

MACROECONOMIC DEVELOPMENTS IN COMESA REGION IN 2020

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# Background

This report presents macroeconomic developments in the COMESA region in 2020, a year which was negatively impacted by COVID-19 pandemic. It analyses developments in key macro-economic performance indicators in the region, assesses the medium-term prospects, and provides policy recommendations in the short-to-medium term in the face of COVID-19 pandemic. And in addition, discusses the risks to the outlook.

# Growth

COMESA region’s average growth contracted sharply in 2020, shrinking by -5.4 percentage points to 0.2%, from 5.6% in 2019, but is projected to rebound in the outer years to 4.3% and 6.0% in 2021 and 2022, respectively. This is attributed to the fact that growth plummeted to negative levels in a number of COMESA member countries

Growth outcome in 2020 was negatively impacted by the COVID-19 induced health and economic crisis since the commencement of the year under review, including, among others, the following: i) impact of containment measures—quarantine, lockdowns, travel restrictions, border closures, cancellations of public gatherings, closing of schools/universities, remote working; and the decline in global demand as well as regional spillovers, resulting in rapid fall in trade and tourism; ii) external financial constraint involving capital outflows and sharp declines in capital inflows and remittance with implications for the exchange rate and postponement of planned bond issuance; and iii) the impact of multiple shocks, particularly the effects of floods, locust invasion and collapse of commodity prices. These notwithstanding, resilient growth in some of the countries seem to have benefited from improving growth fundamentals, particularly the gradual shift from private consumption to investment and exports, which somewhat moderated the negative waves associated with COVID-19.

While a second wave of the COVID-19 pandemic — which swiftly outpaced the scale and speed of the first, has eased somewhat in a broad set of countries in the region and whereas countries could be bracing for further waves as access to vaccines remain scant,the IMF April, 2021 projections show that the COMESA region average growth will rebound to 4.3% in 2021 and further to 6.0% in 2022 (**Fig. 1**).

**Figure 1: COMESA average real GDP Growth (y-o-y % change)**

Source: IMF REO Sub Saharan Africa April 2021

Recovery in growth forecast in the region is being anchored on: a) optimism about a recovery in the global economy, driven in large part by scale up of vaccination efforts against COVID-19 in advanced economies and the extraordinary level of policy support—fiscal stimulus and continued accommodation by central banks, with potential spillovers to the region in the form of increased trade, higher commodity prices, and a resumption of capital inflows; b) recovery in commodity prices and firm worldwide demand particularly in China, along with a recovery in both private consumption and investment. Already, oil prices have jumped to $67 per barrel in March 2021, from $27 per barrel in April 2020, reflecting in part, improving global demand; and c) broadly accommodative global financial conditions—given low global interest rates and spreads. This should support resumption of sovereign issuances in the region.

Going forward, the immediate concern for the region is containing the spread of COVID-19 as well as opening up the COMESA region economies. Striking a balance between the two almost conflicting objectives will go a long way in determining the speed and extent of economic recovery and return to normalcy. Key towards getting the balance right will depend on how effective and efficient governments in the region will be as they continue to carry out public health measures and the extent to which the public will adapt the same. Key among these measures include but not limited to; speedy roll out of the COVID-19 vaccine and enhancement of immunization awareness campaign and uptake, adherence to the World Health Organization (WHO) Standard Operating Procedures (SOPs), mass testing, isolation and quarantine of identified cases.

# Inflation Rate

The COMESA region wide average inflation rate itched for the 2nd consecutive year to 19.1% in 2020, up from 13.52% in 2019 and 9.5% in 2018, but is projected to ease somewhat to 11.4% in 2021 and further to 7.4% in 2022 (**Fig. 2**).

