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Emerging and developing economies: From bad to worse

Coordinator:
Sylvain Bellefontaine (AFD)

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MacroDev - Semestrial Panorama

Semestrial Panoramas are special issues of the **MacroDev** series written by analysts from the Agence Française de Développement (AFD) (French Development Agency). They present a synthesis of macroeconomic and socioeconomic analyses of emerging and developing countries (EDCs). One feature of these short, country-focused articles is a thematic section that sheds light on the short-term and structural issues and major challenges affecting these countries.

List of authors

Sylvain Bellefontaine, Cécile Duquesnay, Marion Hémar, Benoît Jonveaux, Maëlan Le Goff, Emmanuelle Monat, Meghann Puloc'h, Maxime Terrieux, Luciana Torrellio, Cécile Valadier, Alix Vigato.

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Editorial:

Emerging and developing economies: From bad to worse

Cécile Valadier – valadierc@afd.fr

While a number of emerging and developing countries (EDCs) still bear the scars of the crisis related to the Covid-19 pandemic, with a deteriorated per capita income, employment situation and social indicators, the impact of the war in Ukraine is undermining the recovery observed in 2021. In its July 2022 outlook, the IMF has cut its GDP growth forecast for EDCs to 3.6% in 2022 and 3.9% in 2023 (-0.2 and -0.5 pp, respectively, compared to April's forecasts). Three main factors weigh on the short- and medium-term prospects. Firstly, the global inflationary shock is gaining momentum with inflation projected at 9.5% in EDCs this year. Higher food and energy prices, bottlenecks in several sectors and the rebalancing of demand in favor of services are behind the increase in the price index, which is sometimes compounded by the depreciation of national currencies against the US dollar. African and low-income countries are particularly affected by inflation due to the rise in commodity prices, in a context of increasing pressure on public finances in a number of countries and limited social protection systems. Conversely, Asian countries benefit from lower inflation but are affected by the slowdown in economic activity in China, with growth now forecast at 3.3% in 2022. The introduction of lockdowns in the spring in China and in particular in Shanghai, under the authorities' "zero Covid" strategy has global consequences by disrupting supply chains and reducing imports from its trade partners. Finally, the tightening of monetary policies in advanced economies leads to more stringent international financial terms for EDCs, at a level that is dangerously close to the peak observed in March 2020. The cost of refinancing on international markets is driven up by the appreciation of the US dollar and the increase in Eurobond spreads (over 100 basis points on average since April for countries with speculative credit ratings). Africa is once again particularly affected by this trend, with yield rates at their highest since 2000. This complicates Eurobond issuance and refinancing programs, for example, for Egypt, Ghana, Kenya and Nigeria. Foreign currency bond issues are thus down by 40% this year compared to 2021. The increase in interest rates is coupled with significant

pressure on capital flows in EDCs, as the uncertainty drives international investors to prefer safe havens in advanced economies. Similarly, according to the latest UNCTAD report (June 2022), three-quarters of growth in global foreign direct investment (FDI) was concentrated in advanced economies and signs of weakness in EDCs are already apparent for this year.

The rise in commodity prices had already been happening since mid-2020 and is subject to an in-depth analysis in this third issue of the semi-annual MacroDev Panorama. The objective is to place the dramatic increase in prices observed in the spring in a historical perspective and question whether it is temporary or permanent. Beyond the economic impacts on growth trajectories and external account balances, which have varying degrees of exposure and vulnerability to the shock, the social impacts, in particular in terms of food security, and political impacts are of particular concern. The shock affecting food commodity prices has highlighted the materiality of climate risks and their cross border spillover effects, as illustrated, for example, by India's decision to suspend its wheat exports following the drought affecting the country, which is also compounding global supply tensions. The rise in energy and metal prices also raises questions over the pace of a low-carbon transition, which is more necessary than ever. Finally, ten country focuses aim to describe the differential impacts of the rise in commodity prices on EDCs, at the intersection of the economic, geopolitical and sociopolitical fields. They also summarize the main economic and financial developments in the countries concerned: Angola, Democratic Republic of the Congo, Egypt, Guinea, Mozambique, Nigeria, Azerbaijan, Argentina, Bolivia and Peru.

Thematic Section

Developing countries and the low-carbon transition put to the test by the commodity shock

Maxime Terrieux – terrieuxm@afd.fr

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The outbreak of the Russia-Ukraine conflict in late February 2022 almost immediately led to a surge in global commodity prices, including for hydrocarbons, metals and agricultural products. This upward trend had in fact already been happening since mid-2020, but it has been exacerbated by the role played by Russia and Ukraine in the global supply of certain commodities, such as gas, oil, aluminum and wheat. The causes of this increase include the strong recovery in global demand following the shock of the Covid-19 pandemic, the constraints on global supply chains and climate change. While it is not unprecedented, this increase in commodity prices could signal a new cycle of high prices spanning several years, which could have various consequences for emerging and developing countries (EDCs).

In the short-medium term, the greatest beneficiaries of this rise in commodity prices are the main hydrocarbon exporters, while the small open economies with a weak productive base, in particular island States, are suffering from a new external shock. In addition, inflation is back in force as the prime concern of national authorities, as it can affect the purchasing power of people who have already endured a succession of crises. In response, several governments are tempted to use fiscal instruments with tax cuts and increases in public subsidies. This only accentuates the increase in prices by maintaining a strong demand, while further deteriorating public accounts which are often already badly weakened. Social spending will need to be more targeted, but does appear to be necessary to contain latent socioeconomic tensions: in addition to inflation, the deterioration of food security, which existed before the war in Ukraine, will need to be closely monitored.

This particular context, especially the rise in fossil fuel prices, could pave the way for an acceleration of the energy transition worldwide. But the surge in "transition metals" prices is also likely to increase the cost of renewable energies, thereby delaying this transition. Greater coordination therefore appears necessary to reduce the constraints on the availability of these metals. The economic gains of such a transition would only benefit a small group of countries, including only a few emerging and developing countries (EDCs). For the latter, properly managing new revenues, of a potentially staggering level, will be a major challenge.

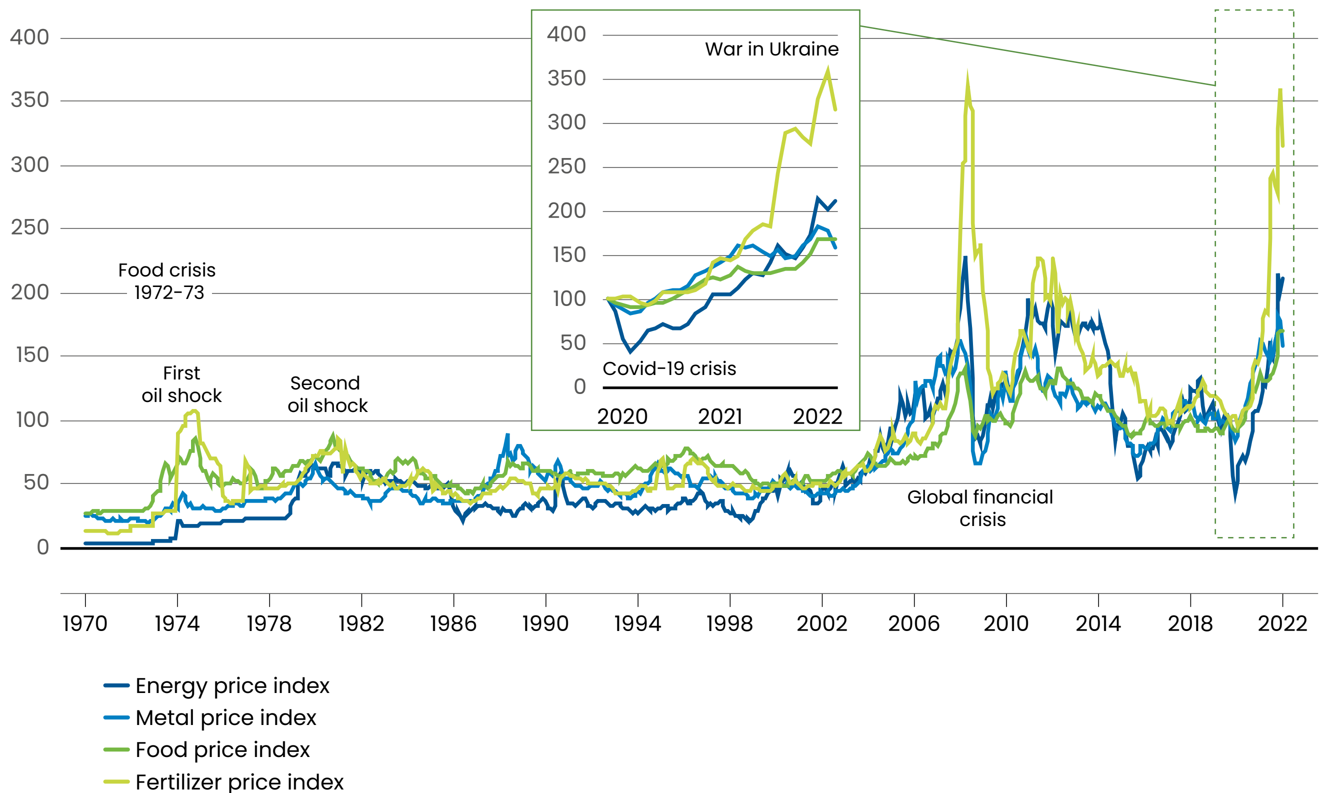
1. A general rise in commodity prices since mid-2020: Is it different this time?

1.1 – A general rise in all commodity prices exacerbated since the outbreak of the war in Ukraine.

In March 2020, the demand shock related to the outbreak of the Covid-19 crisis precipitated a sharp drop in commodity prices and in particular for oil (-65% between January and April and a barrel at $41 on average over the year). But **in mid-2020, there was a sharp reversal in this trend, with a general increase in all commodities:** energy (oil, gas, coal), metals, agricultural products. Between July 2020 and December 2021, the World Bank's energy price index thus jumped by 132%. At the same time, the metals price index rose by 58% and the food price index by 44%. Russia's invasion of Ukraine in late February 2022 accentuated this underlying trend: between January and May 2022, energy prices increased by 43% and food prices by 25%.

This general increase is particularly striking for certain products. In two years (from May 2020 to May 2022), oil prices have almost quadrupled, coal prices have multiplied by a factor of 7 and European gas prices by a factor of almost 19. Following a 64% increase between mid-2020 and the end of 2021, wheat prices doubled in the first five months of 2022. As for metals, the prices of lithium, cobalt and nickel, which are essential in the production of electric batteries (see Section 3), have more than doubled in two years.

Graph 1 – Historical trend in the main commodity indices (2020=100)



Sources: WB (World Commodities Price Index), AFD calculations.

1.2 – Covid-19, the resumption of economic growth, climate change and the war in Ukraine as the main factors behind rising prices.

The oil shocks of 1973 and 1979 were firstly due to a supply shock caused by the embargo on exports decided unilaterally by OPEC and by a reduction in Iranian production, while the super-cycle of the 2000s was driven by Chinese demand. The current increase in commodity prices is due to a multifactor shock to both supply and demand.

Firstly, in terms of demand, **there has been a strong global economic recovery**, following the recession of -3.1% in 2020 caused by the Covid-19 pandemic. The global economy thus grew by 6.1% in 2021. This was in particular driven by China, whose growth rate of 8.1% in 2021 increased demand for the metals required for industrial activity and for certain agricultural products such as corn and soybean. Aggregated global demand, along with demand for raw materials, was also bolstered by the fiscal and monetary stimulus packages in a number of countries. This is the case of advanced economies (whose GDP grew by 5.2% in 2021), but also several economies in EDCs, in particular in Latin America (Brazil, Colombia, Peru, with a regional growth rate of 6.8% in 2021), and Africa (Rwanda at over 10%, Morocco and Côte d'Ivoire at 6.5-7%). **Climate change**, and the disruptions it causes, also weighs on demand, mainly for energy (gas and coal), as the extreme temperatures drive needs for both heating and air conditioning.

On the supply side, the Covid-19 crisis has had well-documented repercussions[1] on **international supply chains:** closures of factories, ports, quarantine of merchant ships, shortages of semiconductors penalizing road transport (slowdown in the production of trucks), social distancing measures for employees, change in the structures of international trade, etc. These disruptions create bottlenecks which reduce the available supply. This is the case for metals, with the price of copper (+65% in two years) having been partly driven by closures or strikes in mines in Chile and Peru, and iron (+40%) by production difficulties in Australia. Climate change also affects supply, in particular for prices of agricultural products. The La Niña meteorological phenomenon was repeated in 2020 and 2021 in South America, with droughts in Brazil and Argentina in particular, which affected corn and soybean production. At the same time, massive floods in Australia (the worst for 60 years in the Sydney region) have also restricted coal production.

The conflict in Ukraine mainly exacerbates the supply shock through two channels. **Firstly, the war disrupts physical supply chains:** in addition to the risk of part of Ukraine's productive capacities being destroyed, in particular for agriculture (9% of global wheat exports and 13% for corn), the transport of goods has been stopped, as Ukrainian ports on the Black Sea are blockaded by Russian forces. **Secondly, the international sanctions towards Russia have changed international trade.** The ban on Russian oil, gas and coal, or at least the planned reduction, has short-term consequences: alternative sources of supply for these goods are not immediately available everywhere in a comparable quantity, which exacerbates the supply shock. Yet household and business demand is relatively inelastic, as they only adjust their behavior and sources of consumption if prices remain at a high level for several months. There is thus automatically a sharp rise in prices. This in particular accounts for the surge in European gas prices by over 50% in March, in the wake of the EU's announcement of an objective of reducing Russian imports by two-thirds by the end of 2022.

1 See for example: EY (2021) "How COVID-19 impacted supply chains and what comes next, 18 February 2021" and McKinsey & Company (2021) "How COVID-19 is reshaping supply chains, 23 November 2021".

1.3 – This rise is not unprecedented in contemporary economic history.

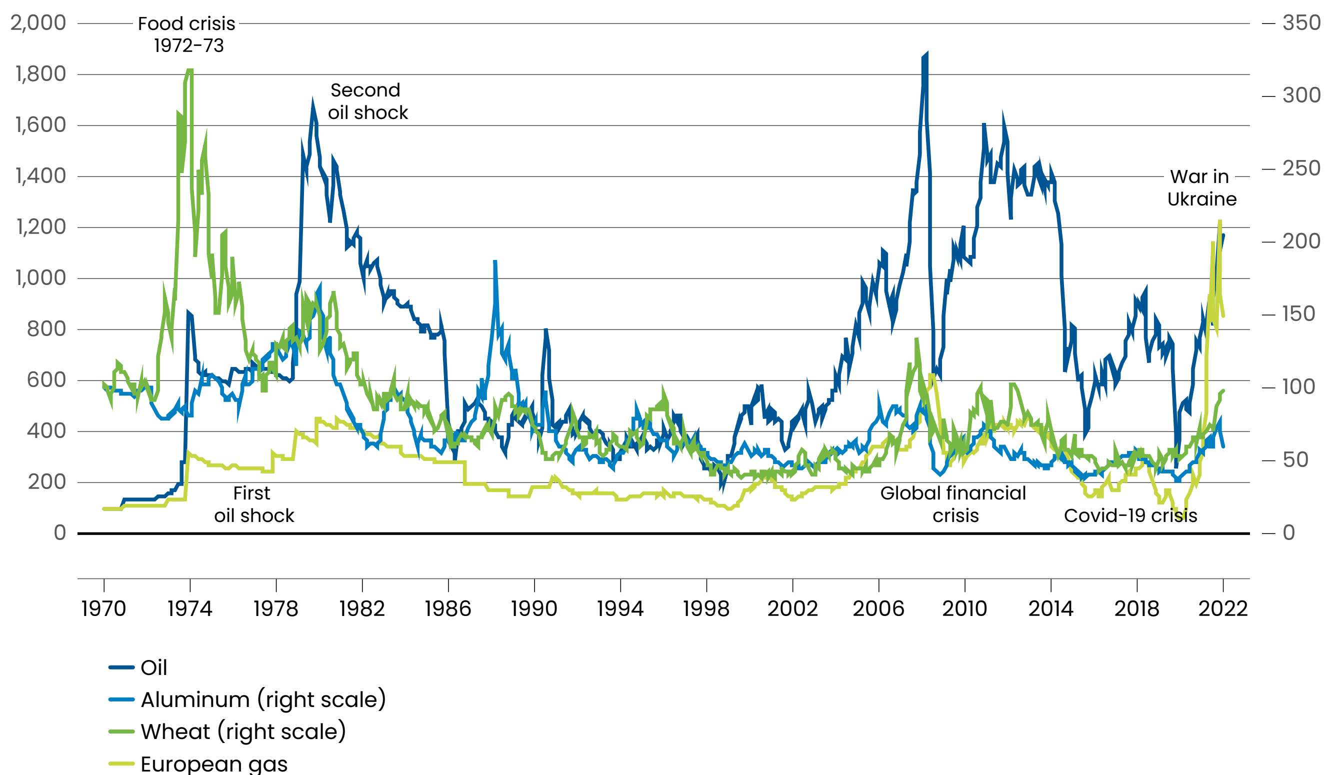
In nominal terms, the increase in prices is particularly striking for several products: European gas, coal, copper and agricultural products (wheat, corn, soybean) have all reached record levels in the first half of 2022. The increase in oil prices since mid-2020 is the highest ever recorded since the oil shock of 1973 and for food and fertilizer the third highest in the last 50 years following major shocks in 1972-1973 and 2008-2009.

