Bruce Edwards:

While the world sees the transition to renewable energy as a major challenge, renewables could offer solutions to Sub-Saharan Africa's biggest problems.

Wenjie Chen:

The Sub-Saharan Africa region actually has 30% of known deposits and production of these critical mills.

Bruce Edwards:

Yeah, it's huge.

Wenjie Chen:

And this is a tremendous opportunity, given this transition globally that we have towards clean energy. So, one of our key policy recommendation is that these countries move up into processing of these minerals to capture more value added, but for that, we need foreign direct investment.

Bruce Edwards:

But with several coups in the past year and some potentially contentious presidential elections in the coming year, that FDI won't come easy.

Wenjie Chen:

When we have political instability that leads to uncertainty, and that itself is a deterrent to investor confidence.

I'm Wenjie Chen. I'm the deputy division chief of the Regional Studies Division in the African Department, and concurrently, I'm also the mission chief to Mali.

Bruce Edwards:

Wenjie Chen leads the team that produces the biannual regional economic outlook for Sub-Saharan Africa. The latest, out last week, presents some good news and some, well, not so good news.

So last year's regional outlook, at this time, was very much focused on the funding squeeze for countries that were facing higher debt servicing costs. This outlook seems to say that the region is on the mend. So what has changed since last April that makes the prospects for the region look better?

Wenjie Chen:

So let me start with the good news first.

Bruce Edwards:

Okay.

Wenjie Chen:

We have some encouraging signs that the region is indeed on the mend, and nearly two-thirds of the countries are actually projected to grow higher compared to last year. The other additional positive signs that we see is a decrease in the macroeconomic imbalances, and what I mean by that are two things. One is that inflation in the region has come down. Last year, when we were looking at the situation, inflation was peaking at almost 10% towards the end of 2022, and now, it's almost half of that, around 6%, the latest data that we have in February of this year. And concurrently also, with that, we have public debt as a share of GDP, broadly stabilizing at around 60% of GDP, and that's really thanks to policies, tough policies that governments have conducted in that region in terms of fiscal adjustment and raising interest rates. And, of course, the big news was that the region after almost a two-year hiatus, has returned to international debt markets.

And this was led, charged by Côte d'Ivoire in January with a $2.6 billion Eurobond issuance, and followed suit by Benin and Kenya.

However, not all things are as rosy, and the challenges actually persist. And first and foremost, the funding squeeze, which you mentioned, is unfortunately still very much a challenge faced by many countries in the region. And what has changed compared to last year's big funding squeeze, as we talked about, is at this point in time, the debt service cost has come to a head, so it's not just the interest payments, which take up more than 10% of the government's revenues, but also the repayments are actually due this year and next year. So for Eurobond redemptions, for instance, about $6 billion are due this year, so this is quite a big chunk of funds that many of the governments do not have to spare, given the large needs that they're facing, in terms the scarring effects that they are still dealing with from the four years of shocks upon shocks, and they're still facing cascading shocks today.

Bruce Edwards:

Okay, so let's back up a little bit here. You've listed a lot of things, a lot of challenges, but debt is a big one. So you mentioned there that debt levels have stabilized, but they're still, on average, 60% or thereabouts of GDP, which seems pretty significant. What are the risks associated with that high level of debt, and what's in this report that might, in terms of guidance, that might help countries to find their way out of it?

Wenjie Chen:

Indeed, debt levels have been really elevated. This is one of the highest that we've seen in two decades, so this is clearly a worrisome trend that we see.

But what's more important is to keep in mind, I think, debt levels per se, public debt to GDP, as long as the funds that the government is borrowing is put to good use, is channeled, what I mean by that, to productive use that yield the returns. In essence, that can be a reassuring factor. So, for instance, if they were to put the money into infrastructure spending, to social spending, health, education, that then, will reap the benefits for the country, and by that I mean, for instance, in terms of economic activity that it can stimulate, which then, in return, will generate a larger tax return for the economy, those funds, in turn, can repay the debt, and then put into other investments that, in return, yield more growth. However, that's in theory, what we see and what is worrisome is that a large chunk, right now, of those proceeds are actually going into repaying debt and into servicing debt, and those are not the most productive use for the future potential and development of these countries. And several, not all, but several countries are indeed facing rollover risks in terms of these, these large repayments that are coming up. Now, given the high borrowing costs and still elevated in the future to come that we see and the liquidity shortfalls, and even though the three countries have returned to the Eurobond market, that's a tiny sliver of funds that they need at very high costs.

So what's really important is that they look domestically into how to raise the funds, and first and foremost, through boosting revenues, domestic revenue mobilization-

Bruce Edwards:

Which essentially is taxation?

Wenjie Chen:

It is taxation, but it's not about only raising taxes. I think what we mean by that is, really, a multi-pronged approach. It's simplifying the tax system, it's cutting out very expensive tax exemptions, which many countries have, and the region has actually quite a potential to also raise the tax base. So if you have more firms, more people to actually tax even small amounts, that can additionally bring in more revenues into your government coffers, so to speak. And at the same time, it's even more important, every dollar that the government has, to spend more efficiently and wisely.

