Overseas Development Institute

The Global Financial Crisis and Developing Countries

An update of the monitoring work

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Acknowledgements

A team of 40 researchers from ODI and 10 developing countries embarked on a unique monitoring study on the effects of the global financial crisis over the period January-March 2009. It found that some effects had already become visible when the G-20 leaders met in London on 2 April 2009, but it was expected that worse conditions were underway.

With current forecasts of the state of the world economy ranging from green shoots, double dips to a long and deep recession, and ahead of the G-20 meeting in Pittsburgh on 24-25 September 2009, where the position of low-income countries should be considered, ODI organised a workshop on 7 September 2009 to mark the start of the second phase (August-December 2009) of the monitoring study (deepening selected Phase 1 studies and covering other countries) and consider the effects of the global slowdown (and possible green shoots) on 11 low-income countries.

This paper includes monitoring updates by the country teams and can be read in conjunction with the workshop report.

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Overview

Dirk Willem te Velde

The Overseas Development Institute (ODI) is continuing to coordinate a large country case study following up on earlier monitoring work of the global financial crisis. We have asked the country study leads to update their previous work, or start a new analysis, describing the effects of the global financial crisis so far on their economies, through the transmission belts (private financial flows, trade, remittances and aid), growth and development effects and policy responses. We have only just begun with this second phase of the research, but important findings are already emerging (and are summarised below).

Bangladesh has been able to avoid the worst consequences of the ongoing global economic crisis. In FY2008/09 (July-June), Bangladesh's export growth was 10.5% and remittances rose by 22.3%. Foreign direct investment (FDI) flow, though rather low, rose somewhat, but portfolio investment registered a negative flow as a consequence of flight of portfolio capital from the share market. The government had to respond in view of some of the negative signals originating from the global market and under pressure from exporters. In April 2009 it introduced a stimulus package worth $495 million. Yet another stimulus package, worth about $720 million, was announced in the budget for FY2009/10.

Despite the shocks experienced, Bolivia has not experienced substantial macroeconomic disequilibria. Growth is slowing considerably, however. There is evidence of a slowdown in the flow of remittances of around 9% from the first quarter of 2009, compared with the last quarter of 2008. Net capital flows are negative for the first quarter of 2009 owing to large declines in portfolio investment and other capital flows. However, the impact of revenues in the current account has played a more stabilising role in terms of the capital account, able to counterbalance net capital outflows.

Cambodia is projected to experience the steepest decline in growth in developing Asia in 2009 as the key growth sectors have lost steam. Overall, the external position of Cambodia is expected to further deteriorate into 2009. FDI flows are expected to decline. Aid is expected to remain stable. Remittances are expected to stabilise. The crisis has resulted in reduced demand in the US market for garments and a reduction in garment FDI inflows. Around 63,000 jobs were lost between September 2008 and March 2009. An absolute increase in the number of poor is expected in 2009, around 200,000 people, or 3-4% of the current number of poor in the country.

In the Democratic Republic of Congo (DRC;, exports as well as FDI inflows have seen a large contraction, especially in the mining sectors. This has resulted in a sharp increase in the current account and balance of payments (BoP) deficits. Although there has been a substantial reduction in imports, the government has had to rely on international assistance to relieve BoP pressures. As a result of the crisis, reserves fell to around $30 million, enough to cover just one to two days of imports, a very dangerous position. Moreover, the crisis also reduced fical revenues, to the extent that the government relied on monetary financing of the budget deficit during the last months of 2008. Both problems feeded into sustantial depreciation of the currency and a surge of inflation. The DRC has made use of the Exogenous Shocks Facility window provided by the International Monetary Fund (IMF), which has turned a very dangerous situation into something the government has been able so far to manage: since March 2009, foreign exchange reserves have generally remained stable, and exchange rate and inflation pressures have eased. The crisis has resulted in severe job losses, especially in the (also informal) mining sector, and a revision of 2009 GDP growth from 10.3% to 2.7%. In terms of institutional response, the government has established an inter-ministry commission and a crisis cell, presenting a package of measures, focusing on regaining macro-economic stabilization and prioviding safety nets, relying very heavily on funding from the donor community.for the execution of this package.

Given that there is no stock market in Ethiopia, and given the general lack of integration of the financial system with the rest of the world, no major impact in terms of the financial transmission channel was expected. But given that the Ethiopian diaspora is around 1 million, some reduction in remittance flows is expected into 2009. There has recently been a dramatic reduction in export growth (in terms of value). Coffee and oil seed prices have declined. There has been a reduction in the growth rate of flower exports in volumes and values. As export values have decreased there has been a severe rationing of foreign exchange. Given the high rate of inflation in the domestic market (around 40% as of October 2008, compared with around 20% in October 2007), most exporters have been trying, where possible, to re-orientate exports to the domestic market. The rationing of foreign exchange has resulted in complaints being levied by importers who have started to experience difficulties.

Mozambique has been growing at an average of 7.5% per year for the past decade and a half. Projections show that this slowed to 6.5% in 2008 and may reduce to 5.5% in 2009. The big impact of the crisis has been in terms of export declines: a 20-25% decline is expected in 2009. As a result of the crisis and reduction in exports, investment and GDP, around two-thirds of the population are estimated to be in a vulnerable situation.

In Uganda, the value of coffee exports fell by 35% in March 2009 compared with a year earlier, with declines explained largely by the drop in export price than by changes in volumes. On the other hand, regional trade, especially in non-traditional exports such as maize, beans and cement, etc, has cushioned Uganda from the adverse effects of the crisis. The level of remittances declined by 24% in fiscal year 2008/09. There are reports of declines in foreign aid, which will affect social programmes and the agriculture sector.

After the crisis hit, there was initially denial in Tanzania; the debate was in relation mainly to financial management. A stock take was begun and more action has been taken since.

The Sudan is becoming an increasingly open economy. However, at the same time, it is also becoming increasingly dependent on oil revenues, which accounted for around 95% of export earnings in 2008. Oil revenues contributed around 63% of total government revenue or 22.8% of gross domestic product (GDP) in 2008. The Sudan has been severely hit by the global financial crisis, mainly through substantial deterioration in its terms of trade, and secondly in sharp reduction in its budget revenues generated by oil exports. The first quarter report on the 2009 budget indicated that oil revenues were at only around 50% of budgeted figures owing to a sharp decline in export prices. The serious and sharp decline in budget revenue has caused problems in relation to the commitments of the central government to transfer revenue to Southern Sudan. The Southern region is dependent on reliable transfers: fiscal capacity is very low as a result of numerous capacity constraints. Portfolio investment declined from $30.03 million in 2007 to -$33.44 million in 2008. The Sudanese stock market has not been hit hard, because most investors are domestic and it is not connected to regional and international stock markets.

Whilst financial institutions in Zambia remained largely unaffected during the last quarter of 2008, the level of non-performing loans (NPLs) increased from 8.8% during the first quarter to 10.4% during the second quarter of 2009. The depreciation of the kwacha against major currencies, which started during the second half of 2008, continued into the first four months of 2009, but began to recover during the second quarter. This can be attributed partially to improvements in the export of copper as a result of increasing copper prices on the global market and the open market operations initiated by the monetary authorities. The Lusaka Stock Exchange recorded a slight increase in market capitalisation from $3,837 million in January 2009 to about $3,902 million in June 2009. The production of copper, Zambia's major export, increased by 15.7% in the first half of 2009 from the 26.4% decline recorded in the second half of 2008. The performance of the export sector will improve as long as the copper price is maintained above $3,000 per tonne. During the first three months of 2009, gross international reserves declined from $1,064 million to $946 million before rising sharply to $1,146.20 in June 2009 in part due to a the disbursement of $162.2 million by the International Monetary Fund (IMF) in May 2009. Government revenues have also taken a hit.

The country monitoring updates in this paper suggest that there are important issues to reflect on, not just at a country level but also when comparing across countries. They also force us to reflect on structural underlying conditions of the countries and how they are placed for a recovery in addition to discussing whether short-term recoveries are taking place.

Relevant questions include:

- Only very few indicators suggest that a recovery is taking place in low-income countries (there is evidence of changes in commodity prices). For example, portfolio flows have not returned as fast as they were withdrawn. Will low-income countries see a lagged response? Or a weaker position for a long period altogether? Or will there soon be signs of a recovery?

- Why have garment exports from Bangladesh increased and those from Cambodia decreased? Will Cambodia be in a sufficiently competitive position to attract investors into garments once the crisis is over?

- A similar comment concerns mining in DRC and Zambia. To boost exports, DRC needs the price of copper to be around $4,500 per tonne, compared to around $3,000 per tonne for Zambia, suggesting that Zambia is in a better competitiveness position than DRC in the current recovery with possible long term consequences for DRC of the price of copper remains depressed.

