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Economic Analysis
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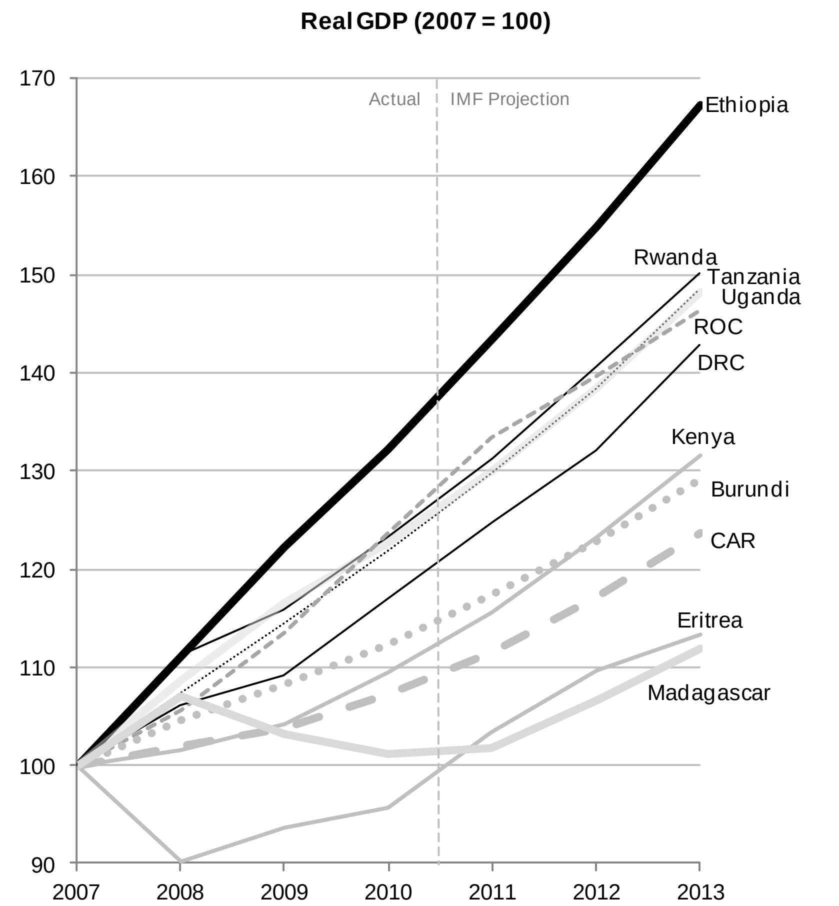
EADS Economic Trends Report

East and Central Africa

September 2011

Economic Overview

Economic growth in the East and Central African region has been strong in recent years, with even the global financial crisis not causing much of a downturn. In most countries, real GDP growth accelerated in 2010 and is projected to remain brisk through at least 2012. Growth rates in the Democratic Republic of the Congo (DRC), Kenya, Tanzania, and Uganda are averaging 6–7 percent this year and next. In the Republic of Congo (ROC) and Eritrea, the economy is projected to expand by nearly 8 percent this year and in Ethiopia growth is expected to be over 8 percent this year and next.



SOURCE: IMF, *World Economic Outlook*, April 2011.

Rapid economic growth in East and Central Africa highlights the pattern seen throughout Sub-Saharan Africa in this cycle: low-income countries are generally posting the most rapid economic growth rates. Some East and Central African economies are prospering from the commodity boom boosting the rest of the continent. Growth in Tanzania has been boosted by new production of offshore natural gas and by gold mining in the Handeni region. The Republic of the Congo is benefiting from new oil sources now in production.

East and Central Africa is also attracting increased foreign direct investment and portfolio equity flows, particularly in Kenya. Investors are responding to increased domestic demand in the region, making it more attractive for business locations.

As is the case throughout Sub-Saharan Africa, rapid urbanization and low density for fixed-lines have spurred investment in telecommunications throughout East and Central Africa. Mobile phone expansion, along with innovations such as the mobile money system in Kenya and the market information scheme in Ethiopia, is improving productivity and increasing growth in East and Central Africa. A 2009 study for all regions estimated that each percentage point rise in phone access was associated with a half percentage point gain in per capita income.

Countries covered in this report include Burundi, Central African Republic (CAR), Democratic Republic of the Congo (DRC), Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Republic of the Congo (ROC), Rwanda, Tanzania, and Uganda. Due to data limits, not all countries are represented in every graph or analytical section.

World Bank Income Groups

Ten of the East and Central African countries are in the World Bank's Low Income group. Two of them—Republic of the Congo and Djibouti—are in the Lower Middle Income group.

