



MACROECONOMIC DEVELOPMENTS IN COMESA REGION IN 2022

PREPARED FOR COMESA 2022 ANNUAL REPORT



Distr.
LIMITED

CS/TC/TTFSC/VIII/23/3(a)
October 2023

Original: **ENGLISH**

**COMMON MARKET FOR EASTERN
AND SOUTHERN AFRICA**

Eighth Meeting of the Trade and Trade Facilitation
Sub-Committee

Through Video Conference
4-6 October 2023

MACROECONOMIC DEVELOPMENTS IN COMESA REGION IN 2022

PREPARED FOR COMESA 2022 ANNUAL REPORT

*Theme: "Economic Integration for a thriving COMESA anchored on green investment,
value addition and tourism"*

Table of Contents

1. Background	4
2 Growth.....	4
3 Inflation Rate	5
4 Monetary Policy and Exchange Rate developments	6
5 Overall Fiscal Balance Including Grants	7
6 Government Debt	8
7 External Current Account Including Grant.....	8
8 Reserve Accumulation.....	9
9 Medium Term Prospects and Recommendations for Chance to Change	10
10 Risks to Outlook.....	12
References	12

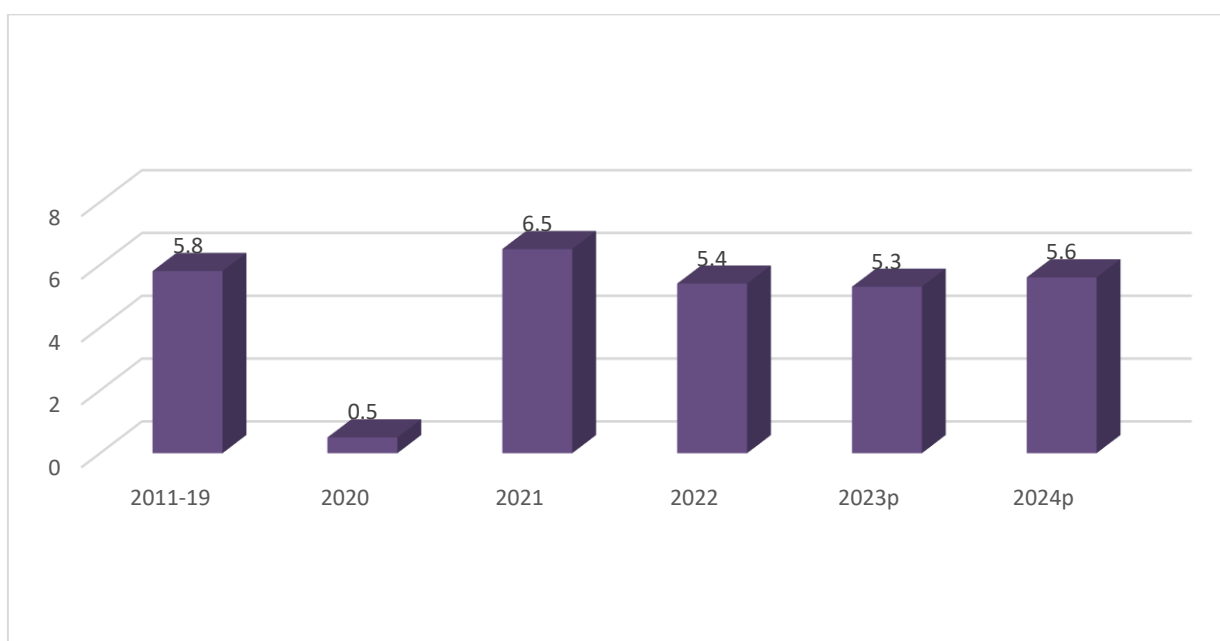
1. Background

This report presents macroeconomic developments in the COMESA region in 2022. It analyses developments in key macro-economic performance indicators in the region, assesses the medium-term prospects and provides policy recommendations in the short-to-medium term and discusses the risks to the outlook.

2 Growth

COMESA region's average growth declined to 5.4% in 2022 from 6.5% in 2021. On average, economic activity contracted in most COMESA member countries (**Figure 1**), on confluence of several factors, including elevated economic imbalance in the wake of the COVID-19 pandemic, a drastic and pro-cyclical tightening of global financial conditions on account of the protracted Russia-Ukraine war. The tight financial conditions have led to higher global interest rate spreads and exacerbated exchange rate depreciations — raising dollar-denominated borrowing and debt servicing costs. The economic situation is further complicated by persistently increasing global inflation leading to a cost-of-living crisis (high prices of food, fuel and fertilizer).

