Sub-Saharan Report

Sub-Saharan Africa is one of the focal regions of Global Challenge 2015.
These reports are by Mr. Kenshi Tsunemine, an expatriate employee working in Johannesburg with a view across the region.

Sub-Saharan Africa - Special Study Edition

January 14, 2016

Mr. Kenshi Tsunemine
Johannesburg Branch
Marubeni Corporation

In order for the Marubeni Research Institute to acquire live information from the field and contribute to the Company's strategy, young Marubeni staff well-versed in economic and industry analysis have been posted to the region.

This year the first Sub-Saharan Africa Report will again be a Special Study Edition. These reports have been written by Mr. Kenshi Tsunemine, one of Marubeni's expatriates in the sub-Saharan region. Last year's Special Study Edition, written by Mr. Tsunemine, was based on a presentation he made at Marubeni's headquarters for the Marubeni Research Institute at the end of 2014 on the sub-Saharan macro-economy.

Mr. Patrick Ryan is the writer of the Special Edition this time

This year we are taking a slightly different approach toward the Special Study Edition. Mr. Patrick Ryan of the Marubeni Research Institute is writing the report this year using the main talking points from Mr. Tsunemine's presentation on sub-Saharan Africa given at the headquarters at the end of 2015, as a base.

Sub-Saharan Africa Overview

As many of you now know there are 49 countries in sub-Saharan Africa, consisting of countries with very small economies, populations and/or land sizes to those with large economies, populations and/or land sizes, and can be divided into 4 sub-regions, West Africa, East Africa, Central Africa and Southern Africa. However, a distinctive feature is that just 7 countries, Nigeria, South Africa, Angola, Ethiopia, Kenya, Tanzania and the Democratic Republic of the Republic make up 75% of the region's GDP and nearly 60% of the population. The region's population of nearly 1 billion is the world's fastest growing at nearly 3% a year and has made sub-Sahara the second fasting growing regional economy in the world over the past decade after emerging Asia with nearly 6% growth.

However, due to low commodity prices, and a slowdown in the Chinese economy and a stagnant EU economy, which are the region's two largest trading partners, 2015 economic growth is estimated to be only 3.8%. The IMF's 2016 forecast is for 4.3% growth, but a continuing fall in oil and commodity prices, a further slowdown in the Chinese economy and predicted abnormal weather that could affect agricultural production could lower that forecast.

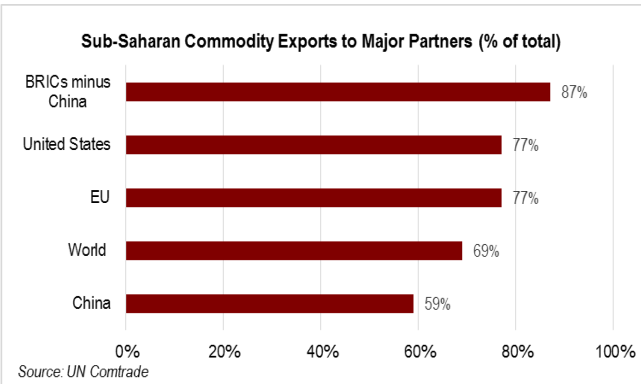
China has built a strong presences in sub-Saharan Africa

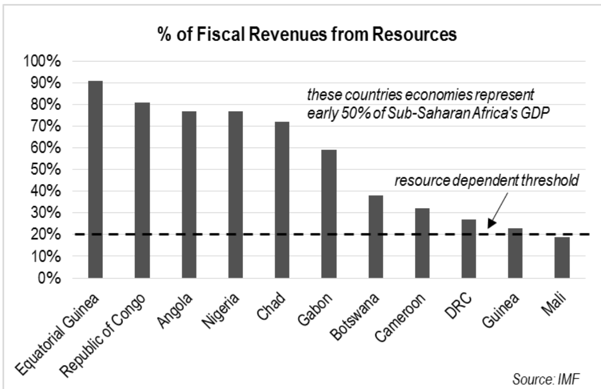
Talking Point - Natural Resources

For some time the spotlight has been on the natural resource rich African continent as resource prices soared, with rising investment and infrastructure development riding the tailwinds. ⇒ However, with the recent steep adjustments to commodity prices, such priorities may be difficult to maintain.