- Why have countries such as Sudan relied on record high prices as the basis for government revenues, when any decline in oil prices could jeopardise transfers consistent with the peace agreement between North and South. Have other countries done better in terms of budgeting, or were they forced to slash crucial spending (as seems the case in Zambia)?

- The role of the IMF has been crucial for survival of countries such as the DRC, where reserves were falling to extremely low values. How have other countries accessed and experienced such support? For example, Zambia also received an IMF loan to boost reserves.

- Is regional trade amongst developing countries holding up better than north-south trade? Regional trade in maize, beans and cement has helped Uganda cushion the impact of export declines in coffee and flowers to other destinations.

This remainder of this monitoring update contains more detailed summary updates of how the global financial crisis affects these developing countries. A workshop report and presentations will be uploaded on ODI's website.

Bangladesh

Mustafizur Rahman

As distinct from many other low-income countries, Bangladesh has been able to avoid the worst consequences of the ongoing global economic crisis. In FY2008/09 (July-June), Bangladesh's export growth was 10.5% and remittances rose by 22.3%. With import payments falling, the balance of trade improved somewhat; thanks to robust remittances, the current account balance remained positive and posted some growth.

However, export performance was highly volatile – particularly in Q2 (-1.6%) and Q4 (0.2%). Readymade garment (RMG) growth was high by any standard, but in FY2008/09 export-oriented non-RMG sectors suffered significant deceleration. Towards Q4, exports slowed down considerably. Even the RMG sector posted a rise of only 3.8% in Q4, while the rate of growth of the non-RMG sector was -11.8%. Remittance growth remained high (because of stock) but the flow of migrant workers decelerated significantly (by about 40% in the first five months of 2009 compared with the corresponding period of 2008). This is likely to put more pressure on the domestic job market. Foreign direct investment (FDI) flow, though rather low, rose somewhat, but portfolio investment registered a negative flow as a consequence of flight of portfolio capital from the share market.

The above decelerating trends towards the end of FY2008/09 led to lowering of gross domestic product (GDP) growth projections for FY2009, at 5.9%, and a further lowering of projections for FY2010, at 5.5%. The relatively lower GDP projections are set to have important adverse consequences on major macroeconomic parameters in the coming years, including job creation, labour absorption and domestic resource mobilisation.

The government had to respond in view of some of the negative signals originating from the global market and under pressure from exporters. In April 2009, it introduced a stimulus package worth $495 million. Yet another stimulus package, worth about $720 million, was announced in the budget for FY2009/10 (it is not clear whether the second one has subsumed the first). The main thrust of these packages is on domestic demand stimulation, support to agriculture and putting in place safety net programmes, with some support to selected export-oriented sectors.

Significant depreciation of currencies of competing countries and the impact of various incentives provided to export-oriented sectors in the stimulus packages are likely to pose a challenge for Bangladesh (e.g. backward linkage textile and yarn vis-à-vis Indian goods, and lower-end apparels exports vis-à-vis Chinese exports).

The challenges before Bangladesh in the new context, when the worst impacts of the crisis appear to be behind and when green shoots of recovery appears to be sprouting in major partner countries, are manifold:

- Addressing the adverse impact of the global financial crisis on the job market (lower absorption, lower migration);
- Designing appropriate use of the announced fiscal stimulus package;
- Designing a safety net programme for vulnerable sections;
- Putting in place appropriate programmes for returning workers;
- Addressing the adverse impact of competing countries' policies;
- Positioning Bangladesh's export sector in view of the envisaged global economic recovery (addressing the impact of stimulus packages and currency depreciation of competing countries).

Bolivia

Luis Carlos Jemio

What effects of the global crisis are already visible on private capital flows, trade remittances and aid?

The global financial crisis has affected the Bolivian economy through several channels and transmission mechanisms. First, export commodity prices have reduced significantly, causing a drop in export revenues. During the first semester of 2009, the average price index for Bolivia's export products dropped by 24.5%. Export prices for the mining sector went down by 33.9%, for hydrocarbons by 11.4% and for agro-industry by 17.7%. Furthermore, during the first semester of 2008, exported quantities dropped by 3.8%, owing to a sharp contraction in hydrocarbon exports, which went down by 23.7%. This sharp reduction owed to the lower demand from Brazil, which also suffered the effects of the global crisis. Conversely, the mining sector's export quantities increased by 13.5%, as a result of recovery in the world demand for metals during the first half of the year.

Second, remittances reduced by 9% during the first quarter of 2009, owing to higher unemployment levels observed in developed countries. Third, net capital flows became negative starting from the fourth quarter of 2008, and continued to be negative during the first quarter of 2009. Foreign direct investment (FDI) and portfolio investment flows reduced sharply, owing to political uncertainties, which have had a negative effect on the investment climate.

How has the crisis affected growth, development and poverty? What is the future prospect for recovery?

Despite the severity of the external shocks, the Bolivian economy has not experienced significant macroeconomic disequilibria. During the first quarter of 2009, Bolivia exhibited external and fiscal surpluses of 1.2% and 1.5% of gross domestic product (GDP), respectively. The fiscal balance exhibited a surplus, despite a drop in fiscal revenues and an expansion in expenditures. The government created various bonuses that were transferred to the population, as a means of maintaining consumption of the population and thus the level of aggregate demand. Because of smaller foreign exchange revenues, foreign exchange reserves stopped increasing at the rates seen in previous periods, but did not experienced significant reductions. Reserves have remained at around $8 billion, equivalent to 70% of GDP. During the first eight months of the year, deposits in the financial system increased by 11.9%. On the other hand, lending by the financial system went up, but by only 3.6%. As a result, financial entities accumulated large liquidity reserves. Public external debt, which had been reduced significantly as a result of various debt relief initiatives, remained stable at a relatively low level. The large amount of revenues available to the public sector, especially in the form of hydrocarbon royalties, made it unnecessary for the government to resort to foreign sources of lending. Finally, inflation has been brought down, with the year-on-year inflation rate in August at 1.4%. However, low inflation rates are the result of a much weaker aggregate demand, as a result of the global financial crisis.

Despite these positive macroeconomic indicators, some risks threaten the Bolivian economy, not only as a consequence of the financial crisis, but also as a result of much deeper structural factors. For instance, the Bolivian economy has absorbed in recent months a significant real exchange appreciation. By July, the yearly rate of real exchange appreciation was 6.3%. The Central Bank has pegged the exchange rate, while other commercial partners have devalued their exchange rates.

Moreover, GDP growth has slowed down significantly, not only because of the global financial crisis but also as a result of reduced levels of investment in key activity sectors, such as hydrocarbons and manufacturing. Significant changes in regulation have discouraged investment in the hydrocarbon sector, which in turn has not permitted expansion in the country's oil and natural gas reserves and exports. Lower production capacity in the hydrocarbon sector is likely to undermine the middle- and long-term sustainability of the macroeconomic equilibrium. Furthermore, the loss of preferential access to the US market for manufacturing products under the Andean

Trade Promotion and Drug Eradication Act (ATPDEA) has caused export and job losses. Low investment rates are likely to undermine growth and employment creation in the medium to long term.

At present, the Bolivian economy is characterised by a surplus of domestic savings and a deficit of investment opportunities.

How has Bolivia responded and how should it respond?

As discussed above, the Bolivian economy has acquired in recent years a greater capacity to undertake countercyclical policies in order to ameliorate the negative effects of the global financial crisis. The larger availability of resources in recent years has allowed the government to create a number of bonuses, through which fiscal resources have been transferred to the poorest segment of the population. The government created three types of unconditional transfer to different groups of the population. According to government figures, the cost of these benefits has amounted to $363.9 million (2.27% of GDP), comprising transfers to: the elderly, totalling $267.2 million (1.7% of GDP); schoolchildren, totalling $27.7 million (0.2% of GDP); and pregnant women, totalling $69 million (0.22% of GDP). This policy has had a positive impact in terms of poverty alleviation and of offsetting a contraction in consumption and aggregate demand. However, it cannot be considered a substitute for policies aimed at creating jobs that are sustainable in the long term. Among such job-creating policies is the creation of a more favourable investment climate, which will promote private investment, and a focus on labour-intensive export products. The opening up of larger foreign markets for Bolivian labour-intensive manufacturing exports is also a policy that policymakers should actively promote.

Another shortcoming of the bonus transfer policy concerns its long-term financial sustainability. The payment of benefits depends substantially on hydrocarbon rent. The reduced investment flows observed in the hydrocarbons sector and a potential reduction in international prices for natural gas exports could bring about a substantial reduction in government revenues and thus jeopardise the sustainability of the transfers.

