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The Impact of the Global Financial Crisis on West African States

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Introduction

The current debate on regional integration and development prospects has sharply focused on the ongoing global financial crisis and its possible consequences on Africa. One of the prevailing arguments is that the region faces too many developmental challenges to support the adverse impact of the financial crisis. The discussion has also specifically targeted West Africa but the events have until recently been too fresh to have a proper assessment of their impact on the sub-region. The purpose of the present study is to document and evaluate the effect of the global financial crisis on West Africa using the most recent economic data available and drawing key lessons from the analysis. To that end, the first section of the paper will conduct a thorough assessment of the purported impact of the crisis on West Africa making use of five sets of economic variables through which the crisis could have been transmitted.

Six major countries of the sub-region with complete and reliable data sets are examined, three from the West African Economic and Monetary Union (WAEMU) zone – Benin, Côte d'Ivoire and Senegal- ,and three non WAEMU countries – Cape Verde, Ghana and Nigeria. In the second section, a number of lessons are drawn from the empirical evidence and several recommendations proposed to help West African countries stay on the course to economic and social development while avoiding the pitfalls of vulnerability to globally induced financial crises.

1. An assessment of the impact of the financial crisis on West African economies

Considering the various transmission channels through which the impact of the international financial crisis could impact upon West African economies, the foregoing analysis aims at investigating the main target variables that are currently the object of public debate. The basic rationale is to identify a significant change in the medium-term trend of the variable and assess the extent to which such change is also observed in, or mirrors, what happens in industrial economies. The USA, UK and Euro Area serve as baseline comparators in the analysis. The assessment of the impact of the global financial crisis will be conducted through the following five sets of variables:

- Finance and the stock market
- Bank credit
- Money supply and reserves
- Foreign exchange and
- Current account.

The impact on real economic activity could not be assessed for lack of available indicators in this regard.

1.1. Finance and the stock market

One of the most spectacular consequences of the global financial crisis was the steep decline in stock exchange indices around the world. The loss of billions of US Dollars of equity wealth caused by stock price decreases was an unprecedented economic and social phenomenon that afflicted most countries. Table 1 below displays the annual returns on national stock market indices for three industrial countries –France, UK and USA -, three West African exchange indices –Ghana, Nigeria and BRVM- and for each stock exchange the value at the end of 2009 of $100 invested at the end of 2007. The figures eloquently demonstrate that the financial crisis took effect in 2008 following a healthy episode of stock market growth in the six sampled exchanges. They also show that the impact of the crisis on the stock market was equally severe in 2009.

Table 1. Annual Rates of Return of National Stock Indices, in %, and Value of $100 invested in 2007

Country / Area	2005	2006	2007	2008	2009	$100 in ‘07 Value in ‘09
France	16.30	20.33	11.70	-25.24	-22.30	$58.09
United Kingdom	14.95	16.87	9.36	-17.51	-14.68	$70.38
United States	2.23	8.16	15.44	-14.56	-21.12	$67.40
Ghana	n.a	n.a	5.36	31.84	-15.57	$111.31
Nigeria	1.01	37.80	74.73	-45.77	-33.78	$35.91
BRVM	n.a	-0.03	77.05	-10.67	-25.89	$66.20

Source: France, UK, USA: International Financial Statistics, IMF, Online, March 2010;

Nigeria: Central Bank of Nigeria, Financial Statistics, Table A.5.7.1., Nigeria Stock Exchange;

BRVM: CGF Bourse, Senegal, Lettre mensuelle, Online;

Ghana: Bloomberg.com, Regional Stock Indices.

The impact of the crisis on West African stock exchanges cannot be differentiated from what it was on the three industrial countries. Indeed, all the exchanges recorded large negative returns of a similar magnitude in the last two years and lost money over the period 2007-2009, except for Ghana that had a cumulated two-year return of 11.31%. Overall, the three industrial countries had an equally-weighted aggregate two-year return of -34.71% while the three West African countries recorded a return of -28.9%.

1.2. Bank credit

One main characteristic of the recent crisis was the sharp decline in credit extended by the banking sector in industrial countries which translated into a system-wide liquidity crunch. This credit crisis deprived firms of working capital and thwarted their planned investment outlays. The resulting reduced level of aggregate output and the harshly rationed credit availability at home may have translated into lower demand of imported primary commodity inputs from developing countries in general, and from West Africa in particular. West African firms facing a lower demand for their exports and increased volatility in global markets may have reacted by adjusting their production level downwards and required less working capital and therefore less credit. In the context of higher global volatility and lower world output, the local banking system could adapt its portfolio composition by lending less to export-dependent domestic firms or requiring more loan guarantees which, in both cases, would result in lower levels of domestic credit.