**Figure 2: COMESA average Consumer Prices (annual av., % Change)**

Source: IMF REO Sub Saharan Africa April 2021

The rise in inflation during the year under review mostly reflects:

1. Higher food prices due to lockdowns and containment measures that affected global, regional and domestic food supply chains, resulting in scarcity of imported and domestically produced food;
2. The impact of depreciation due to plummeting commodity prices that threatened foreign exchange earnings, exerting foreign exchange and inflationary pressures; and
3. A rebound of energy prices towards the end of the year.

Inflation is projected to dampen in 2021 and 2022, largely on account of expected increases of food supply driven by expected good weather and exchange rate appreciation supported by resumption of capital inflows due to a more buoyant external environment.

# Monetary Policy and Exchange Rate Developments

During the year into the COVID-19 pandemic, a number of central banks in the region remained largely supportive—including shifting priority to crisis management objective instead of strict price stability. Most central banks pursued an accommodative monetary policy stance and allowed the exchange rate to depreciate while conducting foreign exchange interventions to smooth disruptive volatility. In addition, they relaxed reserve and capital conservation buffers requirements for banks in an effort to boost their daily liquidity needs, allowed commercial banks to restructure outstanding loans of borrowers facing temporary cash flow challenges and increased limits on agents and corporate wallets for digital transactions, among other measures. However, going forward, and in the context of optimism about global economic recovery, rising food and commodity prices and the risks this pose for domestic inflation, the room for supportive monetary policy could increasingly shrink. Indeed, having loosened policy through 2020, some central banks in the region are keeping policy rates on hold, while some others are already reversing some of the 2020 rate cuts.

Economic disruptions brought about by COVID-19 resulted in tightening of global financing conditions, unprecedented capital outflow and sharp decline in remittances and tourism receipts. These meant severe fiscal and exchange rate pressure across many countries in the region. The tight global financial conditions reduced investment flows to the region, putting a strain on the required resources to deal with the pandemic and support economic recovery. As a consequence, either government had to cut spending, or had a buildup in arrears, or allowed an increase in government borrowing from the domestic market while balancing the consequences this would have on domestic credit and economic recovery. Going forward, should the pandemic persist and tight global financial conditions fail to ease as expected, governments might still have to use such financing as a last resort, but this should be on market terms.

Although fiscal policy is key in addressing the current challenges posed by COVID-19 pandemic, monetary and exchange rate policies can also play an important role in dampening the economic shock. As such there is need to ensure soundness of banking sector through increased liquidity. Also, central banks in the region should consider easing monetary policy especially in countries where inflation is not an immediate concern in order to provide the economy with the necessary impetus to reverse the growth contractionary phase. For countries in the region under flexible exchange rate regimes and enjoying low inflation and absence of large currency mismatches, the exchange rate could be allowed to be the key shock absorber. Foreign exchange interventions to smooth exchange rate volatility will be desirable for countries with shallow foreign exchange markets and large un-hedged balance sheet exposures.

# Overall Fiscal Balance Including Grants

The region’s average fiscal deficit including grants as a percentage of GDP widened by 0.9 percentage points to -5.7% in 2020, from -4.8% in 2019. exacerbated by fresh borrowing to cover revenue shortfalls triggered by the economic crisis induced by COVID-19 pandemic. Governments instituted a number of fiscal measures geared towards containing the COVID-19 pandemic, including provision of health services and extended unprecedented support to households, firms, and financial markets. In particular, most countries in the region responded to the pandemic with massive health spending, tax cut measures to cushion households and SMEs, extended support to vulnerable households through cash transfers and food rations, and targeted and temporary support to hard hit sectors of their economies.