Natural resources' contribution to sub-Sahara's GDP is 17%, the second highest worldwide following the Mideast. Nearly 30% of sub-Saharan African countries' have natural resource contributions of around 20% or more to their GDP. However, it should also be noted that many of the countries with low natural resource inputs to GDP have yet to have much of their resource wealth tapped.

In addition, 70% of all sub-Saharan Africa's global exports are commodity exports with 21 countries having 30% or more of their exports in commodities. These 21 countries represent 80% of sub-Sahara Africa's GDP and 60% of its population. Furthermore, the governments of 11 countries, or more than 20% of sub-Saharan Africa's countries, are considered resource dependent as more than 20% of their fiscal revenues come from natural resources. These 11 countries make up nearly of half of sub-Saharan Africa's GDP, and if South Africa's GDP was excluded it would be more than 60%.





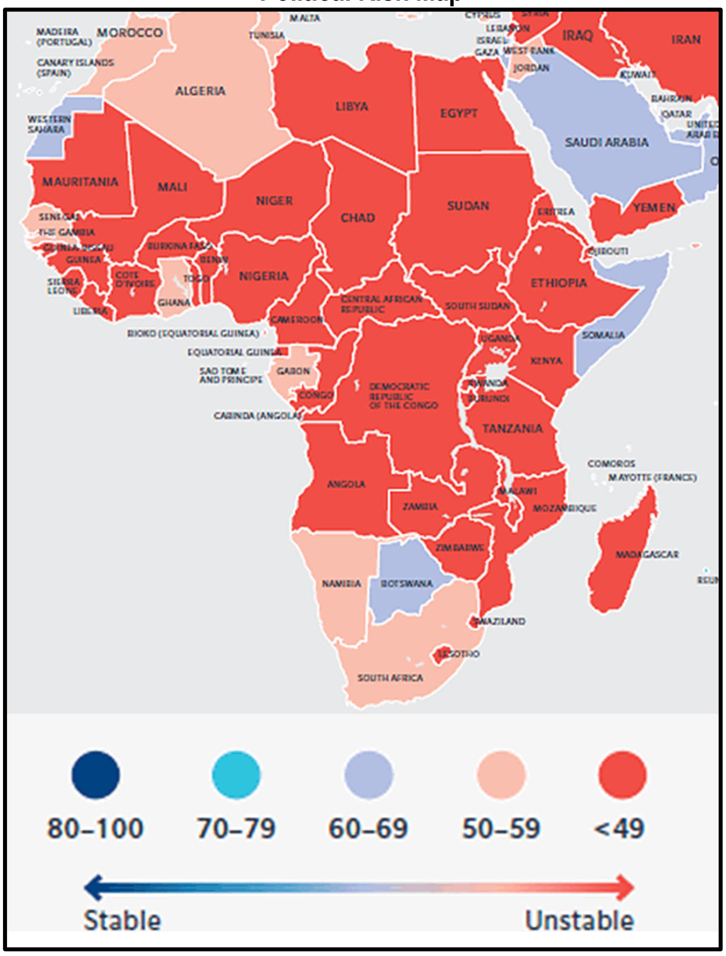
Obviously, a continued fall in oil and other commodity prices will have a strong effect on infrastructure projects, not to mention economic growth, in sub-Saharan Africa as government finances worsen and spending is cut. Up to 65% of the region's infrastructure is domestically financed and official financing institutions' concern will grow over the ability to pay back loans. This will be especially true in the extraction sector where projects also depend on resource prices. Particularly hard hit would be sub-Saharan Africa's eight oil exporting countries and two other economically dependent oil-producers, where the budgetary price of oil in 2014 was on average a little over $100 per barrel and whose economies represent more than 50% of Sub-Saharan Africa's economic size.

