Bully for Africa

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But are there risks to the new commodities craze?

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On his maiden visit to Africa in November, U.S. Treasury Secretary Henry Paulson echoed a crystallizing view of Africa's economy from Wall Street and multinational boardrooms of economic and investment turnaround. He cited key shifts and statistics from public and private sector reports: GDP growth above 5 percent for several years, single-digit inflation, lower external debt with official relief programs allowing buildup of record foreign exchange reserves, commercial and financial market progress as measured by the World Bank's "Doing Business" indicators, and rising bond and stock activity. However, recognition of high commodity prices and global demand is always at the core of such presentations on the continent's nascent emerging market status. Natural resource over-reliance and expectations of bottomless new appetite from Asia and elsewhere could be tested in future cycles, especially as the world economy enters a cooling phase.

Recent multilateral development bank reviews for the region repeat broad themes. Oil-producing countries have grown faster, and account for over half of exports and foreign direct investment. In most of the sub-Sahara one or two raw materials dominate trade. Agricultural output is particularly at risk of bad weather and credit and input constraints. While exchanges with Asia, particularly China, have "expanded dramatically" in the words of the International Monetary Fund, import shares from traditional partners in North America and the European Union remain over twice as large. Overseas portfolio inflows are limited by an array of access, regulatory, liquidity, and operating restrictions.

The United Nation's latest compilation of direct investment numbers shows that Africa took less than 5 percent of the cross-border total, concentrated in Nigeria and South Africa. The other top recipients were mainly oil and gas producers, such as Chad, Equatorial Guinea, and Sudan, along with a

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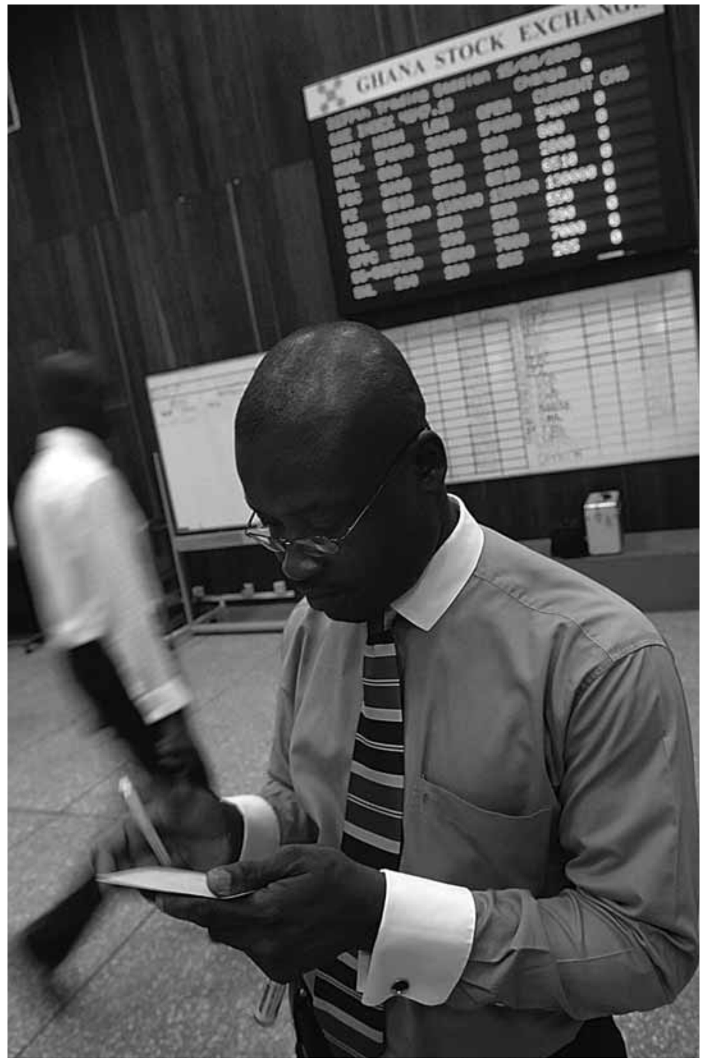
Traders work on the floor of the Ghana Stock Exchange in Accra, Ghana.



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handful of mineral processors, led by the Democratic Republic of Congo. With their former colonial relationships, European firms, joined by new entrants from Russia, maintain the biggest presence, but U.S. and Chinese firms have also arrived in force, focusing on energy. Chevron, ExxonMobil, and Marathon are among the petroleum giants in Nigeria, Angola, and Gabon, which supply one-quarter of American needs.

Chinese projects came to almost US$7 billion in 2006, typically with oil stakes accompanied by packages of aid and concessional loans, which have provoked controversy over alleged lack of transparency, and environmental and human rights conditions. However the largest deal to date was in the banking sector. In October 2007, the Industrial and Commercial Bank of China announced a US$5 billion, 20 percent holding in South Africa's Standard Bank, which has a pan-African network. Indian businesses have also forged links, chiefly in East Africa where large expatriate communities reside. Gulf investors have been prominent in property and telecoms, and launched pioneer private equity funds.

With the extractive industries booming, Africa too has experienced resource nationalism as state-run companies assert greater decision-making and ownership control. Local governments have imposed more favorable royalty and tax regimes for oil in Angola and Nigeria, and for mining in South Africa and neighbors. However, the world's biggest players, with prices still skyrocketing, have adjusted to the changing landscape, both literally and figuratively, as they target Africa's relatively unexplored potential. Leading miner BHP Billiton, based in Australia, will spend over US$1 billion there next year, and Barrick Gold will allocate an equivalent primary portion of its discovery budget. The World Bank's IFC arm plans to devote 75 percent of mining funding to Africa.