Figure 1: COMESA average real GDP Growth (y-o-y % change)



Source: IMF REO Sub Saharan Africa April 2023

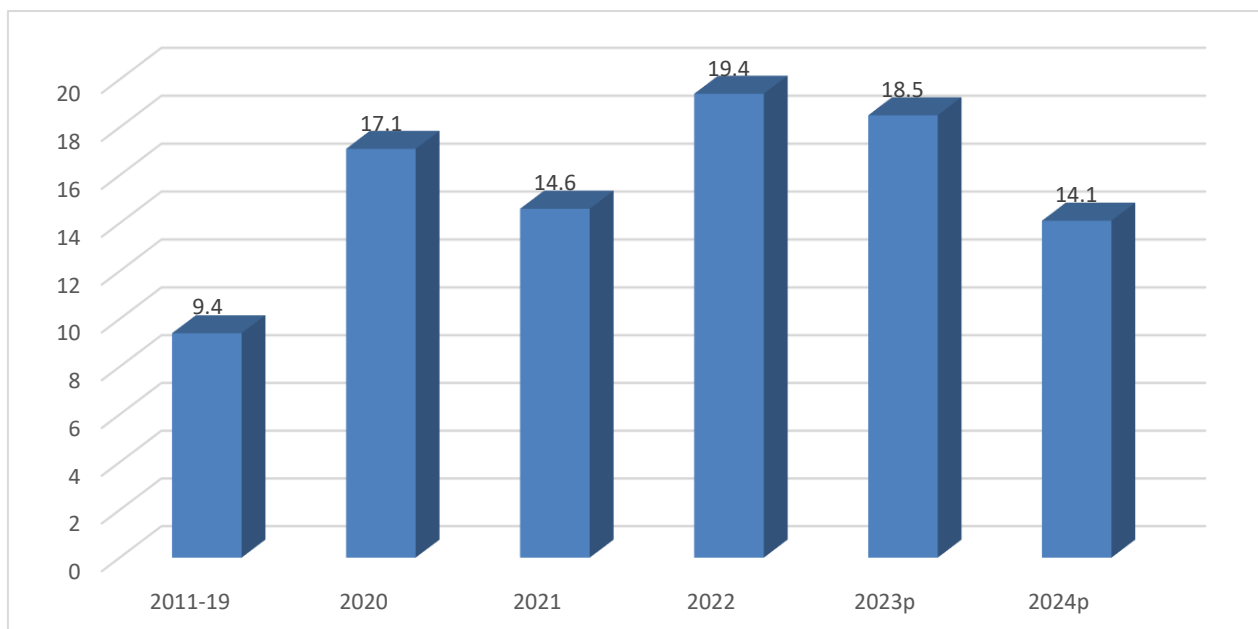
Looking outward, IMF projects the region's growth momentum to slow down for a second year in a row to 5.3% in 2023 following the strong rebound in 2021. Growth will recover somewhat to 5.6% in 2024, but remain subdued relative to pre-pandemic levels. The projected decline in 2023 is on account of shrinking fiscal space arising from the financing squeeze the region currently faces. The global tightening cycle continues to pose higher uncertainty, including increasing foreign currency denominated borrowing and debt servicing costs and exchange rate depreciations. This is compounded by policy struggles from the ramification of the pandemic, including rises in central bank rates to fight inflation; and the dampening effects of the war in Ukraine on global economic activity and thus the region's export demand.

Recovery in 2024 is premised on among others, expected recovery in global economic activity from the effects of the war in Ukraine; expected easing in global financial conditions as global inflation is expected to recede somewhat and expected decline in crude oil prices as demand pressures subside. These factors are expected to jointly lead to higher private consumption and investment in these countries. However, the outlook for global economic recovery is clouded by downside risks, including sizeable uncertainty on account of multiple shocks seen in recent years; sticker-than-expected global inflation which could prompt further tightening of global financial conditions which could pile more pressure on the exchange rate and further squeeze the already tight financing conditions in the region.