Bolivia has substantially changed its hydrocarbon policy in recent years. First, it increased government take, from 18% of total production to 50%. Moreover, the government nationalised hydrocarbon sector industry, transferring to the Bolivian state the ownership of hydrocarbons reserves. These policies substantially increased government revenues in the short term but have also resulted in diminished investment flows and reduced production and export capacity. To compensate for the negative effects of these policies, the government has undertaken the strengthening of the state-owned oil enterprise YPFB. Recently, YPFB has obtained a long-term credit from the Central Bank amounting to $1 billion, which has resorted to its foreign exchange reserves in order to finance this credit. YPFB will use these funds in drilling activities, in order to expand reserves and export capacity. There are, however, considerable risks involved in this initiative. These drilling activities are very expensive and entail considerable risks of non-success. Furthermore, YPFB lacks the necessary technical capacity to undertake large-scale drilling operations, in terms not only of qualified staff but also of technological endowment.

Cambodia

Hossein Jalilian and Glenda Reyes

An unfortunate turn of events

Cambodia was among the 10 fastest-growing economies in the world prior to the financial mayhem. Its poverty rate saw a significant decline within the decade before the global shock. Now its growth is expected to suffer the steepest decline in developing East Asia and the World Bank expects an absolute increase in the number of poor Khmer people. The crisis hit Cambodia through its second-round onslaught, affecting trade, capital flows and, ultimately, the country's growth engines.

Miracle growth suspended

After growing at an average of 9% per annum in the decade prior to the crisis, Cambodia saw its economic growth skid abruptly to an estimated 6.7% in 2008, as per latest official data. As for 2009, the government has downgraded its growth outlook from 6-2%. Note that government estimates have traditionally differed with estimates of key international institutions. The International Monetary Fund (IMF), World Bank and Economics Institute of Cambodia (EIU), for instance, expect Cambodia's economy to shrink by 0.5%, 1.0% and 3.0%, respectively, this year. The country's estimated 11.2% contraction in output between 2007 and 2009 will be the steepest in developing Asia, according to the World Bank. The deceleration in economic growth has resulted chiefly from the country's growth pillars – garments, tourism and construction – losing much of their steam.

Garments: uniqueness turned vulnerability

After growing remarkably at a decade-average rate of 28% per annum, the country's leading export sector, garments, grew by an estimated 2% in 2008. The global crisis transpiring in a post-garment quota environment has unsurprisingly caused the US market-concentrated, mostly cut, make and trim (CMT) and about 90% foreign-owned garment industry to struggle. Garments' export share actually dropped below 70% in 2008. By March 2009, the year-on-year growth of garments' export value fell to -43%. From averaging $250 million in 2008, export value dropped to an average of $170 million in this year's first quarter. In the same quarter, exports to the US reportedly experienced a year-on-year decline in growth of an alarming 34%. Adverse developments are expected to shrink garment sector output by 2% in 2009, a contraction never before seen in the modern history of Cambodia's garment industry.

Tourism: the inevitable downturn

Likewise, tourism in Cambodia skidded in 2008 after experiencing double-digit growth in the decade prior to the crisis. Year-on-year growth of tourist arrivals was consistently negative by the fourth quarter of 2008, and this decline in arrivals continued well into 2009. The sector is expected to grow by a mere 3.9% this year. Specific factors supporting the growth include the boost in domestic tourism and tourism from Vietnam. Meanwhile, the specific factors eliciting the slowdown include the brunt of the crisis on the country's key tourist markets, South Korea and Japan, the political crisis in Thailand (a major gateway for tourism in Cambodia) and the Thai–Cambodia military standoff along the border. Crisis or no crisis, the tourism sector was arguably headed for an inevitable slowdown. Its rapid growth has been unsustainable, banking mainly as it has on Angkor Wat at the expense of other tourist sites, and on attracting mass tourism as opposed to increasing the value added of its tourist services and products.

Construction: when the bubble burst

The construction sector has been following the same rough road as the other two traditional growth sectors. Already having receded to 5.8% in 2008, from 6.7% in 2007 per official data, the sector's growth is expected to experience even more severe contraction in 2009, by -13%. The slump has been primarily a consequence of the deceleration in foreign direct investment (FDI) inflows and the bursting of the domestic real estate bubble, owing in turn to the credit crunch, declining incomes, low business and consumer confidence and overall gloomy economic prospects. Real estate prices have reportedly slumped by as much as 40% so far in this year while, despite the scrapping of the cap to real estate lending, bank credit to the sector continuously fell, from about 7.8% back

in July 2008 to 6.9% in April 2009. Meanwhile, as elaborated on below, a 50% drop in FDI inflows is expected this year.

Back to balance of payments deficit

For the first time in more than a decade, the country's BoP reportedly registered a deficit of $75 million, or about 0.7% of GDP, in 2008. Further deterioration in the overall external position is expected this year. Underpinning these developments have been the following:

- **Widening then narrowing of trade deficit:** The trade deficit widened by an estimated 31%, or from 15-17% of GDP in 2008 vis-à-vis 2007. This owed to slower export growth and still strong import growth, particularly during the first half of 2008. In 2009, the trade deficit is expected to contract – export growth remains sluggish but import growth is expected to weaken significantly as well. Available data support this. Car and motorcycle imports began their sharp declines by about the third quarter of 2008 and are yet to recover.
- **Slowdown in actual FDI inflows:** After peaking at $866 million in 2007, actual FDI fell to about $800 million in 2008 according to updated data. This drop drew heavily from the sharp slowdown in South Korean investments. The total amount of implemented FDI is expected to fall further, by about 50%, to $390 million this year. Already, FDI inflows suffered from a 60% decline in the first quarter of 2009 relative to the same quarter in 2008.
- **Stable official flows, resilient remittances:** With key donors having reaffirmed their aid pledges back at end-2008 (totalling almost $1 billion), aid flows appear to be on track, although appeals for faster disbursements and improved aid effectiveness have been raised. Despite reported lower remittance inflows, international remittances, including unrecorded, have been expected to be resilient. No significant increments in transfers as seen before are expected, however. Thailand and Malaysia, the top two destinations for Khmer migrant workers, officially closed their doors to new inflows. South Korea, the third top, has announced a reduction in the quota of Khmer workers to be accepted in 2009.

Poverty effects: the human face of the crisis

After successfully reducing the poverty rate from 45% in 1994 to about 30% in 2007, 200,000 people are now expected to join Cambodia's more than 13 million existing poor. Job losses and greater underemployment in the country's crisis-hit growth sectors have certainly hurt the incomes of poor households. The slowdown in the garment sector resulted in 63,000 job losses between September 2008 and March 2009, based on official data. Meanwhile, an estimated 25,000 construction workers have lost their jobs as of April this year. Results of the daily earnings surveys conducted by the Cambodia Development Resource Institute (CDRI) substantiate claims about consequential declines of income across sectors over the period of the crisis. The survey results reveal that 9 out of the 10 surveyed vulnerable worker categories registered a significant fall in average real daily income between 2007 and about August 2009, with garment workers, waitresses and cyclo drivers suffering from the steepest drops, of 31%, 26% and 22%, respectively. Survey results further disclosed significant declines in average real daily consumption in five of the surveyed groups, such declines being the highest for rice field workers, waitresses and garment workers, at 20%, 19% and 16%, respectively. Apart from a decrease in consumption (quantity and quality), focus group discussions conducted by CDRI likewise revealed other trends over the period of the crisis, including increase in labour force participation of household members, increase in debt burden and unabated rural-to-urban migration.

Road to recovery

A modest rebound in growth of between 3% and 4% is foreseen in 2010, given an expected modest rebound in Cambodia's growth sectors, agriculture's stable growth (about 5%) and the remedial measures and reforms implemented by the government.

The latter include the following: expansionary budget – 2009 deficit at about 4.3% of GDP per the Budget Law; garment sector – extension of the profit tax holiday; tourism – re-launching of the national carrier, visa fee waivers and 'Kingdom of Wonder' marketing campaign; construction – scrapping of cap on real estate lending, preparation for foreign ownership of real estate; agriculture – creation of support fund, tax holiday for agricultural investment projects; financial system –

inauguration of the Securities and Exchange Commission and imminent launching of stock exchange, creation of overdraft facility for struggling banks, reserve requirements at 12%; trade – creation of the Trade Development Support Programme, rolling out of the Automated System for Customs Data (ASYCUDA); social safety nets – Government Fund for Short-Term Vocational Training, Fund for Self-Employment, Health Equity Fund, Food Emergency Programme, etc.

Three important lessons that are easy to verbalise but hard to concretise have clearly resounded from Cambodia's experience with the crisis. The first is 'diversify or die' – but how to diversify in the context of Cambodia, where vested interests benefit from the lack of diversification and where protectionist policies, open or subtle, continue to serve as hurdles? For instance, renegotiating the Rules of Origin requirement is a must for the garment sector but, clearly, some measure of international cooperation among competitors is needed to achieve this.