Table 2 displays the annual rates of change of the commercial banking sector's credit to the private sector in WAEMU, the Euro Area and selected West African economies for the period 2005 – 2008.

Table 2. Change in Deposit Money Banks' Claims on Private Sector, in %

Country / Area	2005	2006	2007	2008
WAEMU	11,3	8,5	15,5	14,7
Benin	20,2	10,9	25,0	20,1
Côte d'Ivoire	1,1	8,5	19,2	11,3
Senegal	21,3	7,1	10,7	17,1
Cape Verde	7,5	24,9	10,6	26,8
Ghana	43,9	37,4	62,0	43,1
Nigeria	27,2	26,5	108,8	61,3
Euro Area	9,7	11,3	13,5	7,7

Source: International Financial Statistics, IMF, Online, March 2010.

While the Euro Area experienced a sharp decline in the annual rate of change of claims on the private sector in 2008 compared to 2007 (13.5% vs 7.7%), the WAEMU Zone maintained about the same rate of annual growth (15.5% vs 14.7% and seems to have been considerably less affected by the global credit crunch. Furthermore, in 2008 the rate of change for the Euro Area is almost half that of the WAEMU and several times smaller than for the individual countries except for Côte d'Ivoire whose economy still lingers in a situation of political uncertainty. Finally, over the period 2005-2008 no West African country's economy has evolved in a manner that is consistent with a decline in credit to the private sector as a result of the global financial crisis.

By contrast, Table 3 shows that in 2008, West African Governments saw a significant decline in their level of borrowing from domestic banks - Côte d'Ivoire, Senegal, Cape Verde and Nigeria - and a modest increase in the case of Ghana and WAEMU as a whole. Benin is an exception with a two-fold increase in 2008 compared to 2007. There was no decrease in overall domestic credit in 2008 for any of the six West African countries. Therefore, if in 2008, the banking sector of West Africa responded to the global financial crisis by adjusting the composition of domestic credit, it was more at the expense of Government borrowing than of private sector debt which remained generally unaffected.

Table3. Change in Deposit Money Banks' Claims on Central Government, in %

Country / Area	2005	2006	2007	2008
WAEMU	3.7	20.1	34.1	5.1
Benin	47.7	-15.9	100.3	194.3
Côte d'Ivoire	2.1	8.9	37.4	-22.3
Senegal	-1.8	107.3	60.7	-8.6
Cape Verde	10.2	-2.4	13.8	-7.8
Ghana	-7.2	36.3	24.9	16.3
Nigeria	3.6	81.6	94.5	-22.8
Euro Area	7.5	-6.1	4.3	6.0

Source: International Financial Statistics, IMF, Online, March 2010.

1.3. Money supply and reserves

A contraction of domestic credit can, as in the case of the Euro Area during the financial crisis, induce lower money supply and a shortage of liquidity in the economy. As shown in Tables 2 and 3, in 2008, bank lending to the private sector increased for all West African countries but Government borrowing from banks decrease for most of them. However, aggregate domestic credit did not decrease for WAEMU or for individual countries. Table 4

shows that the slower pace of economic activity induced a smaller increase in broad money in 2008 for WAEMU and five of the six countries, Benin being the exception.

Table 4. Change in Money and Quasi- money; in %

Country / Area	2005	2006	2007	2008
WAEMU	8.3	10.7	19.0	8.7
Benin	26.3	14.5	19.6	26.6
Côte d'Ivoire	7.7	10.3	23.6	5.7
Senegal	8.2	12.5	13.1	1.8
Cape Verde	15.6	18.7	9.7	7.9
Ghana	20.3	39.6	44.1	37.8
Nigeria	7.7	50.7	58.1	53.6
Euro Area	9.4	9.3	10.3	9.0

Source: International Financial Statistics, IMF, Online, March 2010.

Table 5 reports a significant reduction in reserves (minus gold) for WAEMU, Côte d’Ivoire, Senegal and Cape Verde. All countries and regions record drastic declines in their rate of change of reserves in 2008 relative to the two previous years.

Table 5. Change in Reserves Minus Gold, in %

Country / Area	2005	2006	2007	2008
WAEMU	-14.8	19.5	30.6	-3.2
Benin	2.6	38.9	32.6	4.5
Côte d'Ivoire	-22.0	36.0	40.1	-10.6
Senegal	-14.1	12.0	24.4	-3.5
Cape Verde	24.7	46.3	10.5	-8.1
Ghana	7.8	19.2	n.a	n.a
Nigeria	66.8	49.6	21.4	3.2
Euro Area	-12.9	6.6	9.3	1.5

Source: International Financial Statistics, IMF, Online, March 2010.

