Developments in the World Economy and Implications for Africa

1

CHAPTER

AFTER THE GLOBAL financial and economic crisis, the world economy demonstrated signs of recovery in 2010, although growth divergences persisted, particularly between the developed economies on the one hand, and emerging and developing countries on the other. Developed economies, in particular the United States (US), the European Union (EU) and Japan remained sluggish (IMF, 2010a). Unsustainable budget deficits and weakened fiscal positions caused by bail-outs of financial institutions led to a severe sovereign debt crisis in the EU in 2010. Some European countries responded by adopting stringent fiscal consolidation measures, which partly consisted of cutting back on public spending. Such consolidation took away many public service sector jobs, worsening the already high unemployment rate and acting as a drag on growth in the euro area and on the global economic recovery more widely. Developing and emerging economies, especially China and India, rebounded strongly, though their growth is slowing and the outlook is uncertain for 2011.

In an attempt to counteract the recession, governments in 2010 around the world intervened with a mix of monetary and fiscal policies. The US continued to pursue a loose monetary policy and even adopted quantitative easing (which pumps more liquidity into the financial system through unconventional instruments), but lending did not fully recover there. The US dollar, however, generally depreciated in 2010 against other major and developing-country currencies. Low interest rates around the globe encouraged capital to move into real estate and commodities. Commodity prices also seemed to benefit from the robust growth in emerging countries, which posted relatively strong performance. Strong economic activity and concerns about overheating prompted some emerging economies, such as China and India, to tighten their monetary policies and raise interest rates in 2010.

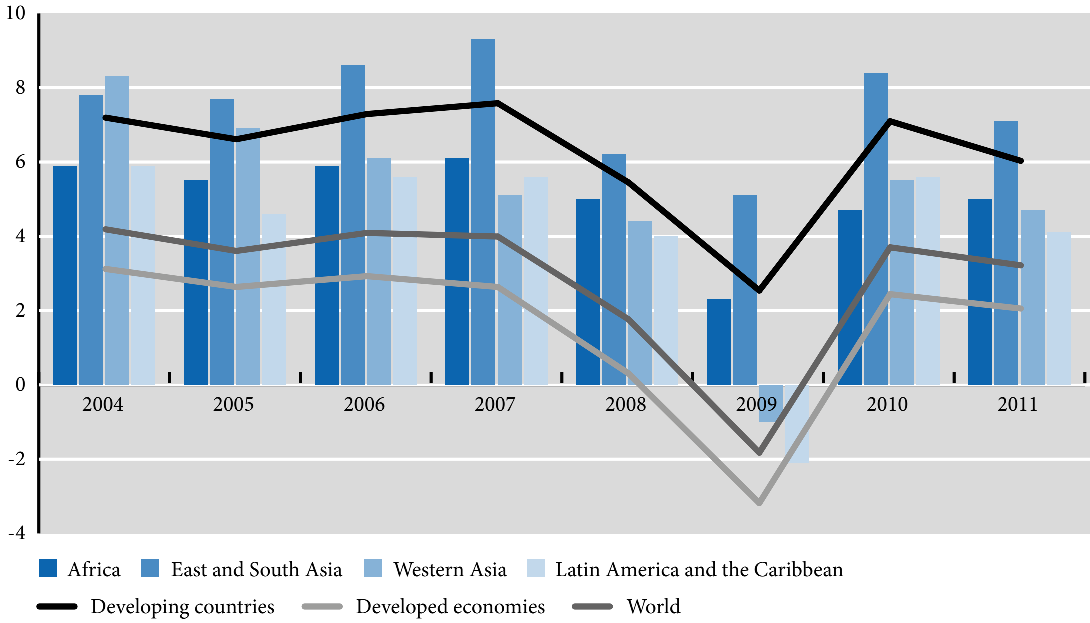
These developments in the global economy brought mixed—though on balance positive—fortunes for Africa. On the one hand, rising commodity prices, increased public spending and foreign direct investment (FDI) in extractive industries supported economic recovery across Africa. On the other hand, increasing commodity (especially food) prices heightened concern over food insecurity and the widening of current account deficits in some African food-importing countries.

1.1 A moderating global recovery in 2010

DESPITE MODERATION IN the second half of the year, the global economy grew at 3.6 per cent in 2010, a remarkable turnaround from the 2.1 per cent contraction of 2009. However, continued recovery relied mainly on fiscal stimuli and strong monetary policy support, particularly in the US. With limited room for fiscal expansion, and a fragile international financial system and weak aggregate demand, global growth is forecast to be only 3.1 per cent in 2011 (figure 1.1).

Figure 1.1

GDP growth rates of major regions, 2004–2011



Source: *UN-DESA (2011), estimates for 2010 and forecasts for 2011.*

Structural adjustments will be the key issue that the majority of developed economies have to deal with in 2011 (EIU, 2010a). Recent bold fiscal stimuli severely deteriorated many of their fiscal balances. Medium-term fiscal sustainability considerations have caused most developed countries to pursue fiscal consolidation, despite increasing social and political pressures against such a move. At the same time, the effectiveness of further monetary loosening, including quantitative easing, is in doubt, as households continue to consolidate their balance sheets by increasing savings rates. Banks are also hesitant to lend money.

On the balance of these factors, developed economies' growth is forecast to be only 1.9 per cent in 2011 (figure 1.1). Growth for emerging and developing economies, although still strong, will decline to about 6 per cent in 2011, despite the recovery of their industrial production and its positive impact on the balance of payments. The recovery of the world economy is expected to be long and painful, with prospects for different economies and regions remaining uneven.

The US economy recovered from contraction in the first half of 2009 and grew at an annualized rate of 1.6 per cent in the third quarter and 5 per cent in the fourth. A deceleration began in the first quarter of 2010, with GDP expanding by only 3.7 per cent. This trend continued in the second quarter, during which the economy advanced at a meagre 1.7 per cent (Bureau of Economic Analysis, 2011). Part of the reason for this slowdown was the tapering off of the stimulative effect of fiscal and monetary policies, as primarily reflected in the downturn of inventory investment, residential and non-residential fixed investment, and state and local government spending. The US unemployment rate remained high and the real estate market stayed sluggish in 2010. With weak private consumption expenditure, the US economy is most likely to demonstrate a subdued recovery. For the whole of 2010, US growth stood at 2.6 per cent, and is projected to decelerate to 2.2 per cent in 2011 (UN-DESA, 2011).

Japan's economy continued to rebound in 2010, owing to strong demand for capital goods from emerging and developing economies. In the first two quarters, GDP growth was estimated at 5.9 per cent and 3.5 per cent, respectively. The weak performance of the US economy contributed to this slow recovery of an economy that has been trapped in deflation since May 2009 (Japan SNA statistics, 2011). In addition, the sharp appreciation of the yen constituted a serious threat to the country's world export share. The economy is projected to grow at 1.1 per cent in 2011 (UN-DESA, 2011).

