The Global Financial Crisis and Sub-Saharan Africa: The Effects of Slowing Private Capital Inflows on Growth

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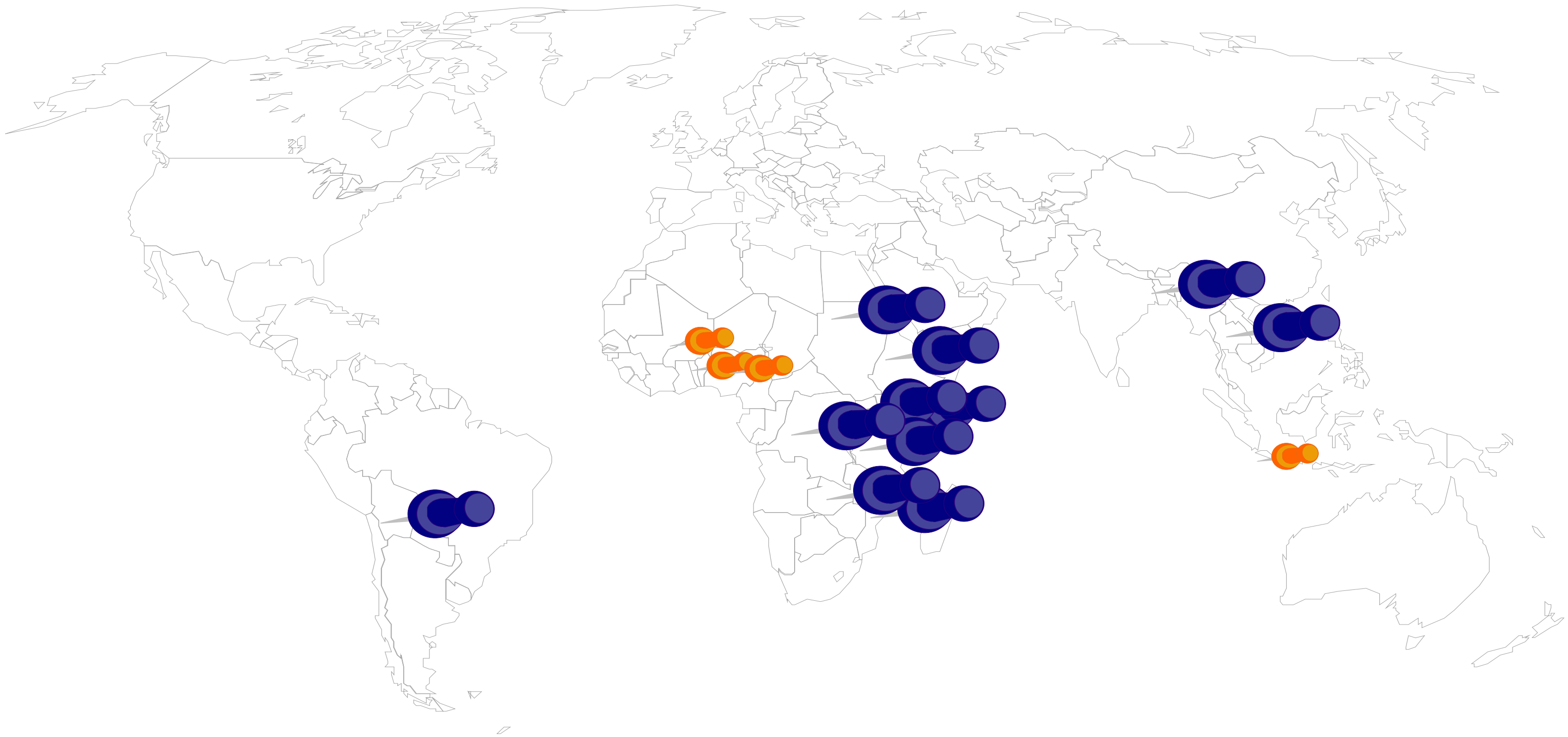
Outline

- ❑ Overview of the impact of the global financial Crisis (GFC) on developing countries through private capital flows;
- ❑ Private Capital Inflows to SSA and the GFC;
- ❑ Growth impact of different types of slowing private capital inflows in SSA.