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However, China's resource rush justifiably captures headlines with its voracious dimensions. Five countries—Angola, Congo, Sudan, Equatorial Guinea, and South Africa—provide 80 percent of the region's exports. Of this group, only the last is a non-oil diversified commodity platform, and also in contrast, just 5 percent of South African trade goes to China. It ships among other endowments aluminum, nickel, chromium, gold, and platinum, and buys manufactured goods, garments, and electrical appliances for an overall bilateral trade deficit. By comparison, China took two-thirds of Sudan's light crude in 2005, which translated into half the country's overseas sales. According to the

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International Monetary Fund, China's thirst for imported oil, required to satisfy almost half of its demand, is matched with 30 percent-plus shares of trade in other African-furnished material such as raw cotton in Benin and Burkina Faso. It also gets an estimated 80 percent of the continent's timber exports.

Attention focuses on high-profile hydrocarbon transactions involving state enterprises, such as a recent 45 percent acquisition of Nigerian fields by the China National Offshore Oil Corporation for US$2.3 billion. The Chinese government stresses in public documents that the overwhelming majority of the hundreds of firms it tracks in Africa are private, and thus do not receive direct financial support, although they qualify for numerous customs and currency-related incentives, and training and technical assistance. They benefit further from the large infrastructure outlays for power and transport underwritten throughout the sub-Sahara by the Eximbank, calculated at almost US$15 billion in recent years. Chinese construction firms are often awarded contracts for these efforts either alone or working with domestic ventures. At the latest annual meeting of the African Development Bank held in Shanghai, Beijing authorities pledged another US$5 billion for such projects into 2009.

Apart from Sudan, where ties have provoked international community outrage over the Darfur conflict, executives and officials have criticized China's relationships with Angola and the Democratic Republic of the Congo. In the former, oil comprises half of GDP and 95 percent of revenue, and the World Bank has recommended greater account disclosure with the Chinese and other counterparts with scant success. Despite a windfall, with the 2007 fiscal plan assuming a price of US$45 per barrel, the deficit has widened above 5 percent of national income with slim detail on spending items. Inflation is over 10 percent, with the money supply and credit swelling by double-digits annually. The currency has fallen against the dollar, and bank earnings continue to emphasize high-yielding Treasury bills and government lending. The Chinese are helping with postwar reconstruction, although the poverty rate is stuck at 75 percent of the population, and they have been accused of spurning Angolese labor.

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In Kinshasa, a multibillion-dollar agreement was reached to secure access to the copper and cobalt-rich Katanga province, which will likely lift China's bilateral commercial position above the United States and just behind former colonial power Belgium. Beijing has long maintained links with next-door Congo-Brazzaville across the river. A new mining code was adopted after formal end of the civil war which has facilitated interest from foreign multinationals, as diamond trade was also normalized with establishment of the Kimberly process for certifying conflict-free gems. The Democratic Republic of the Congo has failed to meet targets under an International Monetary Fund staff monitoring program, with budget and inflation overshooting. With dozens of cabinet ministers in the mix, governance, where the country perennially is at the bottom of global rankings, has been further compromised. Donors have been hesitant to release money that will advance the path of debt cancellation, and the Chinese infusion may postpone already overdue reforms.

Emerging market fund managers have watched these developments warily, and steered their portfolios in turn to a combination of commodity and supplemental holdings. In this sphere European, U.S., and Gulf investors have been far more active than Asian counterparts. They have bought debt and equity for steep returns uncorrelated to the core universe, and favored listings across a range of industries. Outside Johannesburg, Nigeria has benefited the most with an 80 percent index gain through end-2007. It has registered 8 percent economic growth as the world's eighth largest oil exporter, but capacity has been hit by rebel attacks in the south. Official and commercial debts were repurchased, resulting in a B+ sovereign credit rating. Banking shares have been the favorite plays under recapitalization and consolidation mandates ordered by the central bank.

Ghana recently came to market with the first post-Heavily Indebted Poor Country debt relief external bond issue in the area which raised US$750 million and was heavily oversubscribed. Cocoa and gold earnings are up, and an offshore oil find was announced. On the stock exchange, Ghana Commercial Bank stood out with the successful placement of depository receipts in London, and telecom is another keenly followed sector where the government is set to unload its shareholding. Kenya too has seen large-scale privatization of its electricity monopoly in a watershed transaction that was eagerly sought by domestic retail participants, and has advertised for international underwriters to handle an inaugural sovereign bond in early 2008.

In the southern sub-region, Botswana's stock exchange has been on a multi-year run. It is the top global diamond source, and has an investment-grade credit rating and the lowest corruption scores among peers. Banks, such as the local subsidiary of the United Kingdom's Standard Chartered, dominate the bourse, although gem exposure is available, and multilateral development banks have floated pula-denominated bonds. In neighboring Zambia, consumer goods listings, apart from copper, top allocation preference.

Despite the hype about Chinese commodity invasion, direct involvement in the segment is seen as a higher-risk proposition subject both to outside price fluctuation and internal state whim. Middle Eastern and Russian investment firms are the fresh faces on the securities scene, and their arrival has been viewed as positive both in capital mobilization and competitiveness. Africans too are returning to their countries in droves from expatriate stays, redirecting cash and expertise into natural resource ventures, typically on a smaller scale employing innovative technologies. In the final analysis, the message from Africa's commodities boom is that it is an important but partial element of the business and financial picture, and that different nationalities and strategies will define its near-term outcome and ultimate place. ◆