The EU faces worse prospects than the US. The bloc's growth rate is expected to be 1.6 per cent in 2011, down from 1.8 per cent in 2010 (UN-DESA, 2011), partly attributable to weak household consumption expenditure. The euro area sovereign debt crisis in 2010 prompted many countries to adopt stringent fiscal consolidation and austerity measures.

Developing economies are expected to sustain their strong performance, with projected growth rates of 7.1 per cent in 2010 and 6 per cent in 2011 (figure 1.1). China and India are still among the leading performers. China is expected to grow by 8.9 per cent in 2011, down from 10.1 per cent in 2010, and India by 8.2 per cent in 2011, slightly up from 8.4 per cent in 2010 (UN-DESA, 2011). Confronted with weak external demand, China reverted to a more sustainable domestic-oriented growth plan; India's economy has benefited from rising capital inflows and supportive macroeconomic policies.

In Western Asia, recovery was partly driven by developments in oil demand and prices, which in turn depended on global economic prospects. The region as a whole grew by 5.5 per cent in 2010, but is set to decelerate to 4.7 per cent in 2011 (figure 1.1).

Similarly, the economies in Latin America and the Caribbean (LAC), expanded by 5.6 per cent in 2010 thanks to increasing demand for commodities from emerging and developing countries. The LAC economies are projected to expand at 4.1 per cent in 2011, as US GDP growth, a major factor in their growth, tapers off (figure 1.1).

The global economy is expected to continue recovering slowly in 2011, with persistent concerns over high unemployment and weak consumer confidence, among others.

Africa's GDP growth is projected to rise slightly to 5.0 per cent in 2011, up from 4.7 per cent in 2010 (figure 1.1). Contributing to this are large-scale infrastructure investment, rapid development of industrial and service sectors, significant agricultural growth and the rebound of commodity prices. Most African economies seem to have recovered better than many other parts of the world, but they face uncertain sustainability and have narrow production and export structures (discussed further in chapter 4).

Looking forward, the global economy is expected to continue recovering slowly in 2011, with persistent concerns such as high unemployment, weak consumer confidence, uncertain business investment, resurgence of the EU sovereign debt crisis, and rising trade protectionism. The current recovery is still underpinned by stimulus policies, and the global economy has a long way to go to return to its potential growth path. In the face of such anxieties, the world economy now more than ever needs global policy coordination to steer growth onto a strong and sustainable path.

1.2 World trade growth yet to stabilize

STARTING IN THE second half of 2009, world trade rebounded strongly from the global crisis, limiting the export downturn to 20 per cent for the year. In the first quarter of 2010, the volume of world trade in commodities increased by a stellar 17 per cent (EIU, 2010b). The export value of world trade is estimated to have grown by 12.8 per cent in the whole of 2010, and is projected to return to about 8.5 per cent in 2011 (UN-DESA 2011). World trade growth prospects depend on the pace at which global recovery takes hold.

Developing countries' trade recovered in 2010, with exports growing by 15.9 per cent.

Developed economies' export growth is estimated at 10.2 per cent in 2010 (figure 1.2). Affected by the drying up of credit caused by the global recession, imports of the developed world declined considerably and are not expected to recover soon; its export volume grew slowly or remained unchanged. The sum of these two developments was that the trade deficit in developed economies narrowed.

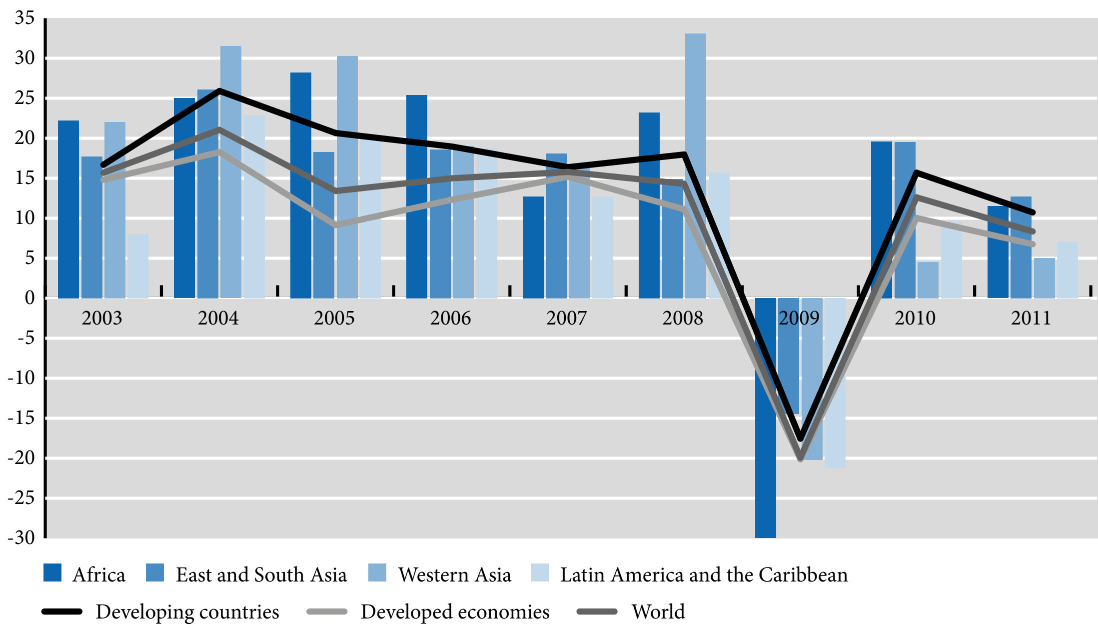
One of the channels through which the global crisis affected developing countries was trade. The value of developing countries' exports contracted by 17.6 per cent in 2009. Their trade recovered in 2010, with exports growing by 15.9 per cent. They are expected to post 10.9 per cent growth in 2011 (figure 1.2). With shrinking import demand from the developed world, developing countries are now facing increasing pressure to revert to a more balanced, domestic-demand driven and sustainable economic development model.

The exports of African economies suffered in 2009 from the crisis, with a fall of 30 per cent, although the continent's total export value constitutes only about 2.5 per cent of the global figure (figure 1.2; IMF, 2010b). With the rebound of commodity prices and strong demand from other developing and emerging economies, African exports saw a forceful upswing of 19.6 per cent in 2010, but this was still slower than 2008's 23.2 per cent.

African exports still rely mainly on primary products, and intraregional trade on the continent remains limited. Both factors contribute to the high volatility of African trade in response to global economic shocks. African imports are steadily increasing to support growing economies, resulting in increasing current account deficits for most countries (chapter 3).

