SLAUGHTER AND MAY

Slaughter and May Podcast

COVID-19: In conversation with Razia Khan of Standard Chartered Bank

David Watkins	Hello and welcome to this Slaughter and May podcast. My name is David Watkins, I'm a partner in the corporate team and part of our African practice group. In this podcast we are delighted to be joined by Razia Khan, a leading chief economist for Africa and the Middle East and Standard Chartered Bank. Razia is going to discuss the impact of COVID-19 on economies in Africa. Razia will share her thoughts on how African nations are responding to the unprecedented economic crisis that we are facing brought about by COVID and how they will recover. Razia will be focusing on impact sectors, policy response, growth opportunities, national debt as well as touching on the impact of the oil and gas crisis. Razia is an expert in the field with over two decades of experience covering emerging and frontier markets, she's a very well-known commentator in the region, she provides regular updates to central banks, financial ministries, sovereign wealth funds, other institutional investors and corporates across the region. Razia is currently a trustee of both the Royal Africa Society and Save The Children UK. She's previously served on the WEF's Global Future Counsel on Migration and the Global Agenda Counsel on Poverty and Economic Development. She was named as one of the 100 most Influential Africans in 2015 by New African magazine and the 100 Africa Economic Leaders by Institute Choiseul in 2017. Razia holds both BSC and MSC degrees in economics from the London School of Economics and without further ado, over to Razia.
Razia Khan	Thank you so as we know given the onset of the COVID-19 crisis the world economy is facing its most challenging time since the great depression. We know that what we are seeing this year in terms of the severity of the downturn across developed, emerging and frontier markets alike out paces even these stale of the contraction that we had experienced during the financial crisis. And naturally there's a lot of questioning not only around the severity and how long lasting this downturn might be, but what recovery ultimately looks like. A few comments on this, at Standard Chartered we believe that we might see something of a, for want of a better expression, a swoosh shaped recovery. We note that the policy response especially in developed countries where there has been so much more space for that policy response. Unprecedented monetary easing, the amount of quantities of

	easing that was seen from global central banks outpacing the balance sheet expansion that we had seen even following the global financial crisis because we assume the policy still has a great deal of potency at some point this must feed into a more broad based recovery. But what we do know and the RMF released updated forecasts for the global economy and many of the key economies as well just yesterday. What we do know is that this is going to be an incredibly difficult time with many economies establishing lockdowns and essentially serves as a deadweight loss. Economic activity in a lot of instances simply can't happen. We know that the year on year contraction is going to be very sharp but there's a lot of focus increasingly on the part of the economist and what the recovery trajectory look like, and indeed if we were to look to market behaviour, markets being forward looking telling us a little bit about how global sentiments might be shaping up, there have been some encouraging aspects. The first is of course the belief still that policy settings do matter. The amount of fiscal easing that we have seen, especially in developed economies, the monetary easing alluded to earlier. Eventually as everyone gets back to work as economies normalised to whatever extend possible, this is likely to provide a more conducive backdrop for the restoration of some growth. Of course what we do think is highly likely is that we will see a multispeed recovery in many instances. We also know that financial markets have generally reacted favourably to what we we've seen initially in Asia, increasingly across Europe as more economies come out of lockdown. There are concerns around a potential second wave, this is still very unclear, still very uncertain. The nature of the underlying health trajectory given the pandemic, perhaps we shouldn't be assuming that it's all business as usual and back to business as usual very quickly. But in some instances, perhaps there is already the sense reflected by the optimism that we've seen in financial markets, that the worst of this crisis is behind us. Now for African markets hit particularly hard by the weakness in commodity prices, by the significant capital outflows that we saw taking place over the course of March. The big question is when global risks sentiments stabilises sufficiently for some calm to be restored to financial markets, for the inflows into these economies with the potential to be growing so much faster for those to resume again. So now of course, there is a great deal of uncertainty around the trajectory of COVID itself in the different African economies. We know from the numbers and perhaps this has something to do with the level of testing as well, that South Africa has been hardest hit in terms of the incidents of COVID. But that's very difficult to separate out from the fact that South Africa has rolled out mass screening. A great deal more testing than many other economies, around ten million, almost a fifth of its population already being either screened or tested for COVID and of course in a lot of the