However, these dramatic price variations and levels need to be put into perspective in terms of real prices. Indeed, in real terms, only European gas and coal have broken their 2008 records (+50% and +30%, respectively). In contrast, oil is 40% lower than its real peak of 2008. Wheat[2] and fertilizer are 70% and 55% lower than their real peaks of 1973 and 1974, respectively. The same goes for metals: aluminum is 52% lower than its peak of 1988 and copper 31% lower than its peak in 1973-1974 (see Graph 2).

This time, the most striking aspect concerns the **simultaneity of price trends**: since mid-2020, all the main price indices have moved in a synchronized manner, with an average correlation close to 90%. In 1973, oil was especially affected, with an immediate impact on fertilizers. The rise in food prices had started back in 1972, due to factors outside the oil shock, mainly a sharp decline in global cereal production. In 2008-2009, the movements were not completely simultaneous, as the decline in metal prices started several months before the turnaround in prices precipitated by the onset of the international financial crisis in September 2008. The major geopolitical upheavals unquestionably have a strong impact on the outbreak of commodity shocks, as was the case for the oil shocks of 1973 and 1979 related, respectively, to the Arab-Israeli war of October 1973 (the "Yom Kippur War") and the Iranian revolution. However, these are the only similarities with the current situation. On the hydrocarbon market in particular, the decrease in supply during the previous episodes was due to the embargos decided by exporting countries, in contrast to the current disruptions on supply chains.

2 US hard winter wheat, US HRW database.

Graph 2 – Real prices* of some major products (1970=100)



*Prices deflated by the US consumer price index (US CPI, 2019 database)

Sources: WB (World Commodities Price Index), AFD calculations.

1.4 – Is a new commodity super-cycle underway?

The World Bank forecasts that the current increase will last beyond 2022, with high price levels until at least the end of 2024. Between April 2021 and April 2022, the World Bank thus substantially revised up its price projections: +49% for the 2022 forecast on metal prices, +92% on hydrocarbons, and +150% on fertilizers. These upward revisions can be seen in the projections for 2023 and 2024, suggesting the idea of a **protracted period of high prices**.

Several factors point to a protracted period of high prices, in particular with regard to supply constraints. The disruptions on international value chains caused by the pandemic in 2020 are continuing in 2022, a sign that the bottlenecks could last in the medium term. The chronic underinvestment in mines in the 2010s has created a structural scarcity of metal supply which will take years to overcome. Furthermore, to reduce its carbon emissions, China has decided to cap its steel production, which contributes to reducing global supply.

However, the effects of rising prices on demand and economic growth are uncertain for many countries, while inflation now appears to have extended to the entire global economy (see Section 2). **Indeed, the inflation and structural damages caused by the Covid-19 crisis could weigh on global demand,** in particular on consumption and business investment. In addition, the last commodity super-cycle (2002-2014, with a brief and sudden interruption in 2008-2009), was largely driven by demand from the booming Chinese economy. In 2022, China's structural

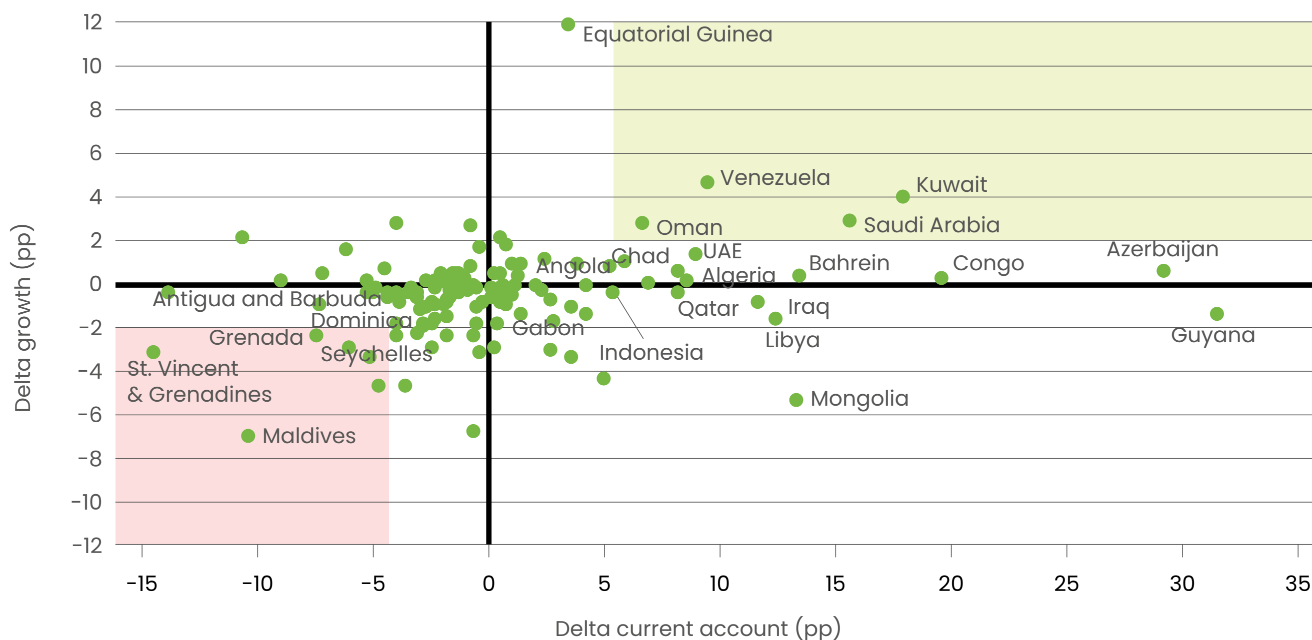
economic growth has decreased significantly compared to the 2000s, and it has been reduced due to the current consequences of the resurgence of the Covid-19 epidemic in early 2022. In the medium term, while Asia should remain the most dynamic continent, with India's growth at over 8% on average, **no country seems able to drive global demand in proportions equivalent to China in the 2000s-2010s**. Consequently, the upward trend for commodities could end faster than expected. The fall in prices of metals (-18%) and fertilizers (-5%) between March and June 2022 could thus be the first signs of a more sustainable lull.

2. Macroeconomic consequences: primarily a terms-of-trade and inflationary shock.

2.1 – A terms-of-trade shock with heterogeneous effects on EDCs

The general increase in commodity prices, exacerbated by the conflict in Ukraine, is firstly a major shock for terms of trade, with an impact expected on the trade balance and current account of economies in the short-medium term. **The greatest winners will mainly be hydrocarbon exporters** (see Graph 3). Between October 2021 and April 2022, the IMF thus substan-

Graph 3 – Gains and losses to the current account and growth*



*The delta corresponds to the revision of figures between the WEO of October 2021 and April 2022.
It should be noted that the increase in global commodity prices cannot alone explain the deltas of figures presented in Graphs 3 to 5.
Sources: IMF (WEO), AFD calculations.

tially revised its current account balance projections for Angola, Indonesia, Chad, Gulf countries (Saudi Arabia and Kuwait in particular), Venezuela, the Congo and Azerbaijan. For most of them, current account surpluses are expected to exceed 10% of GDP, or much more (Congo: 26%; Azerbaijan: 37%). However, for industrial metal producers such as Chile (copper, lithium), Peru (copper, zinc) and the Philippines (nickel), the export gains will not be sufficient to offset the additional cost of imports, meaning that their external position should deteriorate in 2022. For the major agricultural exporters (soybean, corn, wheat), there is a mixed trend: Brazil should benefit from a slight improvement in terms of trade due to a diversified export base (hydrocarbons, mineral products, cereals), while the domestic recovery in Argentina will offset the increase in cereal exports. However, the benefits that agricultural exporters can derive from the current situation is weighted by the simultaneous increase in the cost of inputs (fertilizer).

For certain countries, the gains on external accounts will lead to gains in economic growth, but for a smaller number of countries (Saudi Arabia, Kuwait, Oman, Venezuela and Equatorial Guinea). This should confirm the results of the World Bank's latest Commodity Markets Outlook, which shows that historically, **the rise in commodity prices does not lead to a long-term increase in GDP growth** (with, conversely, a fall in prices having adverse effects in the longer term). Between October 2021 and April 2022, the IMF revised its global growth forecast by -1.3 point, almost uniformly between EDCs and advanced economies. While there are many reasons for this revision (Chinese slowdown, possible resurgences of the pandemic, end of accommodative monetary policies), the increase in prices sustained by the Ukrainian conflict will weigh heavily on the balance. The authorities in countries that will benefit little from the gains in the terms of trade will ultimately face a dilemma between supporting economic growth, curbing inflation and containing fiscal slippages (see below).

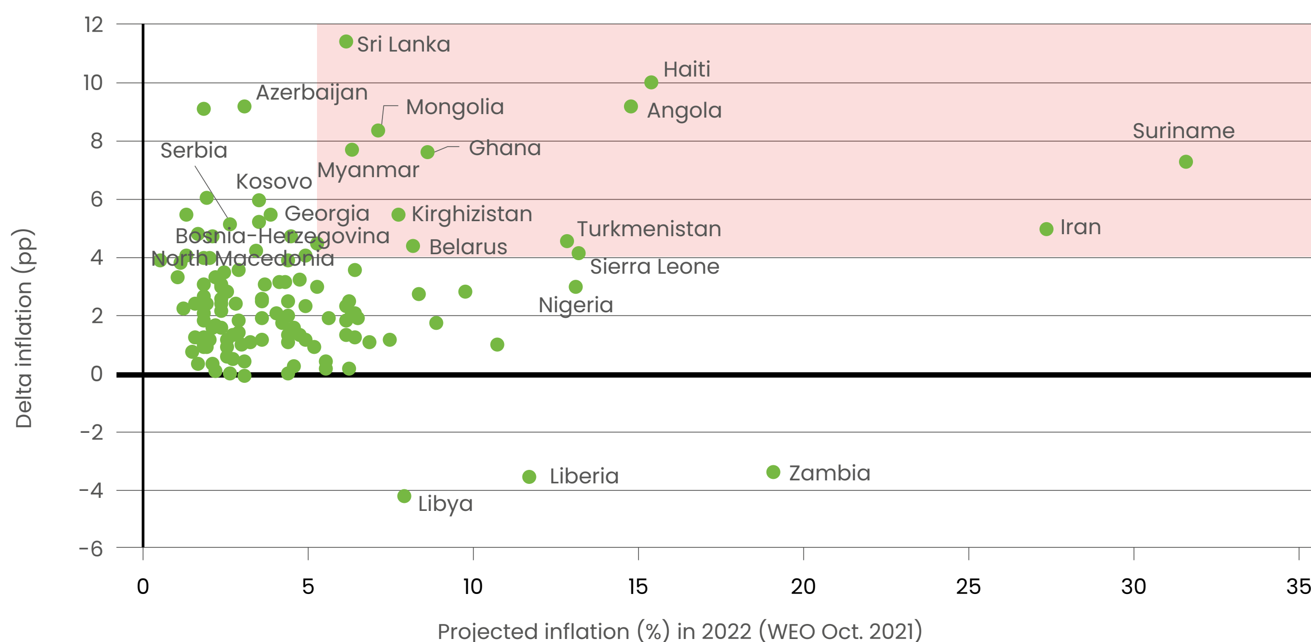
The main losers from the current shock will be the small island States (Grenada, Dominica, Maldives, Seychelles, etc.) which, after suffering from the collapse of tourism during the pandemic, are still expected to have double-digit current account deficits. The main net energy importers among emerging countries, such as India, Morocco and Turkey, should also see a deterioration in the current account balance compared to the forecasts at the end of 2021, but to a lesser extent.

2.2 –An alarming surge in inflation

Since mid-2021, control over inflation, the second direct consequence of the rise in commodity prices, has become a crucial issue once again, shared by EDCs and advanced countries. This is illustrated by the highest inflation in 40 years in the United States and in 30 years in Western Europe. With the recovery in demand and supply constraints, inflationary pressures were anticipated, with a peak forecast in 2022, albeit at a lower level. Furthermore, the continued increase in commodity prices is expected to prolong the trend. Between October 2021 and April 2022, the IMF thus revised up its global inflation forecast from 3.8% to 7.4%, meaning it has nearly doubled.

This increase in inflation is not uniform across regions, but reflects rather the specific characteristics of each country. Major commodity exporters, such as Angola (oil) and Mongolia (coal, copper), which are already facing high inflation, are expected to see a marked acceleration in prices (see Graph 4). For these countries, the increase in global prices automatically affects domestic prices, as a large proportion of consumer goods are imported. The situation is the same for several countries in Central Asia, the Caucasus and the Balkans, although inflation remained moderate in these countries until early 2022. In North Africa, the situation is contrasted: in Algeria and Tunisia, the increase in commodity prices had started to affect domestic prices in 2021, and the repercussions of the war in Ukraine are expected to be more marginal. In Morocco, there has been a small surge in inflation, but the increase in prices is expected to remain contained at about 4.5% in 2022. However, Egypt, given the importance of wheat in its diet, is expected to see a return of double-digit inflation in 2022, after having contained it at 5.5% on average since mid-2019. In Latin America, apart from the case of Argentina and the non-anchoring of inflation expectations, Brazil, Chile and Colombia will have to cope with an annual inflation rapidly moving up towards 10%, while it will be more moderate in Bolivia and Ecuador. The inflation forecast for 2022 in the subcontinent has thus been revised up by 3.5 points between October 2021 and April 2022. This increase will be much lower in Asia (0.7 point), in particular due to the Chinese slowdown. However, Sri Lanka, which is facing major internal difficulties, is expected to have an inflation rate of over 15% (+11 points compared to the forecast of October 2021), with the commodity shock coming on top of the monetization of fiscal deficits. Turkish inflation is

Graph 4 – Revision of inflation projections in 2022*



*The delta corresponds to the revision of figures between the WEO of October 2021 and April 2022. For a given country, the new inflation projection (April 2022) is calculated by adding the projection of October 2021 to the delta.
Sources: IMF (WEO), AFD calculations.

also expected to leap by over 40 points (projected at 60% over the year), with the depreciation of the Turkish lira and the upsurge in prices concurrent with heterodox economic policies for several years.

