

Global Economy Watch

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Governing for growth: improvements to public governance could boost Africa's continental economy by \$23bn

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Dear readers,

There are more countries contained in Africa than in any other landmass on Earth. The continent's geography, economics and politics is startlingly diverse, yet it is often discussed and analysed as a single entity, which rises or falls, succeeds or fails, as one. This reductive type of analysis does Africa a disservice. In our feature article for this edition we consider the variation in economic growth and performance in measures of governance among 53 African countries in recent years and consider the relationship between the two (see Figure 1). Our headline finding suggests that attainable improvements in governance could lead to a continent-wide increase in economic output worth around \$23bn, but that this benefit would not be distributed equally.

In our second article, we explore the phenomenon of weak (or non-existent) global inflation. Policymakers, and central bankers in particular, have waged a multi-generational war on fast-rising prices, and, as our article shows, they appear to have been victorious. But low, controlled inflation can be desirable: most central banks in advanced economies target annual price increases of around 2%. Expectations of higher prices add momentum to an economy and encourage continued consumer spending and wage growth.

Following the global financial crisis and the unprecedented loosening of global monetary policy that was made in response, it was assumed that inflation would rise again once labour markets tightened up. But the US Federal Reserve appears to be nearing the end of its cycle of interest rate rises and inflation has remained consistently below target. We consider the potential reasons behind the failure of inflationary pressures to build and propose that changes to inflation targets might be an option worth considering.

Lastly, in our economic update, we look at the impact of the manufacturing sector on the global economy since mid-2018. Manufacturing indicators have fallen for several major economies, most likely as a consequence of the US-China trade war and the Chinese government's attempts to reduce obsolete capacity in the economy. However, China's stronger-than-expected growth in the first quarter of 2019 suggests that the government is again stimulating the economy to boost its short-term performance. The effects of this may flow outwards in the coming months, supporting the rest of the global economy, albeit without tackling China's long-term structural issues.

Fig 1: Annual change in real GDP per capita (2013-17)



GDP per capita falling quickly GDP per capita rising quickly

Source: PwC analysis, World Bank

Countries with the highest average annual GDP per capita growth (2013-17)

Country	% growth 2013-17
Ethiopia	7.1%
Côte d'Ivoire	5.7%
Djibouti	4.9%
Rwanda	4.0%
Guinea	4.0%

Countries with the biggest declines in annual GDP per capita (2013-17)

Country	% growth 2013-17
Equatorial Guinea	(9.0%)
Central African Republic	(5.2%)
Libya	(5.1%)
Burundi	(2.0%)
Chad	(1.9%)

Governing for growth: improvements to public governance could boost Africa's continental economy by \$23bn

Despite containing more countries than any other landmass on Earth, discourse around Africa often treats the continent as if it were a single country.¹ Looking beyond these accounts is key, particularly as economic performance in the region has been so varied.

Figure 1 shows that economic growth has differed wildly in recent years. Countries like Ethiopia and Côte d'Ivoire have experienced consistent annual average real per-capita growth in excess of 5% since 2013, but others have struggled. Equatorial Guinea and the Central African Republic have seen declines of 9% and 5.2% a year over the same period.

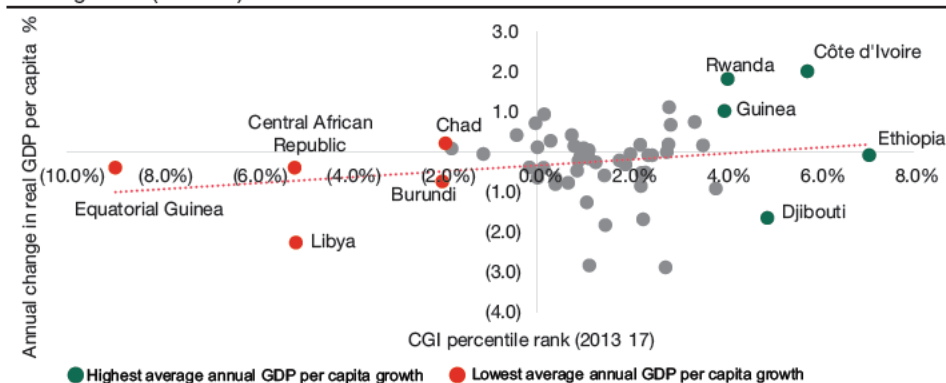
Economic growth has been particularly strong in East Africa (at around 3% a year since 2013).² Central Africa, by contrast, saw annual real GDP per capita fall by an average of 1.3% over the period. North Africa and the Southern region experienced very sluggish growth (of 0.4% and 0.8% a year respectively), while West Africa saw faster growth of 1.9% a year.