The COVID-19-related fiscal packages, amidst severe tax revenue shortfalls fueled by lockdown measures across a number of countries, put considerable pressure on governments fiscal space. The combined effect of sharp decline in revenues, the rapid accumulation of debt particularly for countries that had large fiscal deficits and budget rigidities related to wages and interest payments, has resulted in heightened debt default vulnerability. As countries continue to battle health crisis brought about by COVID-19 pandemic, and the resultant economic crisis, the following fiscal considerations will be critical in the medium term:

1. Countries will need to quickly incorporate the impact of COVID-19 pandemic in their fiscal frameworks, re-assess the impact on revenues and do accurate costing of the responses on the expenditure side.
2. Carry out expenditure reprioritization including rescheduling capital expenditures and consideration of sufficient levels of fiscal stimulus to restart country specific economies in country specific circumstances;
3. Need to aggressively explore possibilities of external concessional financing and temporary/permanent debt relief;
4. There is also need to balance immediate spending demands in response to COVID-19 and cuts in public investments, to avoid excessive negative impact on the economy, employment and future growth—because, sometimes, scaling up public investment with multiplier effect could act as a stimulus and ensure longer term resilience of the economy;
5. Mitigate against corruption and fiscal risks through stringent controls, monitoring and transparency; and continue supporting households and SMEs to preserve livelihoods and employment.

**Figure 3: COMESA average Overall Fiscal Balance (incl. Grants, % of GDP)**

Source: IMF REO Sub Saharan Africa April 2021

The overall fiscal balance for 2021 is projected to narrow to -5.2% and further to -4.0% in 2022 (**Fig. 3**), mainly due to the expected economic recovery—higher revenues, resumption of fiscal consolidation in some countries and expiration of pandemic related measures as countries enhance the roll out and uptake of the COVID-19 vaccine.

# Government Debt

The region’s average Government debt as a share of GDP surged to 59.3% in 2020, as compared to 56.6% in 2019, mainly due to COVID-19 pandemic (**Fig. 4**). The COVID-19-related recurrent expenditure needs, coupled with sharp decline in revenues occasioned by lockdowns and general economic slowdown during the year under review exerted considerable pressures on government finances and forced almost all the economies in the region to run widening fiscal deficits.

**Figure 4: COMESA average Government Debt (% of GDP).**

Source: IMF REO Sub Saharan Africa April 2021

Going forward, average region government debt to GDP ratio is projected to ease somewhat to 58.3 in 2021. However, should new infections and variants lead to renewed lockdowns as is already the case in some countries in the region, and if this is compounded by delays in vaccinations, regional government debt and financing risks could rise further, complicating choices for the existing policy space and eventually, vulnerability of these countries to debt default. Already, the debt to GDP ratio for individual countries portrays a more severe and dire situation with some countries debt to GDP ratio projected to rise past 80%. Thus, unless measures are implemented to curtail growth in debt, these countries could face an explosion in the stock of external debt and servicing costs. If left unchecked, the rate of debt accumulation could result in a major source of macroeconomic instability. Debt relief will be necessary to fight COVID-19 pandemic while preserving macroeconomic stability.

Most economies in the region have little room for maneuver in deploying fiscal policy to address COVID-19 especially given the impact of lockdowns to traditional revenue sources, at time when the pressure to spend and protect lives is not an option. Creditors may need to consider grants to support vulnerable groups; health systems and local livelihoods and businesses.

The need for creditors to implement “debt standstill” called for by the World Bank Group, the IMF and African Governments, will be important in the immediate short term but a more holistic approach for debt relief post COVID-19 will be required, to enable most of the economies in the region to fully recover from the effects of this pandemic. Concerns that accessing bilateral relief package will trigger credit downgrades and undermine future access to capital markets, and concerns of commercial debt obligations will need to be addressed.

# External Current Account Including Grant

The COMESA region external current account including grants, as a percentage of GDP, deteriorated by 0.2 percentage points to an average of -4.9% in 2020, relative to 2019. The deterioration in the external current account deficit for most economies in the region is due to the usual persistent trade imbalances due to a combination of declining export demand and relatively inelastic import bills, and in some cases, late disbursement of external aid flows faced by most countries in the COMESA region. The outturn for the year under review is primarily due to the effects of COVID-19 pandemic. Disruptions to domestic and regional trade and value chains occasioned by lockdowns, together with similar disruptions at global level, severely affected trade for most countries.