The inflationary shock should therefore affect almost all of the world's economies, but heterogeneously. On average, it should be higher for EDCs than for advanced countries. In April, the IMF increased its average inflation forecast by 3.8 pp for EDCs, against 3.4 pp for advanced economies, accentuating the average inflation differential over the year (8.7%, against 5.7%). This difference is due to two factors. The first is directly related to the increase in prices: the average household consumption basket in EDCs contains a larger proportion of food and energy products than in advanced countries. The World Bank (Ha *et al.*, 2021) estimates that food and energy products make up 52% of the average basket in EDCs, against 38% in advanced economies. Food accounts for 25% of the average basket in emerging countries, but over 40% in countries such as Ethiopia, India and Senegal, against 15% in advanced economies. In 2012, the IMF also estimated that a food price shock is in the long term four times higher for EDCs than for advanced countries (Gelos and Ustyugova, 2012). In addition, inflation is also imported through a second channel: the depreciation of the currencies of several EDCs. The trend was already occurring in 2021 (Brazil (-7%), Colombia (-16%), Turkey (-45%)) and is continuing in 2022 in relation to the monetary tightening in advanced economies, coupled with the search for safe havens in the context of strong geopolitical tensions.

The response of national authorities to inflation is firstly monetary, with a near-general rate hike (+350 bp in Ghana, +900 bp in Sri Lanka, +1,125 bp in Brazil since mid-2021). But in a post-pandemic context, the authorities will want to ensure that they do not unduly hold back investment and household consumption. **The erosion of purchasing power also fuels sociopolitical risks**, as illustrated by various demonstrations and riots, in particular in recent months in Nigeria, South Africa and Tunisia,[3] which the authorities are

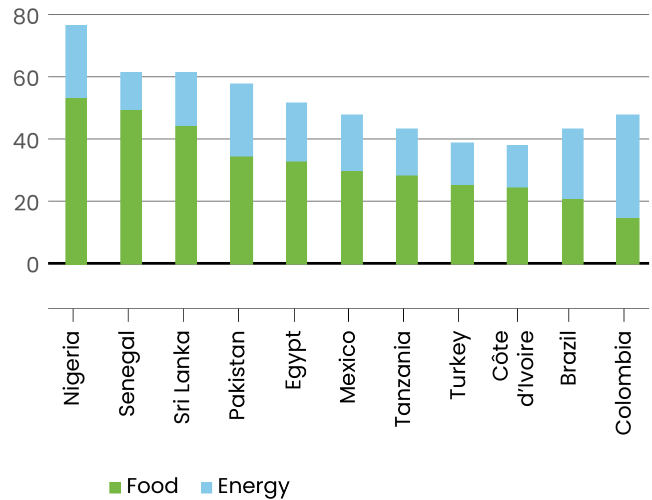
3 The Economist estimates that the risk of uprisings related to the increase in commodity prices is high for the next 12 months in Egypt, Turkey and Pakistan. See https://www.economist.com/international/2022/06/23/costly-food-and-energy-are-fostering-global-unrest

striving to contain. The fiscal response thereby becomes an option, which the authorities may be tempted to use.

2.3 –Direct and indirect consequences on public accounts: mixed effects.

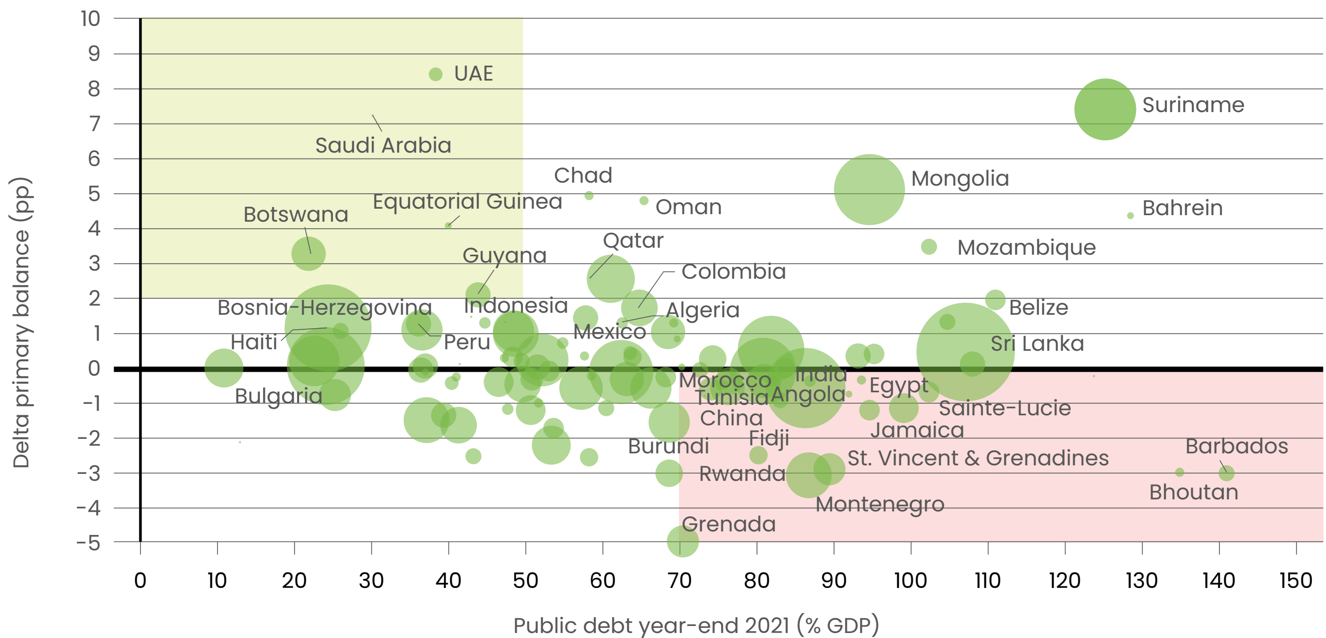
The consequences on public accounts of the increase in commodity prices are more difficult to assess. As for the external accounts, **the main direct beneficiaries of the surge in prices will be the hydrocarbon producing countries** (Middle Eastern countries, Azerbaijan, Congo, etc.), with gains on the primary balance in 2022 (October 2021 forecast against April 2022) of over 10 GDP points for most of them.

Graph 5 – Share of energy and food products in the consumption basket of some EDCs (%)



Sources: Central banks, national statistical institutes, AFD calculations.

Graph 6 – Increase in the primary balance vs. public debt ratio



* The delta corresponds to the revision of figures between the WEO of October 2021 and April 2022.
Sources: IMF (WEO, Fiscal Monitor), AFD calculations

However, faced with inflation, the fiscal instrument will be used as an indirect response in several countries and will lead to an additional cost. This is the case in North Africa, which is historically used to subsidies. It is a price that governments are willing to pay to avoid an "Arab Spring" scenario. The subsidies will deteriorate the primary fiscal balance of Tunisia and Jordan, which were already faced with a high public debt ratio at the end of 2021 (82% and 114% of GDP, respectively, see Graph 6). In Egypt, the return of double-digit inflation will be countered by a substantial increase in subsidies on bread prices. The fiscal surplus generated for three years through a major consolidation should thereby be reduced. It is a similar issue for India, which has established price controls and subsidies estimated at over 1% of GDP. But it has more leeway (favorable debt profile despite a public debt ratio at 87% of GDP). Similarly, Turkish subsidies (bread), estimated at over 0.5% of GDP, can still be absorbed (public debt at 42% of GDP, moderate risk of unsustainability), while the expected gains in terms of budgetary revenues for a commodity exporter such as Indonesia will finance oil and rice subsidies (0.8% of GDP).

2.4 – Food insecurity highlighted again in 2022

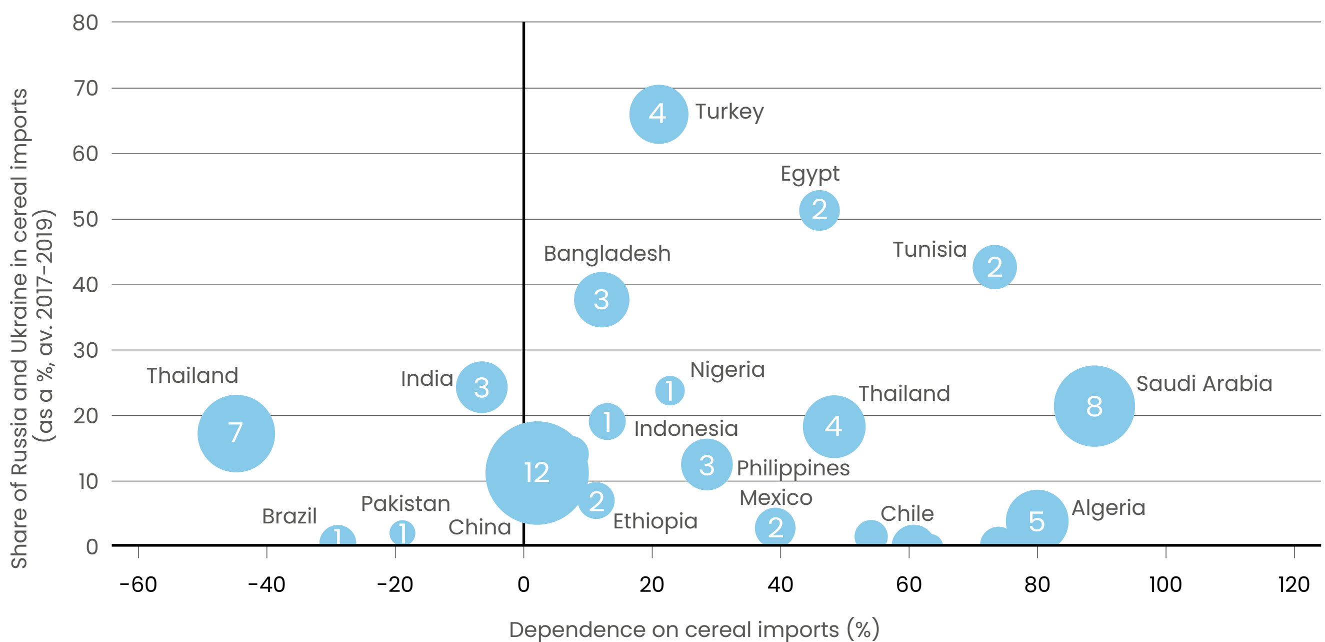
Russia and Ukraine are among the largest global exporters of wheat, corn, barley, rapeseed and sunflower oil. Yet FAO estimates that with the war, it will not be possible to harvest 20 to 30% of cereals for the 2022-2023 season, which will reduce global supply. The sanctions on Russia could also reduce the availability of fertilizer, plant protection products and seeds imported from the EU by Russian farmers, with repercussions on Russian production, although this risk may only occur as of the 2023-2024 season. Russian supply could especially be constrained by logistical difficulties: the war and geopolitical alliances can exacerbate disruptions on international supply chains, reduce the number of ships willing to transport Russian merchandise, and thereby make it more difficult to deliver Russian products.

In addition, the surge in fertilizer prices and the high dependence on fertilizer imports from Russia (over 20% of fertilizer imported in Côte d'Ivoire, Ghana, Kenya, and Rwanda) pose two problems: (i) a higher production cost for agricultural goods, which will affect prices and (ii) potential supply difficulties. A lower use of fertilizer, for reasons of availability or high prices, should thereby reduce the local agricultural production of several EDCs, which will fuel the supply shock.

The reduction in the supply of available cereals from Ukraine, and to a lesser extent Russia, exposes – at least in theory – certain economies highly dependent on Russian and Ukrainian imports to **risks of shortages**. This is the case for most countries in North Africa and the Middle East. Lebanon, which is already faced with an unprecedented economic crisis, imports nearly all its cereals and almost exclusively from Russia and Ukraine. Tunisia and Egypt import over 50% of the cereals they consume, and Russia and Ukraine account for 40 to 50% of these imports (see Graph 7). Ethiopia, Namibia, Rwanda and Uganda import about 50% of their wheat from Ukraine and Russia, while Côte d'Ivoire, Kenya and Tanzania import over 60% of their sunflower oil from these two countries.

To protect domestic stocks and ensure food security in the short term, several countries introduced export restrictions in March. In April, the World Bank recorded a 25% increase in countries imposing export restrictions, bringing the total to 35 countries. This is the case of India (wheat, sugar), Egypt (corn, oil), Indonesia (palm oil; a measure since withdrawn) and Argentina (soybean oil, beef). But **these restrictions are counterproductive**, in particular on the part of major exporters: they constrain global supply, which automatically increases the price of food, and thereby fuel the inflation they are supposed to dampen.

Graph 7 – Share of Ukraine and Russia in the dependence on cereal imports*



*The dependence on cereal imports corresponds to the share of cereals consumed which are imported.
Cereals taken into account: wheat, corn, rice.
Sources: FAO, UN Comtrade, AFD calculations.

In this context, food prices could remain high in the medium term, unless major countries such as China and India revise their storage strategy, which will increase the global supply.[4] However, **the figures on the risks of shortages – particularly for wheat – caused by the conflict in Ukraine need to be put into perspective**. It is true that the share of wheat in the diet in North African countries can be close to 50%, which explains why the authorities in these countries want to avoid new "bread riots". But for the majority of African countries, as in Asia (rice), wheat accounts for less than 15% of the diet. In addition, the Ukrainian and Russian export products hit by a supply shock can be replaced by substitutes around the world (this is the case for sunflower oil, which can be replaced by rapeseed), which mitigates the risks of shortages. Finally, importing countries generally have reserves of 3 to 4 months of consumption, a sufficient amount of time to find new supply channels.

In reality, the war in Ukraine has simply highlighted the risks on global food security again. The FAO State of Food Security and Nutrition in the World 2021 report already pointed out the fact that after being stable at 8.4% between 2014 and 2020, the prevalence of undernourishment in the world had increased again to 9.9% (i.e. 118 million additional people) in 2020. Similarly, the latest FAO Global Report on Food Crises points out that the number of people facing an acute food crisis nearly doubled between 2016 and 2021 (from 108 million to 193 million). The crisis related to the Covid-19 pandemic has logically played a role in this increase, but the security conflicts, climate change and economic shocks also largely contribute to the situation which existed before 2022.

4 It is estimated that China held 50% of the global cereal stock at the end of 2021 (+20 pp in 10 years), which may also have contributed to the increase in prices.

3. Increase in commodity prices and energy transition: the chicken and egg situation

3.1 – The current environment: an apparent opportunity for the low-carbon transition

To respect the climate commitments, the current increase in prices can be interpreted as an **opportunity to accelerate the low-carbon transition for all countries, whether they are hydrocarbon exporters or importers**. For exporters, the windfall accumulated could be used to accelerate long-term investments in renewable energies. For importers, it is a question of reducing external dependence by diversifying sources of supply, but also and especially by investing in the energy transition. For example, the EU will seek to reduce its dependence on Russian gas by turning to the Caucasus, Asia and the Middle East for supplies of liquefied natural gas (LNG). And to mitigate the impact of the increase in prices on people, beyond temporary measures to subsidize the price at the pump or more targeted social assistance, the World Bank especially advocates an acceleration of investments in energy efficiency and renewable energies. But this "moment" to seize comes up against several stumbling blocks.

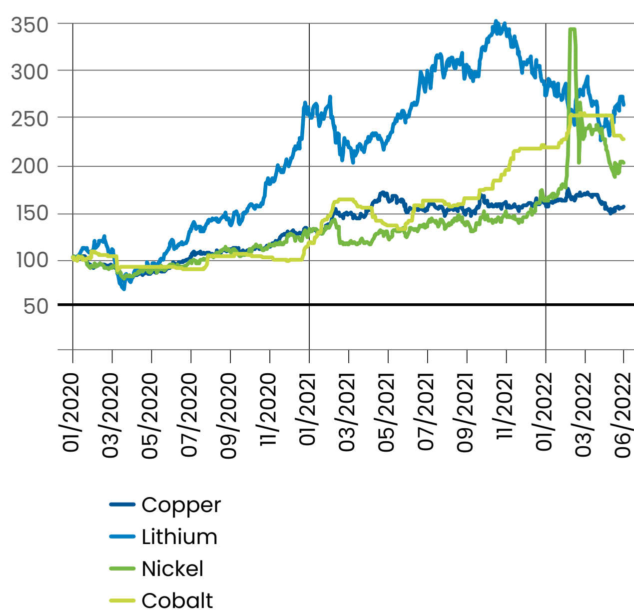
3.2 – The low-carbon transition itself contributes to the increase in prices…

The energy transition has already started, as illustrated by the annual global growth in renewable energy consumption at 11.4% between 2000 and 2020 (negative growth for coal at -0.6%, and -0.5% for oil). But the transition contributes substantially to the current increase in prices, here again by affecting supply and demand.