Talking Point - Political Stability

Following the "Year of Africa" in 1960, which symbolized numerous African countries' gaining their independence from their former foreign colonizers around that time, many African countries suffered coups and civil wars with much of the region becoming plagued by political turmoil. However, in recent years, for the most part, sub-Saharan Africa has been relatively stable. ⇒ However, deteriorating security conditions caused by terror attacks and increasing number of long-term regimes is creating a cause for concern.

According to the Ernst & Young's Africa Attractiveness Survey 2015 (on foreign direct investment) = FDI), political stability, corruption and lack of infrastructure are the biggest impediments to foreign direct investment (FDI) in sub-Saharan Africa. From 1986 to 1999 sub-Saharan Africa suffered from a number of civil wars with many countries recording GDP growth of under 2%, while from 2001-2014, violent conflict and deaths fell substantially according to UCDP-GEP conflict data. The number of multi-party elections in the region increased significantly and over 180 million people in sub-Sahara Africa voted in these elections in 2014 (over 200 million expected in 2015), though there have been instances recently to extend the term limits of serving presidents through constitutional change and other means. All in all, this improvement in political stability certainly contributed to sub-Saharan Africa's stable 6% GDP growth over this timeframe

Political Risk Map



On the other hand, according the Conflict & Political Violence Index 2014 (Relief Web), 5 countries in sub-Sahara Africa are at extreme risk to political violence and 10 countries are at high risk, while the Marsh Political Risk Map 2015 shows that 14 of the top political hotspots in 2015 are in sub-Sahara Africa. And, in Transparency International's Corruption Perceptions Index 2014, half of the 30 countries perceived to be corrupt were from sub-Saharan Africa. So there is a strong perception of political instability and corruption in sub-Sahara Africa by the rest of the world that also has contributed to its low attractiveness as a destination for FDI, which is the lowest in the world.

Country Risk Index: Top 20 Highest Risk		
	Country	2014 Score
1	**Central African Republic**	**22.6**
2	**Sudan**	**24.0**
3	Syria	25.5
4	Afgahnistan	25.8
5	**Guinea-Bissau**	**28.1**
6	Yemen	28.8
7	**DRC**	**28.9**
8	Libya	31.0
9	Haiti	31.6
10	**Mauritania**	**32.9**
11	**Chad**	**32.9**
12	**Mali**	**33.6**
13	**Madagascar**	**34.3**
14	**Guinea**	**34.6**
15	**Zimbabwe**	**35.2**
16	**Burundi**	**35.7**
17	Kyrgyzstan	35.9
18	**Niger**	**36.5**
19	**Sao Tome & Principe**	**38.3**
20	**Ethiopia**	**38.6**

Interestingly, in the Ernst & Young Africa Attractiveness Survey 2015 companies that have already invested in sub-Saharan Africa see the region as a much more attractive place to invest than companies that have yet to invest there. It seems three is a perception gap between those that have visited or worked in sub-Sahara, who see the region in a more positive light than those that haven't.

Although the number of violent incidents and conflicts rose in 2014 and 2015, 83% of them were concentrated in just 5 countries with the Boko Haram insurgents of Nigeria accounting for 70% of them. However, strong efforts by national armies in the region to counter the group seems to have weakened them, although armed attacks are picking up again.

Talking Point – Infrastructure Shortage

Although privatization in sub-Saharan African countries has progressed there is still a lack of road, electric power, transportation, education and other basic infrastructure in the region, plus there is rapidly growing demand for information and telecommunication infrastructure ⇒ which means a multitude of investment opportunities exist.

The lack of physical infrastructure is a serious obstacle to sub-Saharan Africa's growth and development, and results in a low level of intra-African trade and trade with other world regions. The region accounts for 13% of the world population but generates a mere 2% of global GDP and only 2% of world trade. Despite this, six of the world's ten most rapidly expanding economies can be found in sub-Saharan Africa. Bringing the quality of infrastructure up to other developing country levels by bridging the gap in transport and logistics, meaning rail, roads (only 16% of the roads are paved) and ports, electric power and telecommunications could lead to a more than 40% increase in trade, increase productivity and expanding growth in manufacturing, services, and agriculture.

