Capital Flows to Sub-Saharan Africa: Causes, Consequences and Application to Zimbabwe

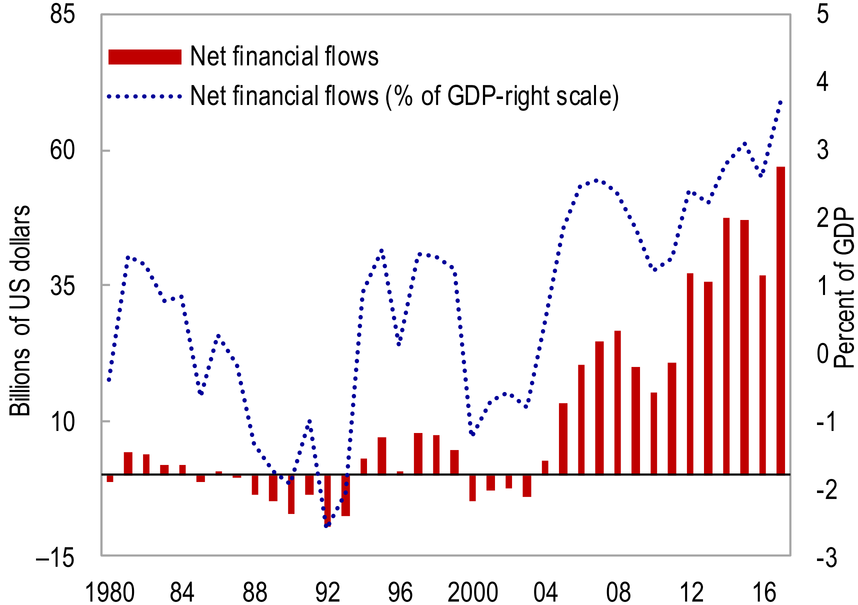
Patrick Imam
International Monetary Fund
October 2018

The views expressed do not necessarily reflect the views of the IMF or the Executive Board of the IMF.

Context

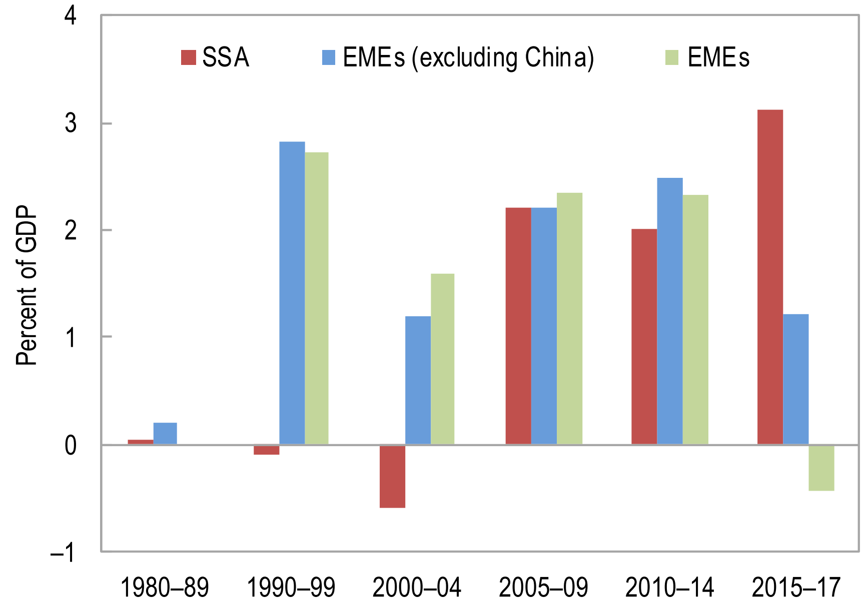
Sharp increase in capital flows to SSA

Sub-Saharan Africa: Net Financial Flows, 1980-2017 (in USD billion and percent of GDP)



Source: IMF, World Economic Outlook database.
Notes: Statistics for 2017 are provisional. Negative values indicate outflows. Flows exclude reserve asset and official other investment flows. Net financial flows in percent of GDP is the sum of financial flows to the region in percent of regional GDP.

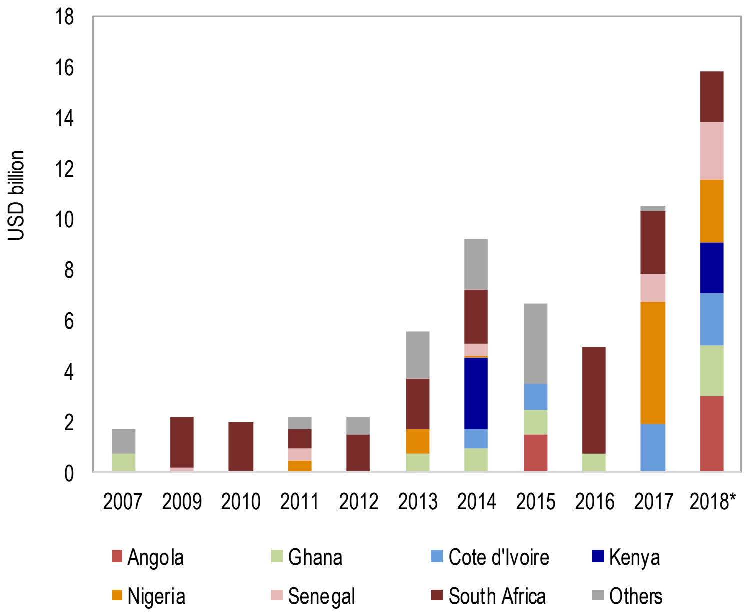
Sub-Saharan Africa and Emerging Markets: Net Financial Flows, 1980-2017 (in percent of GDP)



Source: IMF, World Economic Outlook database, and IMF staff calculations.

Rising concerns about vulnerability to a sudden stop

Sub-Saharan Africa: Sovereign Bond Issuance, 2007–18 (in USD billion)



Source: Bloomberg LLP.
* Data as of June 2018.