Favorable rains in 2010 helped boost agricultural output in Kenya and elsewhere in the region. However, rains in 2011 have not been as favorable and will be a restraint on growth this year.

There are downside risks to the upbeat growth outlook for East and Central Africa. Europe remains a vital trading partner and any recessionary tendencies there will curb exports from East and Central Africa. Another risk is that higher food and fuel prices will restrain the expansion. Political uncertainty can always affect the economic outlook. However, five East and Central African countries have already had national elections this year (and the DRC will have elections this November) without evidencing any destabilizing tendencies. In Kenya, adoption of a new constitution in August 2010 has strengthened stability and improved the business environment.

The IMF (April 2011) cautions that several policy areas in the region "require sustained attention," including: better financial regulation, improved public treasury management, a more favorable business environment, and fiscal tightening to reduce budget deficits.

Fiscal Policy

About half the countries in the region are tightening fiscal policy this year. Madagascar shifted to a tighter policy in 2010, lowering the deficit as a percent of GDP to 1.6 percent by cutting public expenditures on infrastructure and social services. Additional austerity is expected to narrow the deficit in 2011 and 2012. The Central African Republic is expected to reduce its budget deficit this year while working through the HIPC Initiative debt process. In the Republic of the Congo, strong revenues from oil production have enabled the country to post budget surpluses. The surplus (as a percent of GDP) more than doubled in 2010 and is projected to remain at a high level in 2011 and 2012.

Tanzania adopted a expansionary fiscal stance for 2010, but is attempting to narrow the budget deficit this year and next. The government's focus is on raising tax revenue, but unplanned expenditures to offset food shortages are straining the fiscal balance. Djibouti's fiscal tightening has been more successful. Improved administration of the VAT and reduced military expenditures helped cut the deficit by about half in 2010 and additional deficit reduction is projected for 2011.

By contrast, Kenya has been using fiscal expansion as economic stimulus. Spending increases are concentrated on public projects for social services, agriculture, and infrastructure. In Uganda, fiscal emphasis is on infrastructure development and the government's balance sheet went from a small surplus in 2009 to a deficit in 2010. Public sector capital spending in Uganda, however, has been restrained by absorption capacity limitations.

Burundi's government reported a larger deficit in 2010 and an additional widening is foreseen for 2011. A commitment to improving civil servant pay will boost expenditures through 2012, but the prospect of reduced donor inflows could lead to a cutback in expenditures. Rwanda posted a smaller deficit in 2010 but the gap is projected to widen in 2011 as the government remains committed to supporting social sector development. Expenditure increases are enabled by reforms to the revenue authority and improved tax collection.

The DRC narrowed its budget deficit in 2010 by suspending subsidies and reaping higher revenues from exports, but the deficit is projected to widen sharply this year. The government has been delayed in drafting and implementing medium-term frameworks for expenditure.

Monetary Policy

Countries in the region are generally pursuing accommodating monetary policies, with most countries needing more institutional strengthening to improve their policy performance. Burundi, for example, lowered the policy interest rate in July 2010 but the move appeared to have little impact on deposit or lending rates in the economy. The Bank of Uganda adopted a gradual easing stance in 2010. Injections of liquidity by the central bank did lower bond yields, but the desired drop in lending rates was not achieved. Ugandan banks moved to a more conservative risk stance and left rates largely unchanged. DRC monetary authorities cut interest rates five times in 2010, but the tepid credit growth suggests that a poor business climate is keeping investors on the sidelines.

The Central Bank of Kenya has had more success with its four interest rate cuts in 2010. Credit to the private sector has expanded in response to the monetary easing. The National Bank of Rwanda, reacting to the economic slowdown in 2009, cut its reserve requirements and policy rates. Commercial bank rates eased and domestic credit expanded during 2010.

In Madagascar, the central bank has kept reserve requirements and its main interest rate steady for the past several years, attempting to rein in inflationary pressures caused by higher food and energy prices. In Ethiopia, the government cut back on the growth rate of credit as inflationary pressures have mounted.

Some of the countries do not have independent monetary policies. The Republic of the Congo and the Central African Republic are members of the Economic and Monetary Community of Central Africa. As such, the Bank of Central African States (BEAC) maintains monetary policy. BEAC lowered its official rate in 2010.