Indeed, the renewable energy investments already launched will be driven by the major recovery plans, in particular in the United States, through $1 trillion of investments in infrastructure, or in the EU, with €800 billion dedicated to the post-pandemic recovery. **These plans focus on the fight against climate change, thereby driving demand for the raw materials needed for the energy transition.** Indeed, the transition is set to consume staggering quantities of raw materials, in particular "transition" metals: cobalt, copper, lithium, nickel and rare earths. According to the International Energy Agency (IEA), for an equivalent electricity production, wind turbines contain nine times more minerals than gas-fired power plants; an electric car requires six times more minerals than a combustion engine car. To achieve the 2040 climate targets, the IEA estimates that the consumption of lithium will increase by a factor of 40, and by 20 for nickel and cobalt.

Yet for these metals, the supply is currently limited due to a general underinvestment by mining companies in the early 2010s. A catch-up process is underway, but it will be long, as it can take over a decade to open new mines. According to the IMF (Boer *et al.*, 2021), **this mismatch between supply and demand could maintain the real prices of copper, cobalt, lithium and nickel at high levels at least until 2030.**

Graph 8 – Nominal price of transition metals (2020 = 100)



Sources: WB (World Commodities Price Index), AFD calculations.

Regarding EDCs, only a small number of them are set to benefit from this high price scenario. Indeed, the supply of transition metals is concentrated in a small number of countries, with only some of them EDCs. For example, the Democratic Republic of the Congo accounts for 70% of global cobalt supply, Indonesia and the Philippines for nearly 45% of nickel supply between them, while Chile and Peru have 40% of the copper supply between them. Chile could also benefit from the explosion of demand for lithium (25% market share). For these few countries, there could be substantial gains for the external accounts, growth and public finances. However, this requires the increase in prices not to have antagonistic effects, such as in Peru, for example, where the export gains on metals have been offset by the import bill for food and hydrocarbons in 2021-2022. Above all, the potential beneficiaries will need to ensure that they are not victims of the "natural resource curse",[5] which may be a huge challenge for countries with a weak institutional and governance capacity.

3.3 – …which could, in turn, delay the low-carbon transition

To ease the pressure on purchasing power related to the increase in commodity prices, the short-term response of several countries consists of an increase in energy subsidies or fuel tax cuts, which de facto contributes to demand for fossil fuels. Above all, the increase in metal prices will raise the cost of production for renewable energies, undermining the continued reduction of costs observed for over a decade. While technological innovation can maintain the downward trend for costs, it will also come up against the future increase in financing costs with the rise in interest rates.

In this context, and faced with the climate emergency, coordinated international action will be necessary to reduce the supply bottlenecks. The announcement by the IEA, in March 2022, of the extension of its mandates to support the low-carbon transition could be a first step in this direction.

5 A paradox establishing that economic growth rates and, more generally, economic development are lower in resource-rich countries than in other countries.

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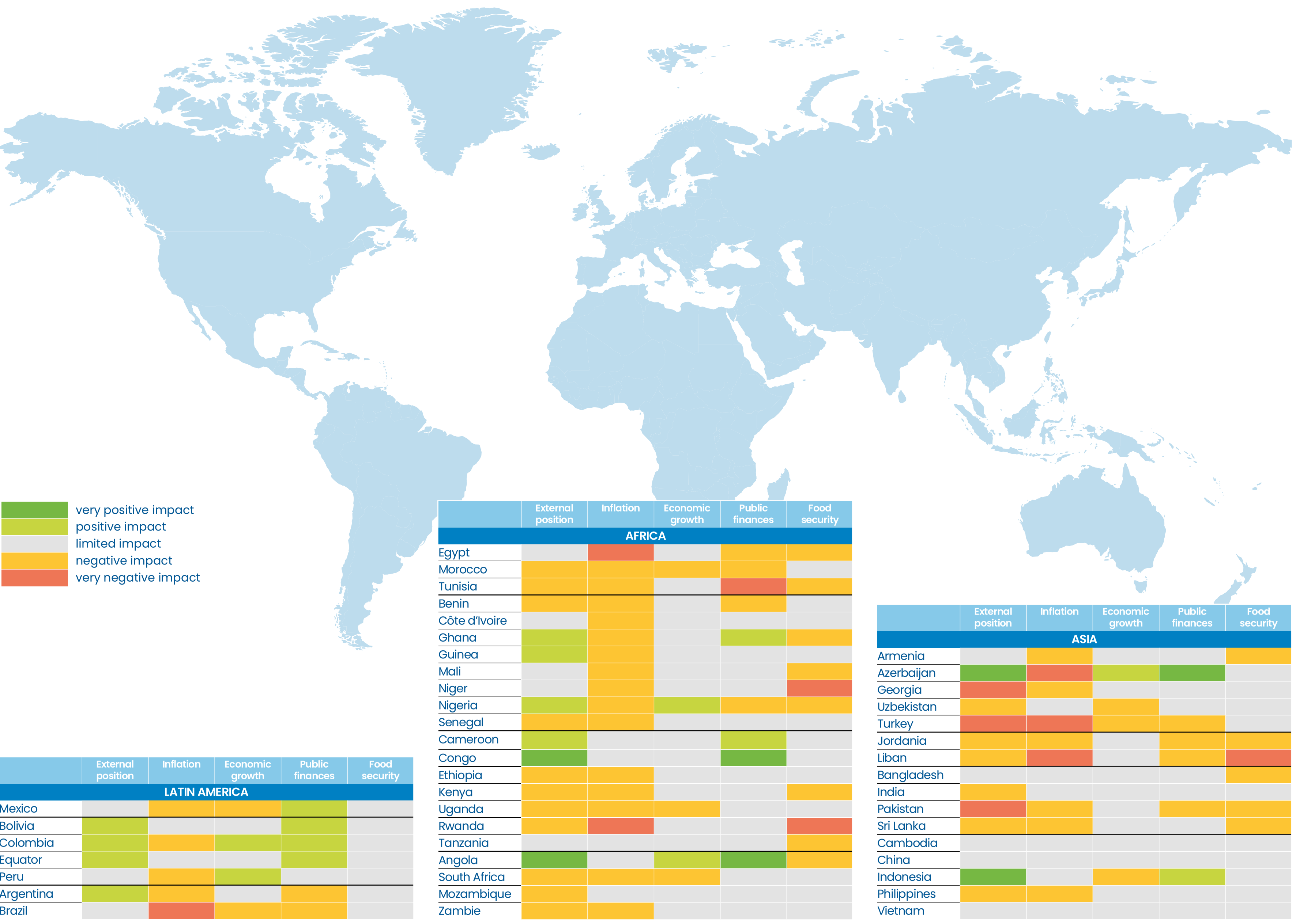
Graph 9: Indicative typology, by region, of the effects of the increase in commodity prices



Country focus

Angola
Democratic Republic of the Congo
Egypt
Guinea
Mozambique
Nigeria
Azerbaijan
Argentina
Bolivia
Peru

Angola: An extremely volatile oil economy

Benoît Jonveaux – jonveauxb@afd.fr

Angola is the second largest oil producer in Africa and its macroeconomic performance is very directly correlated with fluctuations in the price of a barrel. Indeed, depending on the years, the oil sector accounts for about 30 to 35% of GDP, 95% of exports and 50 to 60% of government revenue. The fall in oil prices, which started in mid-2014, has therefore caused major macroeconomic imbalances leading to five consecutive years of recession. It also brought the country to the verge of default in 2020. Conversely, the sharp rise in oil prices since 2021, which has accelerated in 2022, has allowed the country to generate significant surpluses and achieve an unprecedented appreciation of the kwanza. The authorities' efforts to diversify the economic model are encouraging, but still remain highly insufficient to develop strong growth drivers, while there has been a continuous reduction in oil production since 2016.

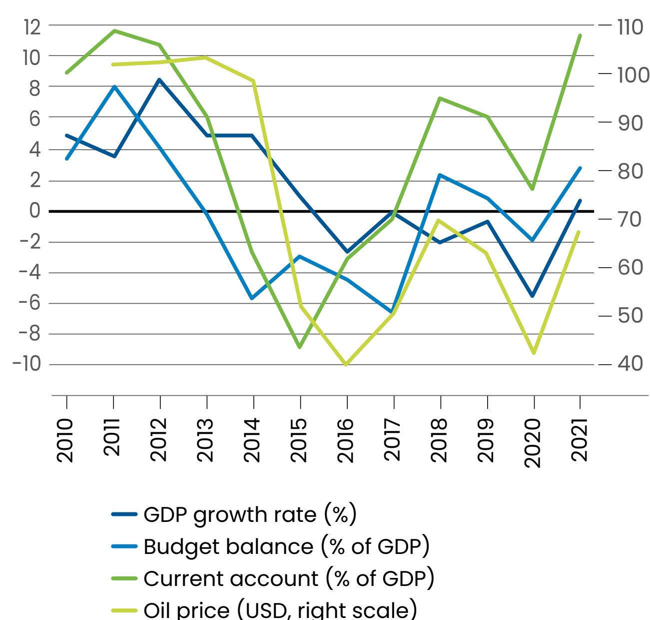
From the euphoria of the oil boom to the doldrums of five consecutive years of recession...

Angola's oil production saw an acceleration starting at the end of the civil war in 2002, from about 715,000 b/d on average between 1993 and 2003 to a peak of 1.9 million b/d in 2008 (then 1.7 million b/d on average between 2008 and 2019), with over 90% for export. This level of production, which is substantial in view of the size of Angola's economy and its population, has led to an extreme dependence on oil of the entire economy. The oil sector thus accounted for up to 40% of GDP and 80% of budgetary revenues (in 2012) and has made up 95% of the country's exports since 2008.

This rise in production, combined with high oil prices during the commodity super-cycle, drove up economic growth to 8.2% on average between 2002 and 2014 and increased GDP per capita from $950 in 2002 to $5,600 in 2014. The government's fiscal situation has also benefited from oil revenues, with a fiscal surplus of 1.3% of GDP on average between 2003 and 2013. Similarly, the current account has been largely in surplus (6.8% of GDP on average over the same period), resulting in an increase in the level of foreign exchange reserves from $650 million to $30 billion.

Conversely, the sharp fall in oil prices since 2014, combined with the decrease in production, from 1.8 million b/d in 2015 to 1.4 million b/d in 2019, has put the economy under heavy pressure and it entered into recession starting in 2016. Current account deficits appeared between 2015 and 2017, leading to a very rapid decrease in the

Graph 10 – Oil price and macroeconomic aggregates



Sources: IMF (IFS, WEO), Ministry of Finance of the Republic of Angola.

country's foreign exchange reserves, which fell from $30 billion in 2013 to $15 billion in 2018. The authorities were forced to devalue the kwanza in 2015-2016, then let it float freely starting in 2018: the kwanza lost nearly 75% of its value between 2015 and 2019. Finally, fiscal deficits increased (-2.2% of GDP on average between 2015 and 2019) and the weight of public debt exploded as a result of a higher debt level and the depreciation, with the debt-to-GDP ratio rising from 39% in 2014 to 114% in 2019.

…and from the crisis in 2020, to a highly favorable situation in 2021-2022

This deterioration in the situation since 2015 gathered pace in 2020, due to the pandemic's effects on the economy and the further drop in oil prices. The recession in 2020 was the highest ever recorded (-5.6%) and the government was forced to negotiate a rescheduling of the debt contracted from Chinese creditors to avoid default, in the context of a further deterioration in public and external accounts. However, the increase in oil prices starting in mid-2021 allowed Angola to return to positive GDP growth in 2021 (0.7%) and generate substantial budget surpluses (2.8% of GDP) and current account surpluses (11.3% of GDP), while the kwanza appreciated strongly (+50% against the USD year-on-year in June 2022).

Economic growth should be consolidated in 2022 (3% according to the IMF) and the budget and current account surpluses should remain at comparable levels. The country also benefits from the adjustments and reforms conducted under the IMF program (2018-2021), in particular the establishment of a floating exchange rate and the improvement in public finance management. This has allowed Angola to be one of the first African countries to issue bonds on international capital markets since the outbreak of the war in Ukraine ($1.75 billion in April 2022).

The net effect of the increase in commodity prices is therefore positive for Angola, due to the weight of oil in the economy. In addition, while Angola is an importer of a large number of products, in particular food, the effect on prices should be moderated by the massive appreciation of the kwanza. Inflation, which is structurally high, has been falling, albeit moderately, since the beginning of 2022 (from 27.7% year-on-year in January to 22.9% in June 2022) due to the effects of the appreciation of the kwanza and the increase in the Central Bank's key interest rate in July 2021 (+450 bp).

A transition of the economic model is necessary, but insufficient at this stage

The diversification of Angola's model must be a priority for the authorities for several reasons. The first is the promotion of a more inclusive growth model in a country where poverty remains high (in 2020, 56% of the population was living on less than $1.90 a day) and there are very marked inequalities. The second is the reduction of the economy's exposure to exogenous shocks, such as those experienced in 2015-2016 and 2020, and therefore of the volatility of economic performance. The third concerns the preparation, in the longer term, of the transition towards a low-carbon model, with lower emissions and less dependent on hydrocarbons. Maintaining oil production (still in decline in 2021, at 1.2 million b/d) at its current level will also require substantial investments, which are more costly because operators are already seeking to reduce the highly emissive nature of oil exploitation in Angola.

The PRODESI program[6] for the diversification of exports set up in 2018 is a first initiative that will contribute to these objectives. However, it is isolated due to the absence of other more ambitious measures with significant political and financial support. For example, this concern was far from being at the center of the general election campaign in August 2022, as seen with the declarations of President João Lourenço who, at a press conference in April 2022, called for a "gradual" transition towards a low-carbon economy and the possibility for African countries to continue to fully benefit from the exploitation of their fossil fuels.

6 *Programa de Apoio à Produção, Diversificação das Exportações e Substituição das Importações* (Program to Support Production, Export Diversification and Import Substitution).

Democratic Republic of the Congo: Overcoming the curse of mining rent

Luciana Torrellio – torrelliobaudoinly@afd.fr

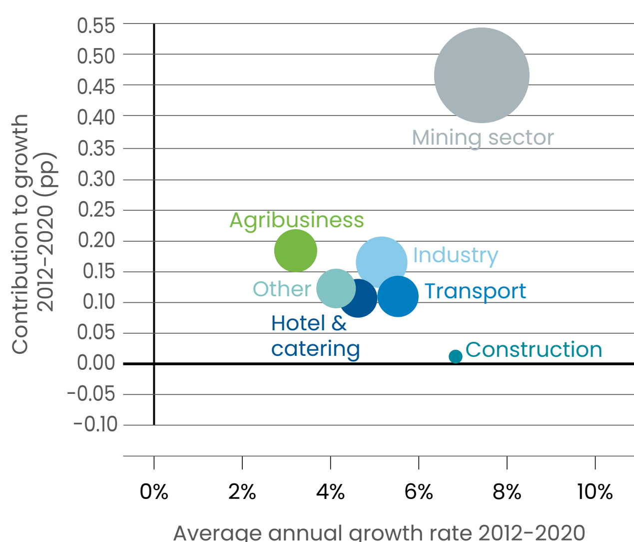
Democratic Republic of the Congo (DRC), the largest country in Sub-Saharan Africa, is a low-income country whose economic activity mainly focuses on the extractive industry. The authorities renewed full engagement with the IMF in 2021, nine years after the last program was suspended and eventually discontinued, demonstrating the authorities' willingness to restore good relations with the international community. Increasing revenue mobilization remains a major issue, even though the government willingness to undertake reforms provides opportunities to improve public financial stability. The effects of the rising commodity prices are antagonistic: they contribute to the clear improvement of external balances, but weigh on fiscal consolidation, in a context where the acute socioeconomic vulnerability hinges on the next presidential elections of 2023.