The global financial crisis and 11 developing countries (phase 2)



ODI project (phase 2)

THE GLOBAL FINANCIAL CRISIS AND DEVELOPING COUNTRIES

LEGEND

- Additional in phase 1: Indonesia, Benin, Ghana and Nigeria
- Phase 2: Sudan, DRC, Ethiopia, Uganda, Kenya, Tanzania, Zambia, Mozambique, Bolivia, Bangladesh, Cambodia

GFC Transmission Belts

1. **Private Capital Flows**:
   - *Foreign direct investment (FDI);*
   - *Portfolio equity flows;*
   - *Portfolio bond flows;*
   - *Cross-border bank lending.*

   Portfolio investment
2. **Trade**
3. **Remittances**
4. **Aid**

Transmission belt (1) *Private capital flows*

- ***Portfolio investment flows*** experienced dramatic drops and sometimes shifted to large net outflows (e.g. Bangladesh, Kenya, Sudan, Zambia) in late 2008 and early 2009.
- However, some signs of a recovery since 2009 Q2 (e.g. Bangladesh, Kenya, Zambia, Tanzania).
- ***FDI*** has been more resilient in 2008 but fell dramatically in several countries in 2009 (e.g Cambodia, Bolivia, DRC, Ethiopia, Uganda).
- Little evidence of a drop in ***international bank lending*** up to 2009, but data from BIS do indicate such effects especially for African countries.

GFC Effects on Private Capital Inflows to SSA

- ***Before the GFC…***

▪ Private capital inflows took off since the early 2000s.

▪ An increasing number of investors in search of high yields were attracted to SSA thanks to improved macroeconomic performance and political stability, vast natural resources environment, external factors such as debt relief and commodities boom.

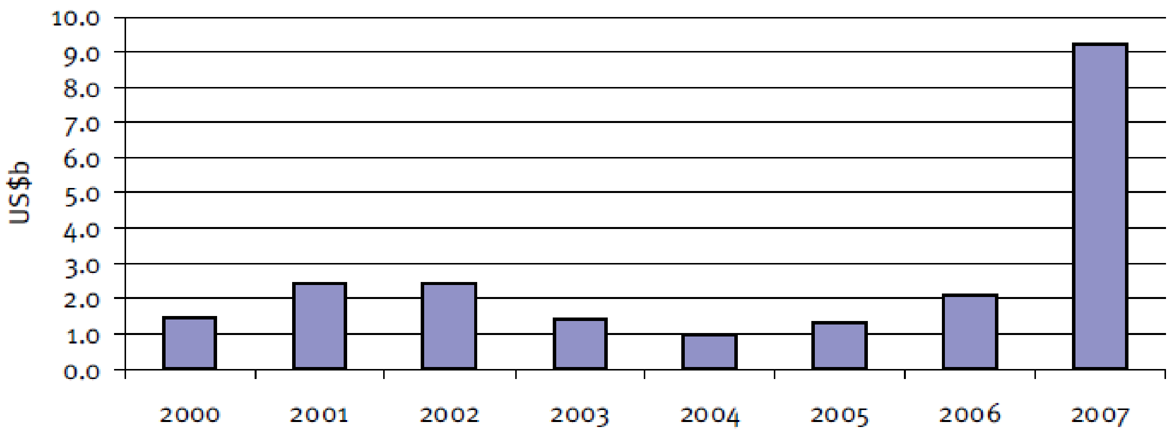
- ***After the spread of the GFC…***

▪ Private capital inflows dropped sharply since Q3 of 2008 due to a reduced capability and propensity to invest (tighter credit conditions, gloomy growth prospects, end of the commodities boom, etc.)

GFC Effects on Bond Flows

❑ ***Before the GFC…***

▪ Bond flows to SSA increased by US$ 7bn from 2006 to 2007: *several new countries issued bonds internationally for the first time (e.g. Nigeria, Ghana).*



Source: WB's GDF (2008)

❑ ***After the spread of the GFC…***

▪ Many bond issuance plans were cancelled (Ghana, Uganda) or delayed (Kenya, Tanzania). No SSA Eurobond came to the market in 2008.