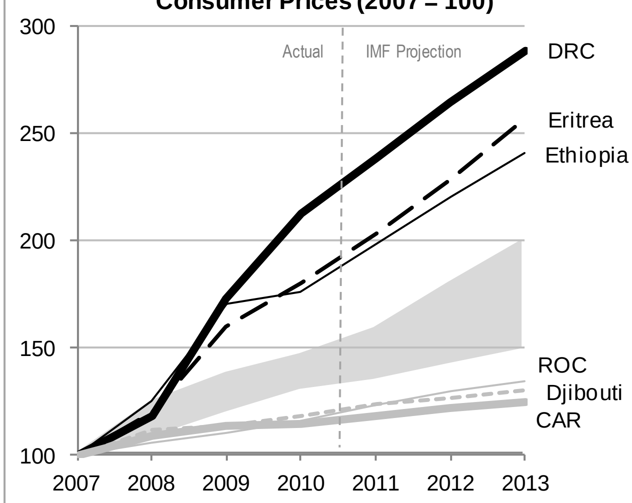
Real GDP Growth Rates, 2010	West Africa 6.3%	**East and Central Africa 6.0%**	Southern Africa 3.1%

Inflation

The East and Central African countries fall into three groups with respect to their inflation rates over the past decade and on into the next year or so:

- High inflation countries (DRC, Eritrea, and Ethiopia) with double-digit inflation projected in each one for 2011.
- Notably low inflation countries (ROC, Djibouti, and CAR) with relative price stability. In the Central African Republic, for example, inflation was less than 2 percent in 2010 and is projected to be less than 3 percent this year.
- The rest of the East and Central African countries (inflation track record shown by the grey-shaded area around the median line in the graph) with inflation rates typically found, more or less, in developing countries.

Consumer Prices (2007 = 100)



SOURCE: IMF, *World Economic Outlook*, April 2011.

High food prices have been a problem in much of the world, but in some East and Central African countries the good harvests of 2010 kept food prices from rising sharply. The strength of harvests this year and next will have a large impact on inflation in the region.

Typically High Inflation

All of the East and Central African countries have had inflationary periods during the last two decades. None of the countries could avoid double-digit inflation at least once during 1991–2010, although the Central African Republic and the Republic of the Congo had the fewest years of high inflation.

Consumer Price Inflation, 2011 (projected)	West Africa	**East and Central Africa**	Southern Africa
	8.7%	**8.4%**	6.9%

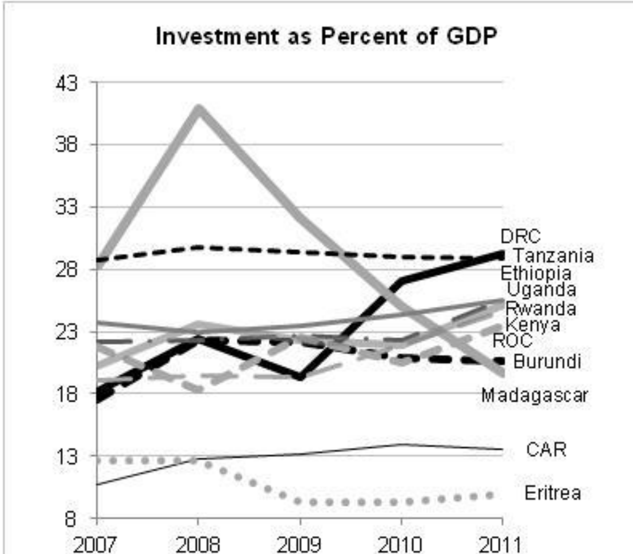
Banking and Financial Sector

Over the past decade, the DRC has significantly increased its domestic credit relative to the size of its GDP. But the outsized gain started from a woefully small base. Tanzania, which nearly tripled this indicator during the decade, is a more significant achievement.

Overall, most countries in the region did not expand the availability of credit by very much. Credit available to the private sector remains relatively more plentiful in Kenya, Burundi, and Djibouti. By contrast, credit remains at low levels in the DRC, Republic of the Congo, and the Central African Republic. In an April report, the IMF identified financial sector regulation and institutions as a key area for policy action in Sub-Saharan Africa. East and Central Africa is the subregion most obviously in need of that focus.

Investment

Despite the recently strong economic growth rates in East and Central Africa, most countries have not raised their investment spending when compared to the size of their GDP. The DRC, Kenya, and the Central African Republic are exceptions, at least during the past several years. Given the generally low levels of productivity in many sectors of the economy, more investment spending would reap benefits from faster economic growth.



SOURCE: IMF, *World Economic Outlook*, September 2011.
NOTE: 2011 values are IMF projections.

