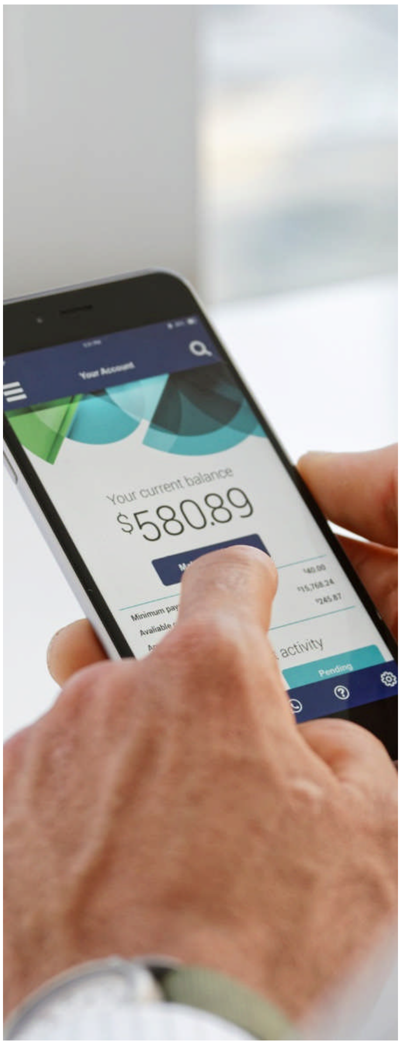
August 2017

Global Economy Watch

Is the rise of Pan-African banking the next big thing in Sub-Saharan Africa?



Dear readers,

A healthy banking system is a vital ingredient for inclusive and sustainable growth in any economy. When functioning well, banks mobilise savings and allocate credit to growing sectors, helping to increase productivity.

Sub-Saharan Africa (SSA) hosts 550 million people of working age, but doesn't have a banking system to match. For example, the latest data from the World Bank shows that the median credit to GDP ratio in SSA's low and middle income countries was just 25% — 20 percentage points below the global average for countries with similar incomes (see Figure 1).

In this edition, we have looked in more detail at trends in pan-African banking in SSA, which have been driven by two primary factors:-

- First, since the 2007 financial crisis, SSA has experienced the withdrawal of several Western banks. They provided a majority of pan-African services and African financial institutions have had to plug this gap.
- Second, intra-regional trade linkages have grown increasingly strong in SSA. This has seen African banks expand and follow their corporate clients abroad.

Our analysis shows that the potential size of the opportunity for SSA banking could range between $490 and $950 billion of additional credit (at 2016 prices). To fully realise this growth potential, it's important African regulators get to grips with the key issues affecting banking in SSA, including restricting the increased risk of contagion that this could bring to the region, but also making sure that financial inclusion is accelerated across all sectors of the economy and especially households.

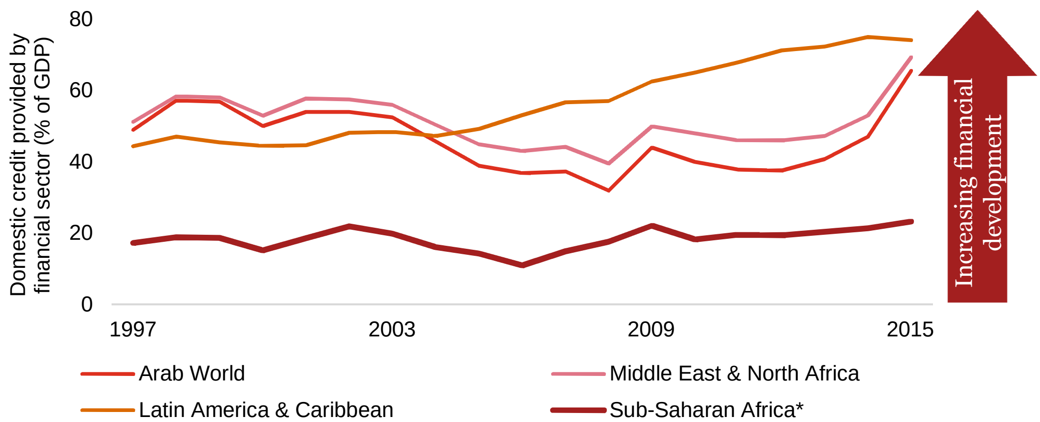
Looking further afield, in the Eurozone we have revised upwards our projection for GDP growth, which we expect to hit about 2% this year – the fastest since 2015. The Eurozone economies are experiencing a synchronised upswing in economic activity with the core and periphery both growing at relatively fast rates. We expect this upswing to continue into the third quarter, particularly for some of the smaller peripheral economies like Malta and Cyprus, which are expected to record bumper years for tourism.