The second lesson relates to agriculture as a stable driver of growth. To be this, agricultural development in Cambodia ultimately needs to be pro-poor, pro-farmer. The crisis has emphasised, for instance, the need to improve price information systems across the country to avoid cheating of farmers ignorant of external developments. This must be acted on.

Third, there is apparently a need for the government to improve its fragmented, aid-dependent and relatively poorly managed social safety net programmes. One other finding of the focus group discussions conducted by CDRI is that no intensification of social safety nets has been generally observed in the past year. Clearly, this is a lapse that must be looked into. It is claimed that the global crisis was triggered by greed at the expense of the poor. On the way to recovery, prioritisation of the vulnerable and the poor is the only fair thing to do.

Democratic Republic of Congo

François Kabuya-Kalala and Danny Cassimon

The impact of the crisis on the DRC

To analyse the impact of the crisis on the DRC, the impacts of other recent shocks that have struck the country have to be taken into consideration. In fact, besides the international shocks commonly described as the 'three Fs' (food, fuel and finance), a fourth internal shock, a new eruption of the conflict in the east, emerged more or less simultaneously with the international financial crisis. Where possible, this last effect must be isolated.

Although the DRC has an open capital account regime with no major capital account restrictions, the country has no high degree of formal *de facto* financial integration in the global financial system: formal cross-border banking links as well as private capital market transactions are limited, and inflows of FDI are still relatively limited, despite an increase in recent years, linked mainly to the development of the mineral sectors. As a consequence, direct transmission of the global financial crisis to the DRC was very limited.

The main impact on the country has been indirect, through the international trade channel. At the outset of the crisis, the DRC had been enjoying several years of substantial growth, fuelled by increased commodity prices and demand for its exports (copper, cobalt, gold, diamond and crude oil, accounting for roughly 80% of total exports). However, lack of diversification made the country very vulnerable to price and global demand shifts and, as the economic crisis hit the country, decreases in both global demand and world prices negatively affected the balance of payments (BoP) in a severe way. Comparing International Monetary Fund (IMF) pre-crisis forecasts with more recent ones provides some idea of the BoP cost of the crisis: exports reduced by about $0.5 billion in 2008 and by $3.7 billion in 2009. On the import side, in contrast, the crisis has been transmitted through decreased world prices of refined oil. IMF estimates show for 2008 an increase of imports of $0.5 billion, owing most likely to the crisis in the east of the country. For 2009 a decrease of $2.4 billion is estimated.

Remittances are estimated to have decreased by 13% in 2008 compared with 2007; they are projected to stay at about the same level for 2009. Inward foreign direct investment (FDI), mainly towards the mining industry, boomed in the recent past owing to rapidly rising commodity prices. As these declined, mining investment flows decreased quickly. While FDI still increased in the first half of 2008, owing to promising price increases, the year closed 4.4% lower than 2007. For 2009, the IMF expects the trend of the second half of 2008 to continue, with FDI going further down, by 64% compared with 2008. Finally, aid levels are estimated to be higher than before the crisis: $1 billion for 2008 and $950 million for 2009, owing most likely to the crisis in the east and the reaction of the international community to the crisis (exceptional, emergency aid). Overall, these different trends have worsened the deficit of the current account and the overall BoP.

The crisis has also seriously impacted the level of international reserves. While the reserves were already structurally low before the crisis, less than two weeks of imports at their peak in 2008, the financial crisis has worsened the situation: since September 2008 foreign exchange reserves have nearly evaporated, to a few days of imports at the end of March 2009. This owed mainly to the economic crisis and the deteriorating trade balance of trade, but also to increased spending related to the security situation in the east. A coordinated emergency response of the international community, led by an IMF intervention through the Exogenous Shocks Facility, put a halt to this extremely dangerous evolution.

The revival of the Congolese economy after the stabilisation of the country in 2002 relied heavily on the mining sector. Growth figures therefore closely mirror the evolution in this sector (and related sectors) and have been repeatedly revised downwards as the crisis has evolved. While the IMF still foresaw a growth rate of 10% for 2008 and 10.3% for 2009 before the crisis, growth for 2008 was finally established at 5.9% for 2008 and revised to 2.7% for 2009. As such, the gross

domestic product (GDP) cost to the country can be established at around 4.1% of 2008 GDP and 7.3% of 2009 GDP.

All these effects have severe negative effects on the government budget, as revenues are heavily dependent on the mining and oil producer sectors. At the same time, the security and humanitarian crisis in the east of the country put an enormous pressure on the expenditure side. These evolutions led to large fiscal deficits starting from September 2008 onwards, with a gap of $134 million over the last months of 2008. During the first seven months of 2009, government revenues continued to be below expectations and expenditure commitments high relative to the available resources. Rationalising expenditures, holding strictly to cash-based budgeting and tight monetary policy, will remain of prime importance.

The DRC economy is largely dollar based, with 85% of bank deposits and 49% of broad money denominated in dollars. Exchange rate trends between the US dollar and the Congolese franc therefore greatly influence the country's economic activity and inflation. Inflation shows a 'twin peaks' profile over 2008-2009. Between April and July 2008, inflation showed a first increase, owing partly to the international food crisis (imported inflation). During this first peak, changes in the exchange rate did not impact on the inflation rate. From November 2008 onwards, a second surge of inflation emerged. This time, monetary financing of the budget deficit as well as a depreciation of the exchange rate put pressure on domestic prices. For the whole of 2008, inflation was estimated at 27.6%. For 2009, the latest projections of the IMF estimate inflation at 31%.

As such, the global financial crisis is transmitted to household income and poverty across the board mainly through the price channel (inflation). On top of that, specific groups were hit in a specific way, namely those that are active in the sectors most affected (especially mining). Although no accurate estimates are available up to now, anecdotal evidence clearly shows a significant negative impact on household consumption, especially in Kinshasa as well as in mining areas.

Government response to the crisis

In response to the financial crisis the government has taken a number of short-term fiscal, monetary and exchange rate measures. Owing to limited means, the authorities had to limit these interventions to anti-cyclical measures trying to stabilise the economy, like cash-based budgeting, focusing spending on expenditures that prop up domestic demand, increasing the central bank policy rate, etc. To mitigate the short-term impact of the crisis on its citizens, the Congolese authorities lack resources and are therefore dependent on donor money. The donor reaction focused on two intervention levels. On the one side, a number of donors, mainly multilateral, have provided macro-level emergency BoP support and budgetary support to ensure macroeconomic stability, the import of necessary goods and the functioning of minimal public services. A second bunch of interventions provided earmarked micro-level support to ensure safety nets for the population. These are mainly highly labour-intensive public works, such as road building, that tackle at the same time the pressing infrastructural constraints of the Congolese economy.

To create additional fiscal space in the short and medium term, the government prioritises normalising its relations with the international community, through the conclusion of an IMF Poverty Reduction and Growth Facility (PRGF) programme. To achieve this, the government restarted discussions with the IMF in mid-March 2009 to conclude a new three-year programme. The last IMF mission, visiting the county in mid-August 2009, gave its discharge to conclude a triennial programme supported by the PRGF. The main precondition to retroactively start the programme on 1 July 2009 was the finalisation of negotiations with its Chinese partner to amend the Sino-Congolese Cooperation Agreement, including the removal of the government guarantee on the mining component. When these amendments are consistent with debt sustainability, the Congolese authorities can seek financing assurances for their programme from Paris Club creditors and the IMF Executive Board can finally approve the programme, probably in September 2009. If the country can stay on track, this might also enable the country to reach the Enhanced Heavily Indebted Poor Countries (E-HIPC) Initiative Completion Point by mid-2010, securing additional fiscal space.

In the longer term, the government is trying to make serious work of the implementation of a long-term development strategy. While the first poverty reduction strategy paper (PRSP) was certainly overambitious and unrealistic, the formulation of the second could provide a good opportunity for rethinking and prioritising a long-term development strategy and aligning the strategy to the (multi-) annual budget cycle. Economic diversification, whereby more attention should be paid to the agriculture sector, constituting about half of the country's GDP, should be a prime focus of this strategy, together with an improvement of the overall business environment. This is again done in close cooperation with the donor community.

Kenya

Francis M. Mwega

This paper updates and extends a recent case study on the impact of the global financial crisis on Kenya.

Kenya's banking system

Banks continue to meet the (four) minimum capital requirements, even though the excess amounts and ratios vary from one bank to another. The rate of return on assets (ROA) showed some decline in 2008 (4.03%) from 2007 (4.11%). The non-performing loans/assets ratio declined further in 2008 (4.02%) compared with 2007 (4.29%). The share of foreign banks (40% of core capital) did not change. Similarly, there was no significant change in the asset portfolios of the commercial banks in Kenya in terms of credit and other assets.