And there, we also see a lot of room for improvements in terms of the efficiency of management of projects, in terms of cutting, for instance, very expensive fuel subsidies, and many of the countries, some countries have taken actions, in fact, on that. And there will be costs to especially the vulnerable people, but there, I think the government, what we advise is to, in fact, have social and targeted transfers to those to alleviate the pain. We, in fact, have an accompanying regional economic outlook note on how to cut budget deficits without undermining development. And there, we go also into more detail about garnering public trust, which is very, very important, to really make this fiscal consolidation more successful and to really show that this is needed for the country, but the benefits is felt by everybody going forward.

Bruce Edwards:

Okay. So you mentioned a couple of times that the Eurobond issuance for the first time in a couple of years, at least. What is the Fund's view on a Eurobond issuance? I mean, is it a good idea to issue a Eurobond for those countries that are struggling to service their debt?

Wenjie Chen:

Now, more generally, issuing Eurobonds or having the potential to issue Eurobonds is a great thing, because it opens up to more investors, it opens up these countries to additional financing sources, diversifying the financing sources, and it can be a great source for raising the needed funds for development. And again, it's about the importance, how that money is being spent.

And in this case, what we see for these three countries that have returned to the Eurobond market, Kenya, in particular, it has bought them time in terms of refinancing their outstanding debt repayment. So that's a good thing in general.

However, they come, the issuance of Eurobonds come with risks as well. First of all, they're generally in a foreign currency, so there's the foreign currency risk associated with that.

Bruce Edwards:

Right.

Wenjie Chen:

We have seen that just not very long ago, with the appreciation of the U.S. dollar and the depreciation, therefore, of the local currencies, all of a sudden, that debt and the debt repayments have increased in terms of local currency value. But again, also, the other thing about these more commercial type of funds is they're associated with higher cost. And in this day and age, even though the spreads, what we call, have come down a bit, Kenya's issuance came at 10.4%, and that's compared to the 6.9% they paid on the bond that's due this year, back, before the pandemic. So therefore, with this higher cost comes higher responsibilities of using these funds wisely.

Another issue we see is that commercial funds tend to be more procyclical. What we mean by that is it coincides with times when the governments might not be in the most dire times of needing them. So when they were, for instance, in need of funds, in fact, the IMF stepped in, and that's our role, to provide countercyclically the financing that's needed.

Bruce Edwards:

So, this issuance of Eurobond, as you said, is in response to ongoing funding shortages, including official development assistance. And given what's going on in the world today, it's unlikely that ODA is going to bounce back anytime soon. So how do you see the path forward in terms of Sub-Saharan Africa, raising those critical development funds that they need now and for probably many years in the future?

Wenjie Chen:

Yes, absolutely. This is quite the challenge, I think, going ahead. And as you rightly pointed out, official development assistance, given the many competing demands in the world, I think the region unfortunately has felt that impact with declining ODA in the past 15 years. Now, in terms of the way forward, apart from the inward-looking things that I talked about before, raising domestic revenues, increasing the efficiency of spending, I think going forward, it's also important to look at structural reforms that could help the countries, both in terms of attracting outside flows that are more stable over time, that are more productive, and in particular, I'm talking about foreign direct investment, that tend to be with investors that have longer-term investment in mind, and we have seen a lot of evidence from existing studies that show that these FDI flows come with creation of domestic jobs. They come with skilled transfers from global multinationals to local firms, to local workers, and with spillover effects as well at the local level.

So those kind of things are very positive if the countries could enable to attract FDI. However, in our report, we mentioned that so far, I think the region attracts about 3% of the global FDI only, and much-

Bruce Edwards:

Wow, which is very low.

Wenjie Chen:

Exactly. Much, much more is needed, and given, again, the tight financing constraints, really cost-effective reforms are needed to attract this FDI. And what do I mean by that? Well, providing stable macroeconomic environment is very important.

Reducing policy uncertainty is key as well. If you're a long-term investor, you want to invest in a stable and predictable environment, and having a more business-friendly climate where red tapes are being reduced, and where more of the investments are being promoted for multinationals, where it's easier to conduct business, and those type of things are very, very important. But again, back to your question, that alone is not enough, and reforms will take time to actually come to fruition. So in the meantime, still, we need the support of international assistance, and there, there are ongoing dialogues. Of course, the IMF is this part of that.

We stand ready to support the region, as we have done in the past four years, in particular. I think we have actually given out close to $60 billion over that time period, and 27 countries in the region are under some form of financial assistance programs with us, but more is needed.

This is not enough just from us, but from the international community. Dialogues are ongoing about leveraging balance sheets by the multi-development banks, and also how to address, I think the poorest countries, in particular.