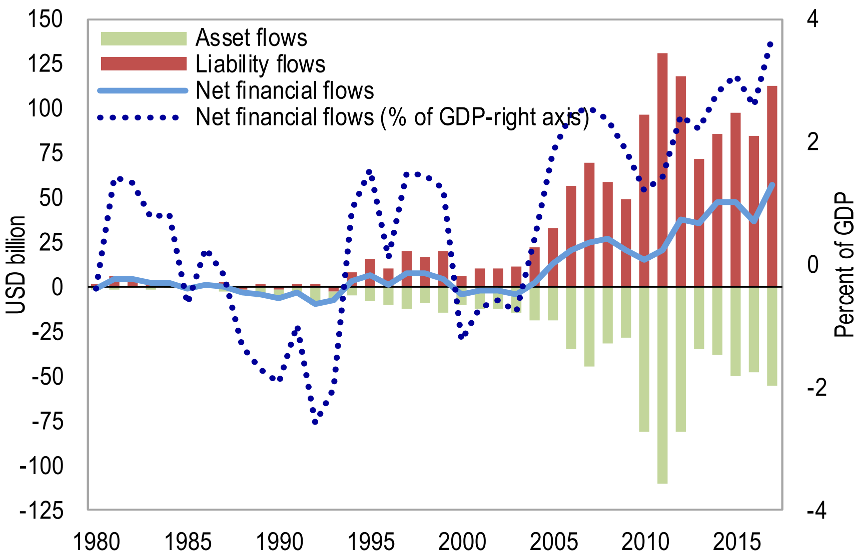
THREE QUESTIONS

- How have non-official financial flows to SSA evolved over time?
  - By investor residency, asset type, recipient country
- What is driving capital flows to SSA?
  - Role of global and domestic factors
- What are the macroeconomic consequences of capital flows?
  - Exchange rates, output, financial stability, domestic investment

Evolution of Capital Flows

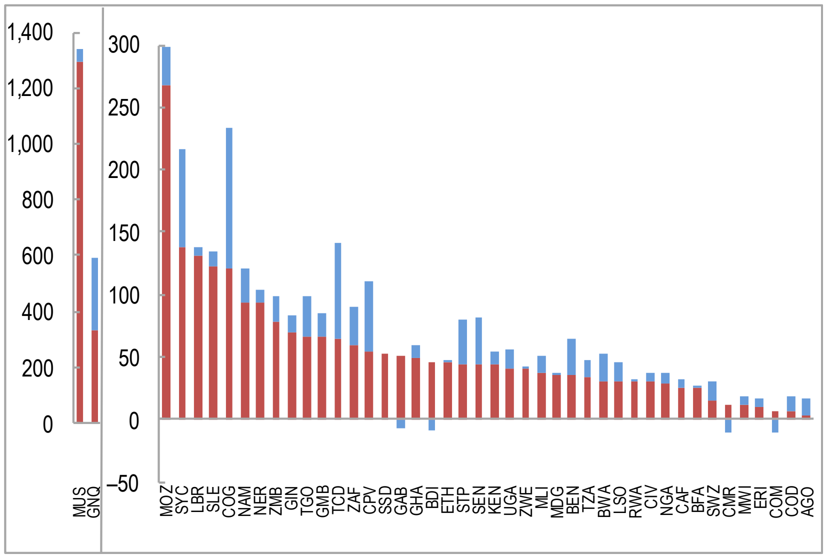
Increasing nonresident flows

Sub-Saharan Africa: Financial Flows, 1980-2017 (in USD billion and percent of GDP)



Source: IMF, World Economic Outlook database.
Notes: Statistics for 2017 are provisional. Negative values indicate outflows. Flows exclude reserve asset and official other investment flows. Net financial flows in percent of GDP is the sum of financial flows to the region in percent of regional GDP.

Sub-Saharan Africa: Liability Flows Before and After the Global Financial Crisis, 2000-17 (in percent of GDP)

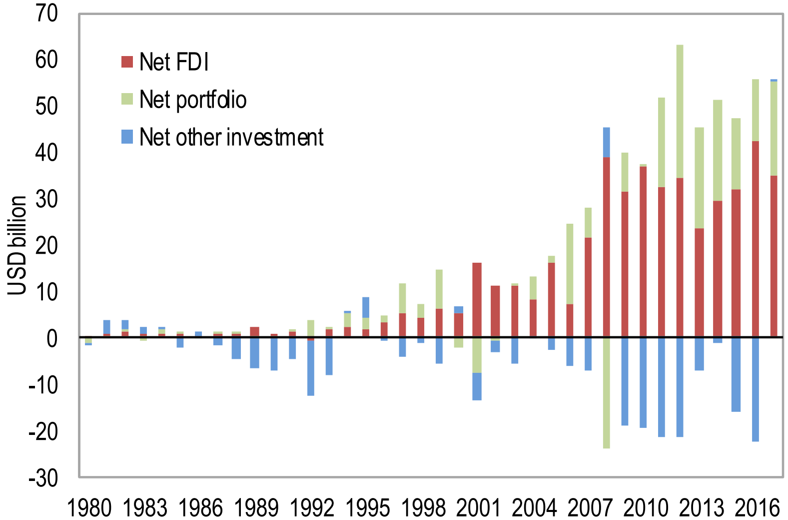


Source: IMF, World Economic Outlook database.
Notes: Statistics for 2017 are provisional. Negative values indicate outflows. Flows are cumulative values in percent of 2017 GDP. Flows exclude official other investment. Mauritius and Equatorial Guinea are plotted on a different scale because of the large size of their liability flows.