The Congolese economy is often associated with the "natural resource curse". Mining is the country's main rent, but also a major factor of vulnerability. Since the colonial times, the mining sector has played a key role in the economic model of the DRC, which is highly focused on exports of low-value-added primary commodities (95% of total exports, including 40% to China). The country's subsoil is one of the richest in the world, with over 50 minerals identified, including the second largest copper reserves in the world (10% of the total recorded) and the largest cobalt reserves (50% of the total recorded). Despite this windfall, the DRC has not managed to unlock its growth potential and promote inclusive growth mainly due to deficient institutions and its political instability. Characterized by one of the highest levels of corruption in the world, the country ranks in 169th place out of 180 in the *Transparency International index*. At the same time, deep divisions persist within the Congolese society and are compounded by conflicts for the control over the mines. Demographic growth, one of the strongest in the world, creates development challenges: consequently, in 2021, 77.2% of the population was living in extreme poverty, at the threshold of $1.90 a day.

A growth regime heavily dependent on the external market

In 2014, the turnaround in commodity prices led to a decline in export and budget revenues, which severely affected investment and GDP growth (CAGR of 4.1% on average in 2015-2019, against 6.3% in 2002-2014). In the context of the pandemic, economic growth slowed down from 4.4% in 2019

Graph 11 – Dynamism and structure of value added by sector



Note: the bubble size represents the average weight of the sector in GDP
Source: National accounts (DRC)

to 1.7% in 2020, with a contraction of 1.3% of the non-mining sector. The shock was largely mitigated by the eased containment measures notably lifting the curfew in place since December 2020, and by the vigorous Chinese demand, which generated a 6.9% growth of the mining sector.

Growth is estimated at 6.2% in 2021, as the sharp rise in prices, in particular for copper and cobalt, which have reached record levels, supported the economic rebound. According to the IMF, it should remain relatively stable in 2022.

A vulnerable budget implementation highly dependent on mining revenue

The DRC's budget implementation is also highly exposed to changes in commodity prices. The country has oscillated between small deficits (less than 2% of GDP) and surpluses since 2005, while having a moderate public debt ratio (projected to fall to 24.7% of GDP in 2022); the low implementation rate for expenditure (~74% for 2017-2021) damages the authorities' budget credibility.

However, the stability pact of the macroeconomic and monetary framework adopted in August 2020[7] and the new IMF program (three-year $1.52 billion Extended Credit Facility) signed in August 2021 should contribute to consolidate public finances and increasing prospects for reforms. Consequently, an increase in tax revenues seems possible.

Budgetary revenues increased by about 60% in 2021 compared to 2020 and stood at 13.2% of GDP, explained by the digitalization of revenues (about 50% in 19 provinces and 100% in the ones under siege) simplifying tax administration procedures and the favorable economic developments (higher commodity prices).This trend is expected to continue with the introduction of the special tax on excess profits. This tax is the first of its kind since the implementation of the Mining Code. It is an important step toward a mining taxation that is still underexploited.

However, the impact of the Russia-Ukraine war on commodity prices and value chains is likely to adversely affect fiscal performance due to the increase in fuel price subsidies. The deficit is forecast at 3.3% of GDP in 2022, whereas it was balanced in 2021. After slowing to 5.3% in 2021 (15.7% in 2020), inflation could reach 11% in 2022 according to the Central Bank's latest projections, in particular due to the surge in food prices.

External position strengthened in the short term

The improvement in the trade balance due to the global economic situation in 2021 has resulted in net foreign exchange inflows which, coupled with the SDR allocations of the IMF (~$1.5 billion), have strengthened foreign exchange reserves. Consequently, they reached a record level of $3.5 billion at the end of December 2021 (*i.e.* only about three months of imports). This increases the capacity to respond to external shocks, but remains insufficient. While the Congolese franc had depreciated sharply in 2020 (-15.2% against the USD), there has been a certain stability since, with a depreciation of 1.4% in 2021 and a stable exchange rate since the beginning of 2022. Despite an increase in the import bill, the current account deficit could be close to balance in 2022 after 14 years of deficit (-4.4% of GDP on average).

But what if cobalt was not sufficient...

The IMF program, the return of international donors and the mining boom, especially for cobalt, open up favorable prospects in the short-medium term. Driven by the objective of achieving carbon neutrality in 2050, global consumption of refined cobalt could reach 200,500 tons in 2025 and 344,000 tons in 2030, according to the World Bank. While the country should continue to dominate the cobalt market until 2025, international efforts to develop new generation batteries and thereby reduce dependence on cobalt pose a risk to the sustainability of the Congolese growth model. This risk is compounded by competitive pressure due to the development of cobalt mines in other countries, in particular in the Philippines and Indonesia. The lack of infrastructure, the limited financial leeway, and a complex business environment, as well as the lack of diversification of the economy leaves the economy extremely vulnerable to external shocks. Furthermore, while there are growing concerns over the risk of a delay in the electoral calendar, the presidential elections scheduled for late 2023 increase the risk of social tensions. Consequently, the acute socioeconomic vulnerability sustains the conflicts and fragility of the country.

7 This pact aims to ensure the absence of monetary financing of the public deficit and the prudent management of public accounts on a cash basis.

Egypt: Inflation and pressures on the balance of payments, return of the old demons

Maxime Terrieux – terrieuxm@afd.fr

While the Egyptian economy had proved to be fairly resilient to the pandemic (no recession), the surge in commodity prices in 2022 could create the conditions for a "perfect storm": food security risks and lower than projected growth undermine fiscal consolidation. But it is the return of double-digit inflation and, especially, of tensions on foreign exchange reserves which revive the demons of a recent past (2016 crisis) and force the authorities to call on the IMF yet again.

"Egypt has wheat reserves sufficient to cover 2022", reassured Mostafa Madbouly, the Egyptian Prime Minister, at a press conference in early March. He made this declaration while the outbreak of the conflict in Ukraine gave rise to a wave of panic over food security in a number of EDCs.

Food security: panic and reality

In Egypt, perhaps more than elsewhere, food security, in particular related to the risk of a wheat shortage, is a real issue. Through bread, wheat is a central component (~50%) of the diet of Egyptians. Bread has been largely subsidized since the 1940s and is a very sensitive political issue. The collective memory is still marked by the "bread riots" of 1977, following the authorities' decision to end subsidies, which caused over 80 deaths. During the 2011 revolution, protestors demanded "bread, freedom and social justice". The importance of bread also explains why the subsidized price has not changed since 1989. Egypt imports over half of its wheat consumption and is the world's largest importer of wheat. And 80% of these imports come from Russia and Ukraine.

In this context, the supply disruptions related to the war in Ukraine give good reason to fear for the food security of over 100 million Egyptians. That being said, the available stock and the new April-May harvest should allow the country to secure its supplies until the end of 2022. This leaves time for a diversification of sources, in particular with India or EU countries. In reality, the challenges for the Egyptian authorities lies more in the prices. To secure the supplies, the authorities will need to accept to pay a high price for the new imports. This will weigh on the State budget, but appears necessary to contain the frustrations of a population already facing rising inflation.

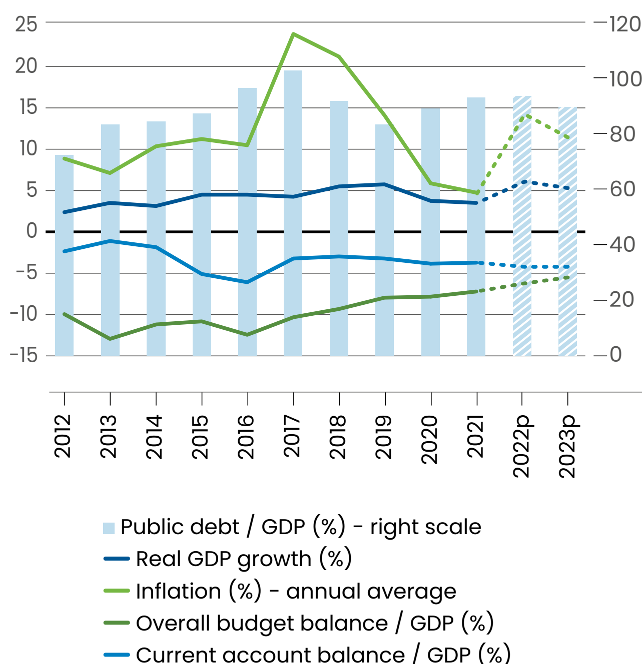
Return of double-digit inflation

While the surge in commodity prices directly affects the economy through several channels, inflation is the main driver. Stable at around 5% (year-on-year) since mid-2019, it reached 15% (year-on-year) on average in the second quarter of 2022, a level which it is expected to remain at throughout the year (consensus around 15% on average). Inflation is mainly driven by the increase in food prices (over 30% of the price index basket), despite the bread subsidies, and will need to be monitored for two reasons. Firstly, it will hold back the growth of an economy that will also suffer from the absence of Russian and Ukrainian tourists (two of the largest groups of visitors in 2021), even if growth should remain relatively high (5.5% on average for the fiscal years 2022 and 2023). Secondly, it will remain a major socioeconomic issue for a population whose standard of living is affected by the successive crises. The high inflation (22% on average for 2017-2018) in particular contributed to the middle-class squeeze during the IMF program of 2016-19. The Central Bank's response, by raising the key interest rate by 300 bp at the beginning of 2022 to 12.25%, will also weigh on households, but seems necessary to bring inflation back down to target (7% ± 2 pp) and support the Egyptian pound and external liquidity (see below).

Staying the course for the consolidation of public accounts

In view of the socioeconomic issues, the authorities will probably not change the prices of subsidized bread. With the increase in wheat prices, this will automatically drive up the subsidy bill and deteriorate the primary balance. The fiscal consolidation efforts (phasing out of fuel subsidies between 2017 and 2019), which have generated a primary surplus for three years (+1.3% of GDP on average for FY 2019-2021), will therefore need to be maintained to allow the public debt ratio to return to a downward path. Stable at a high level (~90% of GDP), public debt was indeed considered sustainable by the IMF in June 2021, but not with a high likelihood. It is primarily exposed to a refinancing risk, shown by public financing needs of over 35% of GDP a year, taking into account the substantial debt repayment level due to the short maturity. While this level can a priori still be absorbed by the liquidity of the local financial market, it is much higher than the theoretical critical threshold (15%). This exposes public debt to a loss of confidence and liquidity pressures, as seen on the local market and on the international market. Sovereign spreads on Eurobonds in particular saw a short-lived surge at over 1,000 bp in early March, prior to a contraction to a continued high level of 900 bp at the end of June.

Graph 12 – Main macroeconomic aggregates



Source: IMF (WEO, April 2022).

New call to the IMF to ease balance of payment pressures

A net importer of a number of essential commodities, Egypt is expected to suffer from a deterioration of terms of trade and see its current account deficit increase in 2022 (revised IMF projection from -3.7% of GDP to -4.3% of GDP between October 2021 and April 2022). The increase in portfolio investment flows since late 2020 to cover the current account deficit, which are much more volatile than the traditional FDI (only covering 30% of the deficit on average for 2020-21, against 70% for 2015-19), exposes Egypt to sudden stops which weigh on external liquidity. This risk has materialized since the beginning of 2022 with an outflow of foreign capital of over $7 billion, triggered by a loss of confidence in emerging countries in a context of the Fed's monetary tightening, and for Egypt in particular with a fall in the real interest rate. Foreign exchange reserves have thus fallen by over 20% since the beginning of the year, lowering the coverage ratio to about four months of imports of goods and services (six months before the onset of the pandemic), and forcing the authorities to take two rapid response measures: (i) a 14% devaluation of the Egyptian pound in March and (ii) at the same time, a request to the IMF for a program with financing, the third in six years. The program, whose outlines are currently under discussion with the Fund's teams, will catalyze financing from other donors and complete the $22 billion promised by several neighboring Gulf countries. While external debt (35% of GDP) and the external financing needs (8.5% of GDP for 2022) are contained, external liquidity will therefore remain a recurring issue that needs to be monitored, given Egypt's history of balance of payments crises.

Guinea: A dynamic mining sector, a strong sociopolitical risk

Marion Hémar – hemarm@afd.fr

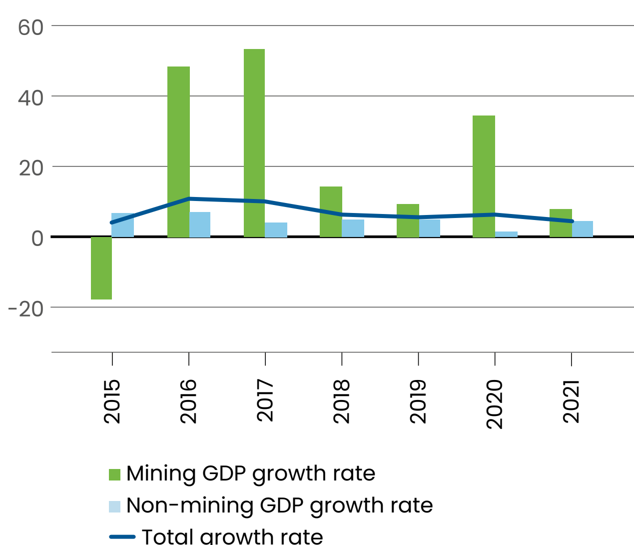
Since the end of the Ebola epidemic in 2016, economic activity has been engaged in a dynamic recovery, in particular as a result of the strong performance of the extractive sector. Mineral exports (bauxite and gold) account for over 90% of the country's exports (2020) and China is the country's main trade partner. Guinea's growth, and more specifically in the mining sector, proved resilient to the effects of the Covid-19 pandemic in 2020-2021 and should remain dynamic in the coming years. However, the increase in food prices and political instability since late 2021 are likely to increase the risk of social unrest and could hold back growth dynamics. The disruptions related to the Russia-Ukraine conflict should only marginally affect Guinean exports.

Since its independence in 1958, Guinea has experienced several periods of political instability marked by coups. In 2020, President Alpha Condé, then 82, decided to engage his party and government in the plan for a new Constitution so that he could run for a third term. The legislative elections and constitutional referendum held in March 2020 were marked by large-scale demonstrations and social unrest. Despite this, the presidential elections were held in October and A. Condé was re-elected, but results was highly contested by the opposition. It is in this context of political turbulence that the military coup took place in September 2021. Despite a Transitional Charter, the government of the coup leader, Mamady Doumbouya, has not yet proposed a clear timetable for the return to civil order and public discontent is beginning to emerge.

A growth driven by the mining sector but affected by the political and health crises

Guinea has considerable economic potential: in addition to being a major gold and diamond producer, the country holds a third of global bauxite reserves and has abundant water resources. Between 2000 and 2010, Guinea failed to capitalize on its abundant natural resources and improve its economic performance, in particular due to the political instability and its institutional weaknesses. Following an initial period of positive results (2011-2012) related to the recovery in commodity prices, Guinea experienced a series of shocks that curtailed economic growth, in particular the political turmoil that preceded the 2013 legislative elections, the sharp drop in metal prices in 2012-2013, the 2015 turbulence related to the presidential election and the Ebola epidemic between 2014 and 2016.

Graph 13 – Trend and composition of Guinea's economic growth (as a %)



Source: IMF (Article IV reports).

In 2020, despite the health crisis and local political turmoil, GDP growth was sustained at over 6%, *i.e.* the second most dynamic growth rate in the world. Growth in GDP from mining (+34.6%) mainly contributed to the achievement of this result, with a rise in production, the recovery in Chinese demand in mid-2020 and the increase in aluminum prices. Non-mining GDP growth (+1.3%) was limited, held back by the containment measures that negatively affected tourism, transport and retail trade. In 2021, GDP growth is estimated at 4.2%, still driven by the mining sector (+7.7%) and the IMF forecasts +4.7% for 2022, close to the growth potential of around 5%.