In fact, the good news is that infrastructure investment and improvements in sub-Saharan Africa have led to half of sub-Sahara Africa's increased growth in recent years, and infrastructure funding has tripled over the last decade with financing from emerging economies, especially China, rising. The bad news is that sub-Sahara Africa still needs $90 billion a year in investment for infrastructure over a decade (initial decade from 2010 - 2020) to catch up to other developing nations, but has been facing a $30 billion shortfall in funding. This makes private financing, or private participation in infrastructure (PPI) in the region, which has greatly increased and is now around 50% of all infrastructure funding, imperative.

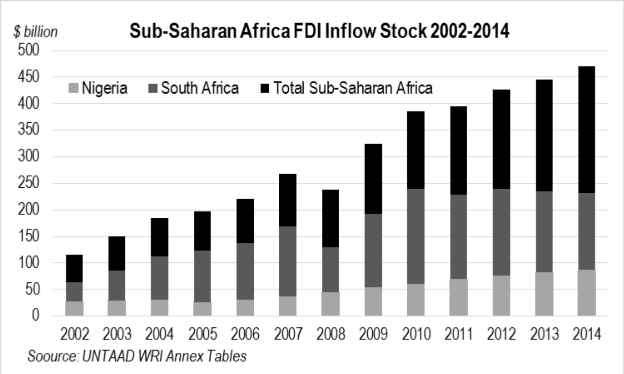
The seven largest economies and the countries with the seven largest populations in sub-Saharan Africa are fairly evenly dispersed in West Africa, East Africa, Central Africa and Southern Africa This has given rise to promoting infrastructure aimed at economically integrating the countries (in various forms, for example the Southern African Development Community or East African Community and so on) in each region to leverage the regions as a whole. At the same time though, sub-Saharan Africa's rapidly growing population is placing structural pressures on the economies of each country, with urbanization taking place without industrialization. Alleviating these pressures will require more localized investment in manufacturing and agriculture.

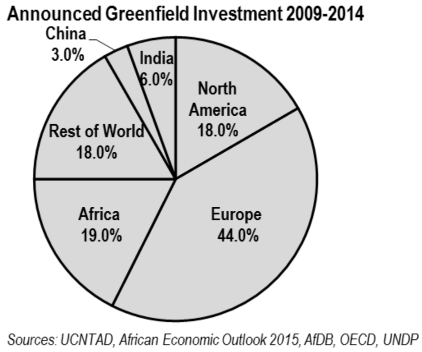
Africa's first light-rail train system in the Ethiopian capital Addis Ababa, with a capacity to carry 60,000 passengers a day

Talking Point - Investment Inflows

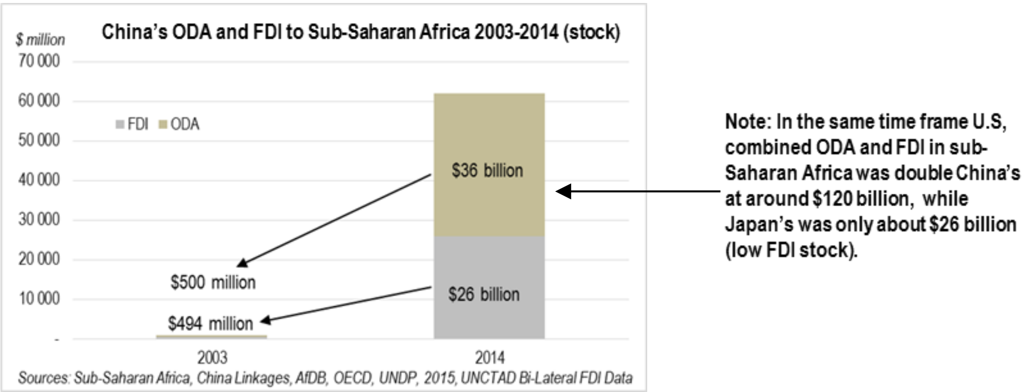
In addition to the traditional investment from sub-Saharan Africa's former colonial European powers, newly emerging economies led by China have been accelerated their investment to gain a foothold in sub-Saharan Africa markets. ⇒ Due to the end of monetary easing policies, capital costs are rising.