Shifting patterns

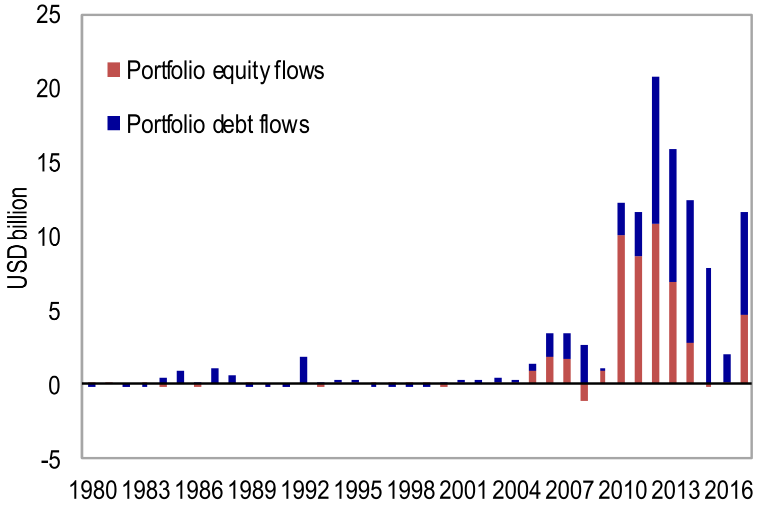
- Portfolio flows, especially portfolio debt flows, are increasing…

Sub-Saharan Africa: Composition of Net Financial Flows, 1980-2017 (in USD billion)



Source: IMF, World Economic Outlook database.
Notes: Statistics for 2017 are provisional. Negative values indicate outflows. Flows exclude official other investment flows. The components do not necessarily add up to total net financial flows because of lack of data availability.

Sub-Saharan Africa: Portfolio Debt and Equity Flows, 1980-2017 (in USD billion)

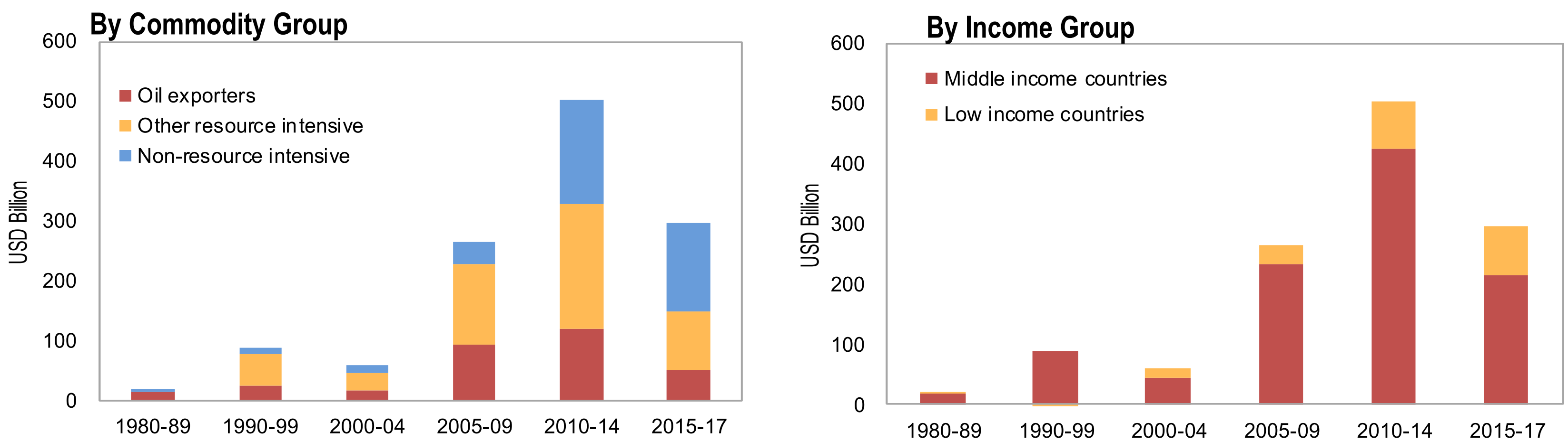


Notes: Portfolio debt and equity flows do not add up to total portfolio liability flows for the region because of lack of data availability. Disaggregated data is unavailable for South Africa.

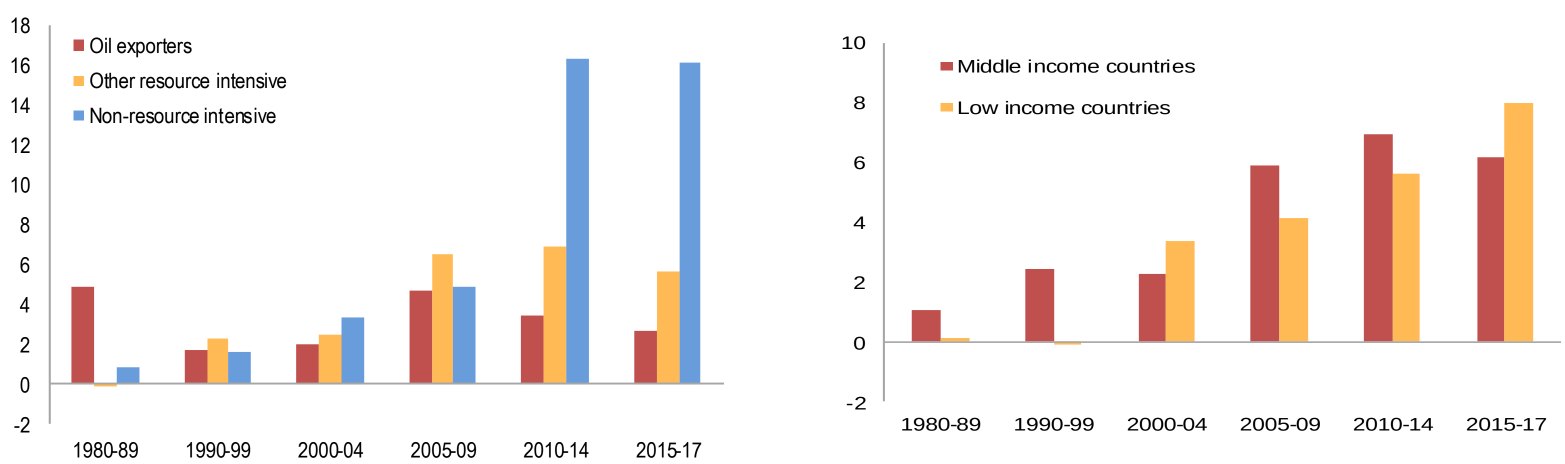
SHIFTING PATTERNS

- Share of non-resource intensive, mostly low-income countries is increasing…

Sub-Saharan Africa: Cumulative Liability Flows, 1980-2017 (in USD billion)