The banking system seems poised to withstand the global financial and economic crisis, unless overcome by pure contagion, as the fundamentals seem quite sound. However, financial statements for the first half of 2009 show a substantial decline in banks' profitability.

Capital flows

Capital market

The data show some recovery in the NSE 20-share Index (and market capitalisation) since February 2009. The 2009/10 budget imposed the requirement that stockbrokers and investment banks publish their semi-annual and annual financial statements. The statements for the first half of 2009 show that these institutions made substantial losses, putting a question mark over their ability to survive if these conditions continue.

Foreign direct Investment

FDI was slightly higher in 2008 than 2007.

Remittances

Data for the first six months of 2009 show a decline in remittances compared with the same period in 2008, from a total for the six months of $329,551,000 in 2008 to $291,922,000 in 2009.

Foreign aid

Net official flows to Kenya in September-November 2008 were below those of the corresponding period in 2007, reversing the pattern earlier in the year, although it is not clear to what extent this may be attributed to the global financial crisis.

Trade effects

Tourism

In 2008, the sector suffered a major blow as a result of the post-election violence, increased oil prices and, more recently, the global financial crisis. As a result, there was a decline in tourist arrivals and earnings by 33.8% and 19.8%, respectively, in 2008.

Commodity exports

Commentators have mainly focused on a few products: tea; horticulture, especially cut flowers; and, to a lesser extent, coffee. These are Kenya's main individual commodity exports.

In 2008, Kenya exported 390 metric tonnes of tea, an increase of 5.4% over 2007. Tea prices also increased by 29.4%, increasing the value of exports by 36.2%. Tea exports are expected to decline in 2009 owing to the drought in the country, which may reduce production.

Data show a similar pattern in horticulture. Kenya exported 41.5 metric tonnes of horticultural products at a price of Ksh 17.2, an increase of 4.5% and 20.3%, respectively, over 2007, increasing the value of exports by 24.6%.

The quantity of coffee exports declined by 25.5% in 2008, but was offset by an increase in coffee prices of 29.1%, so that export values remained roughly constant.

Overall, at the aggregate level, quantity and price indices increased in 2008, by 23.9% and 18.9%, respectively, with terms of trade improving by 10%.

Sudan

Madani M. Ahmed

Key issues

- Sudan is increasingly becoming dependent on oil revenues and exports earnings: 63% and 95%, respectively, in 2008.
- This oil dependency is threatening budget credibility to deliver services and endangers budgetary allocations and resource distribution to different tiers of government.
- Recently, the degree of openness has been rising, amounting to 42% in 2007, making the economy more prone to external shocks.
- Sharp decline in oil exports' revenues, falling remittances and slowing foreign direct investment (FDI) have caused deficits in the trade balance, current account and balance of payments (BoP). They have also caused a fall in economic growth (in the range of 4-6%) relative to the previously higher average achieved for 2000-2007 (of more than 8%).
- Declining oil revenue has been seriously reducing government fiscal ability to transfer resources to the Government of Southern Sudan (GOSS) and sub-national governments.
- More reliable transfers are critically needed to sustain service delivery, social and economic development; contribute to peace and stability; and reduce conflict in the country.
- Pegging the SDG on the dollar and then onto the euro has been depreciating its value and inducing inflationary pressure.

Impact on the external sector

The sudden upsurge of oil prices in 2007-2008, from below $50 per barrel to a record high of $147 per barrel in early 2008, has helped the country increase its export returns enormously and finance the purchase of a continuously expanding level of imports. In response to the rapid rate of growth in gross domestic product (GDP), more and more imports are being used in capital sectors. The high percentage ratio of capital goods to total imports reflects the rising demand for imports created by the rapidly growing oil, construction and service sectors. The crisis has resulted in falling exports and worsening of the trade balance, current account and BoP positions.

The Economist Intelligence Unit (EIU) has estimated that the global crisis will lower the value of imports and exports by 19% and 32%, respectively, in 2009-2010. The trade balance will experience a deficit of $683 in 2009 and a small surplus of $1.1 billion in 2010 because of higher oil prices. On the other hand, the current account deficit is expected to increase to an average of $2.9 billion (5.5% of GDP in 2009-2010). Workers' remittances are expected to decline. Financing of the deficit is going to be difficult from external sources, and government will most likely cut down on imports. Meanwhile, foreign aid is expected to decline sharply. In May 2008, donors promised to give $4.9 billion via the Multi-Donor Trust Fund (MDTF) in aid, but it is doubtful that this will materialise, owing to the Darfur problem and government expulsion of some international non-governmental organisations in 2009.

Impact on foreign direct investment

The country has suffered from mounting external debt problems, with staggering debt burden indicators. The magnitude of Sudanese debt amounted to $15.3 billion in 1990, $19.4 billion in 1996, $28.2 billion in 2006, $31 billion in 2007 and $34 billion in 2008. Debt sustainability is difficult to achieve given the economic and political situation, both locally and globally.

As a result, the Sudan's creditworthiness has been seriously damaged, and the flow of private foreign investment and aid virtually stopped for the period from 1990-1995. FDI declined to zero during the same period, but increased slowly in 1996 to reach $138.9 million, rising to $392 million in 2000, increased to $574 million in 2001 (a rate of growth of 46.4%), climbed sharply to $713 million in 2002 and nearly doubled in 2003, scoring $1,349 million (a rate of growth of 89.2% in 2002-2003). It further rose to $1,511 million in 2004 and then hit a record high of $2,304 million in 2005 (with an increase of 52.5% in 2004-2005).

Investment has been growing annually, on average, at 82.3% for 2000-2005, making the Sudan one of the highest foreign investment receiving countries in the Arab world in the period. Foreign investment has been going mainly to the oil, agriculture, construction and transportation sectors. In 2006, more efforts were being made to attract Arab investors, especially from the Gulf States, in the areas of banking, oil, energy, agriculture, industry, infrastructure and other sectors.

The reason for the upsurge in FDI from 2000-2006 was the ability of the government to establish strong strategic partnerships with China, Malaysia and India and to renew its economic relationship with most of the Arab funds and governments, convincing them to invest in strategic infrastructure projects. FDI increased from $5 billion in 2007 to more than $7 billion in 2008. Some Arab governments invested in agricultural projects to produce wheat, maize, vegetables, fruits and fodder in the River Nile, White Nile, Sinnar and Blue Nile States.

Positive results of Arab investment are endangered by the sharp decline in oil prices, with a number of negative factors working against such investment. As such, the decline has created a credit crunch, forcing investors to keep their portfolios in their own countries to finance liquidity needs. A reduction in the financial surplus and depletion of foreign reserves will make the Sudan less able to borrow and repay its debts, decrease its creditworthiness and create an unfavourable environment for investors, as risk and uncertainty rise and the prospects for profit making decline.

The impact of the global crisis on the stock market

The impact of the crisis on the Sudan has been and will be limited in its effect because of the small number of transactions and limited size of the Sudanese stock market, which has no direct link to regional or international stock and financial markets. There are also no foreign investors in the local stock market. However, a narrow window through which the Sudan may be affected lies in the few companies that are registered in both the Sudanese and the Gulf States' stock markets. The Gulf stock markets have been severely impacted, and unofficial estimates put the losses at as high as 65% of their market value. The Sudanese telecommunications company SUATEL is registered in Sudan and in the Gulf stock markets. The price of its shares will go down because of the crisis. Only a few Sudanese banks are registered in the Gulf, but these will also be negatively affected.

Impact on the fiscal sector

Since 2000, the central government's budget has started to depend increasingly on oil revenues as its main source of financing for service delivery and development, as well other administrative, security and military activities. In 2007-2009, oil revenues comprised on average more than 60% of total revenues. The remaining less than 40% comes mainly from indirect taxes and customs, with a small share from direct taxes and from sales generated by privatised institutions.

Because of oil exports, the share of revenues in GDP has increased steadily, from 15.8% in 2001 to 22.8% in 2008. The World Bank predicts that the ratio of revenues to GDP will decline to 20% in 2010 and 18% in 2012; expenditures will decline from 23% in 2008 to 19.3% in 2009 and reach even lower levels in 2010. A sharp decline in budget revenues, especially from oil, will have disastrous effects on the budget and economy. Government ability to secure funding to improve living standards and finance and implement development projects will be seriously jeopardised. Women and children are likely to be hit hardest by the crisis and the soaring food prices, and are most exposed to economic downturn, fall in the growth rate and cuts in government spending.