Finally, in the US, the Federal Reserve remains cautious about the pace of economic recovery in the face of relatively subdued inflation. A key risk we are watching is associated with the impending negotiations regarding the federal debt ceiling, which could drag and cause short-term uncertainty. In this month's edition we have also taken a closer look at how the Fed is thinking of reversing its quantitative easing programme.

Kind regards

Barret Kupelian
PwC | Senior Economist

Fig 1: Sub-Saharan Africa is behind comparable regions on levels of credit from the financial sector



*Excluding South Africa and Mauritius, SSA's two most credit abundant countries.

Sources: PwC analysis, World Bank

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Economic update: When will the Fed start to shrink its balance sheet?

Despite the US economy exiting recession as long ago as mid-2009, the Federal Reserve's balance sheet remains very large compared to historical levels. In July, the Fed's balance sheet stood at $4.5 trillion – almost five times bigger than its size before the financial crisis. So how does the Fed plan to normalise monetary policy?

First the target rate, then the balance sheet

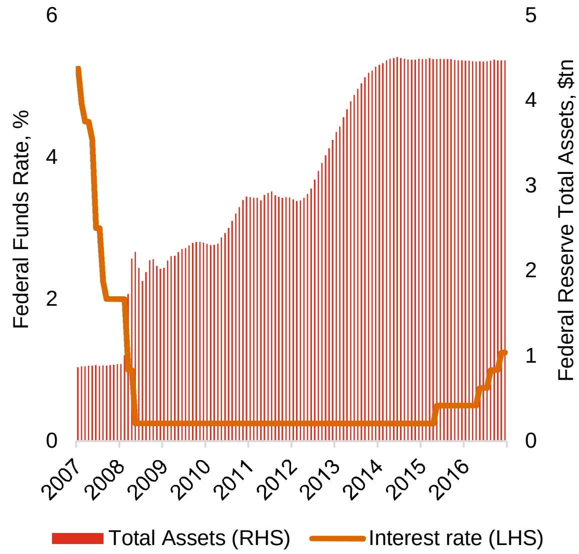
In June, the Federal Open Market Committee (FOMC) amended its 'policy normalisation principles and plans' which outlines the process by which its quantitative easing (QE) programme will be rolled back. These guidelines suggest that the normalisation of the interest rate should be well underway before any unwinding of QE. Specifically, the Fed plans to reduce its balance sheet not by selling assets but rather by not reinvesting proceeds from redemptions of maturing assets, so as to avoid undue disruption to the markets.

At its July meeting, the Fed said it will start shrinking its balance sheet "relatively soon." Given the open-ended nature of the Fed's recent statement, when is this normalisation likely to happen?

The unwinding of QE could begin in late 2017 or early 2018

Since December 2015, the Fed has raised rates four times, by 100 basis points in total, to a rate of 1.25%. We expect this gradual upward trend to continue, though there may only be one more rate rise this year given that core inflation remains below target for now. But the run-down of the stock of QE assets through not investing proceeds from redemptions could start later this year or early in 2018. However, the pace of these moves will remain dependent both on the latest economic data on growth, jobs and inflation, and on political developments over the rest of this year (e.g. in relation to the federal government debt ceiling not being extended as planned, which could cause market instability).