3 Inflation Rate

The COMESA region wide average inflation rate rose to 19.4% in 2022 from 14.6% in 2021, which is more than double the pre-pandemic average of 9.4% (**Figure 2**). There was strong build-up of inflationary pressures in most COMESA countries in 2022, hitting double digit particularly in countries that have greater reliance on food imports or suffered the wrath of climate change (droughts, storms and floods) which amplified the effect of distortions in global supply chain and on a significant increase in international energy prices during the year under review. Furthermore, some countries yielded to significant pressures to raise public wages in response to increases in the cost of living triggered by higher food and fuel prices. As per IMF REO data, nine (09) COMESA member countries, namely Djibouti, Eritrea, Eswatini, Kenya, Libya, Madagascar, Seychelles, Somalia, and Uganda achieved the COMESA macroeconomic Convergence Criteria of average annual inflation rate of 7% (with a band of +/-1%).

Figure 2: COMESA average Consumer Prices (annual av., % Change)



Source: IMF REO Sub Saharan Africa April 2023

The fuel pump price pressures have started to recede following a fall, by up to 30% in international crude prices, as at end of 2022 from their peak in mid-2022 and are estimated at \$74.2 and \$70 per barrel in 2023 and 2024, respectively, down from \$85.5 in 2022. Global food prices have also started to ease and are projected to continue on easing trajectory over the IMF's two year's projection horizon, by 4.9% and 2.5% in 2023 and 2024, respectively. These developments are expected to slow down global inflation, providing some relieve for the region.

Reflecting these considerations, region wide inflation is projected to ease somewhat to 18.5% in 2023 and further to 14.1% in 2024 (**Fig. 2**), although largely remain above the pre-pandemic average of 9.4%. As noted in part above, the bright picture on inflation outlook is contingent on expected easing of global but also local supply challenges, and the likelihood that the region's central banks would anchor inflation expectations should inflationary pressures threaten to strengthen.

4 Monetary and Exchange Rate Developments

In 2022, inflation, on average, remained elevated, hitting double digit particularly in some countries that have greater reliance on food and fuel imports and/or suffered the wrath of climate change and/or yielded to significant pressures to raise public wages in response to increases in the cost of living triggered by higher food and fuel prices. IMF projections point to inflation staying above the pre pandemic level over the immediate two-year forecast horizon. Output levels, at the same time, remain depressed, and is projected to decline steadily for a second year in a row to 2023 at levels below the pre-pandemic level. Deterioration of business and consumer confidence could depress economic activities in key advanced economies and spill over to economies of the region through lower demand for imports and lower commodity prices. Regional Central Banks, thus, face a difficult balancing act between curbing inflation and supporting the still-fragile recovery. To reign on persistently high inflation, exchange rate pressures and to anchor inflation expectations, almost all central banks in the region tightened policy rates through the end of 2022. But this will continue to pose a challenge to a quick recovery in most countries in the region.

Going forward, monetary policy needs to be increasingly data-dependent depending on country specific circumstances. Jurisdictions experiencing persistently high inflation may consider to continue the tightening cycle in a decisive manner to de-anchor the second-round effects. Elsewhere, tight policy stance may be continued but at a pace consistent with the level and trajectory of inflation and in close coordination with fiscal policy, in part, to tame, where they exist, domestic demand pressures; while where inflation has peaked but still relatively elevated, monetary policy need to be steered cautiously until inflation is firmly on a downward trajectory and projections have returned to the central bank medium term target.

For countries in the region under a flexible exchange rate and where inflation was aggravated by the exchange rate passthrough and/ or fiscal imbalances, the tight monetary policy stance and fiscal consolidation helped to alleviate the pressure by keeping inflation expectations in check and stem capital outflows while attracting inflows, and rein in external imbalances and contain the increases in debt related to exchange rate depreciation. Most countries are going through high inflation and also experiencing depreciation of local currencies against the US dollar attributed to a high dependency on imports that are invoiced using US dollars. Currency depreciation is also