What factors are responsible for this variation?

Alongside conventional drivers of growth, such as high net FDI inflows and strong commodity prices, political stability and perceived levels of corruption have also been influential. To demonstrate this, we modelled the performance of each country across six of the World Bank's Worldwide Governance Indicators (2013-17), which cover aspects such as regulatory quality, rule of law and government effectiveness.³

Specifically, we look at how the countries' rankings have changed for each of these variables relative to one another (known as the percentile rank) over the past five years. We then constructed an annual Composite Governance Indicator (CGI) based on an unweighted average of these six variables to highlight which economies have seen the largest improvements and the biggest declines in public governance since 2013.

Fig 3: Annual change in real GDP per capita (2013-17) and change in CGI percentile rank growth (2013-17)



Source: PwC analysis, World Bank

As illustrated in Figure 2, Côte d'Ivoire and Rwanda have experienced some of the strongest improvements in these indicators. Both of these countries have placed institutional reform high on the political agenda. Countries that have experienced conflict or sociopolitical unrest fared particularly poorly, with scores declining in Mozambique, Zambia and Lesotho.

There is a positive correlation between economic growth and rising governance indicators, as shown in Figure 3. Three of the fastest growing economies also saw the strongest improvements in their worldwide governance indicators. This is also true for those with the weakest economic performance, with four of the five countries with the fastest declining per-head GDP also seeing declines in their annual composite governance rank over the last five years.

Improving governance across the continent could therefore be key to economic development. Using the methodology set out by Fayissa and Nsiah (2010), we have estimated the potential impact on GDP if each African economy made an improvement to governance equivalent to that made by the

strongest performer, Côte d'Ivoire, over the past five years.⁴ Across the continent, these gains would be worth around \$23bn if realised.⁵

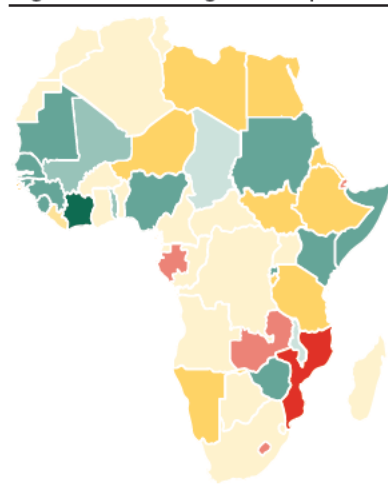
The countries with the largest potential gains are those with a comparatively high GDP per head but a poor track record on governance.

Accordingly, oil-rich Libya and Equatorial Guinea would see the greatest increase, with each person gaining an additional \$430 and \$215, respectively.

Those with lower GDP per capita, such as Niger and Sierra Leone, would see a smaller improvement, despite their governance rank being below the average for the region. By contrast, economies like Rwanda, which have made similar improvements to Côte d'Ivoire, would also only realise a small benefit, with greater gains made through further diversification of their economies and continued focus on developing the skills of their younger workers.

As with economic growth, the benefit from improved governance is varied across Africa. Those economies that have promoted political stability and reduced corruption have seen improvements in real GDP per capita and vice versa. Highlighting such differences illustrates the necessity of moving away from the 'single story' narrative. For those with poor scores for political stability and corruption, improving public governance could be a key component to generating faster economic growth.