Figure 1.2

Annual average growth rates of exports by region (%)



***Source**: UN-DESA (2011), estimates for 2010, and forecasts for 2011.*

1.3 Global interest rates still low but inflation up in some regions

IN AN ATTEMPT to counteract the impact of the global crisis and to stabilize financial systems, economies around the globe cut their interest rates to record lows in 2009. Countries followed diverse interest rate and monetary policy routes in 2010, taking into account their own economic conditions. Most developed economies maintained their accommodative monetary policies and low interest rates to support their still fragile economic systems as they tried to repair their public and private balance sheets, though Australia began to raise its interest rate in the fourth quarter of 2009. India began raising its interest rate in March 2010, and China started reversing its low interest rate monetary policy in October that year. These were all efforts to control rising inflation and to counter asset bubbles, which were partly brought about by currency appreciation expectations and increasing domestic credit in some countries.

Global interest rates are expected to remain low in 2011 and accommodative monetary policy will continue in most cases. Developing countries, however, must pay close attention to asset bubbles and inflation. Most African countries are expected to keep interest rates low in 2011 in view of the moderate inflationary outlook for the continent.

Global inflation increased from 1.4 per cent in 2009 to 2.5 per cent in 2010 and is expected to remain relatively low in 2011, owing to the slow global economic recovery. Demand from developing economies is picking up some of the slack left by decreased household expenditure in developed countries, where inflation pressures are likely to be subdued because of excess capacity and fiscal consolidation, which limit demand pressures. Inflation is therefore unlikely to be a major concern for most economies in 2011.

For developed countries, inflation increased from 0.1 per cent in 2009 to 1.4 per cent in 2010, and is projected to level off at 1.4 per cent in 2011 (figure 1.3). Owing to increasing commodity prices, headline inflation in these economies increased. Nevertheless, underlying inflation is expected to remain low because of high unemployment and excess industrial production capacity. Considering the mild inflation and weak growth prospects, most developed economies are likely to maintain their close-to-zero interest rates and may even pursue quantitative easing in 2011.

Inflation climbed to 5.4 per cent in developing economies in 2010, up from 4.4 per cent in 2009, but is expected to slide back to 4.9 per cent in 2011 (figure 1.3). With continued loose monetary policy and a relatively quick economic recovery, inflation remains a concern in many developing economies in 2011. In China, inflation increased throughout 2010, although it is still under control. India's inflation rate, which is captured by the wholesale price index, was in double-digit levels from the third quarter of 2009, prompting a series of interest rate increases by the Reserve Bank of India (OECD, 2010b).

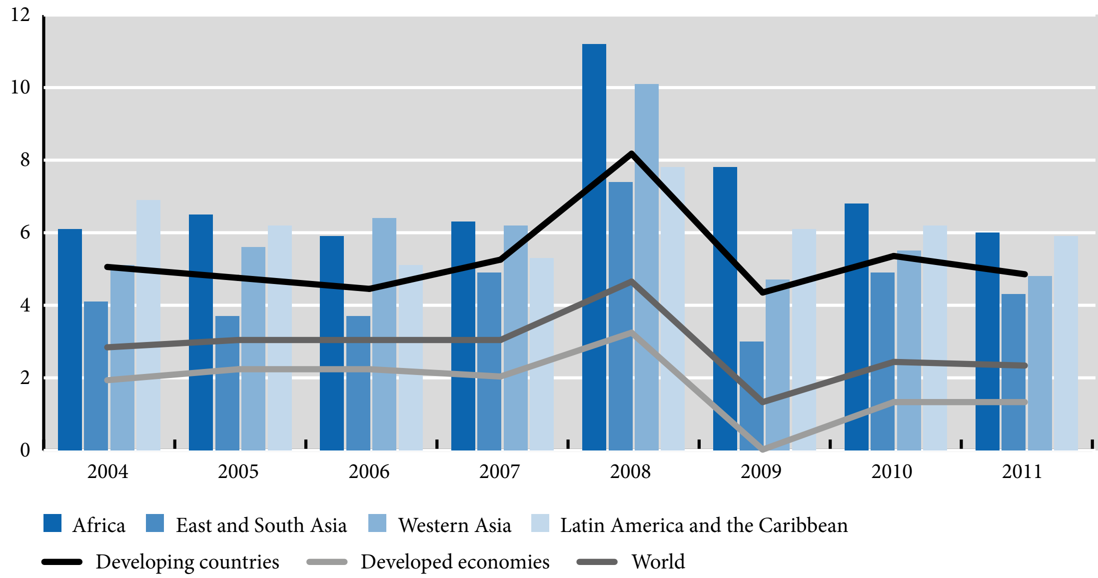
In LAC, inflation reached 6.2 per cent in 2010, but is expected to decline to 5.9 per cent in 2011 (figure 1.3). Given the risk of overheating and balance-sheet vulnerability, unwinding fiscal and monetary stimulus policies is foreseeable for this region's economies.

Although declining, Africa's inflation remains relatively high compared with other regions, owing mainly to continued strong domestic demand and weak supply capacity. Inflation dropped from 7.8 per cent in 2009 to 6.8 per cent in 2010 and is projected to decline to 6.0 per cent in 2011 (figure 1.3).

Global inflation increased from 1.4 per cent in 2009 to 2.5 per cent in 2010 and is expected to remain relatively low in 2011.

Figure 1.3

Inflation rates in major regions and economies, 2004–2011



Source*: UN-DESA (2011), estimates for 2010 and forecasts for 2011.*

With interest rates at an all-time low and recovery in the banking system under way, liquidity could surge, thereby posing a threat to price stability. One of the major challenges for many economies across the world, including African countries, is determining the appropriate time for reversing loose monetary policies.

1.4 Trading in foreign exchange dominated by weak US dollar and fluctuating euro

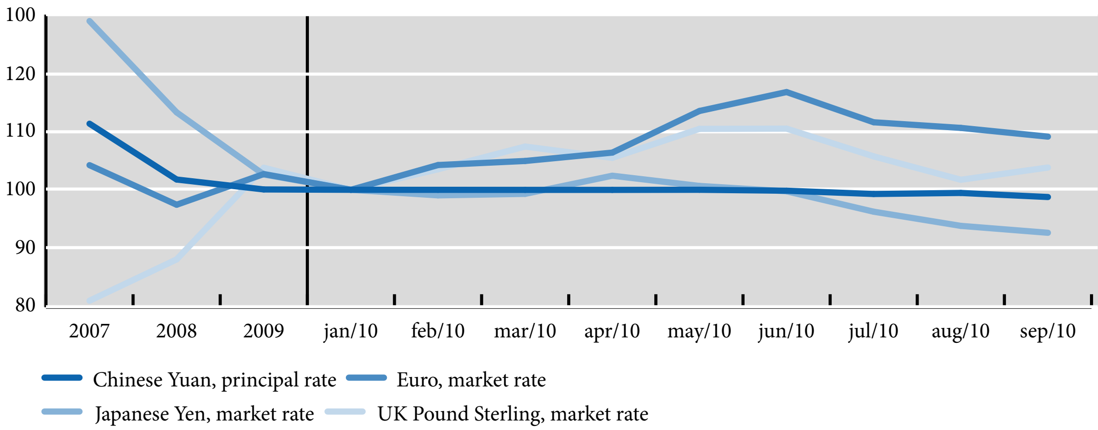
OWING TO THE US Federal Reserve's sustained loose monetary policy and quantitative easing measures, the dollar continued to depreciate in 2010, despite a temporary appreciation in the first half of the year. With the emergence of the Greek and Irish sovereign debt crises, concerns over fiscal sustainability led to a rapid appreciation of the dollar against the euro. By end-May 2010, the dollar index was up by nearly 15 per cent compared with its most recent trough in 2009.