	rest of the region we simply don't see the means, the ability to put in place testing or even screening on that scale necessarily. So it's still very early days and everyone is looking at this, the world health organisation has pronounced on it at various points. It's incredibly difficult especially from the prospective of the economists to say exactly how we are going to see this COVID trajectory developing. There had been a belief, simply because of the somewhat late arrival of COVID on the African continent, that maybe the region would not be impacted as severely as we had seen elsewhere. Thankfully the early evidence is that the fatality rates do not necessarily match what we are seeing elsewhere, but we also know that this is a region where without too much generalisation there is an issue with the provision of healthcare, with the ability to put in place meaningful testing and therefore no one can take many chances in terms of trying to dismiss the impact of COVID and thinking that actually the spread may not be as significant as it has been in other regions. Taking a step back and looking at the wider macro, we know that this also comes at a very difficult time for African economies generally. Not so long ago, late 2014 we had seen the collapse of oil prices, commodity price weakness in 2015, last year market sentiment very much impacted by growing US, China Geo-political tensions and escalating trade tensions. Which did have an impact on investment, investor risk appetite and of course African markets are always impacted by those same global factors as well. Notwithstanding the fact that these may not be the highest beta markets as we call them, the most connected to what is happening in financial markets globally. We know that in terms of the real economy effects, given Africa's ongoing dependence and commodities in many instances and this certainly holds truth at the oil and gas economies, for the mining economies it's very difficult to shrug off the impact off those geo-political tensions on commodity prices. So for contact setting, although many of you on this call will be well aware of the vast potential for African economies and the arguments for growth in the future, Africa is a young region, the demographics are favourable, there is a strong urbanisation trend. We have seen evidence of the rise in productivity that accompanies that migration for rural areas to urban areas. We've seen the adoption of new technology that allows for productivity gains. We have seen the other attendant benefits of urbanisation including better financial inclusion, deeper financial access, all of this contributing to growth. None of those long term positives necessarily go away but we also need to reflect on Africa's growth performance in the recent past. For the oil producers in particular, they had barely recovered from the oil price shock in late 2014. In Nigeria by Q4 2019, growth was only just coming back to the non-oil economy. Of course for much of 2019, oil production, oil

	sector growth held up a little bit better but there is now necessarily a question mark around that for countries like Angola. Angola has not seen a single year of positive growth since being impacted by that decline in oil prices at the very tail end of 2014. Meaning the economy has been contracting since 2015 every single year despite the vast potential of its economy. And even in non-oil producing economies like South Africa, perhaps for entirely different reasons, we have seen the South African economy struggling to achieve meaningful growth above 1 per cent. Per capita income growth has been negative since 2013. The South African economy has been stuck in this very weak growth equilibrium with very little in the way of new momentum to create much more positivity around future prospects. So the first point to establish is, not only is it a very uncertain time for the global economy, there might well be hope that the global policy response and to some extent the individual country response. That was seen in markets, after markets but that has got to safeguard demand to some extent that that will as soon as the immediate health crisis is over, hopefully establish the building blocks for more ground growth. Nonetheless we know that this is still a very uncertain time because none of us know for sure exactly what kind of a COVID trajectory to anticipate. Is there a risk potentially of repeated lockdowns? It's too soon in the economic crisis to know for sure. Financial markets have reacted positively to the opening up of different economies but we don't know about the extent to which this can be sustained. So broadly, there is the belief that the policy reaction has been good, that this will pave the way for some sort of recovery, but we also know in terms of providing that policy space .The kind of fiscal stimulus that has been put in place, in a world where we had already seen immense growth of leverage, following on from those first instances of quantative easing that economists will have to think about, the longer terms implications of this, how does it all play out? There are of course other ways in which African markets are also impacted and that is where the optimisms is very quickly restored to key developed markets, with the unprecedented balance sheet expansion that we have seen from a number of global central banks. The belief is, if nothing else this is feeding optimism in financial markets initially. And the hope is, that there is then significant drip feed into the real economy but we also know that the policy space within Sub Saharan Africa has been very much more constrained. Not only have many of the regions commodity producers are still recovering from that initial commodity crisis downturn and even they hadn't seen a restoration of more normal rates of growth, but even in non-commodity producing countries such as Kenya, for example, rapid growth in the past but alongside the accumulation is a great deal more public debt as different economies focused on the infrastructure gap and putting in place the foundations for what might be stronger growth in the future.