Fig 2: Annual change in Composite Governance Indicator (CGI) percentile rank (2013-17)



Countries with the biggest improvements in annual CGI percentile rank (2013-17)

Country	CGI annual rank change 2013-17
Côte d'Ivoire	2.13
Rwanda	1.46
Guinea	1.02
Kenya	0.91
Comoros	0.81

Countries with the biggest declines in annual CGI percentile rank (2013-17)

Country	CGI annual rank change 2013-17
Mozambique	(3.72)
Zambia	(1.81)
Djibouti	(1.81)
Gabon	(1.74)
Lesotho	(1.64)

Falling CGI percentile rank Rising CGI percentile rank

Source: PwC analysis, World Bank

References

- Chimamanda Adichie Ngozi, 'The danger of a single story' (2014): https://www.ted.com/talks/chimamanda_adichie_the_danger_of_a_single_story
- Note that regional growth has been calculated by averaging GDP per capita growth by country according to African Union boundaries. The Eastern region excludes Somalia and Eritrea due to data availability.
- We took an unweighted average of each of the indicators to create a composite governance index. This approach was also used by Fayissa and Nsiah (2010).
- Fayissa and Nsiah's methodology: https://www.researchgate.net/publication/265723317_The_Impact_of_Governance_on_Economic_Growth_in_Africa. Côte d'Ivoire averaged an annual improvement in its percentile rank of 2.02 between 2013-17 on the composite governance index.
- This estimate excludes the Democratic Republic of the Congo, Somalia and South Sudan due to limited data availability.

Economic update: The impact of manufacturing on the global slowdown

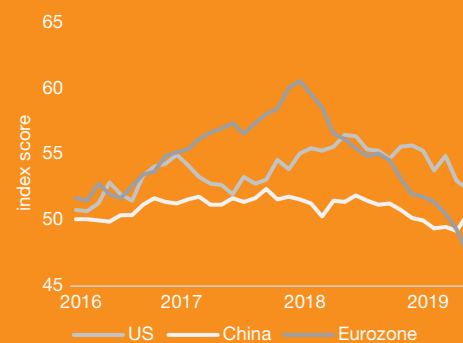
The causes of the slowdown in the global economy since mid-2018 are coming into view. The weakness appears concentrated in the manufacturing sector, with purchasing managers indices for the US, China and the euro zone, in particular, declining. (A score above 50 indicates rising output, a score below 50 suggests contraction.) There are two interrelated stories here.

The first is the effect of the US-China trade conflict, which is causing disruptions to supply chains and suppressing appetite for trade. This can be bad news for Europe too, which is a big exporter to both the US and China. (Europe was a beneficiary of strong import demand from these economies in 2015-16).

The second is the Chinese government's attempt to deleverage its highly indebted corporate sector, which is likely to have exerted downward pressure on its own manufacturing output and those of its main suppliers.

However, the cooling effect of the trade war on the economy has led the government to prioritise its GDP target of 6-6.5% over its deleveraging programme. This short-term relaxation of policy is now visible in the data, with clear evidence of credit becoming cheaper. As greater Chinese spending filters through the global economy, growth is likely to accelerate again from the second quarter of 2019.

Fig 4: Manufacturing PMIs have fallen in three major economies in 2018-19



Source: Eikon from Refinitiv

Why is inflation so low?

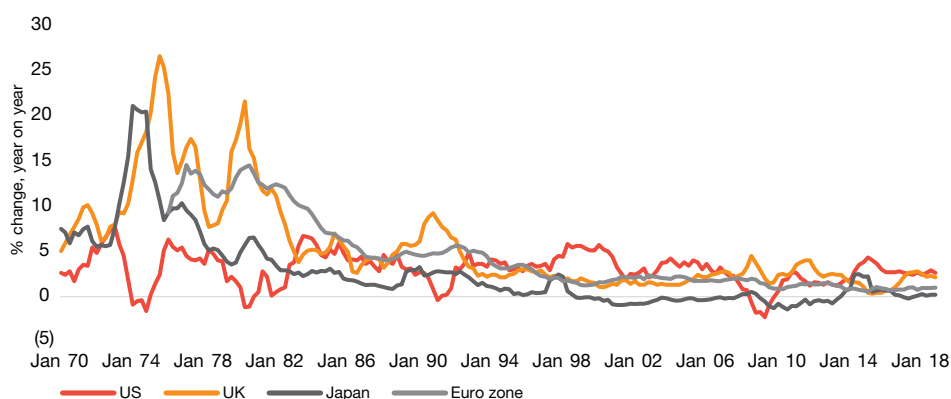
For several generations of economic policymakers, inflation was the enemy. It cut living standards and reduced the value of savings. Many of the world's major economies endured periods of double-digit interest rates to avoid runaway increases in prices. But over the past decade inflation has not just been tamed, it has been rendered dormant (see Fig 6). Policymakers are now facing the opposite problem, of trying to renew upward pressure on prices, even as global growth has picked up and labour markets have tightened. What's going on?