The persistent depreciation of the dollar had a strong influence on global economic competitiveness. In 2010, the yen appreciated considerably against the dollar and the euro, with a nominal appreciation of nearly 10 per cent against the dollar by end-September. Japan's exports saw a decline owing to the yen's appreciation, leading to intervention by the Bank of Japan in the foreign exchange market in September 2010. China was under increasing pressure from the US and EU to let the yuan appreciate as well, given its consistent and sizeable trade surpluses with these trading partners. By end-September 2010, China's currency appreciated by about 1.86 per cent against the US dollar and about 2.53 per cent against the Special Drawing Rights (SDR).

One of the major implications of the US dollar's depreciation is a nominal increase in commodity prices, improving the terms of trade of many African commodity-exporting countries. The continent's relatively high growth rate is also attracting significant private FDI flows into certain sectors.

Figure 1.4

Trends in international foreign exchange markets (against US dollar, January 2010=100)



***Source**: IMF (2010b). UNECA calculated the indices.*

1.5 Macroeconomic imbalances threatening global economic stability

DEVELOPED ECONOMIES SAW their trade deficits narrow in 2008 and 2009, as their imports contracted more than their exports. Current account deficits narrowed from 1.2 per cent of GDP in 2008 to 0.3 per cent of GDP in 2009. With prospects for recovery uncertain, it is likely that the ratio of current account balances to GDP for developed economies will remain relatively stable, with a deficit of 0.3 per cent in 2010 and 0.1 per cent in 2011 (IMF, 2010a). These forecasts, however, conceal differences among these countries.

The US trade deficit stood at 3.2 per cent in 2010 but is expected to narrow to 2.6 per cent in 2011 (figure 1.5). This partly reflects weak household spending. Given the economic uncertainty and their deteriorated balance sheets, US households are cutting their spending, which could reduce the trade deficit.

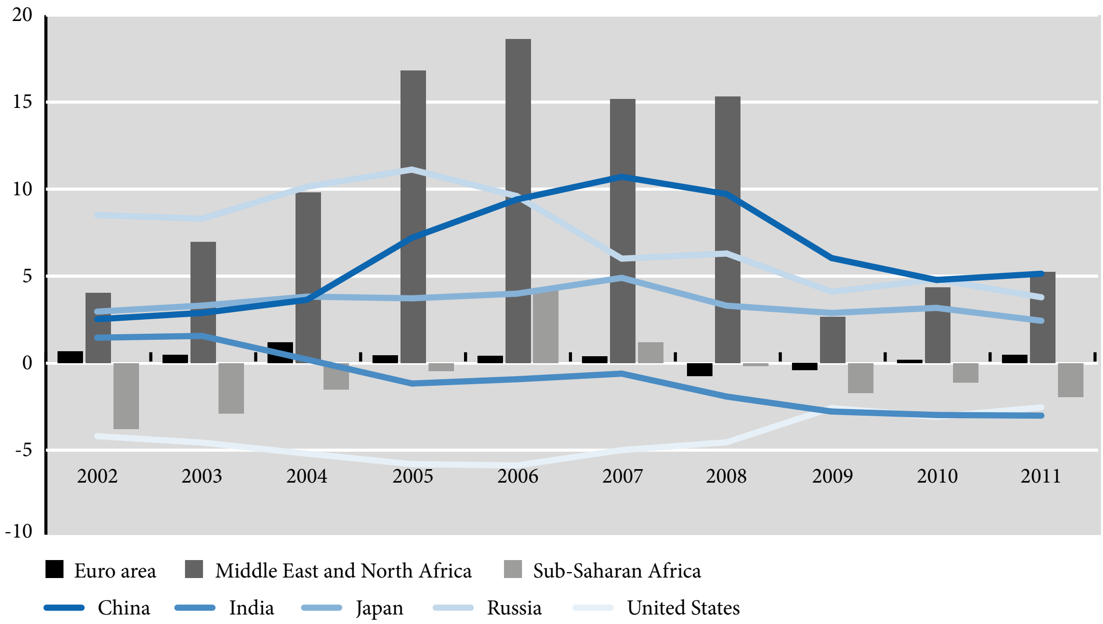
The euro area current account was in near balance in 2010 and is expected to remain around the same level in 2011, again masking divergence among countries. Germany continues to run a considerable surplus, while Greece and Portugal, which were at the centre of the euro area sovereign debt crisis, claimed almost double-digit deficits in 2010 (IMF, 2010a).

Average current account balance in emerging and developing countries remained positive in 2010, and the same trend is expected in 2011, despite the high growth of imports, fuelled by fiscal stimuli. This trend is driven mainly by large current account surpluses in some emerging developing economies such as China and oil-rich countries such as the Gulf States. China continued to post a current account surplus, of 4.7 per cent of GDP, in 2010, which is expected to rise to 5.1 per cent in 2011, although its size will be modest compared with the double-digit levels of before the global crisis (figure 1.5).

Current account movements diverged across Africa (chapter 2). Most oil exporters on the continent are expected to continue running surpluses in 2011, thanks in large part to strong oil prices. In contrast, the majority of oil-importing countries will see their current account balances worsen. This deterioration is likely to cause nominal depreciation in some national currencies, aggravating inflationary pressures.

Figure 1.5

Current account balances for selected regions and countries, 2002–2011(% of GDP)



***Source**: IMF (2010a); 2010 and 2011 estimates; India 2009 estimate.*

> *Foreign reserves in emerging and developing economies grew by 12.3 per cent in 2010, exceeding US$6.2 billion.*

Foreign reserves in emerging and developing economies grew by around 11.3 per cent in 2009. Helped by the recovery in capital inflows (and despite widening trade deficits) they continued to expand, by 12.3 per cent in 2010, reaching over $6.2 billion. China held the largest reserve, accounting for about 43.5 per cent of the stock of all emerging and developing economies (IMF, 2010a). High reserves and a multi-year trade surplus, coupled with foreign exchange control policies, are resulting in low domestic demand in China, as well as asset bubbles, high inflation and lower returns to capital.