Fig 2: US interest rate and total assets held by the Federal Reserve



Sources: US Federal Reserve

European tourism – market outlook 2017

Eurozone Periphery could celebrate a bumper year for tourism

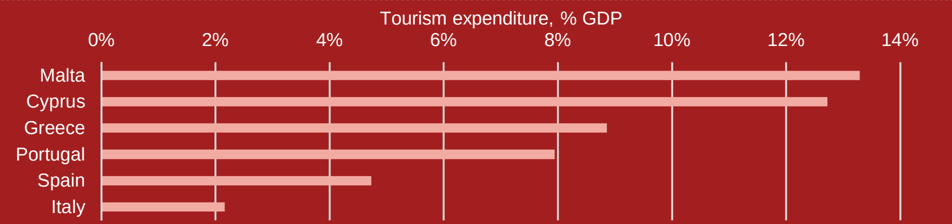
The holiday season is here and for families this often means airports, hotels and hopefully sunshine. But for others, travel and tourism is big business. In 2016, travel and tourism directly supported 109 million jobs and generated $2.3tn globally[1] – this is roughly equivalent to the size of the Indian economy. Tourism is also an important source of tax revenue for central and local governments, particularly given the increased popularity of occupancy taxes.

Despite political instability in numerous parts of the world, the industry's resilience is apparent as it outpaced global GDP growth for the sixth consecutive year. The latest data show that tourism's share of global economic output rose to more than 3% in 2016.

Focusing on the Eurozone, tourism is a disproportionately important industry for its peripheral economies. Given tourism's growing importance, we analysed the latest tourism data to understand how this could potentially affect the third quarter GDP growth figures for those economies.

Figure 3 shows the level of reliance of the peripheral economies on international tourist revenues. Malta leads the pack, with about 13% of its economy directly supported by tourism. Cyprus and Greece follow next. Overall, Mediterranean countries comprise half of the top 10 Eurozone economies reliant on tourism.

Fig 3: Eurozone periphery economies lead the way on tourism



Sources: PwC analysis, World Bank

Strong growth in Malta and Cyprus...

Our analysis suggests that the peripheral Eurozone economies could experience a bumper year for tourism this summer. Specifically, using the latest monthly arrivals data, we calculated the year on year change in tourists in the peripheral economies. We then applied this growth rate to the annual number of tourists. This approach does not fully take into account the highly seasonal patterns in tourism, but is a useful indicator of growth. We found that 4 out of the top 5 tourism reliant economies can expect substantially higher number of tourists in 2017 - if current trends continue and assuming no immediate supply side constraints.

For example, Malta and Cyprus have experienced double-digit growth in tourist arrivals in June (19% and 12% respectively), as compared to 12 months ago - Cyprus is expected to see an all-time high in the number of tourists visiting this year. Using the same approach, Spain could see its tourism numbers increase by 12%, followed by Portugal and Greece (8% and 7% respectively).

One of the main drivers of recent tourism growth is expanding flight capacity, especially that of low cost carriers. Low oil prices and high airline profitability has seen LCCs increase their global share of seat capacity by almost 10 percentage points since 2006 (to 25.5%).

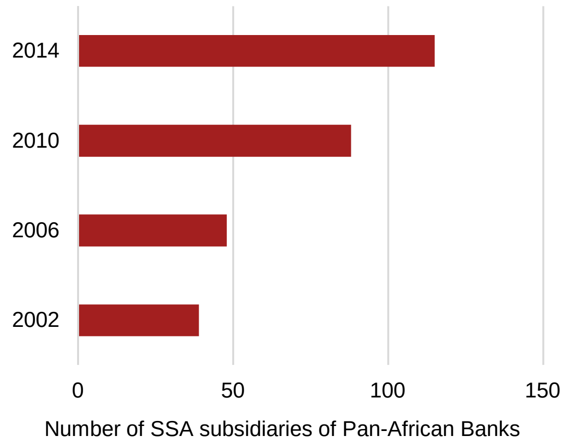
...but Asia remains the fastest growing tourist market globally

In total, over 350 million international tourists visited the Eurozone in 2015. This represents an increase of 31%, or over 83 million, since 2005. However, in the same period the number of tourists across the world grew by 49%. Despite country specific success stories like Malta and Cyprus, the data suggests that the Eurozone market is relatively saturated, with other destinations like the Far East attracting more visitors.