GFC Effects on Portfolio Equity Flows

❑ ***Before the GFC…***

▪ Portfolio equity flows took off: *in 2006 they more than doubled, reaching a value of US$ 15bn*.

❑ ***After the spread of the GFC…***

▪ Portfolio equity flows slowed down or reversed consistently with sharp falls in stock markets (e.g. South Africa, Nigeria, Kenya, Mauritius, Cote d'Ivoire).

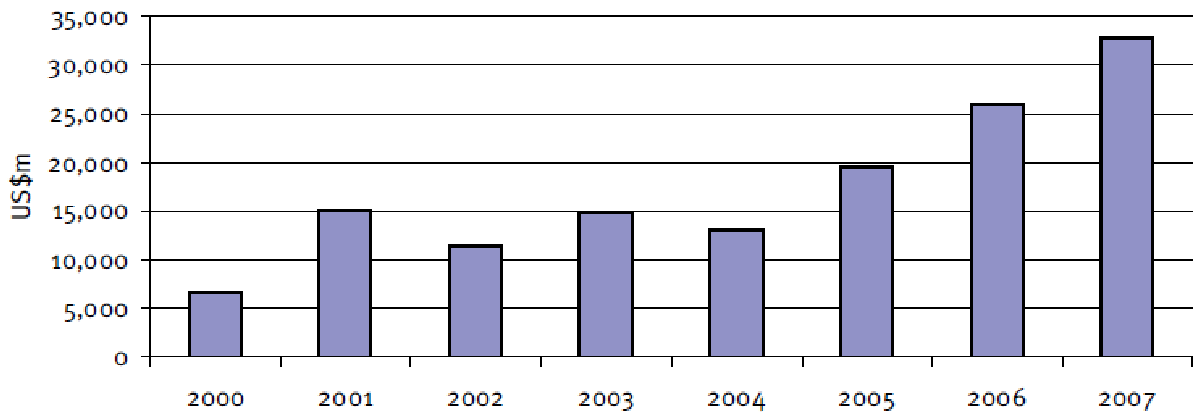
Index	% change in 2008
Nigeria All Share Index	-45.90
Mauritius All Share Indices	-36.20
NSE 20-Share Index	-34.10
JSE All Share Index	-25.70
BRVM Composite Index	-10.70

Source: AfDB (2009)

GFC Effects on FDI

❑ ***Before the GFC…***

▪ Net FDI inflows grew progressively from US$ 13bn in 2004 to US$ 33bn in 2007.



Source: WB's GDF (2008)

❑ ***After the spread of the GFC…***

▪ FDI inflows continued to grow in 2008 *but* at a lower growth rate. A few planned investments have already been postponed or cancelled (South Africa, DRC, Liberia, Malawi, Ethiopia, Tanzania).

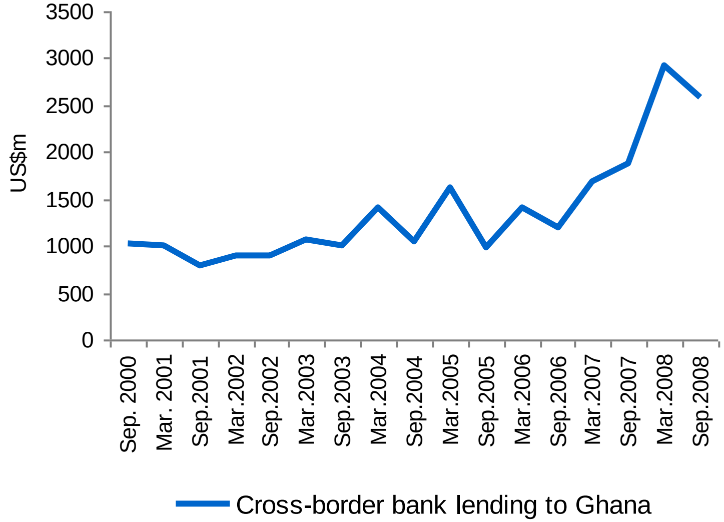
GFC Effects on International Bank Lending