Table 1.1

Foreign exchange reserves in selected regions and countries, total and months of imports, 2003–2011

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Foreign exchange reserves ($ billion)									
Arabian Peninsula and the Gulf	86.2	109.0	259.1	364.3	542.8	670.1	632.3	691.3	742.3
China	408.2	614.5	821.5	1068.5	1530.3	1949.3	2416.0	2852.4	3227.8
Economies in Transition	211.6	289.1	368.3	536.9	764.9	718.2	764.7	883.8	931.1
India	98.9	126.6	131.9	170.7	267.0	247.4	265.2	275.4	307.6
Latin America	193.0	219.5	254.8	310.5	445.8	496.9	546.5	636.0	673.7
Russian Federation	73.2	120.8	175.9	295.6	466.8	411.8	416.6	483.3	519.8
Sub-Saharan Africa	31.1	50.9	69.9	99.2	125.7	133.7	132.5	138.3	149.2
Foreign exchange reserves (months of imports of goods and services)									
Arabian Peninsula and the Gulf	5.0	4.9	9.5	11.1	12.9	12.4	13.6	14.1	14.1
China	11.0	12.2	13.9	15.1	17.8	19.0	26.1	22.8	21.8
Economies in Transition	5.5	5.7	6.2	7.3	8.0	6.2	9.4	9.3	9.0
India	13.2	11.9	9.0	9.4	11.8	8.0	10.0	8.2	8.0
Latin America	5.8	5.5	5.4	5.5	6.7	6.1	8.7	8.0	7.7
Russian Federation	8.9	11.4	13.3	17.4	20.4	13.9	20.8	19.1	19.0
Sub-Saharan Africa	3.5	4.6	5.1	6.2	6.3	5.4	6.5	5.7	5.7

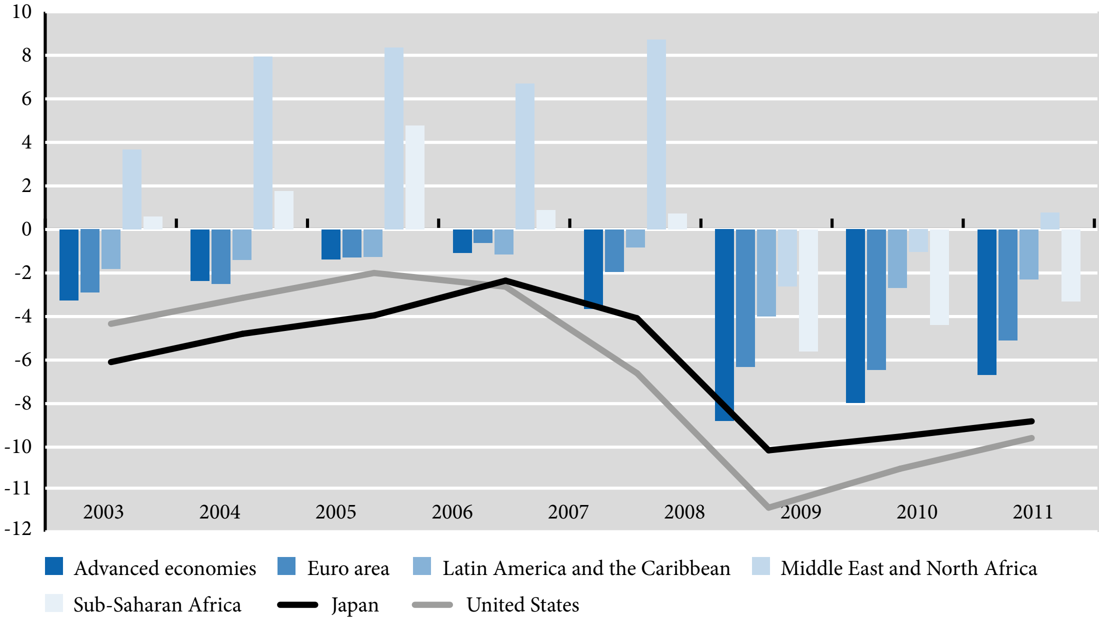
Source*: EIU (2010c), estimates for 2010 and forecasts for 2011.*

The fiscal positions of developed economies deteriorated severely in 2009, largely owing to increased fiscal expenditures to counter the global crisis along with reduced tax revenues that accompanied the recession. After more than doubling, from 3.6 per cent to 8.8 per cent of GDP in 2009, the net borrowing position of developed economies is projected to plateau at 8.0 per cent and 6.7 per cent of GDP in 2010 and 2011, respectively. In absolute terms, the US has the largest debt among developed countries, with gross debt of 92.7 per cent of its GDP in 2010 (IMF, 2010a).

Net borrowing by developed economies is expected to decline to 6.7 per cent of GDP in 2011.

Figure 1.6

Central government fiscal balances for selected regions and economies, 2004–2011 (% of GDP)



Source*: IMF (2010a), estimates for 2010 and forecasts for 2011.*

In 2010, the euro area's sovereign debt crisis and fiscal sustainability concerns almost led to a collapse of the euro. A massive fiscal stimulus was necessary in order to save failing financial institutions and counter the consequences of the recession. As public expenditures rose, fiscal positions deteriorated in many European countries, and their sovereign debt ratings were downgraded, leading to higher interest rate requirements for new government bond issues. The situation was temporarily eased by intervention from the International Monetary Fund (IMF), EU and European Central Bank. However, euro area and other developed countries run the risk of another debt crisis unless they steer their public finances towards sustainable paths.

African economies have relied mainly on tax revenues and proceeds from official development assistance (ODA) to finance public expenditures. A modest recovery of the global economy and fiscal consolidation in donor countries have the potential to constrain government spending in Africa, therefore putting on hold many infrastructure projects and social development efforts across the continent.

1.6 World commodity prices and volatility both up

MOST WORLD COMMODITY prices have risen over the past 10 years, despite a significant decline during the recent global crisis. The upward price trend was largely instigated by increased demand from rapidly growing emerging and developing countries. During the crisis, decreased demand from developed economies caused the commodity price index to drop by 56 per cent from its highest point in July 2008. A rebound in commodity price indices began in February 2009. By end-September 2010, the indices had recovered nearly 53 per cent from its lowest point in 2009 (figure 1.7). There was, however, a slight decrease from April to June 2010 during the euro area sovereign debt crisis.

Most commodity prices increased in 2010, but their extent and sensitivity to economic shocks varied. Food prices were the most stable, whereas metal prices fluctuated the most, followed by energy prices. Fluctuations in the prices of other commodities are highly correlated with oil prices.

Crude oil

In 2010, the price of crude oil continued its strong rebound from its crisis-related slump. By end-October 2010, the crude oil price index had increased 91.8 per cent from its 2009 low (IMF, 2010c).

