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Is Africa Headed for a Financial Crisis?

A rerun of the 2013 "taper tantrum" could spell disaster for emerging economies.

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AUGUST 10, 2021, 2:37 PM

COVID-19 has exerted immense pressure on the world's emerging markets, yet some of the pandemic's most painful economic episodes may be yet to come. A rerun of the 2013 "taper tantrum," a post-recovery collapse in oil prices, and poorly executed multilateral programs are creating economic concerns that match the enormity of many countries' epidemiological concerns.

In sub-Saharan Africa—where a third wave is gripping many countries, and a fourth wave is gripping others—it has become increasingly difficult for governments to get ahead of these challenges. The World Health Organization has reported that Africa's COVID-19 infections are doubling every 18 days, and just 1.3 percent of the continent has been vaccinated. With the health toll mounting, the economic toll rises, too.

The first challenge comes from beyond Africa's borders, as central bankers in advanced economies deliberate an end to the monetary relief that has kept the global economy tenuously afloat for the past year. When the pandemic struck, investors fled from "riskier" emerging markets to the safe assets of advanced economies. Within the first

four months of 2020, capital outflows from emerging markets reached $243 billion,

producing a sharp depreciation in many currencies and a sudden spike in borrowing costs.

Over time, this pain was soothed as the major central banks took unprecedented actions to ease monetary conditions. Interest rates in advanced economies were slashed to near-zero levels last summer, with the yield on the 10-year U.S. Treasury bond falling to 0.5 percent and the 10-year U.K. Gilt falling to 0.15 percent.

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These cuts, combined with other asset purchases and lending facilities, were critical for calming global markets and supporting the flow of credit amid the uncertainty of the early pandemic. As their success in soothing advanced economies entailed pushing those countries' yields to levels where no investor could turn an acceptable profit, the measures also succeeded in pushing investors back to the juicier yields of emerging markets, where (in sub-Saharan Africa) investors could collect around 8 percent on a Nigerian 10-year bond, 9 percent on a South African 10-year bond, and 12 percent on a Kenyan 10-year bond.

The widening gap between emerging markets and advanced economies also revived a familiar old carry trade, in which investors would borrow cheaper, lower-yielding dollars to buy higher-yielding assets elsewhere. Through the end of 2020, emerging markets' capital inflows ended up topping $360 billion, despite the health and other challenges that these countries were facing.

Yet this convenient arrangement of near-zero rates in the rich world, along with large inflows to the developing world, has been coming to an end. As advanced economies have recovered, the yield on the 10-year U.S. Treasury climbed back from 0.5 percent last August to 1.75 percent in March, before leveling off around 1.3 percent today. Higher interest rates in advanced economies have put last year's process in reverse: As investors can now earn more acceptable returns at home, they no longer need to rush to the "riskier" assets of emerging markets. In fact, they will rush away. In March, $290 million fled the world's emerging markets per day, a jarring turnaround from the inflows of the prior year.

Then there are the inflation concerns, which central banks conventionally respond to with monetary tightening. This would exacerbate the situation for emerging markets by driving advanced economies' interest rates up further, encouraging further emerging market capital outflows, and strengthening advanced economies' currencies against those of emerging markets—which makes emerging markets' imports and foreign-currency interest payments ever more expensive. The International Monetary Fund (IMF) has warned the major central banks not to overreact to rising price levels, but it appears they have done so to little avail. Last week the Bank of England indicated that it will raise rates in the near future, contributing to worries about a second "taper tantrum."

The haunting "taper tantrum" occurred in 2013 when then-Federal Reserve Chairman Ben Bernanke commented that he may begin "tapering" asset purchases, which increased U.S. interest rates and sent investors fleeing from emerging markets. In the fire sale of their assets, emerging markets' currencies fell by an average of 13.5 percent. With investors dumping their sovereign bonds, the yields on those bonds spiked by 2.5 percent as well, given that bond prices and yields move inversely. Weaker currencies and higher rates proved to be a painful combination for these countries' borrowing costs.

"I believe this time would be much more profound," worries Carlos Lopes, the former executive secretary of the U.N. Economic Commission for Africa and a professor at the University of Cape Town. With emerging market debt burdens groaning under the weight of higher health care expenditures, lower tax revenues, and depleted foreign reserves, the risks of a second taper tantrum cannot be overlooked.

For sub-Saharan Africa, the most vulnerable economies would be the largest ones with the most liquid bond markets, says Mark Bohlund of REDD Intelligence, an emerging markets research firm. South Africa, the country that has endured the most COVID-19 infections on the continent, and Ghana, which has struggled with its debt sustainability, stand out.

New difficulties servicing debt would also exacerbate one of the continent's greatest pre-existing problems, Lopes says, which is the "punitive interest rates" on African sovereign bonds. For those African countries which do have access to global capital markets, raising the funds from foreign creditors that are needed to finance basic

government operations can be exceptionally expensive by global standards. A key reason for this is how global credit rating agencies perceive African countries.

The debt of just one country on the continent, Botswana, is above "speculative" or "junk" status, in the rating agencies' estimation. Such a uniformly negative outlook on African governments is difficult to justify, Lopes argues, but the consequences are not difficult to see—particularly during the pandemic. Angola, Ghana, Gabon, and Zambia spend more servicing their debt than they do providing health care. In Angola's case, interest payments are more than double its health care expenditures.

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Historically reliable revenue sources such as oil are of declining help to African governments like Angola, says Bohlund. Oil prices have halved since 2008, dropping to levels at which no African country could turn a profit in the beginning of the pandemic, and the "reopening" rebound in oil prices these past few months is slowing down. Rabah Arezki, the chief economist of the African Development Bank, worries that serious political and economic crises will accompany oil's decline.