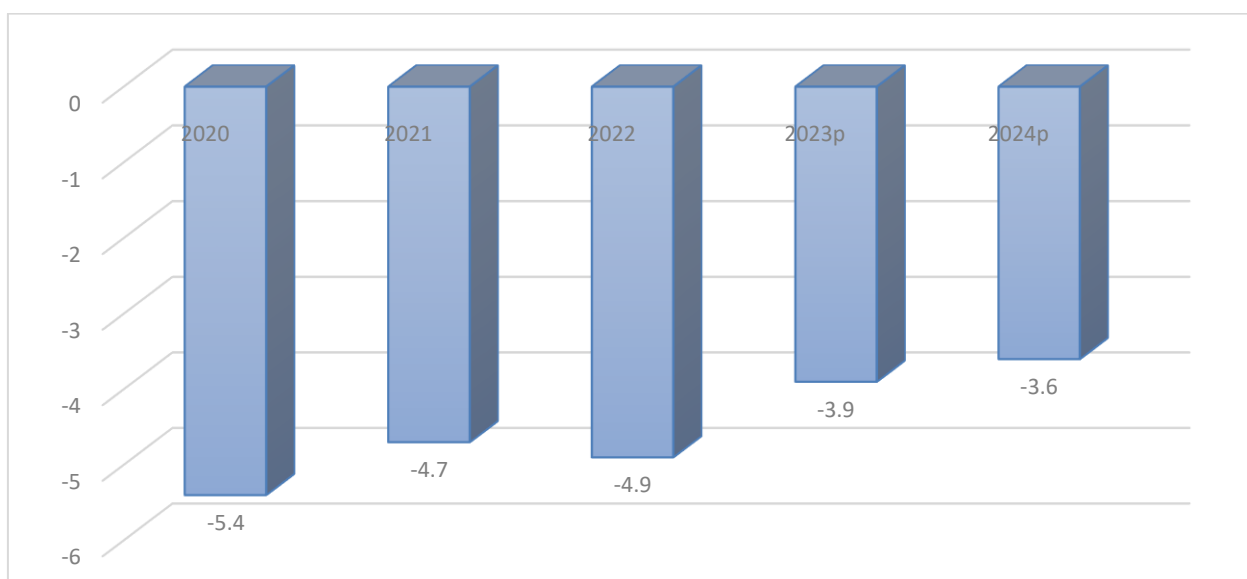
contributing to higher general government debt especially because most external debt is dollar denominated.

Continuation of foreign exchange interventions to smooth exchange rate volatility, provided reserve buffers permit, will be particularly desirable for countries with shallow foreign exchange markets and large un-hedged balance sheet exposures. Therefore, monetary tightening may be needed in some countries to support exchange rates, even in the face of weak economic activity. On the other hand, currency peggers generally experienced moderate inflation, and will need to keep a close watch on inflation trajectory while keeping policy rates in lock with the anchor policy rate to preserve external stability and foreign exchange reserves.

5 Overall Fiscal Balance Including Grants

After a significant deterioration of the region's average fiscal deficit including grants as a percentage of GDP of 5.4% in 2020, the deficit started to decline to 4.7% and 4.9% in 2021 and 2022 respectively, with a projected consolidation to a deficit of 3.9% in 2023 (Figure 3). The deterioration reflects a combination of higher tax revenues and fiscal adjustment as countries continue to consolidate their public finances to preserve fiscal sustainability (particularly those with elevated debt vulnerabilities) on the path to a credible and transparent medium-term fiscal policy framework.

Figure 3: COMESA average Overall Fiscal Balance (incl. Grants, % of GDP)



Source: IMF REO Sub Saharan Africa April 2023

Relative to 2021, the deficit in 2022, narrowed in 12 COMESA countries—Djibouti, Egypt, Eritrea, Kenya, Mauritius, Rwanda, Seychelles, Somalia, Tunisia, Uganda, Zambia and Zimbabwe, but deteriorated somewhat elsewhere. Moreover, as per IMF REO data, 10 COMESA countries, namely, Comoros, DRC, Djibouti, Eritrea, Ethiopia, Mauritius, Seychelles, Somalia, Sudan and Zimbabwe achieved the COMESA macroeconomic Convergence Criteria of overall budget deficit/GDP ratio (including grants) of 5%.

6 Government Debt

The region's average Government debt as a share of GDP increased, albeit marginally to 57.6% in 2022, compared to 57.4% in 2021 (**Figure 4**), reflecting a combination of still-large overall fiscal deficits because of overlapping crises, slower growth and the impact of exchange rate depreciations. As per the IMF REO data, about nine (09) COMESA member countries, including, Comoros, Democratic Republic of Congo, Djibouti, Ethiopia, Eswatini, Madagascar, Rwanda, Seychelles and Uganda, achieved the revised COMESA secondary Convergence Indicator of total government debt as a share of GDP of less than 65%.

Figure 4: COMESA average Government Debt (% of GDP).