1 Travel & Tourism, Global Economic Impact & Issues 2017, World Travel & Tourism Council, 2017

Is the rise of Pan-African banking the next big thing in Sub-Saharan Africa?

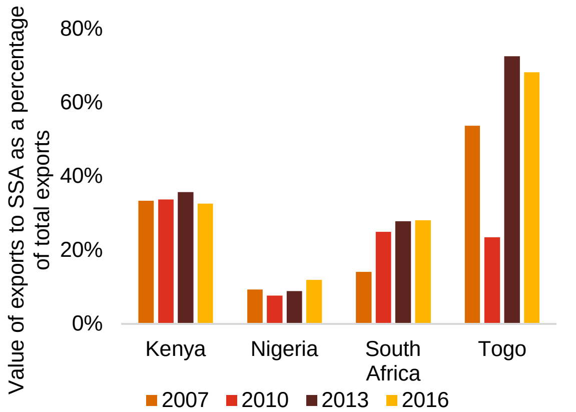
Fig 4: The spread of pan-African Banks has increased sharply since the financial crisis



**Figures are aggregates of a panel of 7 large pan-African Banks*

Sources: PwC analysis, Bank's websites and annual statements

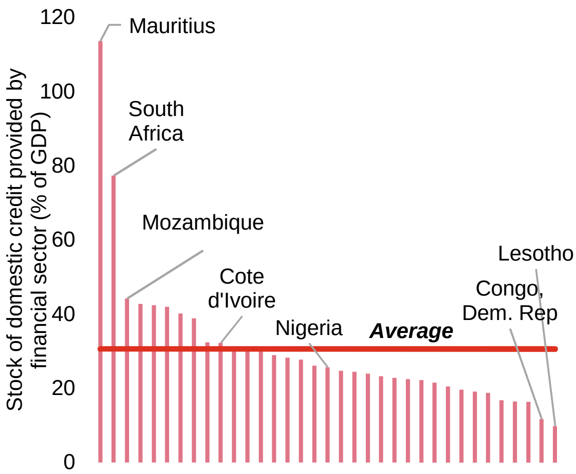
Fig 5: Intra-regional trade has incentivised cross-border expansion in PABs



**Togolese trade in 2010 was disrupted due to political issues from President Gnassingbe's election win.*

Sources: PwC analysis, IMF

Fig 6: Mauritius and South Africa lead the way on financialisation in SSA



Sources: PwC analysis, World Bank

Growing a sound financial system is a crucial ingredient for inclusive and sustainable economic development. As the financial system develops, savings are mobilised and allocated to fast growing, credit-hungry sectors of the economy. If this works well, it should boost productivity.

In Sub-Saharan Africa (SSA), however, the financial sector remains relatively small and underdeveloped. Data from the World Bank, for example, show that the median credit to GDP ratio in SSA's low and middle income countries was just 25% in 2016. This is about 20 percentage points below the global average for low and middle income countries and comes with a cost. The IMF estimates that the relative financial underdevelopment of SSA costs the region 1.5 percentage points of GDP growth per year[1] or approximately $20 billion in 2016 prices.

