

MACROECONOMIC DEVELOPMENTS IN COMESA REGION IN 2021

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Table of Contents

[1. Background 1](#_Toc70943214)

[2 Growth 1](#_Toc70943215)

[3 Inflation Rate 2](#_Toc70943216)

[4 Monetary Policy and Exchange Rate developments 4](#_Toc70943217)

[5 Overall Fiscal Balance Including Grants 5](#_Toc70943218)

[6 Government Debt 6](#_Toc70943219)

[7 External Current Account Including Grant 8](#_Toc70943220)

[8 Reserve Accumulation 9](#_Toc70943221)

[9 Medium Term Prospects and Recommendations for Chance to Change 11](#_Toc70943222)

[10 Risks to Outlook 11](#_Toc70943223)

[References 12](#_Toc70943224)

# Background

This report presents macroeconomic developments in the COMESA region in 2021. 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 and discusses the risks to the outlook.

# Growth

COMESA region’s average growth rebounded in the second half of 2021, prompting an upward revision in growth estimates from 4.3% to 5.9% in 2021. In all COMESA member countries, growth recovered (Figure **1**), primarily on base effects owing to the sharp contraction in most countries in 2020, and in addition, significant remittance inflows and rapid vaccination roll out particularly for tourism dependent countries where the pandemic continues to pose a drag on recovery.

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

Source: IMF REO Sub Saharan Africa April 2022

Going forward, the region’s growth momentum is projected to slow in 2022 to 4.8% on confluence of several factors. The global economic shock triggered by the geopolitical tensions—the Russia-Ukraine war is affecting the region through its effect on global commodity prices. Save for the few regions’ commodity exporters which could generate sizable fiscal windfalls as they face stronger global export demand, higher commodity prices could undermine fiscal and external balances in commodity importing countries. This has compounded the pressing policy challenges surrounding the vulnerability to new waves of Covid-19 infections. While vaccination rates have accelerated reaching the IMF-proposed 40% vaccination rates for 2021 in some regional countries such as Rwanda, Mauritius and Seychelles, the rates and pace of vaccination remain both inadequate and comparatively much slower in a large majority of COMESA region countries (REO/Sub Saharan Africa/ Middle East and Central Asia (April 2022). The slow vaccination roll out in the latter countries increases the vulnerability to new Covid-19 waves and increases the risk of new variants.

Growth is also weighed down by sharper-than-expected tightening in financial conditions in Advanced Economies; several armed conflicts and terrorist threats particularly in Ethiopia and in the Democratic Republic of Congo; severe exposure to climate related shocks and headwinds from lower global demand on slowdown in global economic activity which is partly due to tightening monetary conditions. The resurgence of monkeypox epidemic complicates the situations further. Looking further outward, IMF projects the region’s growth to accelerate to 5.5% in 2023, albeit remains subdued relative to pre-pandemic (**Fig. 1**).

# Inflation Rate

The COMESA region wide average inflation rate decelerated to 14.6% in 2021 from 17.3% in 2020 (**Figure 2**) but down side risks to the outlook loom. There was strong build-up of inflationary pressures in most COMESA countries in 2021, particularly in countries that either experienced larger depreciations of their currencies or have greater reliance on food imports or suffered droughts, storms and floods which amplified the effect of distortions in global supply chain and a significant increase in international energy prices during the year under review.

As per IMF REO data, thirteen (13) COMESA member countries, namely Comoros, Djibouti, Egypt, Eritrea, Eswatini, Libya, Kenya, Madagascar, Mauritius, Rwanda, Somalia, Tunisia and Uganda achieved the COMESA macroeconomic Convergence Criteria of average annual inflation rate of 7% (with a band of +/-1%).

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

Source: IMF REO Sub Saharan Africa April 2022

Region wide inflation is projected to rise to 17.0% in 2022, largely on escalation of the war in Ukraine and sanctions on Russia, and the tightening global monetary conditions. The latter could lead to strong exchange rate pressure feeding through to domestic inflation while the former could push even higher oil prices—putting further upward pressure on food prices, accelerate further global supply shortages and export restrictions in major commodity and food exporters. Inflation is expected to ease somewhat to 13.9% in 2023 on expected easing of global and local supply challenges, and the likelihood that region’s central banks would anchor of inflation expectations should inflationary pressures strengthen even more.