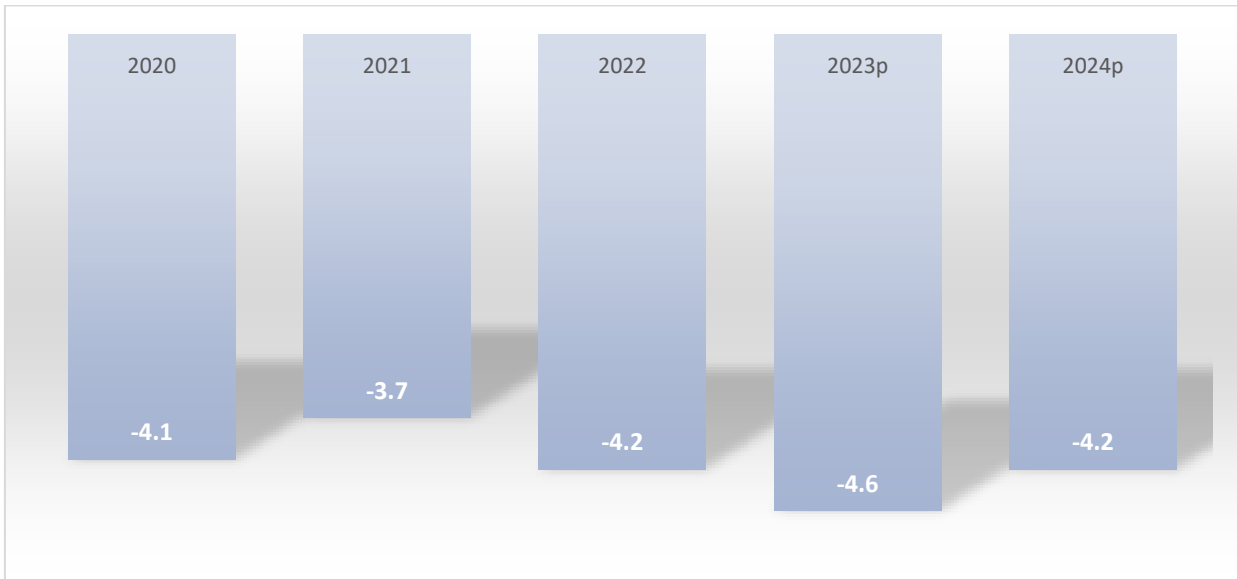
Source: IMF REO Sub Saharan Africa April 2023

Going forward, average region government debt to GDP ratio is projected to ease to 52.7% in 2023 and further to 48.9% in 2024, on account of increased efforts to boost revenue mobilization, and increasing and prioritizing the efficiency of spending, including phasing out of untargeted subsidies. The challenging external financing conditions, marked, in part, by declining aid flows disproportionately adds to the funding squeeze particularly for countries relying primarily on foreign aid for financing their development needs. Climate change is presenting additional spending pressures on shrinking fiscal budgets. In addition to social spending and protecting of the most vulnerable segments of the populations amid the ongoing cost-of-living crisis through targeted transfers, if continued, could raise further regional governments' debt and financing risks, complicating choices for the existing policy space and eventually, vulnerability of these countries to debt default.

7 External Current Account Including Grant

The COMESA region external current account including grants, as a percentage of GDP, deteriorated to an average of -4.2% in 2022, relative to -3.7% in 2021 (**Figure 5**). The persistent external current account deficit for most economies in the region is due to persistent trade imbalances due to a combination of declining export demand and relatively inelastic import bills because of higher commodity prices, and in some cases late disbursement of external aid flows faced by most countries in the COMESA region.

Figure 5: COMESA average External Current Account (incl. Grants, % of GDP)