Surging food prices increase likelihood of social tensions

The Central Bank of the Republic of Guinea (BCRG) is pursuing a policy against rising prices by targeting an inflation target of below 10%. In 2020, during the health crisis, the BCRG took monetary easing measures to improve the liquidity of banks and support the credit supply for the economy. Consequently, it lowered the key interest rate (from 12.5 to 11.5%) and the coefficient of minimum reserves for commercial banks (from 16 to 15%). Inflation stood at 12.6% at the end of 2021 according to the IMF, after 10.6% in 2020 (latest national data as at September 2021), driven by the increase in food prices (+15%) and the rather accommodating monetary policy. Despite the highly inflationary context since the end of 2021, the Central Bank has not increased its key interest rates. The surge in food prices at the beginning of 2022 is likely to heighten sociopolitical tensions. As economic growth is mainly due to the mining sector, it is not very inclusive. This leads to a low standard of living which Guinea is struggling to improve in a context of strong population growth (+2.8% in 2020). The poverty rate, at the national level, stands at about 50% of the population and almost a quarter of the population lives on less than $1.90 a day.

Guinean public finances remain fragile

The budget deficit has remained limited since the adjustment carried out in 2016 after the end of the Ebola epidemic. However, it has risen since 2020 (to -1.5% of GDP in 2021, against -0.5% in 2019) with the increase in expenditure related to the health crisis and despite the sound performance of revenues, which are structurally low (less than 15% of GDP). Guinea's achievement of the completion point of the HIPC Initiative in 2012 led to a substantial reduction in public debt (from 58% of GDP in 2011 to 27% in 2012). The country has since taken on new debts at a rapid pace, with in particular an increase in foreign currency debt. However, in 2021, due to the contraction of the budget deficit and the appreciation of the Guinean franc, there was a significant reduction in the public debt ratio to 39% of GDP, against 44% at the end of 2020.

Extractive industries are a key driver for the country's external sector

With an openness rate of over 50%, Guinea is a particularly extrovert economy. China is the country's main trade partner, with 40% of its exports and 39% of its imports in 2019. The current account balance is structurally in deficit (at 4% of GDP in 2021, against 15% of GDP on average over the last decade) and its evolution is closely linked to mining activity (93% of exports of goods in 2020) and to variations in prices for mining products (bauxite, gold and diamonds) on the international market. The disruptions related to the Russia-Ukraine conflict, such as the suspension of production at the Rusal alumina plant in Ukraine, should only marginally affect Guinean exports, as the subsidiaries of Rusal Group (CBK and COBAD) account for less than 10% of the country's bauxite exports (but almost 5,000 jobs when the FRIGIA refinery is included).

The current account deficit has been historically financed by FDI, mainly in the mining sector, and debt generating flows by the public sector. While FDI seem well-oriented in 2022, financing from donors may be stopped in the absence of a clear political transition. The IMF forecasts that the current account deficit will rise to about 10% of GDP in 2022, with an increase in imports higher than for exports. In 2020, there was a slight increase in foreign exchange reserves to $1.4 billion, *i.e.* 2.2 months of imports (against 2.1 months at the end of 2019). To date, the BCRG has not published the level of reserves at the end of 2021, but the country is expected to reach the level of three months of imports, recommended by the IMF for a managed floating exchange rate regime, in 2026.

Mozambique: A high-risk gamble on gas

Maëlan Le Goff – legoffm@afd.fr

Mozambique bets on the exploitation of its vast gas reserves to initiate a structural transformation of its economy; a strategy that seems particularly timely in a context of high gas prices and Europe's attempt to free itself from the Russian supplier. However, the return on investment has yet to materialize, with projects stopped and a substantial cost for the economy (e.g. deterioration of twin deficits, explosion of debt, increasing tensions in the north, stagnation in per capita income). While the short-term prospects are improving with the start of the offshore-liquefied natural gas (LNG) project and the return of donors, a macroeconomic rebalancing and shift to more diversified and inclusive economic growth do not seem feasible in the short term.

At a time when Europe is trying to free itself from Russian gas, Mozambique's huge reserves (between 100 and 180 billion cubic feet according to sources) are highly coveted. Their exploitation could turn Mozambique into one of the world's main producers of LNG, while the country already sees itself as the leader of the transition in Africa. At national level, the gas rent is presented as a promise of diversification and socioeconomic development. But the country's institutional weaknesses could contribute to holding it in the classic pattern of "fiscal presource curse", which refers to the deterioration of public finances caused by the discovery of natural resources even before their exploitation.[8]

Increasing dependence on raw materials

While Mozambique has one of the richest subsoils in the world (mining products and hydrocarbons) and its financial resources are mobilized on a massive scale for megaprojects,[9] per capita income ($500 at current prices) and the poverty rate (>63%) have stagnated since 2014. While the extractive sector only accounts for 7% of GDP, the economy tends to increasingly focus on it through the investments and exports it generates. Consequently, in terms of economic complexity, Mozambique is estimated to have moved from 89th place worldwide in 2004 to 114th in 2020. In 2019, some 65% of the country's exports were made up of aluminum (and byproducts), as well as coal and natural gas.

The GDP growth dynamic is thereby largely based on the prices of these resources, hence the slowdown as of 2015, compounded by the hidden debt scandal as of 2016. Following a slight upturn in economic growth in the aftermath of the earthquake in 2019 and the Covid-19 pandemic (2.2% in 2021), it is expected to accelerate to 3.8% in 2022, mainly due to the start of the offshore gas liquefaction activities.

Gas projects and insecurity inextricably linked

The progress of gas megaprojects is severely disrupted by the security tensions which have been destabilizing the north of the country since 2017. Out of the three main LNG production projects, only the project conducted by ENI (capacity of 3.4 mt a year), which is more protected from attacks due to its offshore position, should materialize by the end of 2022. However, the TotalEnergies and Exxonmobil projects (with a respective annual capacity of 13.1 mt and 15.2 mt) have been suspended since the attack in Palma in March 2021. Since then, offensives by the Islamic armed group Al Shabaab have continued in the provinces of Cabo Delgado and Niassa.

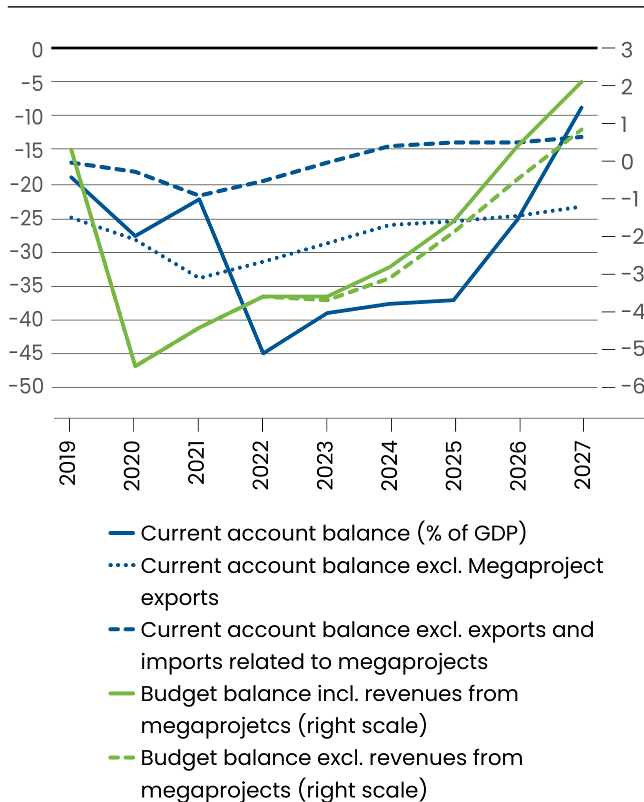
Poverty and the feeling of exclusion of Muslims in the north may explain the origin of these tensions, which are responsible for the internal displacement of 800,000 people (IOM). The latter have also been fueled by the cost borne by local communities with no real benefits, in particular in terms of employment[10].

8 RUZZANTE, M. and N. SOBRINHO (2022), "The 'Fiscal Presource Curse': Giant Discoveries and Debt Sustainability," IMF Working Paper WP/22/10.

9 Mozal aluminum smelter, Moma titanium mine, etc.

10 International Crisis Group, Report n°303, June 2021

Graph 14 – Projections of fiscal and current balances



Source: IMF (Article IV, April 2022).

Resources very costly today...

The country is counting on the future revenues generated by the production of LNG (but also coal, sand and aluminum) and has massively invested in megaprojects and the infrastructure required for their implementation, by incurring debt via loans backed by future gas revenues. This strategy, in addition to the revelation of hidden loans guaranteed by the State for projects related to gas investments, has sent the debt ratio through the roof (from 38% of GDP in 2011 to over 100% in 2016).

The imports required for the investments also weigh on the current account balance. It is structurally in deficit due to oil and food imports and deteriorated significantly following the discovery of gas fields (average of -30% of GDP between 2011 and 2021, compared to -11% for 2000-2010). The resumption of the offshore gas project and, in particular, the import of the floating LNG exploitation platform for $4 billion (1/4 of GDP), combined with the increase in the price of imports related to the war in Ukraine, should thereby significantly contribute to the deterioration of the current account deficit in 2022 (projected at -45% of GDP).

...for distant and uncertain gains

While the authorities consider that the exploitation of gas wealth could raise close to $100 billion of fiscal revenues (7 times annual nominal GDP) over 25 years, the gains should remain low in the medium term. The IMF forecasts that the budget balance will become positive again as of 2026, with limited net revenues from LNG projects (<0.5% of GDP by 2026), given the portion reserved for the repayment of loans. The creation of an investment fund is planned for the end of 2022, in order to facilitate the management of the revenues from gas projects. The current account balance is not expected to benefit from the exploitation of gas resources until 2027. However, the return of donors, encouraged by the signing of an IMF program, through an Extended Credit Facility (ECF) in May 2022, as well as the increase of non-FDI capital inflows, could facilitate the financing of the external financing needs. In addition, according to the IMF's latest debt sustainability analysis (DSA), the country is no longer in debt distress, but its long-term sustainability remains subject to the commissioning of the various LNG projects.

While the prospects would thereby appear to be improving in the short-term, according to Moody's Mozambique is one of the four African countries with the highest risk of sociopolitical destabilization due to the international situation, as can be seen with the "food riots" which swept the country in 2016. In addition, in the longer term, the odds that the growth in the hydrocarbon sector will structurally transform the Mozambican economy are slim, given the country's structural weaknesses.[11]

11 MACUANE, J. J. and C. MUIANGA (2020), "Natural resources, institutions, and economic transformation in Mozambique," WIDER Working Paper, N° 2020/136, ISBN 978-92-9256-893-1, The United Nations University World Institute for Development Economics Research (UNU-WIDER), Helsinki.

Nigeria: The “de-addiction” to hydrocarbons can wait

Sylvain Bellefontaine – bellefontaines@afd.fr

Nigeria entered the Covid-19 crisis still marked by the scars of the oil shock of 2014, due to the sensitive nature of the hydrocarbon sector. The decline in oil production and low refining capacity do not allow the country to fully benefit from the increase in oil prices (GDP growth, external and public accounts). On the eve of the general elections in February 2023, the costly fuel price subsidies are likely to weigh heavily on the fiscal consolidation. The increase in food prices is also likely to increase the risk of impoverishment and further undermine national cohesion. The country’s socioeconomic development trajectory remains highly uncertain, in view of the structural vulnerabilities and the deterioration of economic policies and the business environment since 2015. The Ukrainian crisis may promote the European and global energy transition, but nevertheless opens a window of economic and commercial opportunities for Nigeria.

A symbol of macroeconomic dynamism, two of Africa’s five unicorns are Nigerian (the fintechs Interswitch and Flutterwave). Faced with strong demographic pressure, a stagnation in the standard of living, an increase in poverty, a high security risk and limited social safety nets, the population shows a certain resilience. This is due to the role of the informal economy as a socioeconomic buffer, the development of services and the weight of agriculture, the main drivers of economic growth and providers of employment. However, the energy sector remains the key variable in the macroeconomic equation. While it accounts for scarcely more than 7% of GDP (vs. 15% in 2011), it still generates over a third of budgetary revenues, 90% of exports and a quarter of outstanding bank loans.

The European energy crisis, a bonanza without being a panacea…

The Nigerian economic model is highly exposed and vulnerable to the risk of the low-carbon transition. But pending the phasing out of fossil fuels, the Russia-Ukraine conflict offers opportunities in terms of supplying Europe, in particular in natural gas. The European Union is already Nigeria’s second largest export market (almost a quarter of its exports, just behind India). The country depends on imports of cereals (of which one-quarter is imported from Russia and Ukraine), fertilizer (84% imported from Russia) and refined products. The total external financing needs appear to be moderate in 2022, with a current account deficit contained (~1% of GDP according to the IMF) and a reasonable level of debt servicing (~2% of GDP).

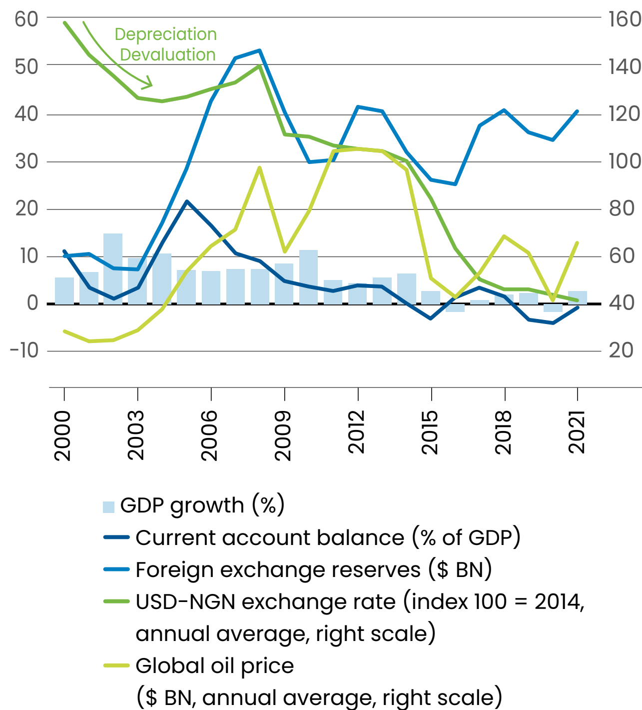
The authorities are very much counting on the opening of the private Dangote refinery at the end of 2022, whose production target is 650,000 barrels per day. The application of the Petroleum Industry Act, which has been postponed until after the elections in February 2023, aims to attract investors in order to double crude oil and natural gas production and develop the liquefaction capacity. Furthermore, there is renewed interest in the projects for gas pipelines towards Morocco and Algeria, in order to ultimately serve Europe.

…in the hope of reinvigorating economic growth…

GDP growth slowed from 7.7% on average in 2000-2014 (commodity super-cycle) to 1.2% in 2015-2019. Following a contained recession in 2020 (-1.8%), the non-hydrocarbon sectors supported the recovery of activity in 2021 (+3.6%). Oil production has halved in a decade and in H1 2022 remained 25% lower than the OPEC+ quota of 1.8 million b/d (problems of maintenance, underinvestment, sabotages and traffic).

The IMF forecasts 3.4% of GDP growth in 2022 and a medium-term potential of 3%, far short of the ambition of 5% of the 2021-2025 National Development Plan, which is based on an unrealistic investment program of $850 billion, with 85% financed by the private sector. Potential growth and economic diversification are constrained

Graph 15 – The oil price, cardinal variable of the economy



Sources: Central Bank of Nigeria, IMF, AFD calculations.

by weaknesses in human capital and infrastructure (transport, electricity), the complexity of the regulatory framework, the additional costs throughout the supply chain, the difficulties of companies to import intermediate goods (foreign exchange controls) and access financing, as well as the lack of export competitiveness and incentives for local and foreign investors, in a sensitive security context.

...a more flexible foreign exchange policy...

Faced with the “fear of floating” (inflationary risk associated with a depreciation of the naira) expressed by the authorities, a strengthening of the external liquidity position, which was weakened in 2020, would help make the exchange rate regime more flexible and ease currency supply. The strategy of pegging to the US dollar, combined with import barriers (tariff, non-tariff, exchange controls) adopted in 2015 to preserve foreign exchange reserves (currently covering six months of imports), develop the productive sector and contain inflation, seems ineffective and disruptive for the economy. It has contributed to shortages and inflationary and recessionary pressures, with ramifications in terms of sociopolitical risk.