Sub-Saharan Africa: Liability Flows, 1980-2017 (in percent of GDP)



INCREASING VOLATILITY OF CAPITAL FLOWS

- Both liability and asset flows (scaled by GDP) to SSA have become more volatile since the global financial crisis
  - Overall, liability flows are more volatile than asset flows
  - Among the different types of liability flows, other investment is the most volatile
  - Notably, the volatility of nonresident flows is higher than that for EMEs—highlighting the fickleness of these flows to the region

Drivers of Capital Flows

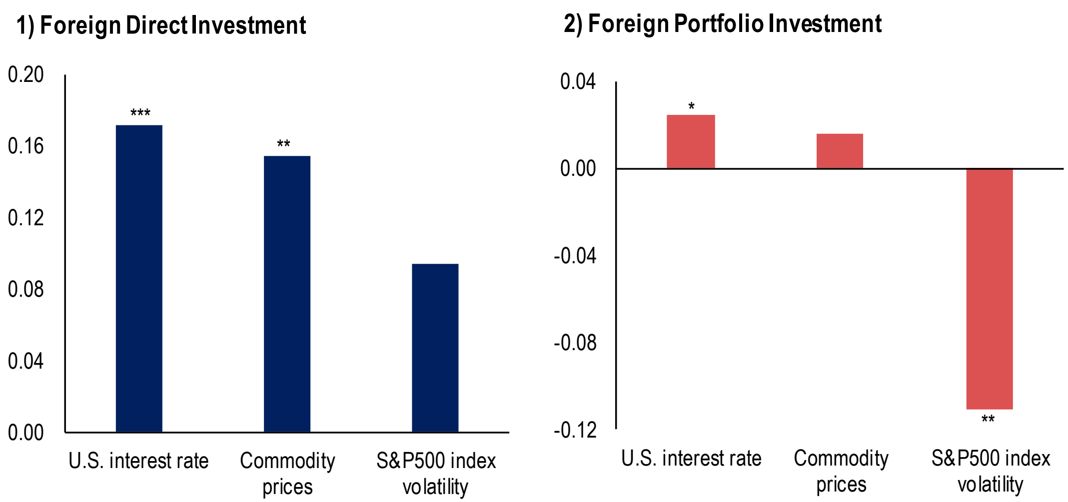
What do we do?

- Analyze annual data for all SSA countries over 1980-2017
- Analyze episodes of large foreign inflows ("surges") and outflows ("reversals")
  - Defined as liability flows in the top and bottom 30th percentile of the country's, and full sample's, liability flow distribution
- Analyze monthly data for fund flows, sovereign bond yields, and stock returns for a sub-sample of SSA countries from 2000-17

What factors matter for SSA?

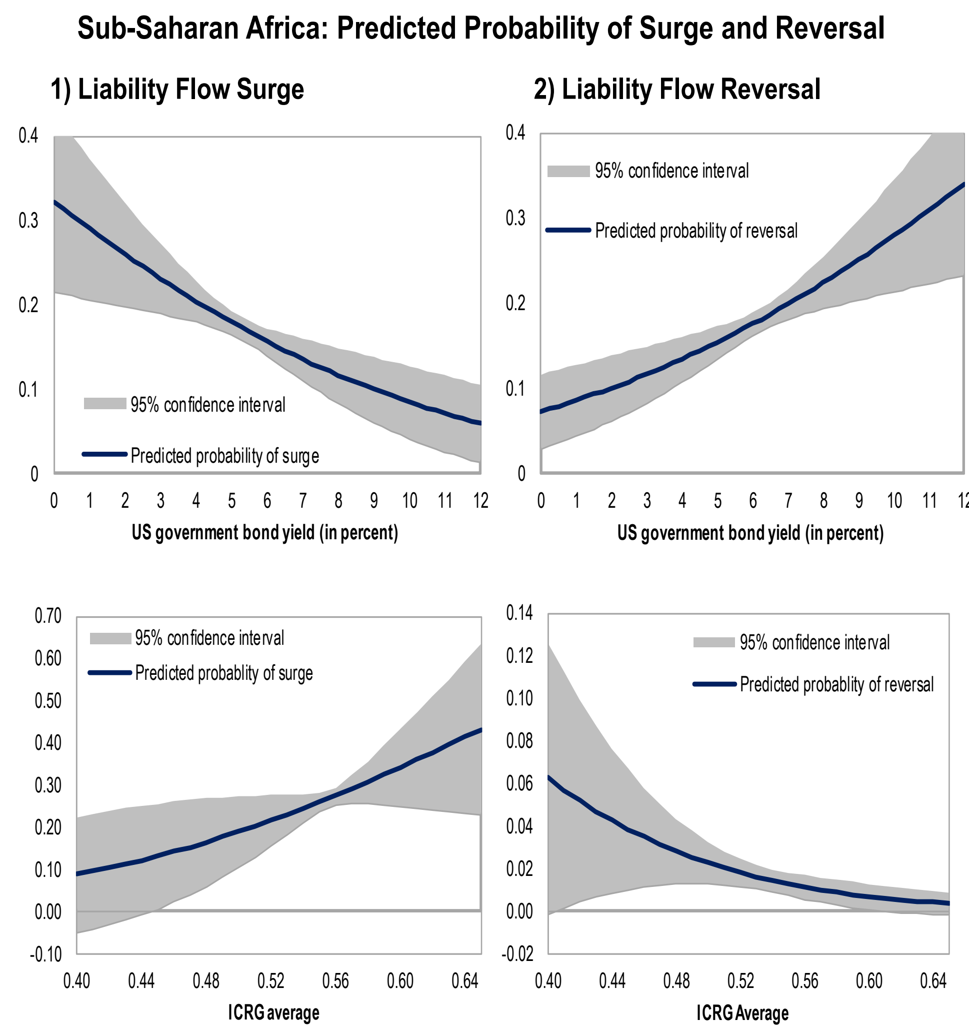
- Push factors: US interest rate and commodity prices
  - A 100 bps decline in the US government bond yield $\Rightarrow \uparrow$ liability flows by 0.3-0.4 percent of GDP
- Pull factors: Institutional quality, real GDP growth, trade openness, external debt ratio
- Importance of factors, however, tends to differ by the type of flow
  - US interest rates/commodity prices have a stronger effect on FDI
  - Global market volatility strongly affects foreign portfolio flows