Bruce Edwards:

So, we hear a lot of talk about how Africa may well benefit from the renewable energy transition, and to me, it makes a lot of sense because there's a huge demand for minerals that's associated with that renewable energy transition, and the continent has all of those minerals. How can countries capitalize on this greater demand for minerals globally, do you think?

Wenjie Chen:

Yeah, I'm very glad you brought up this question because I was also one of the lead authors on the REO Note on how to leverage this critical mineral resource in the ... I think we aptly titled the Digging for Opportunity-

Bruce Edwards:

Very nice.

Wenjie Chen:

Harnessing Sub-Saharan Africa's Wealth in Critical Minerals. And just a key stat, as you already mentioned, the Sub-Saharan Africa region actually has 30% of known deposits and production of these critical minerals.

Bruce Edwards:

It's huge.

Wenjie Chen:

And this is a tremendous opportunity, given this transition globally that we have towards clean energy. Anything from electric vehicle, batteries, you have the cobalt, 70% of that is in the DRC. You have lithium. Much of that is in Zimbabwe and Mali. The known resource is nickel.

You also need that for solar panels. You have the rare earth minerals, which are very much in South Africa, so this is a tremendous opportunity. And in that note, what we looked at is what many of these countries right now are doing is essentially providing the raw materials. Daily, there are actually trucks and trucks of just bare rocks that contain some lithium being transported from mines in Zimbabwe to ports, and being shipped off to other countries for major processing.

Bruce Edwards:

the processing, yeah.

Wenjie Chen:

So Sub-Saharan Africa does not actually capture a lot of the value added, unfortunately, that could be really taken advantage of. And so one of our key policy recommendation is that these countries move up into processing and local processing of these minerals to capture more value added, to catalyze the labor that's needed for that, but for that, we need foreign direct investments.

Bruce Edwards:

Okay.

Wenjie Chen:

So I go back to some of the policy advice we have in the main chapter in terms of how to unlock that. The other key policy priority, and that is, as you mentioned, there's so many of these different critical minerals all on the continent. So what is needed is really for them to band together, to lower their non-tariff barriers, to work together in actually establishing local supply chains, and to form these processing and to make the batteries, hopefully, at some point in time in the future, and then also, to serve their domestic demand.

Remember that the population growth in Sub-Saharan Africa is very different from the rest of the world. In the next 25 to 30 years, the population will likely double from a little over one billion to two billion people, so that will create this huge demand, what we think also, of these clean energy products. And so it has both the capacity to do it, but also the demand on the other side to fulfill that.

Bruce Edwards:

It also has a potential of resolving some of the conflict because minerals are a source of conflict in the region as well, so if they can establish more collaboration between countries on how minerals are processed and where they go, that could also benefit in terms of reducing some of the conflict, which is so problematic and contributes to the political turmoil as well.

Wenjie Chen:

Absolutely. So, just in terms of the integration, just to mention, I think the African Continental Free Trade Area, which was established just a few years ago, is a very promising avenue for countries to collaborate together to lower their barriers to trade. And if, really, that comes to fruition, I think we can see a lot of fruits being reaped from that collaboration. But on your question on the political instability, apart from the critical minerals, and we mentioned this as a key downside risk for the outlook.

Bruce Edwards:

There have been, what, seven military coups in the past year or so? and many general elections on the horizon. Well, within the next year, I think more than a dozen general elections.

Wenjie Chen:

Yes. So we have, I think, latest count is 18 general or national elections and presidential elections that are scheduled for this year, so it's a really bumper year. But let me be clear, that elections are a fabric of democracy, so that's something that we do encourage, and it's a sign of vibrancy of the democratic process that's happening. So that, in itself, is a good thing.

Bruce Edwards:

Yeah.

Wenjie Chen:

Now, the political instability that you mentioned, in conjunction with the coups that we see, especially in the Sahel region, and some of the security problems that we have seen, those are negative things that can really impact on the outlook.

And what we see that is, of course, the security will take money away from already tight budgets. We see also displacement, which will have negative impact on agriculture production, on food insecurity, which is still very much a problem in the area with 140 million people being food insecure in the region.

But overall, when we have political instability, that leads to uncertainty, which I mentioned again also before, and that itself is a deterrent to investor confidence, consumer confidence, which then impacts consumption, investment. And also what's important for this region is the reform momentum that's really needed, to have these difficult policies like fiscal consolidation, like removing fuel subsidies, and that can be sidetracked when there is political instability.

Bruce Edwards:

Yeah. How interesting.

Wenjie Chen is the deputy head of the Regional Studies Division in the IMF's African Department. Thank you so much.

Wenjie Chen:

Thank you so much for having me. It was a pleasure.

Bruce Edwards:

Again, that was the IMF's Wenjie Chen, talking about the latest regional economic outlook for Sub-Saharan Africa. Check it out at imf.org,

and look for other IMF podcasts wherever you listen. You can also follow us on X, what used to be Twitter, @imf_podcast.

I'm Bruce Edwards, thanks for listening.