The devaluations of 2016 and 2020 have not corrected the overvaluation of the naira, and the gap between the new NAFEX reference exchange rate since April 2021 and the parallel exchange rate stands at 30%. Inflation, which is structurally at a double-digit level (18.5% year-on-year in June 2022), is driven by the increase in food prices (19.5%). At the same time a Central Bank, financial regulator, public revenue department and development bank, the Central Bank of Nigeria (CBN) increased its key interest rate by 250 bp in May-July to 14%, maintaining negative real interest rates and a window with a subsidized rate (5%) for certain business sectors. It has become predominant in the financing of the State (~30% of outstanding public debt in 2021).

... and consolidating public finances

The low level of royalties paid by the national company NNPC (sluggish oil production) and the exorbitant cost of fuel price subsidies (estimated at ~2% of GDP in 2022) have led to the adoption in April 2022 of an amended federal budget targeting a deficit of 4% of GDP, against 3.4% of GDP initially. The IMF forecasts a consolidated public deficit of 6.4% of GDP and an absence of budgetary consolidation in the medium term, expecting a cap on budgetary revenues at 7-8% of GDP, without a rebound in the energy sector and a broad tax reform.

The country has not been under an IMF program since 2001 (RFI of $3.4 billion in 2020) and public debt (37% of GDP in 2021) is considered sustainable with a rather favorable profile (¾ of local currency debt, 80% held by residents). But the liquidity risk is high, related to the heavy ratio of interest payments to budgetary revenues (33%) and the increase in exposure to market sentiment in a context of the tightening of liquidity and international financing conditions. The IMF projects a public financing needs of over 11% of GDP on average in 2021-26 (alert threshold at 15%).

Azerbaijan: One of the big winners of the European energy crisis

Cécile Duquesnay – duquesnayc@afd.fr

Benefiting from a strategic position at the crossroads of Europe, Asia and the Middle East, Azerbaijan, following its independence from the USSR in 1991, has managed to develop its oil and gas supply, as a result of new offshore exploration techniques and substantial investments made with major oil companies. Since 2020, its pipelines, which supply Eastern and Western Europe while bypassing Russia, have allowed it to gain market share. This trend has gathered pace since the sanctions imposed on Russia in reaction to the invasion of Ukraine. With the recovery in demand, the economy renewed with growth in 2021 and the high energy prices have boosted the external accounts and public finances, which have returned to the surplus levels they had before the health crisis. Despite the inflationary risk, the short-term macroeconomic prospects are strong. However, the country remains highly exposed to exchange rate fluctuations. While the Covid-19 crisis served as a reminder of the urgent need to diversify the national economic model, the windfall effect related to the current energy crisis and the acceleration of inflation are likely to delay it.

The history of oil started in Baku at the end of the 16th century. By the end of the 19th century, it had already over 3,000 wells which enabled the Russian Empire to become the world's leading oil producer, with 95% of production coming from wells in Azerbaijan. Following the opening of the Baku-Tbilisi-Ceyhan pipeline in May 2005, a strong dynamic for economic growth allowed it to considerably increase average income per capita and significantly reduce the poverty rate. The former rose from $680 to $7,740 between 2001 and 2014 and the latter fell from 49% to 5% at national level over the same period. However, the country's macroeconomic performance is closely related to trends in global energy prices. Since 2014, the fall in oil prices has eroded household purchasing power and the strict lockdown introduced in March 2020 has exacerbated socioeconomic disparities.

Geopolitical position under control

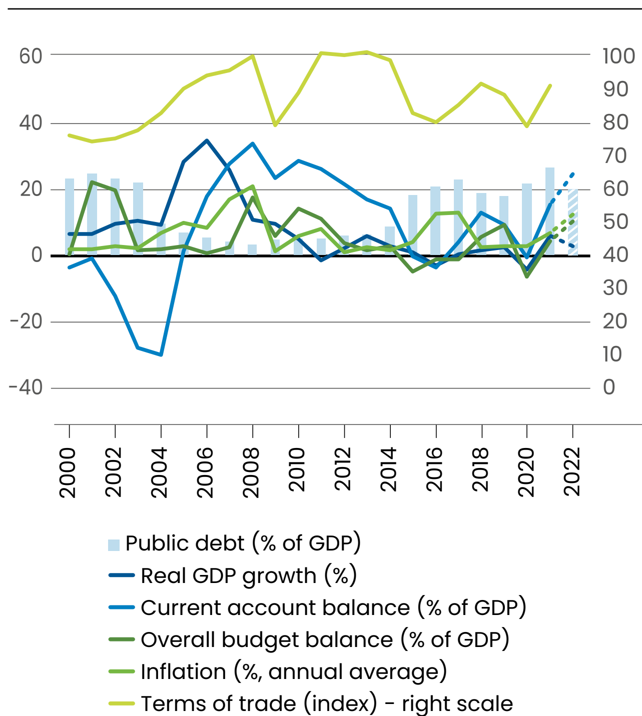
Located at the crossroads of Europe, Asia and the Middle East, Azerbaijan intends to negotiate good deals for its resources by concluding agreements for the supply of gas and oil with Russia, Iran and Turkey, as well as with the European Union and Georgia. Consequently, while presidents Aliyev and Putin signed a new agreement on 21 February in Moscow, which aims to strengthen bilateral relations, Azerbaijan was one of the first countries in the region to condemn the invasion of Ukraine, under the principle of the sovereignty of States (which had also been referred to in order to justify the conflict with the Republic of Armenia over the disputed territory of Nagorno-Karabakh in 2020).

Consequently, following the sanctions imposed on Russia since the invasion of Ukraine, Azerbaijan should continue to gain market share in the energy race. Indeed, with the commissioning of the Trans-Anatolian Natural Gas Pipeline (TANAP) in late 2019, the country has become the main gas supplier in Turkey, ahead of Russia. Total oil and gas production should reach 746 000 b/d in 2022 (compared to 565,000 in 2020), supported in particular by the Trans-Adriatic Pipeline (TAP) which was commissioned in 2020 with 900 km connecting the Italian coast to the Greek-Turkish border. The economy also benefits from the increase in the price of other raw materials, which the country exports, such as aluminum and polymer from the petrochemical industry.

Economic growth highly correlated with the global oil cycle

Economic activity renewed with vigorous growth in 2021 (5.6% compared to -4.2% in 2020), although the pace was lower than the double-digit growth during the commodity super-cycle

Graph 16 – Hydrocarbons, real pillars of Azerbaijan's economy



Source: IMF (WEO), local authorities.

between 1999 and 2008. The IMF forecasts that real GDP growth will increase by 3.8% in 2022, driven by the upturn in demand and hydrocarbon prices (Article IV July 2022). However, potential growth is expected to be limited at 2.5%.

Twin surpluses expected in 2022

Fiscal performance is highly exposed to trends in oil and gas prices, as 50% of government revenues come from the State Oil Fund of Azerbaijan (SOFAZ). Consequently, following a sharp deterioration in 2020 (-6.7% of GDP), the fiscal balance increased by 10.8 pp in 2021, reaching a surplus of 4.1% of GDP as a result of the high energy prices and, to a lesser extent, dynamic non-oil tax revenues and the withdrawal of support measures related to the pandemic. As the 2022 budget has been established on the assumption of a barrel at $50, the fiscal surplus is forecast at 9.7% of GDP (Article IV July 2022), which is its highest level since 2011.

Similarly, with 90% of exports based on the hydrocarbon sector, the country's external accounts have returned to their pre-pandemic levels, with a current account surplus of 15.2% of GDP in 2021. The rise in global prices and in the value and volume of hydrocarbon production will support the increase in exports (44% of GDP). The forecast of current account surplus is 24.6% of GDP in 2022 (Article IV, July 2022), which will be the highest since 2011.

Unfailing external liquidity

The significant current account surpluses between 2006 and 2014 (~23% of GDP on average) have enabled an accumulation of foreign exchange reserves, which now stand at over $53 billion (which represent over 30 months of import coverage), divided between assets from the SOFAZ oil fund (~$46 billion) and the Central Bank's foreign exchange reserves (~$7 billion). Their comfortable level limits the risk of external liquidity and has allowed the authorities to maintain a firm pegging of the Azerbaijani manat to the US dollar (1.70 AZN/USD) since 2017, following the devaluations of 2015. This pegging has de facto allowed inflation to be kept under control in the context of the undiversified economy of the country, where the European currency is the main transmission channel of inflationary shocks.

But the challenge of diversification remains

The growth in non-oil production of over 10% year-on-year in Q1 2022 reflects not only the resumption of services after the pandemic, but also the progress achieved in the development of the 11 new sectors targeted by the 2016 strategic plan for the diversification of production and exports, as well as the creation of new jobs. However, faced with the acceleration of inflation, the Central Bank (CBA) has interrupted its cycle of monetary easing by increasing its key interest rate five times in a row since September 2021 and it reached 7.75 bp in March 2022. The IMF forecasts that inflation, which had reached 12% at the end of 2021 (compared to 2.7% at the end of 2020), should, on average, remain at these levels throughout 2022. However, the monetary easing, which aims to limit consumption and construction expenditure, could also weigh on investments, in particular for private companies outside traditional sectors. Furthermore, the appreciation of the real effective exchange rate could also slow growth in non-oil exports and import substitution products, thereby holding back private sector growth.

Argentina: The contrasting effects of rising commodity prices

Emmanuelle Monat – mansartmonate@afd.fr

Since the dual currency crisis of 2018-2019, Argentina has experienced renewed macroeconomic and fiscal instability. Following the renegotiation of part of the public debt held by private creditors in 2020 and lengthy discussions with the IMF, an agreement was reached in March 2022 for the implementation of a new program. This could ease short-term pressure on solvency and gradually restore debt sustainability and public finances. The increase in commodity prices has contradictory effects on the economy: it should improve the economic outlook and restore progressively international reserves, but could also weigh on fiscal consolidation and inflation, while increasing the risk of social tensions in the run-up to the general election in October 2023.

For several decades, economic growth has been volatile in Argentina, alternating between periods of strong growth and crises. This instability reflects the numerous changes in economic policy adopted by various successive governments. Following the crisis in 2001, economic policies were mainly based on protectionism, State interventionism and consumption. Between 2003 and 2007, economic growth increased, driven by the increase in commodity prices. Indeed, Argentina is a net exporter of commodities (70% of its total exports of goods), mainly of cereals and oilseeds (about 50% of Argentina's total exports). In 2012, the economy started to alternate between weak growth and recessions again, while a number of imbalances started to appear (overvalued exchange rate, high inflation, rise in twin deficits financed via foreign exchange reserves).

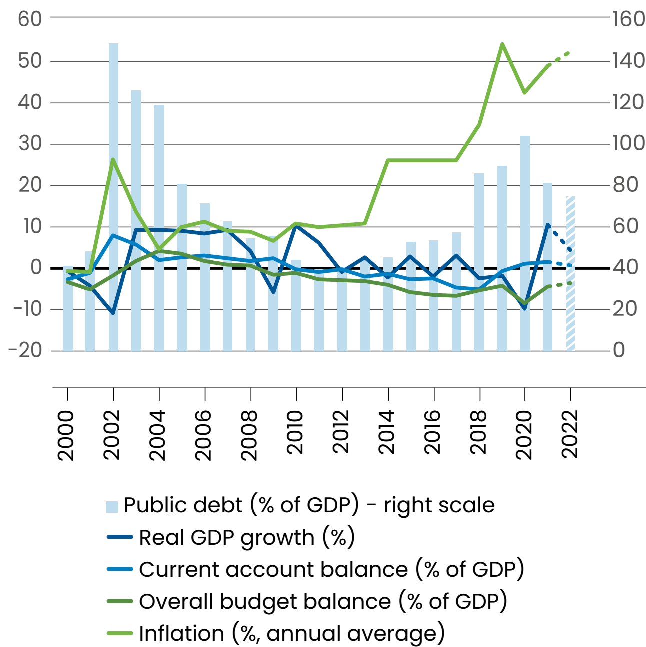
The dual currency crisis of 2018-2019 plunged the country into a recession. The health crisis exacerbated the situation, with a recession in the country of 9.9% in 2020, due to the effect of the lockdown measures on the economy and the decline in revenues from agricultural exports and tourism. However, growth rebounded strongly in 2021, to 10.2%, driven by a major base effect and the increase in commodity prices.

The increase in commodity prices should support prospects for economic growth…

The IMF forecasts that economic growth will reach 4% in 2022, driven by high commodity prices, the recovery in tourism and a gradual return of international confidence, related to the new IMF program agreement reached in March 2022. This program has been subject to lengthy discussions since the suspension of the previous program in 2019. The authorities and the IMF have finally reached an agreement for the implementation of a program, which should ease short-term pressure on solvency and allow introduction of policies to gradually restore debt sustainability and public finances.

In the medium term, some sectors, which have gained in importance in recent years, could be key drivers for economic growth. In addition to the agricultural sector, the country has a lot of energy and mineral resources. It is estimated that Argentina has the world's second largest reserves of unconventional gas, including the fourth largest reserves of shale in the world. Furthermore, it is part of the triangle of countries, with Chile and Bolivia, which share 60% of the global lithium reserves known at this stage. In 2020, Argentina produced 10% of the world's lithium, thereby ranking as one of the top five producing countries. The authorities wish to develop both the mining and gas sectors, as well as renewable energies.

Graph 17 – Main macroeconomic aggregates



Sources: IMF (WEO, IFS), World Bank.

…should have a limited positive effect on the external balances…

The increase in commodity prices should have a limited positive impact on the current account. Indeed, while the country should benefit from the rise in cereal prices *via* the increase in the prices and quantities dedicated to export, the increase in export revenues will likely be partly offset by the rise in energy prices, which will weigh on the import bill. Argentina is a net oil exporter and net gas importer, with an energy balance remaining negative as long as the energy production potential remains underexploited.

While the net effect on the current account is still uncertain at this stage, it could be slightly positive. This would allow Argentina to generate foreign exchange reserves, which is one of the criteria of the new IMF program.

…but will adversely affect public finances…

While the IMF program suggests a gradual fiscal consolidation, increases in energy prices will weigh on the energy subsidy bill. These subsidies were initially supposed to be reduced by 0.6% of GDP in 2022 under the program. The implementation of this reduction now appears complicated. The rise in the cost of energy and in inflation should maintain or even increase the weight of subsidies in government expenditure, and undermine the fiscal consolidation.

That being said, an increase in customs duties, linked to the rise in agricultural exports – taxed at 33% for soybean and 12% for wheat and corn – could partly mitigate the impact of a higher subsidy bill on the budget deficit. However, the net effect is likely to be negative for public finances and will depend on both developments in agricultural exports and the implementation of other budgetary reforms.

…increasing the risk of socioeconomic tensions in the run-up to the 2023 election.

The increase in commodity prices will add to inflationary pressures, which are already high, while food and energy account for over 30% of the household consumption basket. Furthermore, the IMF forecasts that imported inflation will be high, with a 10% increase in global food and energy prices generating a rise in inflation estimated at 1% over 12 months. In a context of structurally high inflation in Argentina, this shock could have a particularly strong impact on the poorest households and increase the risk of social tensions, while the poverty rate already rose following the Covid-19 crisis, to over 40% in 2021.

While the general election in October 2023 should not fundamentally compromise the IMF program, it is nevertheless likely to crystallize the discontent of part of the population over the resulting reforms and over the economic and social effects of the Covid-19 crisis and global increase in commodity prices, which will weigh on purchasing power. The resignation in July of the Minister of Economy, Martín Guzmán, who is considered as moderate in the center-left government, could now lead to an easing of the fiscal policy, coupled with an increase in inflation and a strengthening of capital controls. This would indirectly undermine the IMF program's objectives. Despite the risks and uncertainties over the effective implementation of the program, the latter remains essential for Argentina, in order to make adjustments to restore investor confidence and to return on the financial markets to refinance the new debt maturities in 2026.