"The last oil price super-cycle might already be underway, the end of which could herald an increase in the number of failed states," Arezki warns, citing lower costs of alternative energy sources and new environmental regulations abroad.

This is particularly problematic for oil-dependent Angola, whose production has fallen by one-third since 2015; Mozambique, whose oil investments have been fatally disrupted by an insurgency in the country's north; and Nigeria, whose output has declined as well. With OPEC's agreement last month to ramp up oil production, African

producers will have to reckon not only with declining sales but also with the declining prices that accompany OPEC's supply increase.

International organizations have gone to considerable lengths to address these monetary and fiscal challenges, through a variety of emergency grants, loans, and technical assistance initiatives. In addition to the $160 billion the World Bank has made available and the $110 billion that the IMF has deployed, the two have notably overseen programs to temporarily relieve countries of their debt burdens and to replenish government reserves. Yet both important efforts have suffered a lack of participation from the private sector, advanced economies, and from many low- and middle-income countries themselves.

The lack of participation has proven most detrimental to the Debt Service Suspension Initiative (DSSI), the plan devised by the IMF and World Bank to have G-20 governments defer low-income countries' interest payments during the pandemic. The "Paris Club" of wealthy Western countries rallied around the DSSI in the spring of 2020, but these governments are a decreasingly prominent source of Africa's external financing. The creditors of increasing prominence—private-sector actors in the West and non-traditional official creditors such as the Chinese—have been less quick to participate in the DSSI as they have little desire to pass up on interest payments.

This problem was partially brought on by the Paris Club itself, which bowed to private-sector requests not to mandate relief for commercial debts. It was also partially requested by African governments, which justifiably (if unfortunately) feared the long-term consequences of credit downgrades and losing access to global capital markets if their creditors were inconvenienced by a temporary deferral of interest payments.

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The Paris Club's actions additionally opened the door to China's lack of participation, as Beijing has dubiously claimed that its state-owned China Development Bank is a commercial creditor, not an official creditor, and that it therefore has no obligation to provide debt relief. Coupled with new findings of China's opaque debt contracts, China

has sparked distrust from Africa's other creditors, which complicates debt restructuring processes, Bohlund says. When private sector creditors grew suspicious that China would not be providing equivalent debt relief to Zambia last fall, Zambia's restructuring collapsed and the country experienced Africa's first sovereign default of the pandemic.

Yet the death knell for the DSSI, which has succeeded in suspending just $5 billion worldwide thus far (a fraction of the $16.5 billion the Organisation for Economic Cooperation and Development had projected), were the conditions attached to it, says Lopes. Any government which sought DSSI relief would be compelled not to take on any more commercial debt, a stipulation that was inconceivable for many governments during a crisis that demanded greater government spending.

As for the $5 billion that has in fact been suspended, Lopes sees little upside. "All of this is going to hit us hard when the DSSI finishes," he worries of the program's conclusion in December.

A glimmer of multilateral hope emerged last month that could overcome many of these challenges as the IMF approved a $650 billion issuance of special drawing rights (SDRs), unique assets that can replenish countries' foreign reserves and be exchanged for much-needed foreign currencies. However, as SDRs are allocated to all countries according to the size of their economy, rich countries are set to receive the vast majority of the $650 billion windfall while African governments will receive very little.

At present, the United States alone will take in $113 billion, yet Africa's 54 countries will be granted less than $34 billion. The IMF says it is "identifying viable options" for reallocating SDRs to the countries that need them most, but no plan has emerged. Lopes deems a successful reallocation to be unlikely. This is not only because existing proposals, such as the one French President Emmanuel Macron advanced in May, have largely been ignored. It is also because African governments are wary of the strings that may be attached to accessing rich countries' SDRs if they are only made available through IMF facilities such as the Poverty Reduction and Growth Trust, which seems the most likely outcome at the moment.

"We know that there is no instrument in the IMF that doesn't come with conditionalities. And who's going to draw that list?" asks Lopes. "Nothing has been presented to Africans."

Around the world, emerging markets are facing a turbulent combination of monetary, fiscal, and epidemiological headwinds. Despite a strong early performance in the battle against COVID-19, sub-Saharan Africa has not been spared from this economic storm. Yet if there is to be any optimism, it is because these problems can be solved.

As the G-20 discussed last month, central banks in advanced economies must pay greater attention to global monetary conditions and be careful not to tighten prematurely. As the African Development Bank has noted, international organizations must steer resource-rich countries clear of the impending oil bust, guarantee greener technology transfer, and provide access to capital that is not reliant on resource-backed lending.

And as the shortcomings of the DSSI and SDR issuance have made evident, neither debt relief nor fiscal support should come with carve-outs and conditions that encourage the private sector and Chinese creditors to stand aside, or discourage the participation of low- and middle-income countries.

Global economic conditions, the decisions of a few advanced-economy central banks, and the shortcomings of international organizations will unfortunately continue to weigh on these countries. But in the long run, much progress can still come from the policies of Africa's own governments. Curtailing destabilizing capital outflows, establishing locally-informed credit rating agencies, and abandoning some of the central banking orthodoxies that advanced economies have long since discarded—such as the reluctance to engage in monetary financing—would be promising places to start, says Lopes.

While the U.K. may be withdrawing from the world with its recent foreign aid cuts, there is a clear willingness from the United States, France, and others to provide the support that many low- and middle-income countries need to weather this crisis and its aftermath. The international community should tend to these challenges. It cannot afford the alternative.

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