Foreign direct investment in sub-Saharan Africa has quadrupled over the past 10 years. In terms, of cumulative FDI, Nigeria and South Africa account for 50% of the total FDI that has flowed into sub-Saharan Africa. However, in terms of 2014 inflows they received just 25% of total FDI in the region, with FDI going to a wider number of countries. Still, sub-Saharan Africa's FDI inflows are only 2% of the world total, the lowest among all regions. Europe still dominates in terms of its share of sub-Sahara Africa's FDI stock with nearly 40%, while that of the U.S. was around 12.5%. China's share of sub-Saharan Africa's cumulative FDI inflows is about 7.5%. (Note: The share of FDI stock was calculated based on UNCTAD's bi-lateral FDI statistics rather than the annex tables.) Interestingly, China's share of announced greenfield investment stock in all of Africa between 2009 and 2014 was only 3%, which brings us to the question of China's influence in Sub-Saharan Africa.

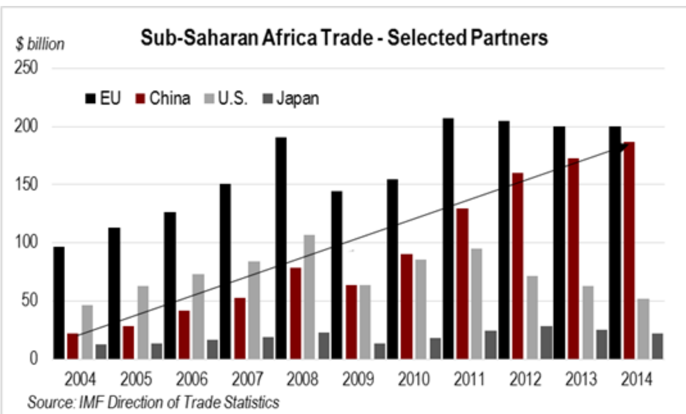




Although China's total accumulated FDI in sub-Saharan Africa was only between about $24 and $26 billion in 2014 (China's Ministry of Commerce reported it as $36 billion), most of it has come only in the last 12 years, and was only $462 million 2003. Furthermore, of China's total ODA budget from around 2002, more than 50% has gone to sub-Saharan Africa, an estimated $36 billion. And, this does not include substantial amounts that go through multilateral aid institutions and other types of infrastructure financing provided by China (Note that most infrastructure financing in sub-Saharan Africa does not use equity methods, so is not considered FDI). All in all, China has been contributing a minimum of around $6 billion a year, and likely more, to the sub-Saharan economies over the last 10 to 12 years (still below the U.S. level), and has been the largest lending country for infrastructure projects. Plus, China has just pledged a further $60 billion in assistance and loans to sub-Saharan Africa over an unspecified period.



If this weren't enough, China has become sub-Saharan Africa's largest trading partner (as a country) with total trade of $186 billion in 2014 with imports form sub-Saharan Africa of $109 billion, 60% of which are commodities. And, while more than 60% of China's total direct investment has been in resources, in recent years more of its FDI has been shifting to manufacturing.



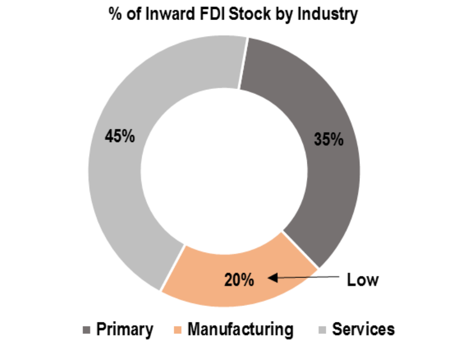
Also, there has been some concern about the poor governance environments and moral hazards related to China's investment in Africa as they have invested in countries Western countries cannot due to corruption concerns. However, the government seems to be taking a different approach recently toward better investment governance and higher standards, likely due to its establishment of the Asian Infrastructure Investment Bank (AIIB). In addition, there are about 2,300 Chines companies, mostly private, operating in the region which are profit driven and have found that they face the same risks, including reputational, in Africa as everyone else, and seem to be approaching their risk management accordingly.