	We also know that the global environment had in itself perhaps impacted different countries in terms of the fiscal policy choices. If we were to take a snapshot view of African countries in very many instances there had been significant fiscal deterioration. Larger and larger deficits had become the norm. We have in recent years seen a big enough build up in public debt ratios. And the immediate focus from many governments with the onset of this crisis was not, is there going to be a lot of fiscal room? Can we put in place a lot more fiscal stimulus? But the medium term focus was all about how to create more, more sustainability in the fiscal space, how to achieve fiscal consolidation, reduce those deficits, reduce debt levels, stop future investments from being crowded out. So if I was to summarise, I would say a very difficult, uncertain time for the global economy at this present moment. We all know that 2021 will likely see a technical bounce, given the severity of the downturn that we see in 2020, it would take some doing for 2021 to be as bad. Chances are it's going to be better everywhere but the real question mark is around what lies beyond that, what does 2022 look like? What does 2023 look like? I would like to put it to you that this could still be Africa's big opportunity. In developed markets we know the big concern is around the permanent loss of spare capacity. If you have a number of different economies at the very same time going into a severe recession, if you have that demand shock initially, but it very quickly translates into a supply shock as well as a loss of spare capacity in the economy is permanently lost and these being mature economies that isn't necessarily that recognition that the growth momentum can come back that easily. Well, most Sub Saharan. African economies in that sense are different, precisely because of what we spoke about early on. The longer term drive is its growth, the younger demographic the population profiles, the urbanisation rates that continues, the adoption of new technology, the pushing out of production frontiers, the impact of productivity growth in super-turbo charging economic growth. Many African economies are still fundamentally insight of that, and therefore compared to their more mature counterparts perhaps has less at risk of seeing a permanent loss in supply capacity from which it would be very difficult to recover. Yes, there are constraints, and that is that the fiscal space isn't necessarily available to put in place a very large stimulus package in terms of trying to combat this slowdown but we also need to recognise the natural strength of African economies. This is not to say that the near term is going to be without challenge and the capital flow reversal that we have seen in the recent past, something that many frontier economies have yet to recover from is a symptom of that challenge. We know from past global crises even though the severity of what we are seeing now is on a far greater scale than what had been seen around the time of the financial global crisis. We know that as much as risk sentiment recovers and markets start to do a little better, it can

	take a long, long time before we see new capital flows into emerging markets that are perceived as riskier and longer still before we see those flows into frontier markets and the impact of that. In developed markets it has been a lot easier for central banks to turn on the stimulus to play their role in terms of providing that stimulus. In the very near term, given the severity of the downturn, we have seen central banks across Africa putting in place easing measures as well. We know that interest rates have been cut in economies like Kenya, Uganda, Zambia as well, South Africa, we continue to see this in a lot of the regions but the policies space is more limited. Simply because the lack of availability of new capital inflows does often create exchange rate pressures that can make reacting to the crisis, with sustained easing that much more difficult. We also know that there has been significant supply chain disruption and this has also complicated the policy response because it isn't entirely clear that inflation has been absent in all places with the onset of the slowdown. In Nigeria, the reaction to the COVID crisis, the closure of the land borders, the end of international travel for a short period of time. That was still sufficient to drive up inflation, driving food prices higher, a big component of the CPI baskets in Africa. So it is the case that not only is the fiscal room for policy stimulus that much more constrained within Africa but the monetary room for meaningful economic stimulus is similarly constrained. In developed markets, especially those that enjoy reserved currency status, quantative easing is a choice. For many African economies in the recent past grappling with exchange rates depreciation, grappling with higher rates of inflation where there really isn't a threat of sustained deflation despite the current weakness of demand isn't a choice at all. And this brings us on to the global debate about what can and what should be done for African economies. Many of you will be aware of the fact that there has been significant calls from the region's policymakers for comprehensive debt relief. The G20 has itself championed this, and announced a debt service suspension initiative that will initially last to the end of this year. For qualifying poor counties, the countries qualify that are categorised as poor countries by the UN developing countries, those eligible for official development assistance normally, other eligible countries too. These if they have programmes with the IMF or World Bank are able to request multilateral debt service suspension, official bilateral creditors' suspension and there is a question mark of course around their other debt obligations. Many of the regions policymakers have argued that a debt service suspension just to the end of this year isn't necessarily going to be sufficient. Such is the scale of the challenge in terms of the immediate demands and fiscal policy. The collapse of the revenue basis that we've seen in country after country, that even though there may not be immediate pressures in being able to repay the debt. It does cause significant liquidity pressures further out and therefore momentum is building for perhaps a more comprehensive debt relief