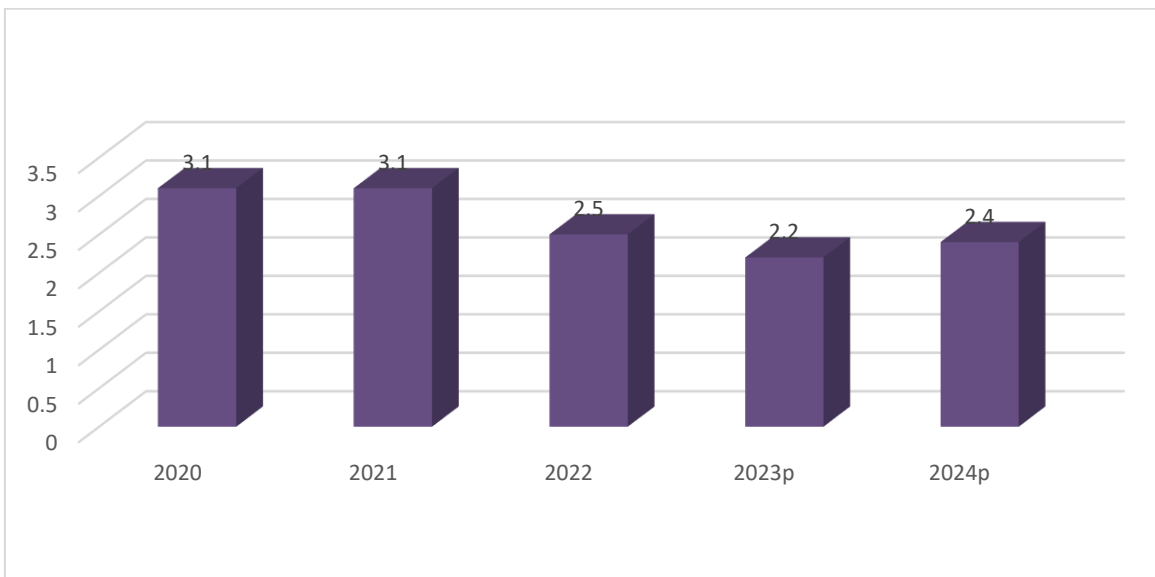
Source: IMF REO Sub Saharan Africa April 2023.

The external current account including grants is projected to deteriorate to -4.6% of GDP in 2023, but improve, albeit marginally, to -4.2% of GDP in 2024, on account of expected fall in international commodity prices, rebounding tourism, resilient remittances and fiscal consolidation.

8 Reserve Accumulation

The COMESA region external reserve cover dwindled further to an average of 2.5 in months of imports of goods and services, down from 3.1 months of import of good and services in 2021 and 2020 (**Figure 6**).

Figure 6: COMESA average Reserves (Months of imports of goods and services cover)



Source: IMF REO Sub Saharan Africa April 2023

At an average of 2.5 in months of imports of goods and services, reserves have breached the standard import-cover benchmark for the COMESA macroeconomic Convergence Criteria of External Reserves of equal to or more than 3 months. As per the data beforehand, eleven (11) COMESA member countries, including, Comoros, Egypt, Eritrea, Kenya, Madagascar, Mauritius, Rwanda, Seychelles, Tunisia, Uganda and Zambia met the threshold on reserves in months of imports of goods and services cover.

Relative to the historical average, the region's reserve cover, in the outer years of 2023 and 2024, is projected to dwindle even further to 2.2 and 2.4 months of import of good and services, largely reflecting impact of market interventions to offset unwarranted volatility and depreciation of the exchange rates in response to tightening global financial conditions.

9 Medium Term Prospects and Recommendations

The region is facing a number of challenges including, among others, global slowdown in economic activities, higher borrowing costs following tightening of monetary policies and a global increase in inflation. Due to these challenges, IMF projects inflation to stay above the pre pandemic level over the medium-term. Output levels, at the same time, remain depressed, and is projected to decline steadily for a second year in a row to 2023 at levels below the pre-pandemic level (figure 1). The challenging external financing conditions continue to drive the funding squeeze, worsened by climate change, which is presenting additional spending pressures on shrinking fiscal budgets. Fending off these extraordinary headwinds and uncertainties, amidst dwindling fiscal space, will require the COMESA region member countries to, among others:

- a) Take measures to bring inflation undercontrol while supporting economic recovery. The current drivers of inflation are largely external (such as imported food and fuel prices and or the effects of exchange rate pass through) rather than domestic demand pressures, and have started to subside, meaning that inflation is likely to start declining in most of these economies, although with a lag. However, the decision to tighten monetary policy further or not much be country specific depending on the evolution of inflation dynamics such as wage growth and international food and energy price developments. .
- b) Most economies in the region are recently experiencing significant depreciation of there currencies due to among other, increases in interest rates in advanced countries and adverse terms of trade. The depreciation contributes to a significant rise in inflation and external debt burden. Most countries have responded through tightening of monetary policy, foreign exchange market intervention and administrative measures to control foreign exchange rate flows. However, levels of reserves limits the scope for foerign exchange intervention. While the exchange rate can act as an automatic stabilizer, policy actions may still be required to mitigate possible adverse impact on the economy of excessive and volatile exchange rate adjustment. For countries where exchange rate pass through to domestic inflation is significant, tightening monetary policy can assist to contain further slide of the currency and stem capital out flow while at the same anchoring inflation expectations. For countries where fiscal imbalances are the source of exchange

rate pressure, fiscal consolidation can assist contain the increase in debt related to currency adjustment. For countries with sufficient foreign exchange reserves, foreign exchange intervention can reduce the volatility of the exchange rate, but at the risk of depleting foreign reserves if the exchange rate pressures persist because of underlying economic fundamentals.