❑ *Before the GFC…*

▪ International banking activity expanded significantly: *total international claims on SSA held by banks reporting to the BIS increased by 56% from 2005 to 2007.*

❑ *After the spread of the GFC…*

▪ Signs of a drop in total international claims on SSA countries (e.g. Ghana, Tanzania, Zambia, Uganda)



Source: BIS (2009)

Open Questions

- What is the growth impact of the slowdown of private capital flows into SSA due to the GFC?
- Need to investigate the growth impact of different types of private capital flows.
- Emerging evidence in the literature on this issue w.r.t. developing countries (see Reisen and Soto, 2001; Durham, 2003; Gheeraert et al., 2005; De Vita and Kyaw, 2009).
- But no evidence so far w.r.t. SSA.

Which Types of Private Capital Inflows Foster Growth in SSA?

Aim: to study the relationship among economic growth and 4 types of private capital inflows: cross-border bank lending, FDI, bonds flows, portfolio equity flows.

Tool: GMM and bias-corrected least-squares dummy variable estimators

$$\boxed{Y_{it} = Y_{it-1}\gamma + BOND_{it}\eta + EQUITY_{it}\mu + FDI_{it}\phi + BANK_{it}\varphi + X_{it}\beta + u_i + \varepsilon_{it}}$$

Sample: 15 SSA countries

Time Horizon: 1980-2008

Data Sources: World Bank's GDF and WDI ; IMF's IFS

Results

	Whole Sample			Without South Africa and Nigeria		
	(1)	(2)	(3)	(4)	(5)	(6)
Y_{it-1}	0.196***	0.196***	0.196***	0.188***	0.188***	0.190***
FDI_{it}	0.296***	0.296***	0.296***	0.334***	0.333***	0.329***
$BOND_{it}$	0.110			0.066		
$BANK_{it}$	0.150*	0.156**	0.157**	0.256***	0.261***	0.260***
$EQUITY_{it}$	0.072	0.072		-0.338	-0.312	
$TRADE_{it}$	0.030***	0.030***	0.030***	0.032***	0.032***	0.032***
GOV_{it}	-0.137***	-0.137***	-0.137***	-0.127***	-0.127***	-0.127***
N	360	360	360	321	321	321
Countries	15	15	15	13	13	13

*Notes: Dependent variable is the real per capita income growth rate. *, **, and *** denote significance at the 10, 5, and 1 percent level.*

Conclusions

❑ ***FDI*** and ***cross-border bank lending*** have a ***positive and significant impact*** on SSA growth;

❑ The growth effects of *portfolio equity flows* are *not significant*;

❑ *Bonds flows* have *no impact* on SSA growth;

❑ The GFC is likely to have an important effect on SSA growth through FDI and cross-border bank lending:

→ ***a drop by 10% of FDI flows may lead to a 3% decrease of SSA growth***

→ ***a drop by 10% of cross-border bank lending may reduce SSA growth by up to 1.5%***

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Policy implications

- ❑ FDI and cross-border bank lending are important for fostering SSA economic growth.
- ❑ It is important to monitor their trend especially in the context of the current global financial crisis.
- ❑ Promoting political and macroeconomic stability, improving the business environment, and creating adequate physical and social infrastructure remain important for continuing to attract FDI inflows.
- ❑ A sound supervisory and regulatory framework is essential to benefit from cross-border bank lending without incurring contagion risks.
- ❑ Stock markets should not be neglected.

Further research

- How will FDI and international bank lending to LICs be affected by changes in the G20 regulation?

- Which is the nature of the relationship between the different types of private capital flows and development? What policies may help to make international bank lending work for development?

- Is there a threshold in terms of volumes and variability beyond which the costs associated to capital inflows outweigh their benefits? If this is the case, which instruments could developing countries use to improve the management of capital inflows thus mitigating their potential negative effects?

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Thank you

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Selected sample

Botswana	Nigeria
Cameroon	South Africa
Cape Verde	Sudan
Ghana	Swaziland
Kenya	Tanzania
Malawi	Uganda
Mauritius	Zambia
Mozambique	