# Monetary and Macro-financial Policy and Exchange Rate developments

During 2020, 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, inflationary pressure has built and in the context of the war in Ukraine and sanctions on Russia which has quickly reverberated through global financial and commodity markets, the risks to the inflation outlook remain heightened. Output levels, at the same time, remain well below the pre-pandemic level. Regional Central Banks, thus, face a difficult balancing act between curbing inflation and supporting recovery. Having loosened policy through 2020, Central Banks need to tighten monetary policy should inflation expectations drift up and also tighten financial regulations that may have been relaxed during the pandemic to guard against financial stability risks.

Surging global oil and food prices and tightening global financial conditions associated with the war in Ukraine and sanctions on Russia compounded by heightened market volatility have placed severe fiscal and exchange rate pressure across many countries in the region. The tight global financial conditions could disrupt capital flows to the region at a time they are need most, putting a strain on the required resources to deal with the pandemic and support economic recovery. Going forward, should the war escalate and tight global financial conditions persist, governments might have to either cut spending, or have a buildup in arrears, or allow an increase in domestic borrowing while balancing the consequences this might have on domestic credit and economic recovery, but this should be on market terms.

Although fiscal policy is key in addressing the current challenges posed by the global economic shock triggered by the Russia-Ukraine war and the pandemics, monetary and exchange rate policies can also play an important role in dampening the economic shock. In jurisdictions where inflation is not an immediate concern, central banks should consider holding back on tightening monetary policy in order to provide the economy with the necessary impetus for recovery. Where inflationary pressures have picked, the 2020 rate cuts should be reversed to anchor inflationary expectations. 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. Therefore, monetary tightening may be needed in some countries to support exchange rates, even in the face of weak economic activity.

# Overall Fiscal Balance Including Grants

The region’s average fiscal deficit including grants as a percentage of GDP narrowed to -5.1% in 2021, from -5.5% in 2020 (**Figure 3**), mainly on account of economic recovery—higher revenues, resumption of fiscal consolidation in some countries and expiration of pandemic related measures as countries enhanced the roll out and uptake of the COVID-19 vaccine.

The deficit narrowed in 11 COMESA countries—Burundi, DRC, Eritrea, Ethiopia, Libya, Mauritius, Rwanda, Seychelles, Sudan, Tunisia and Zambia; remained at the 2020 levels in Kenya and deteriorated somewhat elsewhere. Moreover, as per IMF REO data, 10 COMESA countries, namely, Burundi, DRC, Comoros, Djibouti, Eritrea, Ethiopia, Libya, Somalia, Sudan and Zimbabwe achieved the COMESA macroeconomic Convergence Criteria of overall budget deficit/GDP ratio (including grants) of 5%.

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

Source: IMF REO Sub Saharan Africa April 2022

The overall fiscal balance for 2022 is projected to deteriorate to -5.3% (**Fig. 3**), more so for net commodity importers, mainly on account of the global commodity price shock, and targeted transfers and subsidies as countries undertake efforts to cushion the vulnerable segments of their populations from the skyrocketing oil and food prices.

# Government Debt

The region’s average Government debt as a share of GDP narrowed to 58.5% in 2021, compared to 61% in 2020 (**Figure** **4**), mainly on account of economic recovery and on continued withdraw of the pandemic-related fiscal measures. About seven (07) COMESA member countries namely, Democratic Republic of Congo, Comoros, Djibouti, Ethiopia, Eswatini, Madagascar, Malawi and Uganda, as per the IMF REO data, achieved the revised COMESA secondary Convergence Indicator of total government debt as a share of GDP of less than 65%.

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.

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

Source: IMF REO Sub Saharan Africa April 2022

Going forward, average region government debt to GDP ratio is projected to ease somewhat to 58% in 2022 and further to 54.8% in 2023. However, should the targeted transfers and subsidies to vulnerable segments of the populations gain momentum, and new infections and variants compounded by logistical challenges and vaccine hesitancy and weak local health systems lead to renewed lockdowns, 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.