- c) To adapt to an environment with tighter financing conditions while aiming to preserve fiscal sustainability. This will require countries to double efforts at boosting revenue mobilization, and prioritize and increase the efficiency of spending where possible, while minimizing possible negative impacts on growth and poverty. Boosting revenue mobilization, in particular, can help attract more external financing as a country's revenue stream is the main metric for its debt repayment capacity. However, in the near-term, authorities will struggle to secure external financing and debt vulnerabilities are likely to worsen in the current environment of rising borrowing and debt servicing costs.
- d) Managing fiscal risks against the background of funding squeeze will be important for fiscal and debt sustainability. This will require among others, the ability to contain increased temptation for the government to accumulate arrears and off budget spending pressure, and ever increasing appetite to extend guarantee and contingent liabilities. This calls for better public finance management practices and better risk management in order to improve debt dynamics, including fiscal transparency and oversight of state-owned enterprises.
- e) For some countries faced with aggravated debt vulnerabilities /or are likely to experience the same and require debt reprofiling or restructuring, a well-functioning debt-resolution framework is vital if they are to create the much-needed fiscal space. Countries have widened the variety of debt instruments; the creditor base has also become more diversified; and negotiations more complex. In this environment, it is crucial that creditors increase their reliability and predictability, co-ordinate credit delivery systems and also make it more transparent and introduce a standstill on debt service during the debt treatment process. It's vital for creditors to implement a well-functioning "debt-resolution framework" as reached by government's staff-level agreement with the IMF for countries faced with aggravated debt vulnerabilities and require debt reprofiling or restructuring, to create fiscal space. Coordination among creditors has been and remain challenging. Aid processes need to be predictable and timelier, and creditors and the international financial institutions need to enhance earlier sharing of information, and introduce a standstill on debt service. Effective and proactive debt management is critical to lowering debt risks. Debt management can help strike the balance between funding the government's needs and ensuring that debt levels remain sustainable. This includes enhancing debt reporting, lengthening maturities, and avoiding bunching of repayments to mitigate refinancing risks.
- f) In the medium term, structural transformation and economic diversification of individual economies in the region will be crucial, particularly reforms that raise potential growth by bolstering private sector development and increasing the benefits from trade.

- g) The dislocation of trade routes and supply chain disruptions that followed the war in Ukraine highlight the importance of expediting efforts that actively pursue economic diversification and reduction of distortionary trade restrictions. Such measures will strengthen resilience to future shocks and exposure to climate change.
- h) Leverage African Continental Free Trade Area (AfCFTA)(AfCFTA) to strengthen value-addition and industrial growth and increase the role digitization continue to play in the economies of the region.
- i) There is need to fund and address climate change while ensuring continued provision of basic needs like infrastructure, health and education. Most countries in the region are experiencing limited fiscal space and funding squeeze with concerns that climate funding is putting spending pressure on already shrinking fiscal budgets. It is therefore critical that climate financing does not crowd out funding for basic needs and other development goals. Innovative ways need to be devised to ensure among others, more concessional finance is unlocked and or increased participation of the private sector in climate financing.

10 Risks to Outlook

Policy makers in the region, on top of the ongoing repercussions from a recent cascading series of shocks, are staring at yet at another difficult year, marked by tighter financing conditions and subdued growth. This, compounded with several armed conflicts and terrorist threats and climate related shocks poses serious risks to economies of the COMESA region. On somewhat a good note, the fuel pump price pressures and global food prices have started to ease and are projected to continue on easing trajectory over the medium-term, providing some retrieve for the region.

References

1. IMF REO Sub Saharan Africa (April 2023)
2. IMF REO Middle East and Central Asia (May 2023);
3. IMF Article IV Consultations Staff Country Reports
4. AfDB African Economic Outlook (March 2023)