China DRC copper and coal mine development and road construction project

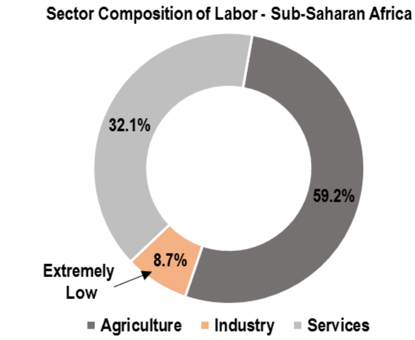
In terms of sectors, FDI, which has been concentrated in resource extraction in sub-Saharan Africa, is becoming more diverse with an increasing amount going into the manufacturing sector. The share of cumulative inward FDI in sub-Saharan Africa by sector is 20% in manufacturing, 35% in the primary sector and 45% in services, of which around 55% is in the finance industry. However, from 2011 to 2014 the value of announced greenfield FDI in sub-Sahara Africa in the manufacturing sector was nearly twice that of the primary sector, or 35% of total announced greenfield FDI in the region, and just 10% lower than services. Much of the FDI in manufacturing, but not only manufacturing, is being driven by investment from such emerging economies as China and India, among others (Brazil in Portuguese-speaking countries in mining/infrastructure). It is also coming increasingly from other sub-Saharan African countries/companies, particularly South Africa (19% of the total FDI stock in sub-Saharan Africa is intra-African). Interestingly, companies from these emerging economies have been taking over divestures by companies from developed countries, which has increased in the past few years. It seems that companies from emerging economy and developing countries are used to operating in riskier and less favorable economic environments than companies from advanced countries and as such, may see the risks involved differently.

Which brings us to a certain dilemma regarding investment in sub-Saharan Africa. FDI can basically be divided into three types; resource seeking, market seeking and efficiency seeking. Resource seeking is aimed mostly at resource extraction and possibly raw material processing. Market seeking is aimed at market size and growth, which would involve manufacturing and services for the local market, and possible exports to neighboring countries. Efficiency seeking is aimed at manufacturing by taking advantage of low-cost labor and production, efficient infrastructure and a relatively skilled labor force mostly for export.

Up until recent years FDI in sub-Saharan Africa has mainly been resource seeking. Manufacturing makes up only 11% of value-added GDP in the region and the primary and manufacturing sectors make up only about 8.7% of total employment in sub-Saharan Africa, while agriculture accounts for 60% and services 32%. Currently, the urban population in sub-Saharan Africa is growing by 5% a year, however this urbanization is taking place in the basic absence of industrialization, which is leading to growing urban poverty. Manufacturing investment traditionally creates more jobs than the primary sector and in many countries in the region more jobs than service sector investment does. Moreover, the return on investment is higher in manufacturing than all other sectors (9.5% on average).



Sources: UNCTAD, Manufacturing FDI in Sub-Saharan Africa, World Bank Group



Source: Manufacturing FDI in Sub-Saharan Africa, World Bank Group

Usually, in typical economic development, as in China's case, urbanization accompanies large increases in agricultural productivity and the development of a large manufacturing industry. However, in sub-Sahara Africa's case, which has 25% of the world's arable land but produces less than 10% of the world's food, this has not been true. So, the dilemma for governments in the region it seems is the prioritizing of investment. 80% of the farmers in the sub-Sahara Africa are small farmers, and although urbanization id growing rapidly, the region still remains rural with large increases in the rural population continuing. So, rather than large farms, which would only increase migration to urban areas with little or no manufacturing industry, the small farmers need to be made more efficient. This can be done by providing them with know-how, farm finance, high yielding seeds (digital technology to connect farmers with this information has been recommended) irrigation systems, as well as the storage and transport infrastructure to give them access to city markets. Already, many countries in the region are importing food and face high import prices, as much of sub-Sahara Africa is subject to drought, productivity is low (although improving) and again, farmers lack access to larger markets for their produce.

