in India. Access to internet, and ICT, has allowed African consumers to be connected to supply in an atypical way. Nigeria, Kenya, and Morocco form the Top 3 countries of our ranking (*Figure 10*). Morocco, whose internet connectivity rate is 70%, embodies the African trend of thriving e-commerce. In Kenya, over 15% of the population pay most of their bills using a mobile phone.

Figure 8: Governance Indicators



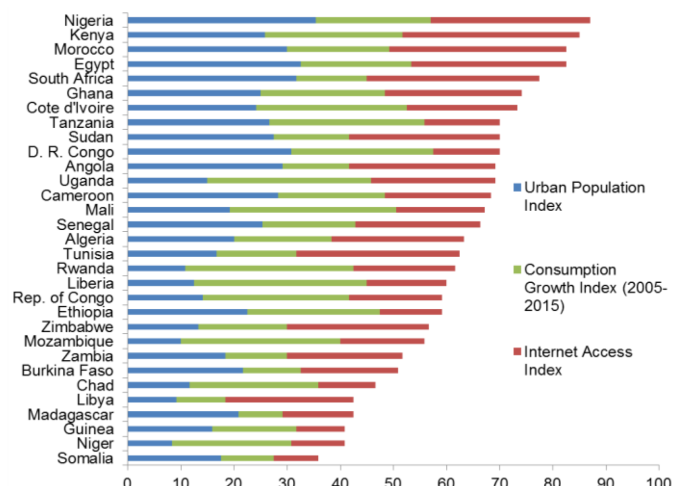
Sources: World Bank, United Nations, Euler Hermes.
Note: In addition to the six indicators of the World Bank, we add one by the United Nations, which measures the availability and quality of public services online. Each index is rated out of 100; 0 being the worst, 100 the best, and 50 the average.

Figure 9: Internal-and External Financing of Africa's growth



Sources: IMF, World Bank, Euler Hermes

Figure 10: Euler Hermes Consumption Potential Index
(*100 = maximum value*)



Source: World Bank, Euler Hermes.
Note: Each indicator (additional urban population, consumption growth, access to internet is normalized between 0 and 33 to create an index of 100.)

Myth #8 You cannot work with African companies. Wrong!

One of the major impediments facing the development of small-and medium enterprises in Africa is the lack of financial information, which prevents access to financial services such as credit insurance. 60% of Africa's yearly imports (worth 800 billion Euros) are paid in cash! If a payment term of 30 days were granted on these operations it would free up over the 40 billion euros of working capital, a sum equivalent to Tanzania's GDP (*Figure 11*)!

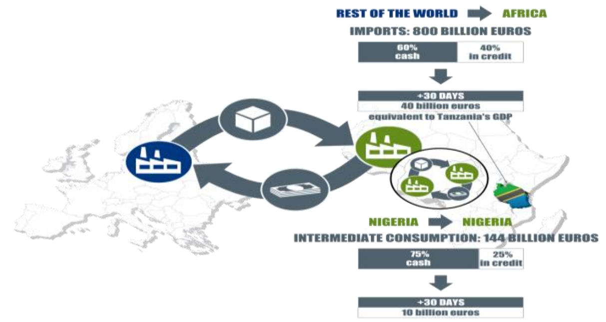
Myth #9 Agriculture is passé. Wrong!

Africa's agriculture has been long forgotten till the 2007 crisis. Since, it has undergone a massive transformation, mainly because it is still the largest employer - in Rwanda (75.3%), and Ethiopia (72.7%). The Green Revolution that lifted millions out of poverty in Asia is underway, including a productivity shock (*Figure 12*). Increased market access through the elimination of trade barriers has allowed Ethiopian and Ivorian agricultural exports to grow by +30% and +27.5% respectively from 2005-2015, mainly through cash crops. The growth in intensity of agricultural production of +45.5% in Malawi points to the increased mechanization of agriculture. From price discovery (commodity exchange) and marketing, to better inputs and extension services, countries are transforming their primary sector.

Myth #10 Africa has no talent. Wrong!