Sub-Saharan Africa: Impact of External Factors on Direct and Portfolio Investment Liability Flows (in percent of GDP)

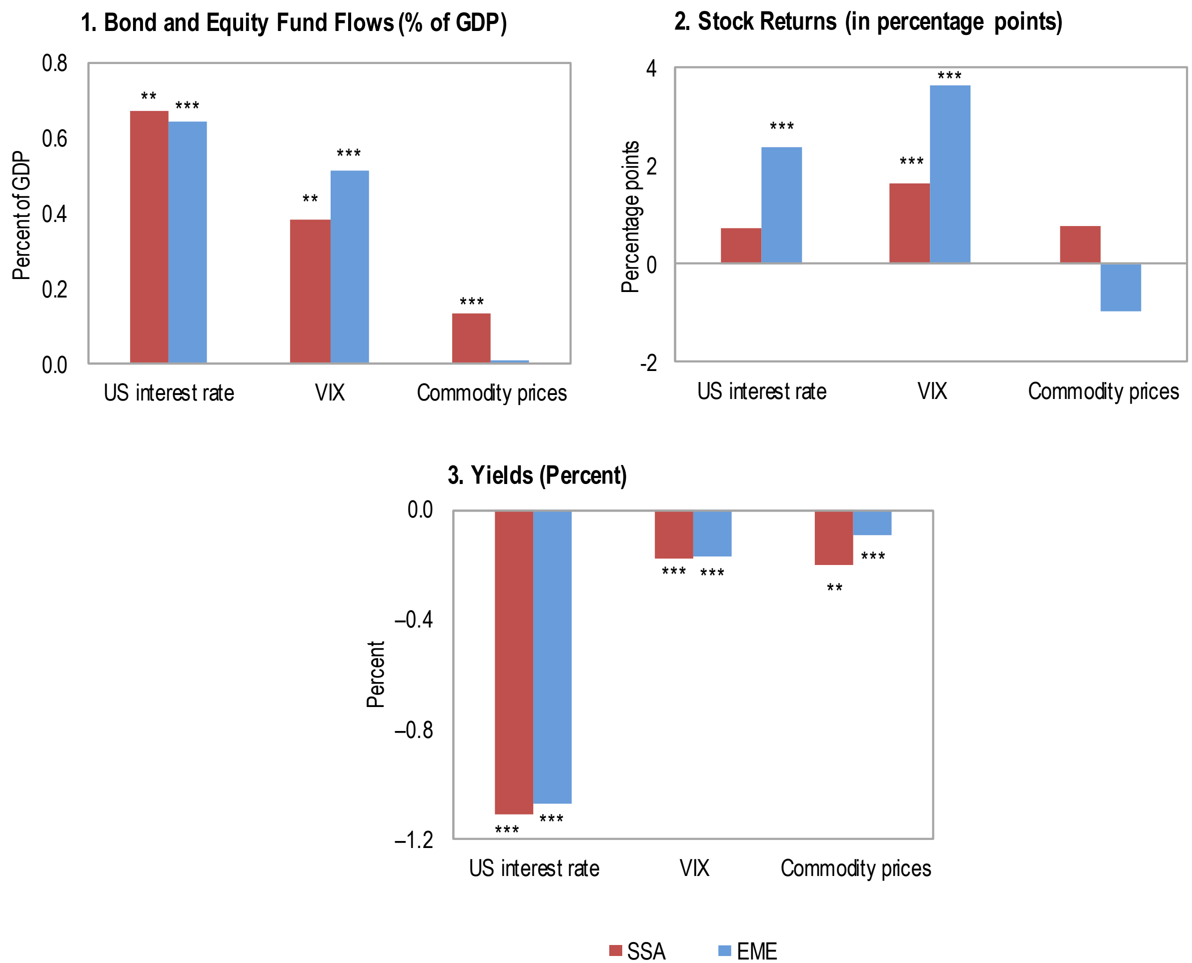


SURGE VERSUS REVERSAL

- US interest rate affects both surge and reversal likelihood
- Commodity prices strongly affect surge likelihood, and reversal probability in resource intensive countries only
- Among domestic factors, higher real GDP growth and better institutional quality increase (decrease) the surge (reversal) likelihood