The greatest negative effect will be felt by GOSS, which depends entirely on the central government transfer of oil revenues (oil receipts constitute almost all budget revenues). GOSS will be unable to compensate for the sharp drop in oil revenues, causing serious political tensions among salaried workers (who constitute more than 80% of current spending), fostering insecurity and an environment of conflict. In other words, there is a grave threat to the Comprehensive Peace Agreement (CPA) and the Abuja and Asmara Peace Agreements.

Impact on resource distribution among tiers of government

With the implementation of the CPA, more resources have been transferred to the Southern and Northern States from the National Revenue Fund. In 2005, the first year of the CPA, transfers to

GOSS amounted to more than 13% of total federal government revenues, while the Northern States received slightly more than 23% and the federal government 64% of total revenues. In 2007, more resources were transferred to the Northern States and Southern Sudan, amounting to 44%, whereas the federal government's share declined to 54% of total revenues

Sustaining peace is the fundamental requirement for solving social, economic and political problems. Transfers can help in reducing the vulnerability of the poor to diseases, unemployment, natural disasters, economic crisis, harvest failures, hunger disability and maternal and infant mortality. Reducing the risk of epidemics via public health programmes should be a top priority, in addition to the construction of dams to reduce the risk of flooding. However, transfer hopes have been shattered by the sharp decline in oil revenues caused by the global financial crisis.

Prospects for economic growth in the future

The World Bank has predicted that Sudanese oil revenues will decline to about $80 per barrel in the medium term and $70 per barrel in the long term, slowing economic growth from a record high of 10.2% in 2007 to 8.5% in 2008, 7.7% in 2009 and 5.5% in 2012. The 2008 budget predicts that the GDP growth rate will be about 6%, even lower than World Bank projections. The EIU forecasts that, owing to global economic pressures and domestic problems, real GDP growth will shrink to an average of 3.1% in 2009/10 (lower than World Bank estimates).

Indeed, there is a great danger that the Sudan will not be able to achieve high growth rates in the future owing to a decline in oil revenues, affecting the central budget's service delivery projects. A sharp decline in oil prices will reduce export earnings and affect the flow of investment, which has traditionally used oil revenues as an incentive to encourage development activities in the country, resulting in a slowdown in the anticipated growth in foreign investment.

The greatest effect on the growth rate of the real economy will be seen in the unemployment rate of graduates and unskilled labourers in the rain-fed agricultural areas of the Sudan. The drop in GDP growth rates, coupled with a decline of investment in the economy, will cause a rise in both unemployment and poverty levels.

Impact on the monetary sector and the economy

A sharp decline in oil revenues (about 68-70%) has reduced the volume of inflows of hard currencies to the Sudan, resulting in foreign currency deficiency. The shortage of reserve currencies has also been exerting strong pressure on the Sudanese currency to fall (the SDG fell by 20-30% in 2009), making imports more expensive. Falling growth rates and production, rising tax burden and increased deficit financing owing to declining oil revenues will all cause a downward economic spiral and an extremely volatile monetary situation.

Meanwhile, the Sudan, fearing both US economic sanctions and the loss of banking deposits and transactions in US dollars, decided to peg its local currency to the euro. However, many Sudanese bank holdings' have depreciated as the value of the euro has fallen sharply, owing to the deep recession that has affected the euro region.

More inflationary effects expected

Historically, governments in the Sudan do not have a good record of being willing or able to curb public expenditure, for obvious political, security, social and economic reasons, with reliable systems not functioning properly in many tiers of government. Fiscal discipline and prudence are not easily attainable from the expenditures side, and the failure to mobilise revenues through sound tax generation and management will require institutional reforms and a substantial capacity-building effort, which will take time to expedite. The result will be an increasing budget deficit arising from an expansionary fiscal policy, adding inflationary pressure on the money supply and nationwide banking system.

International Monetary Fund (IMF) figures show that consumer price inflation averaged 16% in 2008. Depreciation of the SDG is expected to fuel imported inflation. In 2010, government spending is expected to increase by 20%, as a result of elections and security spending. The

combined effects of increased deficit financing, expanding government spending and SDG depreciation will all push up inflationary pressures.

Government response

The initial response of the government to the global crisis was slow and apologetic, and almost denied any possible negative effects on the economy. According to the IMF in 2009, the slow response of the government to the sharp oil reduction, especially the slow adoption of a flexible exchange rate policy and inability to tighten and quickly prioritise government spending, has contributed to macroeconomic instability and led to the deterioration of foreign currency reserves.

The government continued in the same manner until June 2009, when the Minister of Finance and National Economy and the Governor of the Sudan Central Bank jointly wrote a letter of intent to the IMF, mentioning that the Sudan was affected by the global crisis and that the country would like to have IMF help to deal with the impacts. The IMF staff team prepared a staff-monitored programme for 2009-2010, with the main emphasis on sustaining economic growth, maintaining macroeconomic stability and building foreign exchange reserves, as requested by the Ministry.

On the fiscal side, and in the face of sharply falling budget revenues, the Ministry hastily raised VAT to 15% (from 10% in 2000 and 12% in 2006), scaled up customs rates on some imported goods and increased indirect taxes on luxury goods, cigarettes and other products in 2009. However, the Central Bank of the Sudan has been more proactive and realistic, announcing monetary policy to reform the banking system, improve banking supervision, restructure and raise banks' capital and deal with the problem of the high non-performing loan ratio (in some banks reaching 26%, with an overall average of 20%).

Tanzania

Hoseana Bohela Lunogelo

The country's economic context

For about 10 years, Tanzania was among those sub-Saharan economies performing above the continent average economic growth rate and controlled inflation rate, before the effects of rising fuel and food prices and later the global crisis arrested this positive record. The country has also sustained stable and peaceful transformations from a centrally controlled economy and one-party rule to a market-determined economy and pluralistic democratic system. With growth projected at less than 5% in 2009 (compared with historical levels of above 7% per annum) and an inflation rate of about 10% (compared with below 6% in previous years), Tanzania is faced with multiple challenges of insulating itself from the crisis and preventing the erosion of gains made in social and economic spheres. The current efforts have to be translated into solving both supply- and demand-side constraints for the economy to have the required impetus to deliver optimum income generation and distribution. Sustained success is necessary for the country to achieve the Millennium Development Goals (MDGs) by 2015 and targets of a middle-income industrial economy between 2020 and 2025. Despite recent problems, the country has enough foreign exchange stock held by government, individuals and banks to support five to six months of imports.

Transmission mechanisms to Tanzania

A multi-stakeholder national conference was organised by government in early 2009 to assess the impact of the crisis and chart out mitigation plans. This identified impacts through: 1) export trade from Tanzania to the US, Europe and Asia in commodities, as exporters experience reduced demand for goods: raw (e.g. cotton, tanzanite) and finished (e.g. knitted garments) and services, through reduced demand for tourist attractions and education facilities, for example; 2) import trade from the rest of the world: erratic and escalating importation costs of goods and services; 3) reduced capital inflows (foreign direct investment (FDI)), including diaspora remittances; 4) reduced bank lending and other bank transactions owing to reduced business; and 5) exchange rate and interest rate changes.

Among the effects in export trade have been both reduced demand and declining markets for traditional agricultural commodities such as cotton (more than 130,000 bales of cotton lacked a market early this year). Equally affected were companies and cooperatives. The manufacturing sector recorded a drop in export revenue of about 50%, mostly cancelled apparel orders to the US. Tourism was affected by a 30-40% decline in sales. The mineral sector suffered a blow as the price of tanzanite fell by about 80%, prompting a freeze in its sales. Revenue collection was projected to fall short of the fiscal year plan by 10%, equivalent to TZS 0.473 trillion ($0.353 billion). FDI was affected, as evidenced by the delayed or scaling-down in or withdrawal of new investments. The major source of foreign investment in Tanzania continues to be the UK, followed by Kenya, South Africa and India.

Banking/ financial system and weakened international trading system

One of the major consequences of the failed banking and financial system in developed economies is tightening of lending rules and therefore narrowed access path and raised rates of borrowing by both Tanzanian and wholly or partially foreign-owned financial institutions in Tanzania, mostly affecting wholesale banking involving large long investment projects. The government has also postponed plans to use sovereign bonds for financing infrastructural projects, which had been identified as critical for stimulating pro-poor growth. The increased cost of borrowing has also affected export and import trade. By March 2009, CRDB Bank alone had suffered defaulted repayment worth TZS 168 billion. The global financial crisis provided a reason for further postponement in liberalising the capital account.