In conclusion, one of the impacts of the global financial crisis may have been slower growth of money supply and a significant reduction in non-gold reserves for many West African countries. These two factors may in turn affect the degree of liquidity of these economies in the short term and the expansion of their level of monetization in the medium to long term.

1.4. Foreign exchange

Table 6 indicates a faster erosion of the nominal exchange rates of the Ghanaian Cedi and the Nigerian Naira in the last two years, 2008 and 2009, than in the previous two, 2006 and 2007. Indeed, at the end of 2009, the Cedi had lost 28.6% of its value compared to the end of 2007 and the Naira's loss over the same period was 20.1%. But the Cape Verdian Escudo remained within the same range of 75 to 80 per US Dollar in the last three years. With a fixed peg to the Euro the CFA Franc of WAEMU countries cannot be ascribed any specific impact with respect to its nominal exchange rate. In short, while Ghana and Nigeria experienced significant declines in the nominal values of their respective currencies, the Escudo was more stable, which precludes a uniform impact of the global financial crisis on West African currencies. The degree of openness, structure of aggregate output, composition of exports and imports and the capacity and willingness of the Central Bank to defend the national currency may be among specific factors that helped determine the evolution of each national currency during the financial crisis.

Table 6. Nominal Exchange Rate: National Currency Per US DOLLAR

Country / Area	2005	2006	2007	2008	2009
WAEMU	556.0	498.1	445.6	471.3	455.3
Cape Verde	93.5	83.7	74.9	79.2	76.5
Ghana	0.9	0.9	1.0	1.2	1.4
Nigeria	129.0	128.3	118.0	132.6	147.6
Euro Area	0.848	0.759	0.679	0.719	0.694

Source: International Financial Statistics, IMF, Online, March 2010.

1.5. The Current Account

No specific pattern emerges from Table 6 regarding the evolution of the Current Accounts of the Balance of Payments of West African countries. Except for Côte d'Ivoire that displays a high degree of volatility, each country has steadily followed its own positive –Nigeria- or negative trend - Cape Verde and Ghana- without any significant break in its pattern. In other

words, the evidence available does not allow to conclude that the Current Account served as an adjustment variable of the impact of the global financial crisis on West African economies.

Table 7. Current Account in Millions US Dollars

Country / Area	2005	2006	2007	2008
Benin	-270.321	-327.321	-653.208	n.a.
Côte d'Ivoire	39.674	478.965	-139.040	488.072
Senegal	-675.870	-861.189	-1310.780	n.a.
Cape Verde	-40.673	-82.730	-198.265	-205.479
Ghana	-1104.610	-1042.610	-2151.470	-3543.120
Nigeria	37263.600	38227.500	30927.500	39357.100

Source: International Financial Statistics, IMF, Online, March 2010.

2. West African lessons from the global financial crisis

For West Africa, the current global financial crisis has brought to the fore a number of developmental issues related to economic growth, international financial flows, volatility of global markets, aid, trade and investment. Considering that these issues are interconnected with respect to their relevance to West African economies, it is warranted to address the following three key questions: 1) What is the degree of integration of West African countries into the global economy?, 2) Is West Africa ready for the next global financial crisis, and 3) How to shield West Africa from the adverse consequences of future crises?

2.1. West African integration in the global economy

The past decade has shown that Africa in general and West Africa in particular have not enhanced their degree of integration into the world economy when compared to other developing regions. Being one of the poorest regions in the world, West Africa has seen its share of world trade erode gradually despite several initiatives to support its exports e.g. AGOA, the European Union's "Everything but Arms" Initiative and the Economic Partnership Agreements, not to mention China's vigorous attempts to increase its imports of primary commodities from Africa. The evidence also indicates that West Africa is not a prime destination for foreign direct investment except in the extractive industry, namely oil in Nigeria, gold in Ghana, Senegal and Mali, gems in Sierra Leone and Liberia, uranium in Niger, iron ore and phosphates in Senegal, etc. These enclave sectors have little spillover effect on the rest of local economies and therefore little impact on the overall integration of West African countries.

Despite some countries' efforts to diversify their export base, no significant new export sector has emerged from West Africa, which exposes their economies to the vagaries of single commodity export receipts and declining international competitiveness with adverse consequences on global integration. Although the West African economies are tuned to the movements of global financial markets as illustrated by the co-movement of their stock exchanges with those of industrial countries and their flexible exchange rate regimes, foreign portfolio investment and external borrowing by the private sector are very limited, and set West Africa far behind other developing regions. This low degree of integration into the global economy weakens channels of transmission of economic performance from the world to West Africa and shields it against adverse shocks. But it also deprives it of growth opportunities when there is a boom in the global economy.