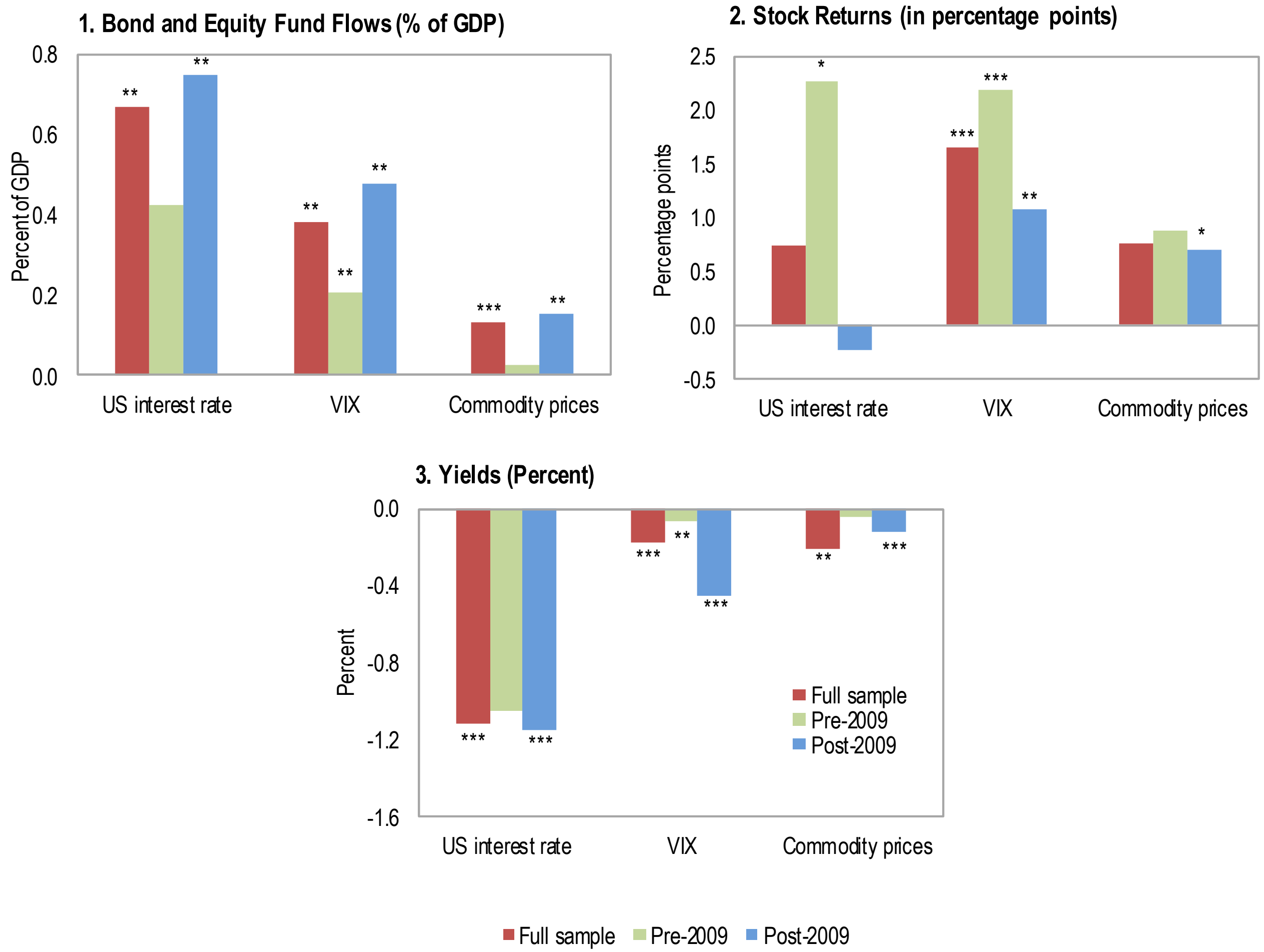


Fund flows and asset prices



Notes: Panels compute the estimated impact of a 100bps decline in the US government bond yield; a one standard deviation decline in the (log) VIX index; and a one standard deviation increase in the (log) commodity price index. . ***,**, and * indicate statistical significance of the variable at the 1, 5, and 10 percent levels, respectively.

Fund flows and asset prices



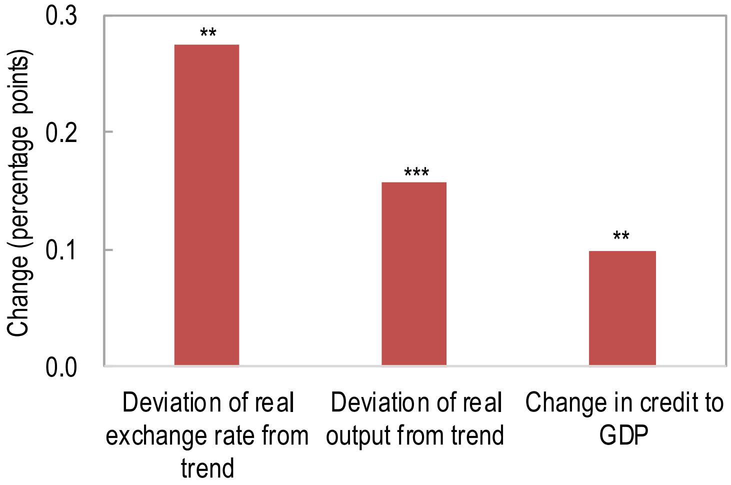
Notes: Panels compute the estimated impact of a 100bps decline in the US government bond yield; a one standard deviation decline in the (log) VIX index; and a one standard deviation increase in the (log) commodity price index. . ***,**, and * indicate statistical significance of the variable at the 1, 5, and 10 percent levels, respectively.