In the meantime, market seeking FDI needs to be promoted, as well as urban infrastructure, to develop local light manufacturing industries near urban areas throughout the region. FDI is also needed to develop the resource and raw material processing industry to gain the extra value-added as resources are mostly exported raw. Currently, only six countries in sub-Sahara Africa receive the majority of manufacturing FDI in the region. So while large-scale regional integration is important, it may be a question of prioritizing investment in local areas and markets first, in the short term, while gradually investing in larger regional integration infrastructure in the longer term to spur economic development.

Regarding the hike in U.S. interest rates, it was small and more symbolic than anything given there is little or no inflation in the U.S. right now. Of course capital costs would increase somewhat, however, new investment in sub-Saharan Africa really depends on each target country's situation and each investor's business strategy. Countries with large external debts might see their currency depreciate which would make investment in the country cheaper. Also, depending on a company's business they might see growth in certain sectors and certain countries and a potential return on investment that would counter higher capital costs.

Middle Class Expansion

The region has the fastest growing population in the world and due to its growing population its middle class is also expanding. ⇒ Will middle class incomes stagnate?

In my opinion, developing a larger middle-class and sustaining middle-class incomes will depend on developing the local manufacturing sector and creating a productive agricultural industry. Once local manufacturing is developed to a certain extent, and regional infrastructure is gradually improved, efficient seeking investment will come to the region, which will further increase employment and incomes through exports.

What I haven't mentioned is that this will also take a skilled workforce to accomplish, which of course would require investment in education. On the other hand, sometimes, through FDI, the development process can be leapfrogged through technological and know-how transfers. In any case, real GDP growth must exceed the population growth rate substantially to raise middle-class incomes. In China, between 2000 and 2014 China's GDP growth averaged 9.7% per year, its population growth was 0.5% and its per capita income grew 7 times, or 50% per year ($950 to $7,571). In India, during the same time frame, GDP growth was 7% and population growth 1.7% per year resulting in an increase in per capita of 2.5 times, or 18% per year. With sub-Sahara Africa's population growth at 2.7% per annum and with an estimated 4.3% GDP growth rate, per capita GDP would only see a 1.6% increase ($26) per year, and if commodity prices continue to drop and emerging economies slow, and/or abnormal weather hurts Sub-Saharan agriculture, middle-class incomes will certainly stagnate or fall in the short-term.

Certainly, sub-Saharan Africa faces many challenges; the lack of physical and social infrastructure, poverty and political instability, an overdependence on resources and fiscal concerns. Investing in sub-Saharan Africa is not an easy task and tricky at best, which can be seen in Japan's comparatively low levels of investment and trade with the region. What it comes down to from this point on is whether the actual risk of the investment is higher than not investing in a fast growing market at all, or whether the actual risk of the investment outweighs gaining early entry into a potential mega-market, the so-called "last frontier".

Sources:

African Economic Outlook 2015, AfDB, OECD, UNDP, 2015

Global Economic Prospects, Chapter 2: Sub-Saharan Africa, AfDB, OECD, UNDP, January and June 2015

World Investment Report 2013 and 2015, Regional Trends - Africa and Annex Tables, UNCTAD

Manufacturing FDI in Sub-Saharan Africa: Trends, Determinants and Impact, World Bank Group, June 19, 2015

IMF World Economic Outlook Database, October 2015

China's Cautious $60 Billion for Africa, China Bystander, Dec. 6, 2015

Resource Dependence and Fiscal Effort in Sub-Saharan Africa, IMF Working Paper, August 2013

Regional Economic Outlook, Sub-Saharan Africa - Navigating Headwinds, IMF April 2015

Financing African Infrastructure, Can the World Deliver?, Brookings, March 2015

Addressing Africa's Infrastructure Challenges, Deloitte, 2015

Most Vulnerable Countries to Chinese Economic Downturn, Atradius Economic Research, February 2015

OECD DAC ODA Statistics

Food and the Transformation of Africa, Foreign Affairs, Nov.-Dec. 2015

	Marubeni Research Institute	Telephone: 3378-3649 E-mail: ryan-p@marubeni.com
Address	1-4-2 Otemachi, Chiyoda-ku, Tokyo 100-8088, Marubeni Building 12th Floor	
WEB	http://www.marubeni.co.jp/research/index.html	