A fundamental analysis of oil demand and supply explains 2010's strong price rise. In 2010, world oil demand was up by an estimated 2.2 per cent. From developed economies, demand was nearly the same as in 2009, with an estimated 0.4 per cent growth, but from emerging and developing countries, especially China, it increased rapidly. China's demand for oil in 2010 accounted for 10.5 per cent of total global demand, second only to the US at 22.3 per cent. During the last quarter of 2009 and the first quarter of 2010, China's oil demand grew at a double-digit rate, owing to booming infrastructure construction and greater domestic demand for vehicles (IMF, 2010a).

On the supply side, oil production is expected to be close to full capacity, allowing only limited increases in supply. On the balance of the two forces, oil prices are therefore expected to experience a steady upward trend in 2011, buttressed by continuing rapid expansion of demand from emerging and developing economies and relatively stable demand from the developed world. Speculative trading by hedge funds may contribute to increasing the volatility of the oil price.

Africa has almost 10 per cent of global oil reserves and is attracting increased investment in the oil production sector. In 2009, investments rose by 4 per cent while other oil markets saw significant declines. African oil covers almost a fifth of US oil imports and a third of Chinese imports (Afrique Avenir, 2010). With oil prices steadily rising, African oil-exporting countries are expected to enjoy a firm and steady economic recovery in 2011.

Food and beverages

Compared with other commodity indices, the food and beverage index did not fluctuate much in 2010. By end-September 2010, the food and beverage index was up by around 30 per cent from its 2008 low point. In the first two quarters of 2010, the index fluctuated mildly owing to financial market turmoil accompanying the euro area sovereign debt crisis. The index jumped after June 2010, reflecting the rising price of wheat. In fact, the wheat price has been increasing since the end of the second quarter of 2010, reflecting adverse weather that hit major wheat-producing countries and areas, including Russia, Ukraine and parts of North America.

Despite changes in the global economy, the prices of food and beverages remained relatively stable in 2009 and 2010 owing to their special supply and demand features. As basic necessities, demand for them tends to be inelastic. Against this, the productivity of food and beverages has been increasing consistently in recent years. Yet rising demand and energy costs may push the prices of food and beverages upward in 2011.

The sharp increases in grain prices that were observed after July 2010 pushed current account balances of grain-importing African countries into deficit. Rising grain prices also posed daunting challenges to efforts to eradicate hunger in some of the continent's countries.

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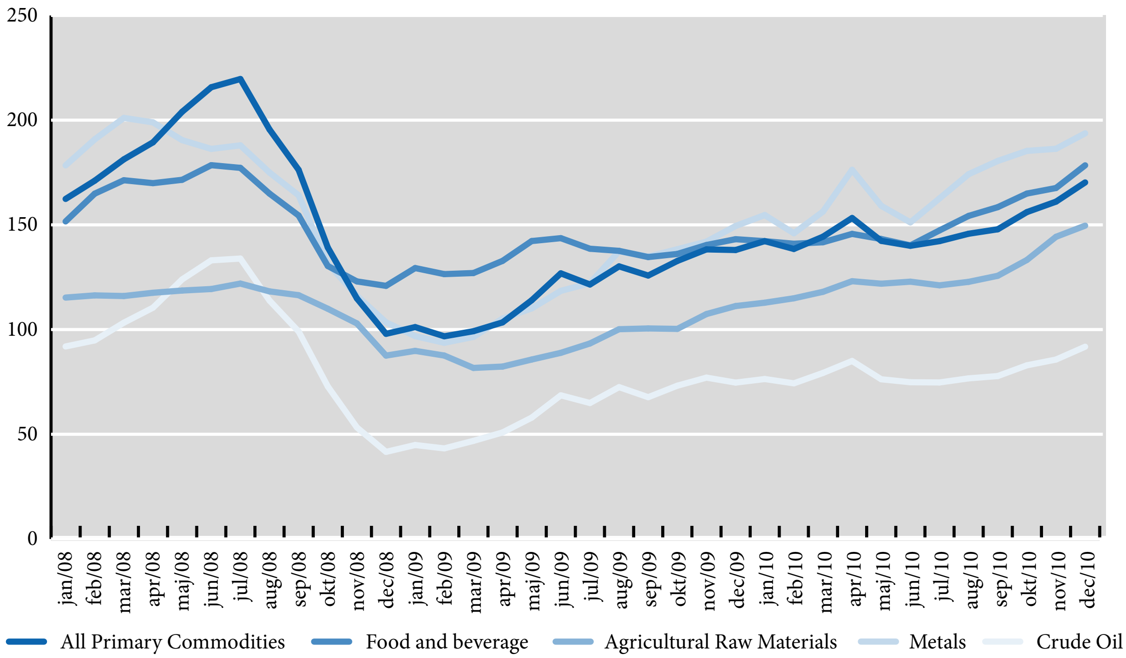
Figure 1.7

Indices of primary commodity prices, January 2008–September 2010 (2005=100, $)



***Source**: IMF (2010a).*

Agricultural raw materials, minerals, ores and metals

The agricultural raw material price index maintained an upward trend in 2010, rising by about 34.5 per cent from the start of the year to December 2010. Cotton prices continued to increase in 2010, with some fluctuations: a slight decrease in June but from then up to September a sharp increase of over 24 per cent. Rubber prices rose during the first quarter of 2010, gradually declined during the second, then picked up again in the third, but did not recover all their lost ground.

Metal prices increased in 2010, also with fluctuations. The largest change in the metal price index was recorded in the second quarter, with a drop of nearly 15 per cent, driven in part by the euro area sovereign debt crisis. For specific metal prices, the aluminium, copper, lead and zinc price indices were highly correlated with each other in the first three quarters of 2010. They, too, were all severely affected by the crisis in the euro area, before maintaining an upward trend.