Bolivia: Developing extractive resources, anticipating the transition

Meghann Puloc'h – pulochm@afd.fr

In light of the rebound in commodity prices, Bolivia's economic outlook is looking brighter. However, thiswill not erase the scars of the political crisis, followed by the health crisis. While the sustainability of Bolivia's fiscal and monetary policies had been undermined by the accumulation of macroeconomic imbalances since the reversal of the terms of trade in 2014, the favorable economic situation offers welcome respite. This could be a window of opportunity to adjust the strategic policies in order to ensure they provide an effective response to tomorrow's challenges.

An Andean country benefiting from substantial natural resources of hydrocarbons (natural gas) and minerals (gold, zinc, silver and tin), Bolivia has, for decades, based its economic growth model on its extractive sector, which accounts for 80% of its export base. The country now faces two challenges: stabilizing its macroeconomic imbalances and initiating its transition towards a low-carbon model.

The extractive sector contributes to social progress

The generated revenues, which account for over a third of government revenue, financed the redistributive social policy pursued by President Evo Morales (2006-2019). GDP per capita thereby rose by 56% between 2004 and 2019, and the absolute poverty rate fell from 29% in 2000 to 3% in 2019, while income inequality has also been reduced.

The Covid-19 health crisis and measures taken to restrict mobility in order to contain it could have had a serious socioeconomic impact in view of the 10% fall in GDP per capita, i.e. a return to its 2014 level. However, it would appear that recourse to self-entrepreneurship, widespread direct cash transfers, and the maintaining of fuel subsidies have largely absorbed the deterioration of the population's living standards. Consequently, the increase in poverty estimated in 2020 (+1.4 pp for the poverty rate, +1.5 pp for extreme poverty according to the ECLA) is one of the lowest in the region, while inequalities remain below their 2017 level.

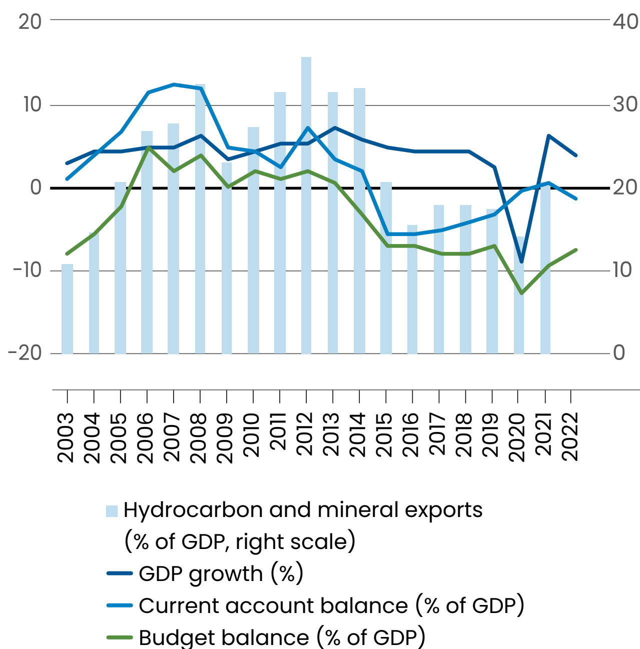
In the short term, the purchasing power of Bolivian households is relatively safeguarded from international inflationary pressures (projection above 3% in 2022, against 0.7% in 2021) due to two mitigating factors. Firstly, the pegging of the boliviano to the US dollar, established in 2009, has maintained a stable exchange rate since the end of 2011. Secondly, administered prices partly absorb the surge in commodity prices. In the medium term, with social indicators remaining below the regional average, a formalization of the economy is required.

Commodity prices volatility: a danger for the sustainability of macroeconomic balances

Stimulated by fiscal and monetary expansionary policies, public investment and consumption have been the main drivers of a dynamic economic growth, of 5% on average between 2005 and 2015. The continuation of these policies, despite the terms of trade shock in 2014 and the fall in the related revenues, helped soften the slowdown in growth until 2018. Bolivia's growth has since borne the scars of the political crisis in 2019 (+2.2%), then of the health situation in 2020 (major recession of 8.8%).

In this context, substantial fiscal imbalances (deficit of 7.5% of GDP on average between 2015 and 2019), partly financed by the Central Bank, led to an increase in the debt level of 19 pp between 2014 and 2019, to reach 59% of GDP. The pandemic has further exacerbated the fiscal imbalances: the deficit increased to 12.7% of GDP in 2020, then remained at a high level of 9.3% of GDP in 2021.

Graphique 18 – Macroeconomic imbalances sensitive to commodity prices



Sources: IMF (WEO), Central Bank of Bolivia.

At the same time, the country has experienced a reversal of the external balances, following a decade of current account surpluses (current account deficit of 5% of GDP on average between 2015 and 2019) with lower inflows of FDI (below 2% of GDP since 2015). Foreign exchange reserves have thus been solicited to fill the financing gap and protect the parity of the currency through repeated interventions on the foreign exchange market by the Central Bank.

Foreign currency liquidity has thereby fallen sharply since 2014 and the decline accelerated in 2019 and 2020 (-40% a year), with increased use of monetary financing to address the Covid-19 crisis. At the end of 2021, foreign currency reserves only amounted to $2.2 billion, against $13.5 billion in 2014, jeopardizing the sustainability of the exchange rate regime.

In 2022, a favorable economic climate offers reprieve for expansionary economic policies

The rebound in commodity prices, strengthened by the war in Ukraine, is supporting economic growth, but to a limited extent. Indeed, hydrocarbon production has accounted for less than 3% of GDP since 2015. In addition, chronic underinvestment since 2015 holds back gas production, while contracts govern the volumes of exports towards Brazil and Argentina, the sole recipients of Bolivian gas. Mining activity weigh more heavily (6% of GDP) and made a significant contribution to the rebound in real GDP growth in 2021 (+5.5%). However, in view of the already very high levels last year, Bolivian mineral and metal prices do not benefit from a significant additional surge. The projections for economic growth for 2022 have thereby been revised up only slightly from 3.5% to 3.8%.

However, public finance and the external balances largely benefit from the favorable economic situation. Gas revenues, which could return to their 2016 level, should contribute to bringing the public deficit down to its pre-crisis level. While current account imbalances have been considerably reduced since 2020, the increase in the import bill for refined oil is only expected to generate a slight deficit in 2022 (-1.5% of GDP), after two years of balance.

However, these trends only give the expansionary fiscal and monetary policies of the Bolivian authorities a short-term reprieve, in view of the persistent macroeconomic imbalances and the increasing scarcity of external sources of financing.

Green ambition needs to be developed

In the medium term, the diversification of production is an increasingly pressing issue, in order to reduce the exposure to external shocks and address the risk of the low-carbon transition. While gas plays an ambivalent role in this global process, the main minerals and metals mined in Bolivia are not strategic resources. However, a large-scale exploitation of lithium – as yet hypothetical – would offer promising prospects to the country, which holds some of the largest deposits in the world. These mining activities do, of course, generate greenhouse gas (GHG) emissions, but Bolivia's contribution to global GHG emissions is limited and, in reality, mainly comes from deforestation and agriculture. Consequently, while foreign investments are falling and recourse to the international financial markets is limited and costly, investment in extractive sectors remains essential. Indeed, their exports – projected to fall due to a lack of exploration – provide an essential windfall of foreign exchange reserves to finance this economic transformation.

Peru: A double-edged rally in commodity prices

Alix Vigato – vigatoa@afd.fr

Peru's development model is largely based on the exploitation of its substantial mineral resources (copper, gold, silver, iron, zinc, lead, tin, etc.). While the end of the commodity super-cycle led to a slowdown in economic growth and a deterioration in fiscal and external balances between 2014 and 2019, the economy experienced a strong rebound in 2021 as a result of the rise in commodity prices. However, this increase in commodity prices is also fueling a rapid acceleration in inflation and is consequently exacerbating an already deteriorated sociopolitical situation.

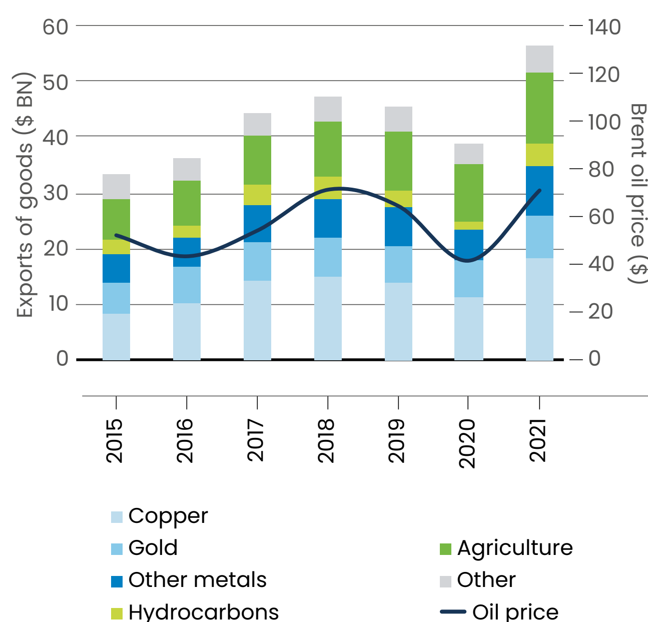
Peru has been one of the most dynamic economies in Latin America for about 20 years now, with an annual average growth rate (CAGR) of 5.1% between 2002 and 2019. The main driver of this dynamism is the mining sector, which accounts for 12% of GDP and has largely benefited from a productive investment cycle and buoyant international demand over the period. The country is the world's leading producer of gold, lead and tin and the second largest producer of copper, silver and zinc. The mining concessions are estimated to cover 14% of the country, and Peru's substantial reserves of minerals that are essential to the energy transition provide the extractive sector with favorable prospects: the US Geological Survey estimates that Peru has a substantial proportion of global reserves of silver (20%), copper (10%), zinc (9%), lead (7%), gold (5%) and tin (2%).

Since 2014, there has been a slowdown in the GDP growth rate as a result of the end of the commodity super-cycle, which has led to a decline in international prices and investments, and due to strong institutional instability. The CAGR thereby fell by 3.1% between 2015 and 2019. However, the polymetallic structure of mining production and the relative diversification of the economy (agricultural goods, fisheries, services) provide the economy with a certain resilience to exogenous shocks.

The rise in commodity prices strongly boosted economic growth in 2021

In 2020, the economy suffered very badly from the effects of the Covid-19 pandemic and experienced a recession of 11.0%. Indeed, Peru had the highest per capita death rate in the world (213,000 deaths at the end of June 2022). The economy was also particularly affected by the fall in global commodity prices and by the restrictive health measures, which led to a temporary halt to mining operations.

Graph 19 – An export base dominated by commodities



Sources: INEI, Macrobond.

In 2021, the economic rebound was more dynamic than anticipated, with a GDP growth of 13.3%. In addition to a significant base effect and the maintaining of fiscal support measures, this recovery was supported by the sharp rise in commodity prices. For example, copper prices reached an all-time high. However, in the short and medium term, the outlook appears less favorable due to the tightening of the fiscal and monetary policy and uncertainties over the sociopolitical situation. Consequently, the IMF anticipates a growth of only 3.0% in 2022 (3.4% according to the World Bank, 3.6% according to the government), in line with potential growth.

Public and external accounts fluctuate widely depending on commodity prices

As Peru has a fiscal rule, and due to a certain orthodoxy from the government, it has managed to maintain its public debt at a relatively low level over the last decades. However, in 2014, the fall in commodity prices and the simultaneous slowdown in economic growth led to a deficit in the fiscal balance, which had previously shown a surplus. Public debt thereby rose by 6 points between 2014 and 2019, then by 8 points in 2020. In 2021, the strong recovery and increase in commodity prices helped reduce the fiscal deficit (to 2.6% of GDP, against 6.2% still anticipated in October 2021) and stabilize the debt ratio at 36% of GDP. The IMF forecasts an improvement in the fiscal deficit over the medium term, estimating it will gradually move closer to balance.

Peru's current account balance also strongly depends on fluctuations in the extractive sector: commodity exports, global prices and flows of profit remittances by multinational companies operating in this sector. The current account balance thereby mechanically reached a low point in 2015 (about -5% of GDP), before gradually improving. In 2021, the strong recovery in imports and outgoing flows of profit remittances exceeded the increase in exports, bringing the current account deficit to 2.8% of GDP. The external position remains strong, as the country benefits from very comfortable foreign exchange reserves (covering 14 months of imports at the end of 2021), privileged access to international financial markets (sovereign credit has a rating of investment grade by the rating agencies) and a "precautionary" Flexible Credit Line of $5.4 billion from the IMF until 2024. Since mid-2021, there has been a certain volatility of the sol – largely due to political tensions – which the Central Bank is seeking to limit via substantial interventions on the foreign exchange market ($18 billion injected in 2021, *i.e.* 8% of GDP).

The recent surge in inflation is deteriorating an already fragile sociopolitical situation

Peru has been experiencing a period of strong institutional instability for several years. The four presidents who led the country from 2000 to 2018 are all involved in the Odebrecht corruption scandal, and there were five successive presidents between 2018 and 2021. Elected in July 2021 following an extremely tense presidential campaign, the socialist Pedro Castillo is facing a lot of opposition, starting with Congress (dominated by the center-right). In this context, since the election, Mr. Castillo has largely moderated his speech and has pledged to prevent any slippage in public and external accounts.

Peru is not very exposed to the Russia-Ukraine conflict, apart from imports of Russian fertilizers (≈40% of supplies), but its economy suffers from the increase in prices indirectly resulting from the war. Inflation has thereby been accelerating for several months (8.8% year-on-year in June 2022, its highest level since 1997). While underlying inflation remains under control, the Central Bank has sharply tightened its monetary policy with 12 increases in the key interest rate between August 2021 and July 2022. While various emergency measures were introduced in April 2022 (cut in the fuel tax and VAT, revaluation of the minimum wage), the increase in food prices enhances the discontent of the population, and President Castillo's position, which has already been undermined by the succession of four Prime Ministers and two attempted impeachments since his election, has been very much weakened.

List of acronyms and abbreviations

AAGR Average annual growth rate

AFRREO Sub-Saharan Africa Regional Economic Outlook

ARA Assessing Reserves Adequacy – IMF measure

AsDB Asian Development Bank

b/d Barrels per day

BCEAO Central Bank of West African States

BEAC Bank of Central African States

CEMAC Central African Economic and Monetary Community

CNY Chinese yuan or renminbi (RMB)

COM French Overseas Department

DROM French Overseas Departments and Regions

DSA Debt sustainability analysis

DSSI Debt Service Suspension Initiative

EBRD European Bank for Reconstruction and Development

ECF Extended Credit Facility

EDCs Emerging and developing countries

EFR External financing requirement

EU European Union

EUR Euro

FDI Foreign direct investment

FRELIMO *Frente de Libertação de Moçambique* (Mozambique Liberation Front)

FY Fiscal year

G&S Goods and services

GBP British pound

GDP Gross Domestic Product

HIPC Heavily Indebted Poor Country

IDS International Debt Statistics – World Bank database

IEDOM *Institut d'Emission des Départements d'Outre-Mer*

IFS International Financial Statistics – IMF database

IMF International Monetary Fund

INEI *Instituto Nacional de Estadística y Informática* (Peru)

JPY Japanese yen

LIC Low-Income Country

LMIC Lower-Middle-Income Country

NPF Need for public financing

ODA Official Development Assistance

OECD Organisation for Economic Co-operation and Development

PC Paris Club

PI Portfolio investment

pp Percentage point

RCF Rapid Credit Facility

RFI Rapid Financing instrument

SDR Special Drawing Rights

SSA Sub-Saharan Africa

TANAP Trans-Anatolian Natural Gas Pipeline

TAP Trans-Adriatic Pipeline

UMIC Upper-Middle-Income Country

UNCTAD United Nations Conference on Trade and Development

UNDP United Nations Development Programme

USAID United States Agency for International Development

USD United States dollar

WAEMU West African Economic and Monetary Union

WB World Bank

WEO World Economic Outlook – IMF report

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Agence française de développement
5, rue Roland Barthes
75012 Paris l France
www.afd.fr

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