Over the past 20 years a consensus has emerged among central banks in advanced economies to aim for annual inflation of around 2% per annum. This is the official target in the US, Canada, the UK, the Eurozone, Japan, Australia and New Zealand. A level of 2% is attractive because it provides both a reasonable buffer against deflation and is likely to require interest rates above zero (which in turn gives some reward to savers and means interest rates can be cut to support an economy during a downturn). However, at present there is little evidence that any of these economies are capable of generating consistent inflation of 2%.

The current low (or no) inflation environment is caused by two sets of factors. The first are those triggered by economic policy, the second by those beyond the scope of it. Considering the first group, it is becoming increasingly clear that the US Federal Reserve has overestimated the threat of inflation. Although the Fed pledges that its 2% target is symmetrical, it has raised interest rates nine times since the end of 2015, but its preferred measure of inflation has only exceeded 2% in nine of the 37 months since then, suggesting a strong preference for keeping inflation below, rather than above, 2%.

In its monetary policy statements the Fed has long argued that low unemployment would push up inflation through higher wages. This may still prove correct, but it is consistently underestimated the amount of slack in the labour market.

Fig 5: Consumer price inflation has gone from problematically high to puzzlingly low



Source: St Louis Federal Reserve

Note: US figure is personal consumption expenditures, as targeted by the Federal Reserve

In December 2016 when unemployment was 5%, the Fed's projections suggested that the long-run employment rate was 4.8%. In December 2018, when unemployment was 3.8%, the Fed revised its forecast for joblessness in the long run down to 4.3%. The true level may be lower still. Again, this suggests that the Fed has been too fearful of inflation.

In Europe, the European Central Bank (ECB) has kept monetary policy accommodative, but inflation has been weak. Granted, the regional economy is stumbling at present (see Economic Update), but even when it was growing quickly in 2018, the core inflation remained at around 1%. Like the Fed, the ECB believes labour markets will eventually drive up prices. Evidence across the region is patchy. The link appears clearer in the Netherlands, where unemployment is at 3.3% and inflation 2.9%, than in Germany, where joblessness is 3.4% and inflation 1.4%. Compared with the US, European fiscal policy was not loosened to anywhere near as much in response to the financial crisis and it has since been tightened much more. More expansionary government spending may help to generate stronger domestic demand, and with it, inflation.

Meanwhile, the Bank of Japan has pushed monetary policy to its very limits – the central bank now owns assets worth more than GDP – in search of higher prices, but inflation has barely budged.

Years of cheap borrowing costs have not persuaded firms to invest and test the capacity of the economy. Nor has inflation been imported from elsewhere; the yen has held its own against the US dollar in recent years. Instead the root may simply be expectations: no-one in Japan behaves as if prices are about to rise, so prices remain static.

The second group of factors are external. The erosion of trade union membership has weakened workers' bargaining power. (The proportion of workers belonging to a union in the UK has fallen from around 40% to 20% over the past 30 years and in the US from around 20% to 10% in the same period.) Commodity prices, another source of potential inflation for energy-hungry advanced economies, have also been low recent years.

The Fed is reviewing its monetary policy framework amid concerns that its target – combined with subdued global growth – has effectively set a ceiling on inflation. One option might be to switch to a target of long-term average inflation of 2%, which would take into account periods in the recent past where inflation had fallen below this level. This would commit the Fed to making its inflation target truly symmetrical. However, it remains to be seen whether central banks have the influence to kick-start global demand. The experience of the past decade suggests reasons to be sceptical.