The external current account including grants is projected to improve to -4.5% of GDP in 2021 and further to -4.3% of GDP in 2022 (**Fig. 5**). This improvement is being anchored on increases in exports as worldwide demand firms up, higher export commodity prices for commodity exporters and a resumption of capital inflows, particularly recovery in remittances.

Figure 5: COMESA average External Current Account (incl. Grants, % of GDP)

Source: IMF REO Sub Saharan Africa April 2021

Going forward, COVID-19 crisis will likely reshape global value chains, bringing challenges but also opportunities for the COMESA region and Africa at large. Strengthening continental value chains should be a priority given the uncertain global business environment. As the private sector advances its digital transition, it is important for the continent to invest in enhancing essential telecommunication infrastructure, including fiber optics and high-speed Internet, as well as to complete the regulatory (e-commerce) agenda for digital transition. This will be essential for the emergence and expansion of 21st century value chains in the region. In the medium-long term, the effective implementation of regional integration agenda of the Regional Economic Communities and the AfCFTA will be key to strengthening regional production networks and trade, reduce the continent’s vulnerability to external shocks, and consequently lead to improvements in external current account balances.

# Reserve Accumulation

The COMESA region external reserve cover averaged 3.2 in month of imports of goods and services, down from 3.9 months of import of good and services in 2019. The dip in external reserves in months of imports of goods and services during the year under review reflects considerable pressure to provide for foreign exchange to support importation of COVID-19 health related equipment’s and drugs; smoothing disruptive volatility in the exchange rate and supporting food imports for food deficient economies of the region. Albeit low, the average of 3 months of future imports of goods and services reserve cover over the last four consecutive years is a testimony to prudent monetary and exchange rate policies. In outer years of 2021 and 2022, the average external reserve position for the region is expected to hover around the historical average of 3.2 months of import of good and services (**Fig.6**).

**Figure 6: COMESA average Reserves (Months of imports of goods and services cover)**

Source: IMF REO Sub Saharan Africa April 2021

# Medium Term Prospects and Recommendations for Chance to Change

1. The immediate challenge for most countries in the region will be stopping the COVID-19 pandemic, as the region is still in the grip of the pandemic health and economic emergency. Therefore, of priority, going forward, is still to save lives—which will entail added spending to strengthen local health systems and containment efforts, and to ensure that the logistical and administrative prerequisites for a vaccine rollout are in place.
2. Member countries should do whatever is possible to support the speed of recovery of their economies. Fiscal stimulus in the short run should be continued, targeting public health, crisis response and income support to the most vulnerable.
3. To reign on the threatening debt levels, member countries will need to create more fiscal space, through domestic revenue mobilization, prioritization and efficiency gains on spending. Beyond this revenue and spending measures, governments need to maximize the fiscal space by improving their fiscal frameworks to credibly balance the need for short-term support with medium-term consolidation.
4. In the medium term, structural transformation and economic diversification of individual economies in the region will be crucial. COVID-19 has clearly demonstrated that with disrupted trade channels, local manufacturers have been able to rise to the occasion. There is therefore need to sustain emerging pharmaceutical and medical supply industries in a post Covid-19 era.
5. Leverage AfCFTA to strengthen value-addition and industrial growth and increase the role of digitization to continue to play an important role in the economies of the region.

# Risks to Outlook

Risks posed by the COVID-19 pandemic are unprecedented. The crisis is like no other whose impact on the global economy is devastating and still highly uncertain. The real challenge for policy is to properly assess the trade-offs between short, medium, and long-term priorities. Different policy interventions will be required as economies enter the successive phases of crisis-response: surviving the epidemic (ensure adequate resources go to basic needs such as medicine and food, and ensure people’s physical and mental health, as well as safety); getting back to normal (support individuals and firms to resume their activities and repair the damage sustained during the pandemic); and re-focusing on the long term (shift resources and attention to long-term development). Not getting the policy right in any of these phases poses serious risks to economies of COMESA member countries.

# References

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