Intra-regional trade and retrenchment of western banks are incentivising the expansion of pan-African banking

However, African banks have started to expand their footprint across Sub-Saharan Africa. Figure 4, for example, shows how the number of cross border subsidiaries of African banks has almost tripled since 2002. There are now ten pan-African banks (PABs) with a presence in at least ten SSA countries, and one with a presence in over 30 SSA countries. We think this is driven by two factors:

- First, growing intra-regional trade in SSA. The expansion of domestic businesses into SSA markets has seen cross-border banks follow corporate clients abroad. For example, in our panel of home countries of major PABs, the total share of exports to SSA across the four economies increased from 12% in 2007 to 23% in 2016, or by $11.7bn (see Figure 5). The share of exports to SSA has increased in 3 out of 4 of these countries, though European, American and Asian trade links remain much larger in volume.
- Secondly, since the global financial crisis there has been large scale retrenchment of Western banks from Sub-Saharan Africa. Historically, European and American banks dominated pan-African banking but regulatory tightening - especially with respect to capital requirements - and the large fixed costs of maintaining relatively small-scale operations proved too costly. PABs have therefore begun to fill the gap which was left behind.

The opportunity for pan-African banks could be between $490 and $950 billion of additional credit

As mentioned above, the majority of SSA countries have relatively shallow financial systems at present. However, this varies greatly across the region, with total credit ranging from 114% of GDP in Mauritius to 10% in Lesotho. This represents an opportunity for PABs to capitalise on (see Figure 6). Our analysis shows that the potential size of the opportunity for PABs could range between $490 and $950 billion of additional credit (in 2016 prices). This depends on whether the SSA economies reach a level of financialisation similar to Mauritius or South Africa.

Regulators, banks and technology companies need to work together to reap these benefits

However, SSA comes with a set of unique challenges. The first priority of regulators should be to improve financial inclusion particularly for the household sector. The IMF's Financial Access Survey[2] shows there are approximately 5 bank accounts for every 10 people in SSA, in comparison to 14 globally.

Cheap and simple technological developments have been critical in helping improve access to financial services. For example, SSA is a world leader in the field of mobile banking. Worldwide 2% of adults have a mobile money account compared to 12% in SSA[2]. Fintech can also enable SSA to leapfrog stages of financial development.

Also, encouraging the growth of pan-African banks means that the financial cycles and business cycles of the SSA economies will become more integrated. This could mean that shocks are transmitted faster across these economies. Currently, inconsistent regulation across the region (in terms of IFRS accounting standards, Basel II and depositor insurance especially), is restricting coherent regulation across the region. So a key challenge that local regulators will have to deal with is facilitating further financial integration while safeguarding against the increasing risk of cross border contagion if financial problems do arise.

In conclusion, SSA has a long way to go to reap the potential benefits of a fully functioning deep credit market. However if regulators, banks and technology companies work together to drive financial inclusion forward then pan African-banking could help businesses and households reap the advantages of a well-functioning credit market.

1 Financial Development in Sub-Saharan Africa, IMF, 2016. 2 Financial Access Survey, IMF, 2015. 2 Global Findex, World Bank, 2014.