Global economic projections commentary: May 2019

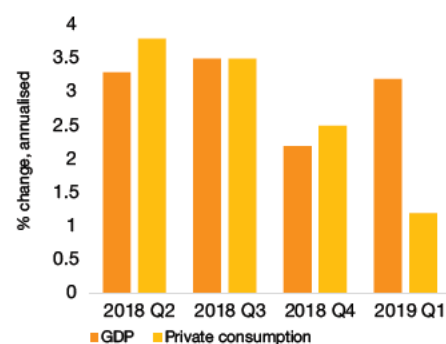
The Americas

In the US, GDP growth of 3.2% on an annualised basis in the first quarter exceeded expectations, but was pushed up by the effects of import tariffs on net trade, and sharp inventory accumulation. Neither of these factors is likely to be a sustainable long-term driver of growth. By contrast, private consumption growth slowed to 1.2%. As a result, the Federal Reserve is likely to keep interest rates on hold for the remainder of the year as the underlying economy cools. We continue to expect growth of 2.4% for 2019 as a whole.

In Canada official data showed that economic growth in early 2019 was weak, with concerns about US trade policy still exerting a drag, as did mandated oil production cuts. However, a strong labour market and healthy manufacturing shipment indicators suggests that growth will be quicker in the second quarter, and therefore we have made only a slight downward revision to our projection for growth this year, which now stands at 1.6%.

In Brazil economic recovery is slowing in line with global growth and limited progress on social security reform. We have revised our 2019 GDP projection to 1.9%, from 2.4%.

US: After matching or exceeding the pace of overall economic growth in recent quarters, private consumption growth slowed in Q1



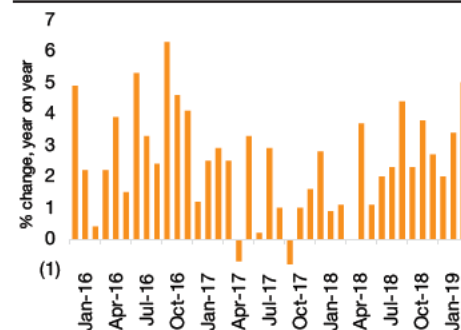
Source: St Louis Federal Reserve

Europe

The Eurozone economy perked up in the first quarter of 2019, growing by 0.4% quarter on quarter, compared with 0.2% in the final quarter of 2018. However, with the country breakdowns yet to be published, it is difficult to interpret from where the stronger performance originated, or assess its sustainability. There is little indication among leading indicators that the prospects for the manufacturing sector have improved, although the Chinese government's decision to stimulate the economy rather than face slowing growth could lead to higher demand for Eurozone exports in the remainder of the year. For now, we are maintaining our projections for the region as a whole.

The UK economy has also performed more strongly in the early months of 2019 than had previously appeared likely, with consumers showing no indication of moderating their spending, despite the Brexit-related political uncertainty. Household spending has continued pick up the slack from falling business investment, and as such we have raised our projection for the year to 1.2%, from 1.1% previously.

UK: Retail sales have emerged from a soft patch to grow far more quickly than the economy as a whole



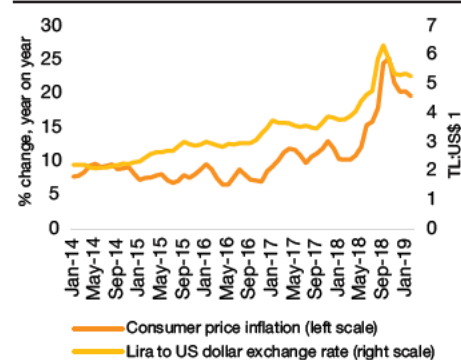
Source: ONS

Eastern Europe, Middle East and Africa

The Turkish economy continues to slide deeper into recession amid rising political instability. After the big depreciation of mid-2018, the lira has remained volatile, and investors are concerned about political pressure on the central bank and more recently, the disputed results of the mayoral election in Istanbul in May. Although the yawning current-account deficit has narrowed, consumer price inflation remains in excess of 20%, while the unemployment rate hit a decade high of close to 15% in January. These indicators suggest there are few prospects for a swift recovery in the short term. We expect the economy to shrink by 1.5% in 2019 and grow by 2.6% in 2020.