# External Current Account Including Grant

The COMESA region external current account including grants, as a percentage of GDP, improved to an average of -3.7% in 2021, relative to -4.1% in 2020 (**Figure 5**). The persistent 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 increases in exports as worldwide demand firmed up, higher export commodity prices for commodity exporters and a resumption of capital inflows, particularly recovery in remittances.

The external current account including grants is projected to deteriorate to -4.3% of GDP in 2022, but improve, albeit marginally to -4.2% of GDP in 2023. This deterioration in the external current account is on account of confluence of factors. Lower global demand because of the slowdown in global economic activity driven by less fiscal stimulus and tighter monetary conditions; and climate change which poses an extreme challenge for the region given its exposure to weather-related shocks.

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

Source: IMF REO Sub Saharan Africa April 2022

Going forward, the crisis due to the pandemics and the geo-political tensions 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

Adequate reserves help countries better manage their economies and respond to external shocks, while appropriate reserve management is essential for minimizing the opportunity cost of holding reserves and maximizing returns.

The COMESA region external reserve cover dropped further to an average of 3.0 in month of imports of goods and services, down from 3.1 and 3.9 months of import of good and services in 2020 and 2019, respectively (**Figure 6**). 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 smooth disruptive volatility in the exchange rate and supporting oil and food imports particularly for commodity importing economies of the region.

Albeit low, the average of 3 months of future imports of goods and services reserve cover over the last three consecutive years is well within the standard import-cover benchmark for the COMESA macroeconomic Convergence Criteria of External Reserves of equal to or more than 3 months. As per the data beforehand, eleven (11) COMESA member countries namely, Comoros, Egypt, Eswatini, Kenya, Madagascar, Mauritius, Rwanda, Seychelles, Sudan, Tunisia and Uganda met the threshold on reserves in months of imports of goods and services cover.

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

Source: IMF REO Sub Saharan Africa April 2022

Relative to the historical average, the region’s reserve cover, in the outer years of 2022 and 2023, is expected to drop substantially to 2.6 and 2.7 months of import of good and services, largely on market interventions to offset exchange rate pressures in response to tightening global financial conditions.

# Medium Term Prospects and Recommendations for Chance to Change

The region faces particularly challenging environment marked by higher and more volatile commodity prices, rising inflationary pressures, tighter-than-expected global financial conditions, and a lingering pandemic. Fending off these extraordinaire headwinds and uncertainties, amidst dwindling policy space, will require the region to :

1. Accelerate the vaccination campaign to reduce the risk of new COVID-19 waves and the emergence of new variants and the outbreak of monkeypox. Therefore, countries need to address logistical challenges, counter vaccine hesitancy and enhance vaccination uptake through aggressive awareness campaigns as well as bolstering the resilience of local health systems—by investing in therapeutics, testing, and epidemiological surveillance—to reduce over reliance on the donor community.
2. Carefully strike a balance between containing the ongoing inflationary pressures and supporting the on-going economic recovery, while at the same time manage exchange rate volatilities in response to tightening global financial conditions.
3. Cushion vulnerable segments of their populations from the surging prices of essential commodities without worsening the already high post-pandemic debt vulnerability through a reprioritization of spending. It is a step in the right direction for countries in the region that are cushioning their citizens by raising the minimum wages, putting in place energy subsidies and local tax cuts on goods of common use, while keeping a lid on debt.
4. In addition, 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 balances the need for short-term support with medium-term consolidation.
5. 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
6. 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 a prolonged war in Ukraine and sanctions on exports from Russia may fuel further upward pressure on oil and food prices. This will weigh heavily on the region’s commodity-importing countries, exacerbating the burden on vulnerable segments of the populations. The region is also vulnerable to tightening in global financial conditions and slow down in global demand. Locally, the slow vaccine rollout increases the vulnerability of the region to new COVID-19 waves and could favor the emergence of new variants. This, compounded with several armed conflicts and terrorist threats and climate related shocks poses serious risks to economies of COMESA member countries.

# References

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