Shielding factors

The partial shielding is manifested through: 1) the low level of integration with the international capital and financial markets, whereby the foreign asset component in the commercial bank system is less than 11% of total commercial bank assets in Tanzania; and 2) ensuring that

commercial banks in Tanzania are licensed, regulated and supervised under Tanzanian law, meaning they are not operating as branches of parent banks abroad but as independent subsidiaries. These factors have helped delay the impact of the first round, especially the fact that most businesses and banks had limited amounts of foreign borrowing and none held securities in the international banks that were affected by the crisis.

Impacts for different sectors of the economy

The Tanzania Investment Centre reported a 30% decline in the value of new investment projects applied during the first half of 2009. The country received $750 million in FDI in 2008, compared with $600 million recorded in 2007. Agriculture was the most vulnerable sector, followed by tourism and mining. On the other hand, while traders of traditional export commodities (e.g. cotton) had severe loan repayment problems, exporters of non-traditional crops (e.g. cashew nuts and simsim) managed to repay 74% and 68% of their loans, respectively. The decline in horticultural products export orders by 30% threatened the jobs of 50,000 Tanzanians already employed and earning Tanzania about $130,000 annually.

Domestic financial crisis mitigating actions

Tanzania's government response included a homemade rescue package of $1.23 billion (TZS 1.7 trillion) included in its 2009/10 budget, which included time-bound support to the banking sector and a hastened approach to reduce supply- and demand-side constraints to production, value addition and export trade. Priorities include sustaining investment in infrastructure development (roads, irrigation) and farmer income stabilisation (via enabled marketing coops/companies). By August 2009, some $6.85 million (TZS 21.9 billion) had been used to bail out companies through loan guarantees. Other strategies include recapitalisation of the Tanzania Investment Bank (with plans for an agriculture sector investment lending window) and maintaining fertiliser subsidy levels (to offset tripled world market prices). International support has come from the G-20 (which had promised to provide an additional $220 million to the government's rescue package), the International Monetary Fund (IMF) (for foreign reserve stabilisation) and the African Development Bank (AfDB) and the Chinese and US governments for agriculture and infrastructure development. The objective of the package is to ensure that the economic gains made during the past 10 years are not drastically eroded. In light of the urgency under which the country had to come up with solutions, it is difficult to say whether there would have been a better system to address the crisis, but what is obvious is that there was delayed action to institute measures to streamline government expenditure (e.g. purchase and use of luxury vehicles, encouraging use of locally made goods and redirecting input subsidy funds to public infrastructural goods as a way of solving supply constraints in rural areas).

Conclusion

One of the anchors of Tanzania's economic stability and resilience to the crisis will be to continue with pro-poor growth strategies, enhanced management of macroeconomic variables, prudent management of the banking and financial sector and mobilising domestic and international support to mitigate crisis impacts. This will entail maintaining fiscal stability via both revenue mobilisation and prudent expenditure management, and controlling the money supply to meet inflation and economic growth targets, as well as maintaining an adequate level of foreign exchange reserves. In the short and medium term, alleviating the critical infrastructure constraints in the transport, communications and energy sectors and establishing a mechanism for translating economic growth into broad-based poverty reduction are crucial. Equally important will be to sustain the credibility of both public and private sectors in good governance and improving the environment for doing business within the country and with the outside world.

The next stage of this work will be to analyse the various impact transmission mechanisms and provide an update on how the economy has been affected by the financial crisis and the responses by government and private sector.

Uganda

Sarah Ssewanyana

Introduction

Uganda has not been spared the second-round effects of the economic crisis, such as reduction in financial inflows like remittances, foreign direct investment (FDI) and official development assistance (ODA), as well as reductions in international demand for traditional exports such as cotton, tea and coffee. There are indications of a slowdown in the economy by 2 percentage points compared with the last financial year. However, the slowdown has been much less severe than that in other sub-Saharan African countries, and the government is already putting in place efforts to mitigate both social and economic impacts of the crisis.

Visible effects of the crisis so far

Private inflows have significantly declined. FDI declined owing to difficulties in raising capital and to foreign firms moving inwards to solve domestic challenges. The level of remittances into the country declined by 24% in fiscal year 2008/09. The value of ODA, in the form of budget and project support, increased in 2008/09 after a particularly low point in 2007/08. However, inflows to non-governmental organisations declined by 5.3% between 2007 and 2008, with the decline more pronounced since October 2008.

The aggregate impact of the decline in these income and capital inflows was a deterioration of the balance of payments (BoP) and a depreciation of the Uganda shilling against the dollar and an increase in domestic interest rates. The Uganda shilling depreciated by nearly 22.5% between September 2008 and March 2009 compared with an appreciation of 4.4% in the corresponding period a year before. A weaker shilling has put more pressure on domestic prices, resulting in higher inflation because of an increase in the price of imports, especially when coupled with the pressure on food prices in the East African region.

The crisis has indirectly affected Uganda's financial markets, despite the minimal involvement of Uganda's banks in trading complex securities. There has been a drop in demand for government securities as investors retreat to safer destinations like the US. For example, the Bank of Uganda had to suspend a number of Treasury bill auctions in the first quarter of 2009. This has had spillover effects on the stock market, resulting in, for example, the All Share Index of the Uganda Stock Exchange falling by 29.4% over the period September 2008 to February 2009, compared with an increase of 4.4% in the same period in the previous financial year. It should be understood that, even if the number of foreign investors exiting the market appears small, most of them are large institutional investors, which cumulatively might add up to a big capital withdrawal. There has since been a slight rally, with the index gaining some ground between February and April 2009, but this seems to have been short-lived: it retreated again in May 2009.

There has been a marked reduction in exports growth in 2008 and 2009 compared with 2007, signifying one effect of the crisis. Uganda's exports growth fell by 10.3% in September 2008 compared with a year earlier, with sharp declines continuing through May 2009, with only a slight increase between February and March 2009. But impacts differ between exports destined for international markets (traditional exports such as coffee and cotton and non-traditional exports like fish and flowers) and regional-bound exports (food products like cereals and pulses). For example, the performance of the coffee sector, which contributes nearly 20% of total exports, and with market mainly in Europe, worst-hit by the crisis after the US, has gone down. The value of coffee exports fell by 35% in March 2009 compared with a year earlier, with declines explained largely by the drop in export price than by changes in volumes.

On the other hand, regional trade, especially in non-traditional exports such as maize, beans and cement, etc, has cushioned Uganda from the adverse effects of the crisis. Indeed, in the last quarter of 2008, Uganda witnessed significant increases in non-traditional exports, owing partly to relatively higher food prices. Exports to the regional market accounted for about 45% of all of Uganda's foreign trade. However, regional trade is mainly in food crops like maize, beans and

other produce which do not usually go to the international market and whose prices have been resilient to the global slump. For example, growth of exports of maize and beans continued to increase from 2007 through to 2009, even as the economic crisis became more severe.

The crisis has had a major impact on revenue collection. High import prices and reduced business activity owing to increased cost of doing business have resulted in poor performance in tax revenue collection, which has suffered a significant shortfall. Overall, revenue collection fell by 12.8% in July-December 2008 compared with the same period in 2007. Other contributory factors include low local demand and expansion plans by companies in telecommunications and manufacturing (beer and clay) to name a few, with the main impact on corporate tax and VAT. The fall in revenue coupled with potential reductions in revenue will potentially result in a deficit estimated at UGX2.2 trillion (about a quarter of government expenditure).

What has been the outcome of the above visible effects? The impact on the real economy of the crisis has so far been rather benign. The Ugandan economy grew less fast in FY2008/09 than the 9% recorded for the previous fiscal year but quite robust compared with the sub-Saharan Africa average of just 2.4%.

Future effects of the crisis on the Ugandan economy

We identify three main channels through which the financial crisis is impacting the Ugandan economy. These include: 1) reduction in foreign financial inflows, including aid, grants, FDI and remittances; 2) reduced demand for exports of major cash crops and non-traditional exports like flowers; and 3) increasing food prices within the region, which have partly cushioned Uganda against the crisis.

Overall, we find that the economy will contract by about 0.4% annually on average during 2008-2010. This reduction in growth is more pronounced in 2009, with a slow recovery thereafter. The decline is driven mainly by the manufacturing and agriculture sectors. The overall decline in the manufacturing sector is estimated at 1% on average, driven by low production in non-food processing, which depends on imported raw materials. The agriculture sector will decline by 1.5%. The larger reduction will come mainly from traditional and non-traditional exports, given declines in prices and demand in international markets. Lastly, we also observe a reduction in trade within the services sector, owing largely to the depreciation, which has increased the cost of imports.

Government response so far

The expansionary fiscal policy response, which started in FY2008/09, remains in place, with increased funding to agriculture and energy. There have been no increases in tax rates. Instead, the government intends to strengthen its tax revenue administration. There is also a strategic move to focus on regional trade, which is said to have cushioned Uganda from the adverse effects of the crisis. Supervision of the financial sector has been strengthened and there are also efforts to put in place social protection interventions for vulnerable groups.