	response from the global community for African countries taking into account the difficulties that arise because of the COVID crisis. Now, opinion on the debt initiatives, on the debt service suspension initiatives is of course very divided. Rating agencies have made clear that in instances of multilateral creditors offering debt relief there are no long lasting implications. There can be a service suspension, there can even be debt relief, and this doesn't necessarily have longer term credit implications. The difficulty is as they see it that many more developing countries have borrowed in more commercial terms in the recent past, and according to current rating criteria, if there is any risk that private creditors are invited to participate in the debt service suspension initiative and that isn't seen as voluntary and that could well have more severe rating implications. At this point we do need to pause and look at the big picture. All of the successes of the development of African markets in the recent past was not just that more and more countries were able to tap international capital markets or able to overcome the domestic financing constraints by tapping into that much wider pool. That much wider availability of capital from global investors but this was able to play a significant role in terms of boosting infrastructure financing, the financing that many African countries needed to such a great extent to close that infrastructure gap, and therefore it played a big role in terms of thriving economic growth as well. The question is are those gains going to be lost potentially permanently because of the COVID crisis? Now as we speak, there is still a lot of discussion around the preferred format of the global community response given the weakness of healthcare provision in many African countries, given the limited fiscal space for any meaningful counter fiscal stimulus. What would be in the best interests of the global community? We would argue that an increased SDR allocation, boosting the reserve assets of all countries as was seen after the global financial crisis, may be a good way to do this. Of course, for a number of reasons that has being rejected already. The US Treasury has said it's not the preferred option because if there were an increased SDR allocation, poorer countries would only get about 3% of that total allocation, the bigger of G20 economies might get 70% of that allocation and therefore the poorer countries would not be benefitting proportionately at all relative to their need. Another issue of course is whether there can be a reallocation of the existing reserve assets of wealthier economies to the less wealthy economies and that discussion is underway. But there is still a great deal of uncertainty, we know very little about the recovery from the COVID crisis, the underlying health crisis and its trajectory and chances are if actual situations within the regions should worsen meaningfully, then a lot of these discussions are likely to gain new prominence towards the end of the year. So a lot of unanswered questions still.

	What we do know is that the global economy likely needs the boost to demand that a restoration of growth in Africa can provide. African growth will ultimately be a boost to the rest of the world's prospects as well, it is in everyone's interest to see a prosperous Africa, but what we haven't yet seen is necessarily the degree of multilateral cooperation that would bring about the meaningful changes to the international financial architecture to safeguard this and that is one issue. I'm conscious of the time so maybe just a very quick word on prospects as we see them in the key economies. Starting with Nigeria, Nigeria unfortunately as an oil producer, it's caught in this very difficult place of having to weather its weaker oil prices now having signed up to the Opex club's commitment to reduce oil production, seeing weaker production levels as well, as well as the onset of the COVID crisis. We have seen much more of a limited lockdown period in Nigeria, the authorities are more confident that perhaps a significant downturn can be averted simply because oil is just 10% of Nigerian GDP. Others and we see this in the IMS forecasts yesterday are less confident that there will not be a worsening contraction of economic activity. Nigeria needs to use this crisis to really push the diversification to emerge with a healthier growth base and the key test is going to be whether we see a repetition of some of the same issues in the past, problems with the availability of foreign exchange, a slowdown in domestic economic momentum that could have been averted, or whether the Nigerian authorities are able to overcome that. A quick word too on South Africa, yesterday South Africa produced its special adjustment budget. None of the assumptions produced as recently as the February budget really hold now. The economy is expected to experience a contraction of over 7% at least this year. South Africa announced a record deficit in the current fiscal year, possibly close to 16%, possibly even greater than that if it turns out that the growth downturn is even weaker but markets reacted quite favourably to that budget, and the reaction was favourable because of the belief that against these very, very difficult circumstances, the South African authorities were going to be pushing for reform. They realised that they face a wall of debt and the only way to try to overcome that in a meaningful way is to restore growth momentum. So the test is whether we see that reform being enacted between now and the October medium term budget, whether we see concrete steps to try to limit the accumulated of new debt and whether that creates the hope that the South African can break out of this place of great slowdown.
David Watkins	Well thank you very much to Razia for that absolutely fascinating and insightful updates on the impact which COVID has had across the continent. I'm hopeful that some of the factors which Razia has spoken about, Africa's young population, development in new technologies, rapidly expanding financial inclusion and deeper financial access will all

	help spur the growth in the African economy, and help it through the crisis and thank you to everybody for listening. If you would like to read more about our insights you can find further information on our website or please speak to your usual Slaughter and May contact. Thank you and goodbye.

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