Prospects for Saudi Arabia's economy improved in the first quarter of 2019. Global oil prices, the dominant driver of Saudi's economic performance, have risen by 30% since January. The non-oil sector, which has struggled since oil prices tumbled in 2014, is also showing more signs of vigour. In early 2019 a non-oil PMI rose to its highest rate since late 2017, while lending to non-oil firms is also accelerating.

Turkey: Nine months after severe economic stability, the lira remains very weak and consumer price inflation rapid



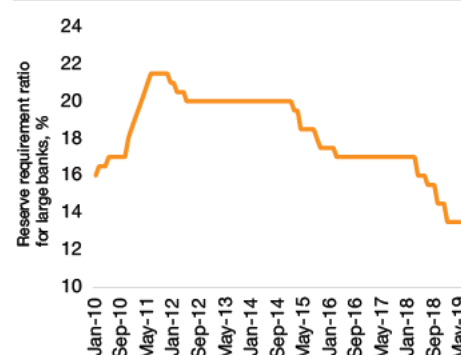
Sources: Eikon from Refinitiv

Asia

China's long-term economic slowdown is set to continue in 2019-20, although government stimulus measures are likely to mean that the pace of moderation remains almost imperceptible. The effects of higher state spending were visible in data for the first quarter. The economy expanded by 6.4% year on year, the same rate as in the previous quarter. One casualty of short-term stimulus will be work on deleveraging and debt restructuring. We expect growth of 6.3% in 2019, slowing further, to 6.2%, in 2020.

India is likely to remain the fastest-growing large economy in the world over the next two years. Its low GDP per head and huge catch-up potential means growth in excess of 7% a year should be attainable. Japan may be among a group of Asian countries that suffers from a trade conflict-related weakening of external demand. However, consumption growth should be strong in the middle of 2019 ahead of an increase in the consumption tax in October. We expect growth of 1% this year, a similar pace to that of 2018.

China: The central bank has made cuts to the level of reserves banks have to hold in order to encourage more lending



Source: Eikon from Refinitiv

Projections: May 2019

	Share of 2017 world GDP		Real GDP growth				Inflation		
	PPP	MER	2018e	2019p	2020p	2021-25p	2019p	2020p	2021-25p
Global (Market Exchange Rate ('MER'))		100.0%	3.2	2.8	2.8	2.8	2.3	2.7	2.6
Global (Purchasing Power Parity ('PPP') rate)	100.0%		3.7	3.4	3.5	3.4	2.8	3.1	3.0
G7	30.6%	46.0%	2.1	1.7	1.5	1.5	1.6	2.1	2.0
E7	37.6%	26.6%	5.3	5.1	5.3	5.1	3.7	3.7	3.7
United States	15.3%	24.3%	2.9	2.4	1.8	1.8	1.8	2.3	2.2
China	18.2%	15.0%	6.6	6.3	6.2	5.9	2.4	2.7	2.9
Japan	4.3%	6.1%	0.6	1.0	0.3	0.6	0.9	1.7	1.2
United Kingdom	2.3%	3.3%	1.3	1.2	1.5	1.8	1.9	2.0	2.0
Eurozone	10.2%	13.9%	1.7	1.1	1.6	1.5	1.4	1.8	2.0
France	2.2%	3.2%	1.6	1.2	1.5	1.8	1.4	1.7	1.9
Germany	3.3%	4.6%	1.4	0.7	1.6	1.4	1.4	2.0	2.3
Greece	0.2%	0.3%	1.9	2.0	2.2	1.5	0.7	1.5	1.8
Ireland	0.3%	0.4%	6.8	3.4	3.7	3.0	1.0	1.5	1.9
Italy	1.8%	2.4%	0.8	0.1	0.9	0.8	0.9	1.5	1.7
Netherlands	0.7%	1.0%	2.5	1.6	2.3	1.9	2.3	1.8	2.0
Spain	1.4%	1.6%	2.5	2.3	1.8	2.0	1.5	1.9	1.9
Poland	0.9%	0.7%	5.2	3.8	3.0	3.0	2.0	2.5	2.5
Russia	3.2%	1.9%	1.7	1.5	1.8	1.5	4.5	4.8	4.7
Turkey	1.7%	1.1%	0.4	(1.5)	2.6	2.4	17.1	14.2	13.0
Australia	1.0%	1.7%	2.8	2.2	2.7	2.8	2.1	2.3	2.5
India	7.4%	3.3%	7.1	7.3	7.5	7.7	4.2	4.8	5.0
Indonesia	2.6%	1.3%	5.2	5.2	5.1	5.2	3.4	3.9	3.0
South Korea	1.6%	1.9%	2.7	2.5	2.8	2.8	1.4	1.6	2.0
Brazil	2.6%	2.6%	1.3	1.9	2.2	2.2	3.5	4.0	4.0
Canada	1.4%	2.1%	1.8	1.6	1.8	1.7	1.8	2.0	1.9
Mexico	1.9%	1.4%	2.1	2.3	2.7	2.7	3.5	3.0	3.0
South Africa	0.6%	0.4%	0.8	1.3	1.7	1.8	4.8	5.4	5.5
Nigeria	0.9%	0.5%	2.0	2.5	2.5	2.5	11.9	13.0	14.0
Saudi Arabia	1.4%	0.9%	2.1	1.8	1.9	2.1	2.8	3.1	3.0