Projections: August 2017

	Share of 2016 world GDP		Real GDP growth			Inflation		
	PPP	MER	2017p	2018p	2019-2023p	2017p	2018p	2019-2023p
Global (Market Exchange Rates)		100.0%	3.0	2.9	2.9	2.6	2.5	2.5
Global (PPP rates)	100.0%		3.5	3.5	3.5	3.1	2.9	2.9
G7	31.5%	46.4%	1.8	1.8	1.9	1.9	1.9	1.9
E7	36.2%	25.9%	5.3	5.2	4.9	3.3	3.3	3.6
United States	15.8%	24.5%	2.1	2.2	2.3	2.1	2.2	2.0
China	17.3%	15.2%	6.6	6.2	5.7	2.0	2.2	2.8
Japan	4.2%	5.6%	1.2	0.7	0.8	1.0	1.0	1.5
United Kingdom	2.4%	3.9%	1.5	1.4	2.0	2.8	2.9	2.3
Eurozone	12.0%	15.8%	1.9	1.7	1.6	1.5	1.4	1.5
France	2.3%	3.3%	1.6	1.6	1.7	1.2	1.3	1.5
Germany	3.4%	4.6%	1.8	1.7	1.4	1.9	1.8	1.8
Greece	0.3%	0.3%	1.2	2.0	1.3	1.0	1.0	1.1
Ireland	0.3%	0.4%	3.8	3.3	2.7	0.8	1.2	1.5
Italy	1.9%	2.5%	1.3	1.0	1.1	1.2	1.2	1.2
Netherlands	0.7%	1.0%	2.2	2.0	1.7	1.2	1.5	1.7
Portugal	0.3%	0.3%	2.6	1.8	2.0	1.6	1.5	1.4
Spain	1.4%	1.6%	3.0	2.3	2.3	1.8	1.2	1.2
Poland	0.9%	0.6%	3.4	3.3	3.5	1.8	2.0	2.4
Russia	3.3%	1.8%	1.3	1.4	1.5	4.2	4.0	4.0
Turkey	1.4%	1.0%	3.0	3.2	3.4	10.0	8.1	7.0
Australia	1.0%	1.7%	2.7	2.8	2.7	2.5	2.2	2.5
India	7.0%	2.8%	7.3	7.5	6.5	4.8	4.9	5.0
Indonesia	2.5%	1.2%	5.1	5.3	5.4	4.5	4.4	5.1
South Korea	1.6%	1.9%	2.6	2.8	3.3	1.6	2.8	3.3
Argentina	0.8%	0.9%	2.6	2.8	3.0	25.0	-	-
Brazil	2.8%	2.4%	0.4	1.5	2.6	4.2	4.5	4.5
Canada	1.4%	2.1%	2.0	2.1	2.0	2.1	2.1	2.0
Mexico	2.0%	1.6%	1.7	2.0	1.9	4.0	3.5	3.0
South Africa	0.6%	0.4%	0.8	1.2	3.0	6.1	5.8	5.5
Nigeria	1.0%	0.7%	0.7	1.8	4.2	15.0	14.1	12.0
Saudi Arabia	1.5%	0.9%	0.2	1.0	3.5	3.5	4.8	2.5

Sources: *PwC analysis, National statistical authorities, Datastream and IMF. All inflation indicators relate to the Consumer Price Index (CPI). Argentina has recently launched a new CPI measure, which only contains data from April 2016. Therefore we only project inflation for 2017, and will provide 2018 and 2019-2023 projections once a longer series is available. 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.*

Interest rate outlook of major economies

	Current rate (Last change)	Expectation	Next meeting
Federal Reserve	1.25% (June 2017)	Further gradual tightening in the next two quarters	19 – 20 September
European Central Bank	0.00% (March 2016)	No rate rise for the foreseeable future	7 September
Bank of England	0.25% (August 2016)	No change in rates expected in the short-term	14 September

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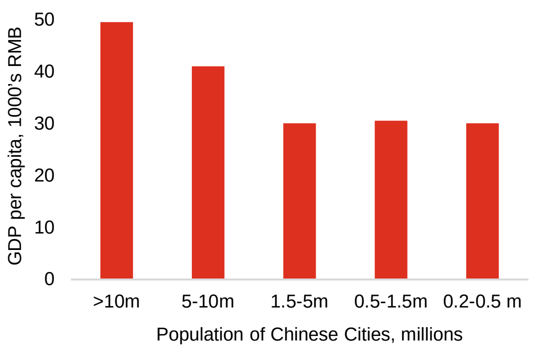
Chart of the month

Recent analysis from the OECD highlights the contrasting fortunes across cities of different sizes in China - larger cities tend to be more wealthy and productive.

You can find out more on the importance of cities to the global economy in our *Cities of Opportunity* report. We also rank the top 30 global cities driving innovation, prosperity and growth.

In China, large cities tend to be wealthier and more productive than smaller ones



Source: WEF, OECD, National Bureau of Statistics of China

We help you understand how big economic, demographic, social, and environmental changes affect your organisation by setting out scenarios that identify growth opportunities and risks on a global, regional, national and local level. We help make strategic and tactical operational, pricing and investment decisions to support business value creation. We work together with you to achieve sustainable growth. Do get in contact with one of the team if you would like to discuss any of these topics.