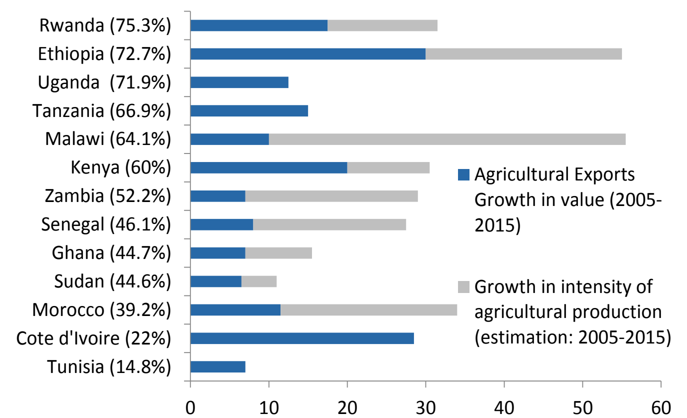
For African entrepreneurs, leapfrogging creates opportunities to circumvent the constraints faced by insufficient public service, especially tertiary education ones. Other than South Africa, which has a tertiary education enrolment rate of 20%, most African countries have low tertiary education enrolment rates, and an urgent need to improve their entrepreneurship climate (*Figure 13*) to avoid a Not in Education, Employment or Training NEET generation. Many businesses are in the informal sector, which forms an important basis for human capital formation in Africa. Cities such as Lagos and Kampala are attempting to unleash this potential by encouraging the transition into the formal sector through reforms of the cadastre system, and improving urban connectivity.

Figure 11: Additional Free Cash Flow with higher DSOs
(DSOs = Days of Sales Outstanding)



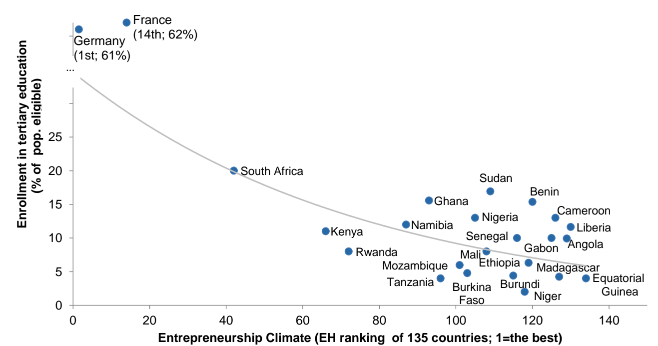
Sources: Euler Hermes

Figure 12: Euler Hermes Index for Agricultural Productivity
(*Countries ranked by pop. employed in agriculture*)



Sources: UNCTAD, African Development Bank, Euler Hermes calculations

Figure 13: Level of education and opportunities for entrepreneurs



Sources: World Bank, Calculations and Data from Euler Hermes
Note: The entrepreneurship climate index by Euler Hermes consists of the regulatory environment, and the degree of access to tools useful to entrepreneurs (quality of internet access, logistics, and business climate).

DISCLAIMER
These assessments are, as always, subject to the disclaimer provided below.

This material is published by Euler Hermes SA, a Company of Allianz, for information purposes only and should not be regarded as providing any specific advice. Recipients should make their own independent evaluation of this information and no action should be taken, solely relying on it. This material should not be reproduced or disclosed without our consent. It is not intended for distribution in any jurisdiction in which this would be prohibited. Whilst this information is believed to be reliable, it has not been independently verified by Euler Hermes and Euler Hermes makes no representation or warranty (express or implied) of any kind, as regards the accuracy or completeness of this information, nor does it accept any responsibility or liability for any loss or damage arising in any way from any use made of or reliance placed on, this information. Unless otherwise stated, any views, forecasts, or estimates are solely those of the Euler Hermes Economics Department, as of this date and are subject to change without notice. Euler Hermes SA is authorised and regulated by the Financial Markets Authority of France.
© Copyright 2016. Euler Hermes. All rights reserved.

View all Euler Hermes Economic Research online
http://www.eulerhermes.com/economic-research

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Publication Director and Chief Economist
Ludovic Subran
ludovic.subran@eulerhermes.com