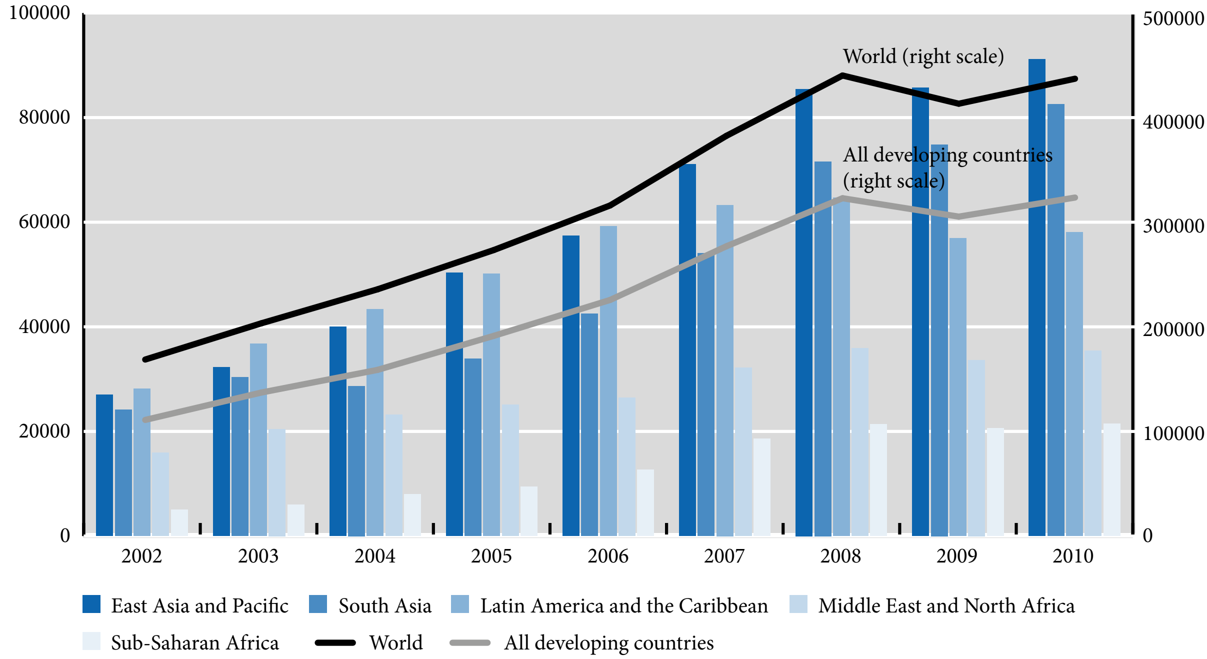
1.7 Remittances and foreign direct investment starting to pick up again

Remittances

REMITTANCE FLOWS REPRESENT only a small portion of total world private capital flows. Yet for a number of countries, remittances constitute a major source of resource inflows that significantly influence current account developments. World remittances are estimated to have been $416 billion in 2009, representing a 6.1 per cent decline from 2008. They recovered somewhat in 2010, growing by 5.8 per cent. The same trend is expected to continue in 2011, with growth of 5.4 per cent (World Bank, 2010). These growth rates compare unfavourably with the double-digit rates seen before the global crisis (figure 1.8).

Figure 1.8

Remittance inflows by major beneficiary regions, 2002–2010 ($ billion)



***Source**: World Bank (2010), estimates for 2010.*

The level of remittance flows in LAC in 2010 is estimated to be close to the 2009 level and to recover to pre-crisis levels in 2011. Remittance flows to East Asia and the Pacific are estimated to have expanded strongly in 2010, at 6.4 per cent (figure 1.8). Again, this is far below pre-crisis rates of growth.

The flow of remittances to sub-Saharan Africa did not drop as much as expected and remained at the same level in 2009 as in 2008. However, the growth of remittance flows to Africa over 2010–2011 is estimated at only 4.5 per cent, which is far lower than before the crisis (World Bank, 2010).

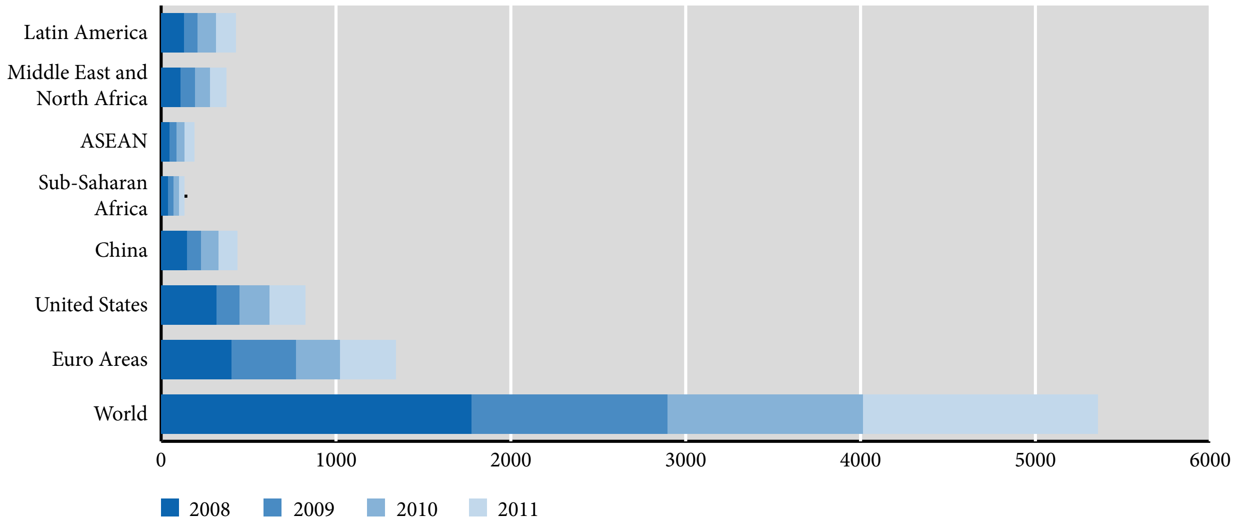
Foreign direct investment

FDI—a major source of international capital flows—saw substantial falls during the crisis. World FDI inflows dropped by 36.7 per cent to $1,122 billion in 2009 (figure 1.9). With investors' returns declining, FDI inflows to developed economies dropped by 44 per cent that year. Inflows to developing economies declined by 24 per cent, owing to global risk aversion and higher requirements for investment returns (UNCTAD, 2010).

FDI—a major source of international capital flows—saw substantial falls during the crisis.

Figure 1.9

FDI inflows by region and for selected economies, 2008–2011 ($ billion)



***Source**: EIU (2010c), estimates for 2010 and forecasts for 2011.*

The UNCTAD FDI Global Quarterly Index in the first quarter of 2010 was a shade lower than in the second half of 2009. The index then fell sharply in the second quarter of 2010, suggesting that global FDI was still stagnant and sensitive to economic shocks, such as the euro area crisis. Latest estimates indicate that global FDI inflows were a little higher in full-year 2010 than in 2009, although still only about half the record reached in 2007 (UNCTAD, 2011).

Against this backdrop, the pattern and nature of global FDI are changing. In 2009, FDI inflows to developing and transition economies accounted for over half the global total, the highest ever. This growing share reflected an improving investment environment and much higher expected returns than in developed economies. Also, a larger share of FDI went into services and primary commodities, rather than traditional manufacturing, mirroring weak global growth prospects and high expected inflation.

Official development assistance

ODA constitutes an important source of development finance for low-income countries. Despite the adverse effects of the global crisis on the economies of donor countries, ODA to developing countries sustained its upward trend, increasing from $126.7 billion in 2008 to $127.5 billion in 2009 (chapter 3). In fact, nominal ODA flows to African countries were at an all-time high of $47.6 billion in 2009 and are estimated to have grown by 4 per cent in 2010. In absolute terms, Africa topped the post-crisis receivers of ODA among developing regions. This reflected the global community's long-term commitment and support to the development and welfare of the continent.