Zambia

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The adverse impact of the global financial crisis and recession on Zambia was first observed during the third quarter of 2008. The major impact was through the trade channel. The impact produced macroeconomic imbalances. This resulted in rising interest rates, depreciation of the kwacha against the major currencies, inflation and falling stock market prices. In addition, most exporters, especially the mines, scaled down their investments and cut production. Some units were closed, resulting in massive job losses. The major exporting sectors, such as mining and tourism, were adversely affected. On the whole, the crisis threatened the country's growth prospects, reversing the gains that had been made during the previous eight years. The ultimate effect was to threaten efforts at the eradication of poverty.

There are indications that the global recession is easing in most industrialised countries. However, there is still a need to continuously monitor the impact and response of the economy to the crisis, to provide a systematic overview of what has happened recently and what is happening as a result of the global crisis and recession. Monitoring is achieved through analysis of its impact on the key transmission mechanisms: trade, official development assistance (ODA), private capital flows and remittances. This paper covers January-July 2009, depending on data availability. On the whole, the overall effects of the crisis during the first and second quarters of 2009 have been highly mixed. Some of the macroeconomic fundamentals are showing signs of improvement, but the government fiscal position has continued to deteriorate. Some of these effects are discussed below.

Financial sector

The first-round effects in Zambia were felt first in the trade sector, following the sudden collapse in copper prices. Financial institutions remained largely unaffected during the last quarter of 2008. During the period under review, the overall financial performance and condition of the banking sector remained satisfactory. The banks were fundamentally sound and the sector remained a major recipient of foreign direct investment (FDI). Two new banks were registered and two banks that were registered during the last quarter of 2008, when the crisis was first felt, started their operations during the first and second quarter of 2009.

Credit crunch

Despite this, the level of non-performing loans (NPLs) increased from 8.8% during the first quarter to 10.4% during the second quarter in 2009. The weighted lending rate continued to deteriorate. The lending base rate increased from 20.9% in March to 22.4% in June. The increase in interest rates was accompanied by reduced growth in domestic credit, slowing from a 36% increase during the second half of 2008 to a 5.4% increase during the first and second quarters of 2009. Private sector credit growth declined to 4.2% during the first and second quarters from the 26.2% recorded in the second half of 2008, contributing 3.3 percentage points to domestic credit, while net claims on central government grew by 9.7% compared with the 88.0% recorded in the second half of 2008, and contributed 2.1 percentage points to domestic credit growth.

Exchange rates

The depreciation of the kwacha against major currencies, which started during the second half of 2008, continued into the first four months of 2009. The value of the kwacha was under pressure from a number of developments in the economy. These comprised demand for food imports, servicing the financing facility for oil procurement and the widening current account deficit. The kwacha began to recover during the second quarter. This can be attributed partially to improvements in the export of copper as a result of increasing copper prices on the global market and the open market operations initiated by the monetary authorities.

Inflation rate

Overall inflation trended downwards during the first quarter of 2009. The decline was driven mainly by the fall in food inflation as a result of government intervention through the subsidisation of food during the last quarter of 2008 and increased supply of maize during the period under review.

Inflation remained slightly higher because marginal gains in food inflation were offset by the increase in non-food inflation arising from the pass-through effects of the exchange rate depreciation.

Stock market and price index
Trading activities on the Lusaka Stock Exchange during the period under review continued to reflect the effects of the global financial crisis. The All Share Index recorded a decline, particularly in the first part of the review period, from 2,505.9 to 2,143.4 in April 2009, before recovering to 2,744.6 at end-June 2009. However, there were some positive gains in market capitalisation in May and June 2009. This can be attributed mainly to the increase in investor confidence in the Zambian economy and the stock market in particular. The Lusaka Stock Exchange recorded a $65 million increase in market capitalisation between January and June 2009. Market capitalisation increased from $3,837 million in January to about $3,902 million in June.

Private capital flows

Foreign direct investment
Most of the FDI in Zambia is concentrated in the mining sector. During the period under review, the country had new investment in the sector. The mines that were closed during the last quarter of 2008 as a result of the global recession were acquired by new investors, which have since started or are about to start operations. The reopened mines have absorbed some of the workers who lost their jobs before. In addition, FDI has continued to flow into the manufacturing and banking sectors. While FDI in the banking sector is largely from within Africa, most of the investment in mines and manufacturing is from Asia.

Foreign portfolio investment
There is still a net outflow of portfolio investment on the stock market, but this is now showing signs of reversal. Confidence in the stock market can be demonstrated by the recent rights offer for Zambia Sugar PLC, which was very successful.

Trade
The crisis has continued to impact negatively on Zambia's trade. Generally, trade has slowed, affected by the crisis in two ways. First, the declining trend in the level of exports observed during the last half of 2008 continued during the first half of 2009. On the whole, exports earnings declined by 25.8% in the first half of 2009 compared with performance in the second half of 2008. This owed to the decline in earnings for both metal and non-traditional exports. Total exports, which amounted to $2,144.7 million during the second half of 2008, declined to $1,728 million during the first half of 2009. Compared with the first half of 2008, total exports in the first half of 2009 represented 63% of total exports during the first half of 2008.

However, production of copper, Zambia's major export, increased by 15.7% in the first half of 2009 from the 26.4% decline recorded in the second half of 2008. While imports rose between March and May on account of machinery imports by investors in the mining sector, they slowed down during June and July. The opposing forces of a sharp decline in imports resulted in the country recording a balance of payments (BoP) surplus in June and July 2009.

Metal exports, dominated by copper, have remained the main source of foreign exchange. The increase in export revenue during the period is explained mainly by the rise in copper prices. These have taken an upward trend during the past two quarters, increasing by almost 50% between January and June 2009. The performance of the export sector will improve tremendously if the copper price is maintained above $3,000 per tonne.

The performance of the export sector is reflected in the performance of the accumulation of foreign exchange reserves. During the first three months of the year, gross international reserves (GIR) declined from $1,064 million to $946 million before rising sharply to $1,146.20 in June 2009. This increase in the GIR in the period under review was partly a result of the disbursement of $162.2 million by the International Monetary Fund (IMF) in May 2009.The IMF disbursement followed the

completion of the first and second reviews of Zambia's economic performance under the Poverty Reduction and Growth Facility (PRGF) arrangement. It was aimed at cushioning the domestic economy from the impact of the global financial crisis.

Official development assistance
Donor pledges were largely not revised during the first half of 2009. ODA was therefore expected to flow as pledged during the Fourth National Development Plan. However, the major donors to the health sector, such as Sweden and Norway, did not disburse their pledges on time on account of alleged lack of accountability by the Ministry of Health. This event is totally unrelated to the global financial crisis but it did affect government expenditure in the health sector. This impact has been felt more by poor and vulnerable groups.

Remittances
Although remittances are an important source of external capital in many African countries, this is not the case for Zambia. Our impression is that the picture has not changed significantly. However, there is still a problem of data and information on the flow of remittances into Zambia.

Growth and poverty
Zambia's growth prospects in 2009 were moderated to take into account the global financial crisis. This resulted in projected gross domestic product (GDP) being revised downwards to 4.0% from the 5.0% announced in the budget speech in February 2009. Previously, we projected a growth rate of 4.5% for 2009 and 5% for 2010. There are indications that the projected growth rate of 4.5% for 2009 will be surpassed.

However, government revenue has significantly reduced during the year. Revenues from key sectors such as mining, tourism and manufacturing have fallen. Furthermore, reduced imports have resulted in reduced collection of trade taxes. The Bank of Zambia has indicated that tax revenues have been significantly below projections, largely reflecting lower trade taxes and donor inflows. However, the government recorded a lower budget deficit than had been planned. This was achieved through a substantial compression of expenditures. This obviously adversely affected the implementation of social and infrastructural programmes envisaged in the 2009 budget. The government maintained total domestic financing under control during the first half of the year. Preliminary data indicate that the budget deficit was K751.7 billion during the first half of 2009. This is 4.4% lower than the planned deficit of K786.6 billion, made possible mainly through expenditure reductions, as revenue performance was less than satisfactory, according to the Bank of Zambia. Overall, it seems that growth was affected during the first two quarters. However, with copper prices increasing, it looks as though growth is slowly being regenerated in the economy.

Policy responses
In response to the crisis, the government has pursued tight fiscal and monetary policies. This is in the context of the broad policy of maintaining macroeconomic stability. It has also, under great pressure, maintained a market-determined flexible exchange rate policy. In reaction to the global financial crisis, the government has also reprioritised its resource allocation to social sectors. Apart from these policies, there has been no great effort by the government to address the crisis. Some measures have been announced but these seem to be of little consequence.