Sources: PwC analysis, National statistical authorities, Datastream and IMF. All inflation indicators relate to the Consumer Price Index (CPI). Note that the tables above form our main scenario projections and are therefore subject to considerable uncertainties. We recommend that our clients look at a range of alternative scenarios. UK and Ireland numbers are contingent on a reasonably smooth Brexit.

Interest rate outlook of major economies

	Current rate (Last change)	Expectation	Next meeting
Federal Reserve	2.25-2.5% (December 2018)	No rate rise in 2019	June 18-19
European Central Bank	0.00% (March 2016)	No rate rise in 2019	June 6
Bank of England	0.75% (August 2018)	One rate rise in the second half of 2019	June 20

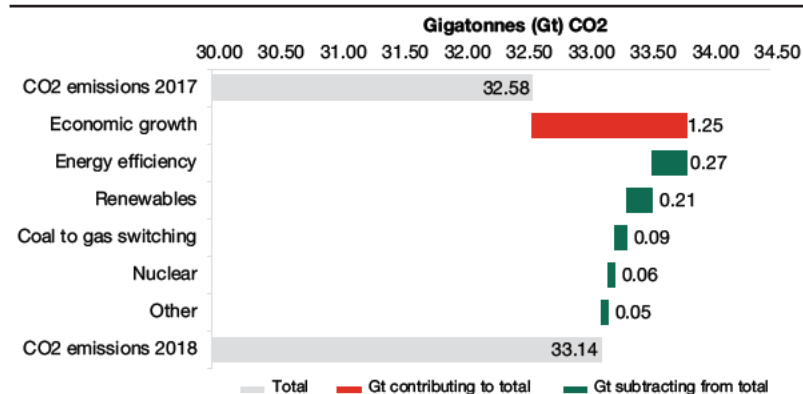
Chart of the month

Global energy-related CO₂ emissions rose to 33.1 gigatonnes (Gt) in 2018, from 32.6 Gt in 2017, according to the IEA.

Emissions growth was flat in 2014-16 which gave hope to the idea that they had peaked. In simple terms, emissions rose because the increase in energy demand growth was greater than the decrease in the carbon intensity of that energy.

The IEA's explanation relies on a counterfactual that economic growth drives emissions growth and relies on hypothetical 'reductions' in emissions from energy efficiency and renewables. In reality, energy efficiency is a driver of economic growth, and some countries, such as the UK, have shown it is possible to decouple economic growth and emissions growth. Renewables only reduce emissions if they supplant fossil fuel based generation, which is rarely the case in emerging markets.

Strong economic growth in 2018 led to another annual increase in global energy-related carbon emissions, which was not balanced by abatement efforts



Source: International Energy Agency