Despite the adverse effects of the global crisis on the economies of donor countries, ODA to developing countries sustained its upward trend.

1.8 The quest for reform of the global financial architecture

THE WORLD'S FINANCIAL architecture has gone through several changes in the last couple of decades, focusing on different issues, as the international community has sought to apply the lessons learned from the world's many crises, such as the Mexican crisis of 1995, the Asian crisis of 1997, the Russian crisis of 1998, the Brazilian and Ecuadorian crises of 1999 and the Turkish and Argentine crises of 2001–2002.

After the recent global crisis, it has come under renewed attack and faced many calls for reform. Policymakers have an urgent need to consider the changes needed in the policies and structures of international financial institutions, and to identify the main problems and challenges of the international payments system. They have voiced their concerns at G-20 summits (London, April 2009; Pittsburgh, September 2009; Toronto, June 2010; and Seoul, November 2010). To reform the international financial structure, the G-20 has sought to coordinate policy actions, addressing the immediate need for recovery arising from the crisis.

Further, under the auspices of the United Nations, a Commission of Experts chaired by Joseph Stiglitz was established to advise on the nature of necessary reforms in the international monetary and financial systems. Numerous events have also taken place within global civil society concerned with the attempts to redefine the international financial and economic order (Stiglitz et al., 2010).

As a result, the G-20 (among others) has made various proposals for addressing global imbalances and reserve accumulation: redefining the role of the US dollar as a reserve currency; connecting exchange rate regimes and financial crises; strengthening supervision and regulation of the international financial system; and improving governance of international financial institutions.

Africa's challenges with the current global financial architecture relate mainly to lack of voice and effective representation in decision-making bodies. With South Africa as the continent's only country in the G-20, most of Africa is preoccupied with the issue of better representation, particularly against the background of the continent's diverse socio-economic realities. This concern has been partly addressed in the G-20 Seoul Declaration which called for further reforms by January 2013 "aimed at enhancing the voice and representation of emerging market and developing countries, including the poorest". Finance ministers and central bank governors are called upon "to continue to pursue all outstanding governance reform issues at the World Bank and the IMF" (The G20, 2010).

The Seoul Declaration emphasizes several approaches to help countries cope with financial volatility and sudden reversals of capital flows. The G-20 welcomed the creation of a new IMF Precautionary Credit Line to provide lending to countries facing potential financial difficulties, as well as enhanced collaboration between the IMF and regional financing institutions. It underlined an increased role for the IMF in anticipating systemic financial risks, particularly its recent decision "to make financial stability assessments under the Financial Sector Assessment Programme a regular and mandatory part of IMF Staff assessment of country performance for members with systemically important financial sectors".

As the debate on reforming the financial superstructure continues, African countries should quickly position themselves to develop a better understanding of the reform process and the opportunities such change offers. They also need to undertake their own structural reforms to address the inadequacies of their financial systems and to enhance Africa's financial integration, subregionally and regionally. These reforms require huge financial resources,

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but in quantity and quality, this additional external financing is yet to materialize. This is partly because, owing to the global crisis, developed economies themselves are facing significant economic challenges, and have an increasing focus on reducing their budget deficits. It is too optimistic to expect developed-country governments to meet Africa's financing needs—and turning the coin, Africa has an opportunity to reduce its dependence on development aid.

In the immediate term, African countries should hold the G-20 accountable for full implementation of the commitments made in three areas at the 2009 G-20 summits. First, with regard to increased resources from international financial institutions, they should follow through on speedy implementation of the commitment to increase lending to multilateral development banks by $100 billion with a commitment to increase this to $300 billion over the following three years. They should also ensure rapid implementation of the IMF review of the restrictive Debt Sustainability Framework of the IMF and World Bank. They need, as well, to seek clarification on the modalities of access for the $50 billion set aside for low-income countries at the London 2009 Summit.

Second, on strengthening financial supervision and regulation, because the policy process leading to Basel-II and Basel-III largely excluded inputs from developing countries, Africa needs to make its voice heard as the modalities for implementing the Basel-II capital framework and other prudential regulations are finalized for implementation. Also, it needs to place the issue of access to financial services by the poor and small and medium-sized enterprises at the top of the agenda, and should therefore be represented on the proposed G-20 Financial Inclusion Experts Group.

Third, for resisting protectionism and promoting global trade and investment, although the significant new money (at least $250 billion) for trade finance is welcome, Africa should press for clarification of the sources of funds and their rapid disbursement.

For many African countries, the issue in the trade arena is one of increasing their access to developed countries' markets. They can help to achieve this by, among other things, continuing their demands for relaxed rules-of-origin requirements and lower non-tariff barriers, and pursuing Aid for Trade initiative. African countries generally need to decide on their main priorities for the Doha Round negotiations, so that they can push through their main interests. They should also continue to press developed countries to open up their markets for trade and live up to their promise to make the Doha Round the "Development Round".

1.9 Conclusions

THE RECOVERY OF the global economy was under way in 2010, following the most severe recession since the aftermath of the Second World War. Such a recovery is delicately poised owing to downside risks and uncertainties. Economies are recovering but at a much slower pace than expected.

Developed economies were beset by persistent weak internal demand and high unemployment in 2010. The stability of the euro was challenged by large and unsustainable budget deficits, driven mainly by massive rescue packages. Austerity measures initiated in an attempt to put fiscal deficits on a sustainable path have constrained internal demand, dampening the prospects for full economic recovery of euro area countries as well as the global economy.

Developing and emerging economies recovered strongly but are projected to show lower growth rates in 2011.

Developing and emerging economies recovered strongly but are projected to show lower growth rates in 2011. Increased global liquidity fuelled asset bubbles, thereby causing rising inflationary pressures in these countries. In response, emerging economies such as China and India are tightening, or can be expected to tighten, their loose monetary policies.

Besides their economic measures, major global economies put reform of the international financial architecture on the agenda of the Seoul G-20 meeting. Their move stemmed from the distortion of the international financial architecture, among the most criticized of the many explanations for the global crisis.

The severe post-crisis recession presented African economies with both challenges and opportunities for economic growth and development. Rising international prices were positive for African oil and commodity exporters, but these countries must take effective measures to address the risk of price fluctuations. These include short-term measures aimed at improving the management of commodity revenue as well as medium- and long-term measures to diversify the economic base.

Overall FDI inflows to the continent declined in the aftermath of the crisis, but FDI increased in the extractive industry attracted by prospects of higher returns. Harnessing the full potential of FDI and other financial resources requires African economies to direct these inflows into infrastructure and manufacturing. African governments must play an active role in guiding development activity to ensure economic transformation as a means to achieving high-level, sustainable and shared growth.

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