Considering that over the last half century countries that recorded rapid economic growth were high exporters and fully integrated into the world economy, it is important for West Africa to formulate policies that will help it achieve further global integration.

2.2. West Africa's readiness for the next financial crisis

West Africa's lack of financial development may limit its exposure to the adverse effect of global financial crises. But financial development is a necessity on the path to economic and social development. Therefore, as governments and the private sector succeed in attracting foreign capital, West Africa may increasingly be the adjustment destination of international investors who, in order to respond to global conditions, invest in the region last during booms, and divest from it first during busts, with untold variability in cross border capital flows and painful economic consequences for the domestic economies. It is noteworthy that West African countries lack the capacity to benefit from rapid and sizeable temporary balance of payments relief measures to alleviate the consequences of massive capital flight. Indeed, neither their private sector nor their governments have ready access to sizeable foreign borrowing from international private lenders.

In the absence of a strong export base and given its low savings rate, West Africa has the choice between remaining financially under-developed and, thanks to its low level of global integration, enjoy some degree of protection from future financial crises, or developing its financial sector and integrating it further into the world market, but also exposing it and being more vulnerable to global financial shocks. Naturally, some of the risks inherent in financial development could be curbed but the sub-region would need to design and implement its financial development strategy before the adequate hedging mechanisms can be identified and implemented. Current discussions on creation of a single monetary zone and dual listing of stocks at home and abroad constitute promising initial steps but much still needs to be accomplished on that score.

2.3. Shielding West African countries from future financial crises

In light of the foregoing discussion it is legitimate to inquire about ways in which West African economies can be protected from future financial crises. Some of the implications of the description of these economies may provide sound starting points for the design of protective policies. First, West African countries could coordinate their efforts to achieve significant diversification of their exports thereby reducing the risk of commodity price fluctuations or lower demand of their exports caused by the onset of financial downturns, e.g. oil exports. Second, one of the desirable effects of a single currency arrangement is the pooling of foreign reserves which, in itself, is a mechanism of cross-insurance among member countries especially in cases of financial crises with differentiated impacts on members. Such reserves would also serve as an adequate instrument to mitigate the consequences of capital flight. Third, further regional integration of trade and financial markets would reduce reliance on and exposure to, international economic conditions and secure lower variability economic growth for the sub-region.

Finally, the sub-region could undertake counter-cyclical policies with respect to its external sector in three areas. The first one is related to foreign reserve management. In periods of export booms, countries could use the windfall increase in foreign assets to pay down their external debt rather than engage in expansionary spending that could not be sustained after the boom but would require external borrowing to complete spending programs started during the boom. If reserves are not used to pay back external debt, they could be accumulated and drawn down and used to supplement lower revenues during economic downturns.

Servicing of external debt provides a second area of countercyclical policies. West African countries could agree with their creditors to make service of their external debt contingent on the performance of their external sector. Accordingly, scheduled debt service payments would be reduced or postponed altogether if the borrower country's export earnings fall below an agreed-upon level. This facility could be coupled with capitalization or forgiveness of accrued interest or indefinite postponement of payments until conditions improve on the basis of full transparency and accountability. Scheduled debt service payments would resume when the borrower country's external performance improves.

A third countercyclical measure would make foreign aid a substitute for West African countries' foreign reserves if reserves are depleted in the advent of a global financial crisis to procure essential imports or to service external debt. The size of aid flows would be commensurate with the magnitude of the reserve draw-down and would ensure a smoother economic growth trajectory for recipient countries.

Conclusion

The advent of the global financial crisis is too recent and, in fact still ongoing in various parts of the world, to conduct a proper assessment of its impact on West African countries. However, the empirical evidence that is available has shown a rather strong impact with respect to stock markets but to varying degrees across countries. There was no significant adverse effect of the crisis on bank credit to the private sector or on money supply. However the levels of reserves and of nominal exchange rates of West African countries have changed noticeably during the crisis but more research is needed to attribute these variations to the global financial crisis. Trade and the current account do not seem to have been negatively impacted upon by the crisis.

West African countries' poor integration into the world economy have created a weak economic transmission mechanism that protects them in case of crisis but limits their capacity to benefit from global booms. Arguably, there is need for enhanced financial development in the sub-region to secure economic and social development even if it temporarily exposes countries more to future economic and financial crises. Ways to increase the level of protection of West African countries from future adverse financial shocks include further region-wide export diversification, more regional integration of trade and financial markets, pooling of foreign reserves and adoption of a number of counter-cyclical policies to stem the severity of capital outflows during episodes of financial adversity.