Consequences of Inflows

MACROECONOMIC CHALLENGES

- No statistically strong evidence that overall liability flows contribute to macroeconomic and financial vulnerabilities
- But the type of flow matters…
- Portfolio inflows are more prone to moving the real exchange rate and output above trend, and to fueling domestic credit growth
- These findings are consistent with those for EMEs

Sub-Saharan Africa: Macroeconomic Consequences of Portfolio Inflows (Percentage points)

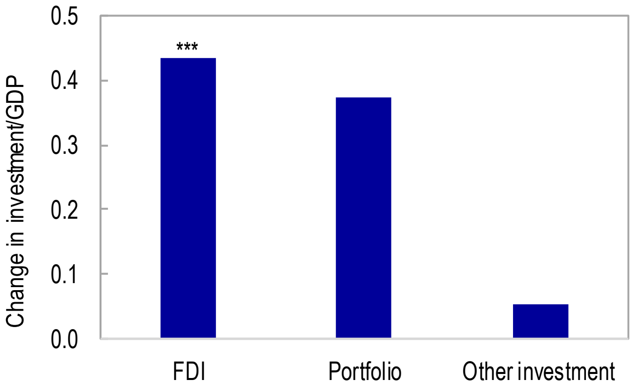


Source: IMF staff estimates.
Note: ***,**, and * indicate statistical significance of the variable at the 1, 5, and 10 percent levels, respectively. FDI = foreign direct investment.

Domestic investment and growth

- While portfolio flows pose macro challenges, historically no strong evidence that they support domestic investment
- By contrast, FDI flows are strongly associated with higher investment rates in SSA, in turn supporting economic growth
- Portfolio flows are, however, strongly associated with public consumption (including social spending)

Sub-Saharan Africa: Impact of Liability Flows on Domestic Investment (Percentage points)



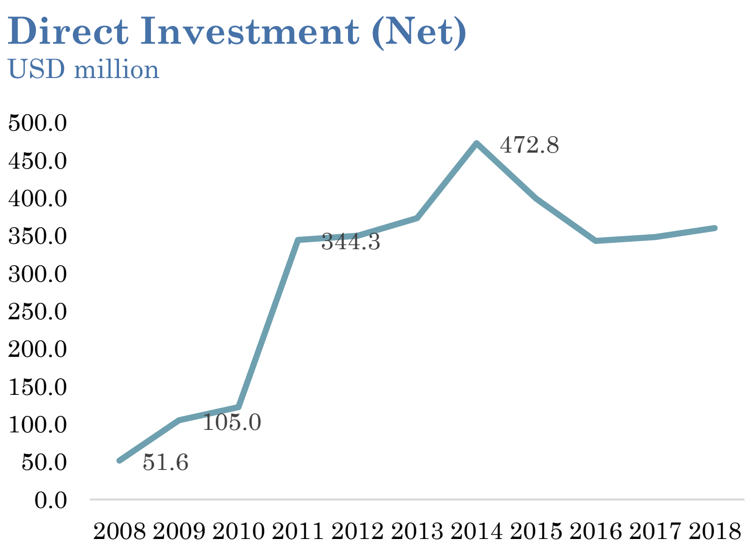
Source: IMF staff estimates.
Note: ***,**, and * indicate statistical significance of the variable at the 1, 5, and 10 percent levels, respectively.

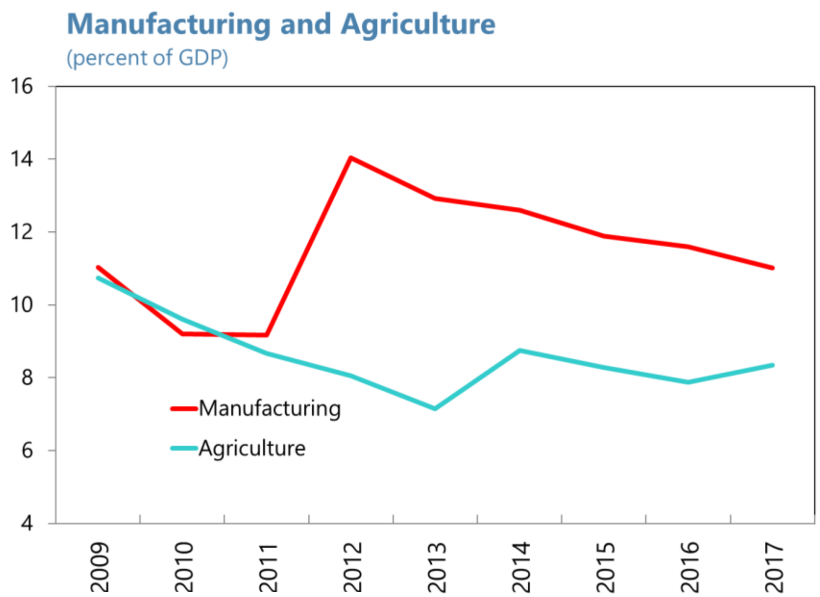
KEY TAKEAWAYS

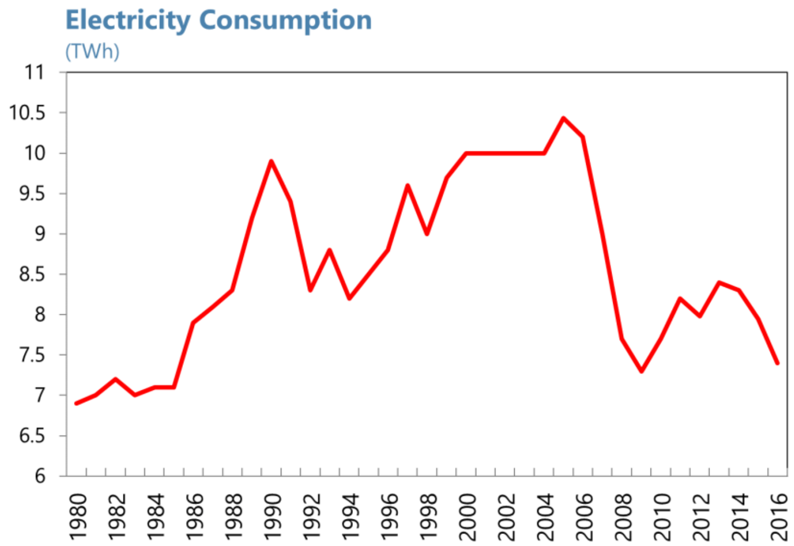
- Capital flows to SSA are highly sensitive to global factors
- But some domestic factors also matter…
    - Growth, prudent fiscal management, and strong institutional quality are important to mitigate the risk of large reversals
- Capital flows offer potential benefits but also carry risks, calling for careful management of capital flows
    - **Be Prudent:** Sovereigns need to ensure that the borrowed resources are utilized effectively, enhance productivity, and promote sustainable economic growth
    - **Be Vigilant:** Vigilance is warranted against the buildup of macroeconomic and financial imbalances. Countercyclical macroeconomic and prudential policies should be adopted to limit vulnerabilities, build adequate buffers, and preserve debt sustainability
    - **Build Resilience:** Strengthen domestic fundamentals, have adequate buffers, and improve business climate