As is true in other parts of Sub-Saharan Africa, gains in investment spending in East and Central Africa are often in the capital-intensive mining sector. Foreign investors have been stepping up their allocation of funds in East and Central Africa. Throughout the continent, countries are trying to maximize mining's contribution to economic growth by joining the "Extractive Industries Transparency Initiative." As of June, only the Central African Republic was deemed to be in compliance with this initiative among East and Central African countries, but other countries are in the process of getting compliant.

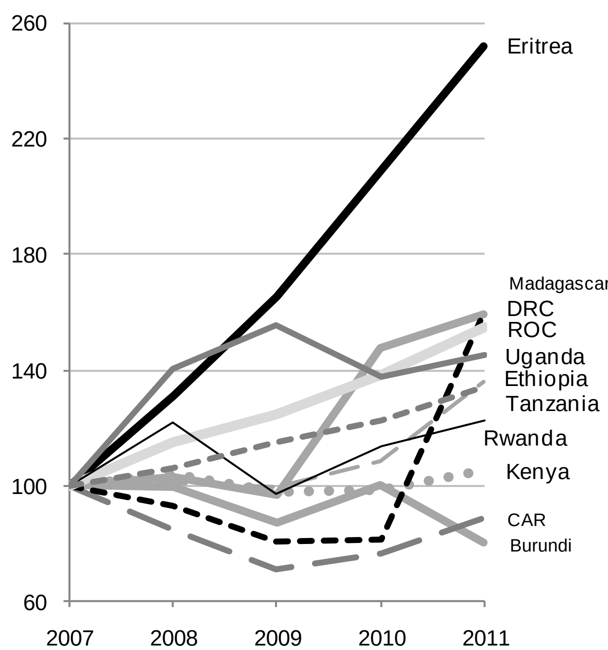
Investment as a Percent of GDP, 2010	West Africa 24.6%	**East and Central Africa 23.9%**	Southern Africa 20.0%

Trade

East and Central African trade expanded rapidly in 2010, more than reversing the decline in 2009. A sharp rise in exports in the DRC was led by the mining sector, buoyed by both higher demand and higher prices. The DRC is expected to continue to expand its trade as it is now joining the free trade area of the Common Market for Eastern and Southern Africa (COMESA). The only East and Central African country to see a decline in exports for 2010 was Uganda, where traditional export crops such as coffee met with weak demand.

Export growth has been strong in most of the countries over the past decade, particularly in Uganda, Ethiopia, the DRC, and Tanzania. Notable laggards over the past decade have been CAR, Burundi, and Madagascar—although Madagascar is projected to achieve robust export growth in 2011. Mining exports by Madagascar are boosting the economy, while the traditional products such as agriculture and textiles are showing less strength.

Export Volume of Goods and Services (2007 = 100)



SOURCE: IMF, *World Economic Outlook*, April 2011.
NOTE: 2011 values are projections.

Percentage Change in Export Volume of Goods and Services, 2010	**East and Central Africa 8.6%**	Southern Africa 4.6%	West Africa -1.6%

Regional Integration

Compared to West Africa and Southern Africa, the East and Central Africa subregion is more integrated with respect to merchandise trade. As the graph indicates, 11 percent of East and Central African exports in 2010 went to other East and Central African countries while this integration measure was less than 10 percent in both West and Southern Africa.

Over the past decade, however, East and Central Africa's export markets in the rest of the world have grown faster than has intraregional demand. At the country level, there was not a uniform pattern of trade change. Ethiopia and Kenya became significantly less dependent on East and Central African markets for exports as the decade progressed. By contrast, Djibouti, Rwanda, and Uganda went in the reverse direction and increased their export share to other countries in the subregion. The remaining countries did not change their trade patterns very much, at least on this score.

Many of the regional organizations to promote integration are expanding and lowering trade barriers between member states. However, the percentage of exports from East and Central African countries which are staying in East and Central Africa will continue to ease downward so long trade with the rest of the world remains faster than intraregional trade.

Promotion of Regional Integration

Four regional organizations which promote East and Central African integration are the Common Market for Eastern and Southern Africa (COMESA), the East and Central African Community, the Economic Community of Central African States (ECCAS), and the Southern African Development Community (SADC). Nine of the twelve East and Central African countries covered by this report are in COMESA, five are in the East and Central African Community, two are in ECCAS, and three are in SADC.

Additional Information

For country-specific data and additional information about the countries covered in this report, please visit the EADS Country Portal at http://esdb.eads.usaidallnet.gov/query/do?_program=/eads/esdb/countryPortal.

Sources used in compiling this report include the semi-annual World Economic Outlook from the International Monetary Fund (http://www.imf.org/) and the Global Economic Prospects from the World Bank (http://www.worldbank.org/).