ZIMBABWE CAPITAL FLOWS

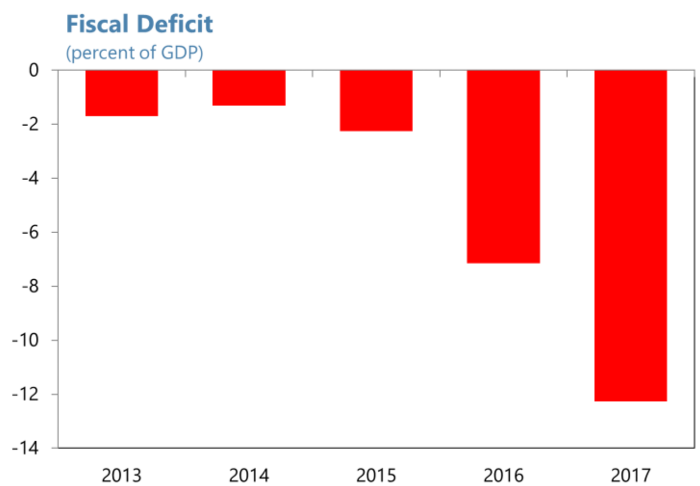
THE RECOVERY IN FDI FOLLOWING THE 2009 CRISIS HAS COME TO A HALT …

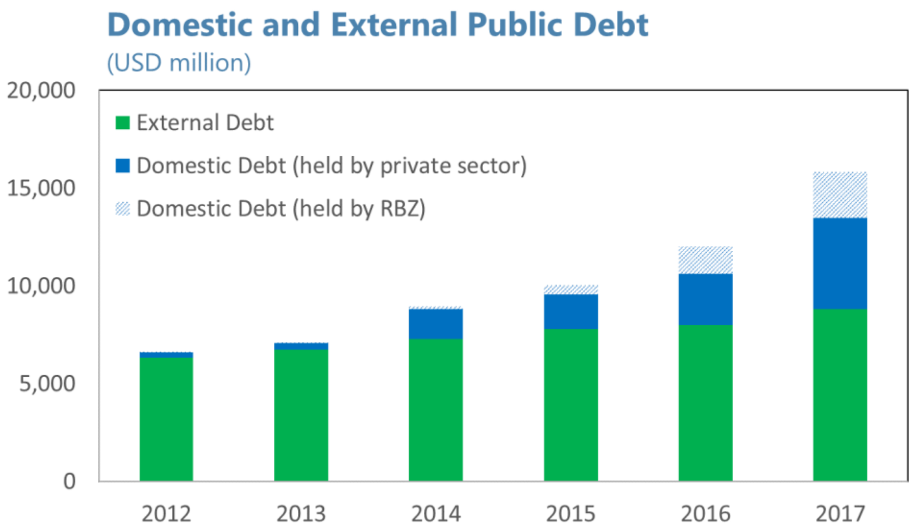


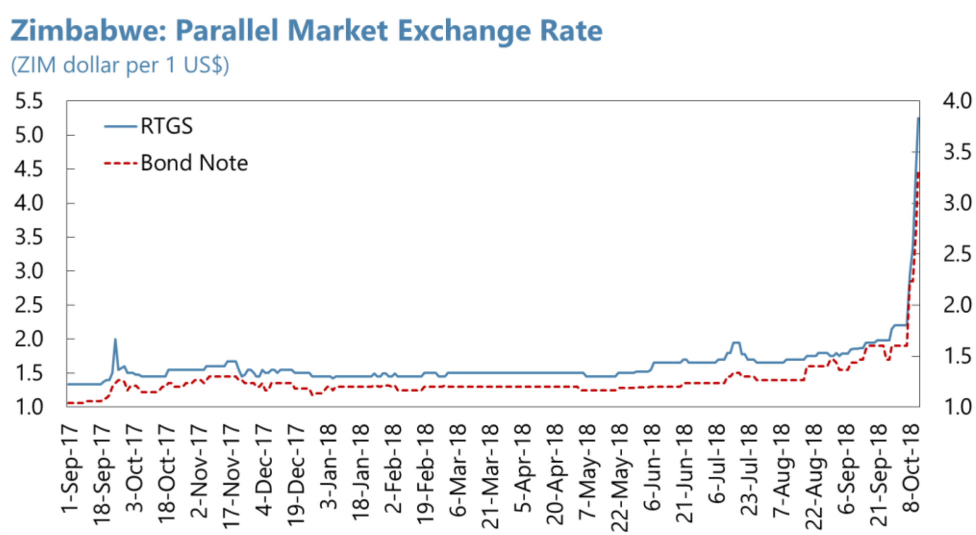




REFLECTING THE POOR MACROECONOMIC ENVIRONMENT







Factors affecting capital flows in Zimbabwe

- A stable macro economic environment is necessary, though not sufficient, to encourage capital flows.
- There is need to improve the policy environment – get the budget deficit under control.
- Government must put the exchange rate on a sound footing – the lack of access, and the need to be able to repatriate it
- Government must improve on its communication policy, and also ensure consistency.
- The business environment must be ameliorated by strengthening legal, institutional and regulatory frameworks

Thank you