SHIELD

by SOURCEREE

What's Inside

National Security Newsletter

September 2021

SOURCEREE

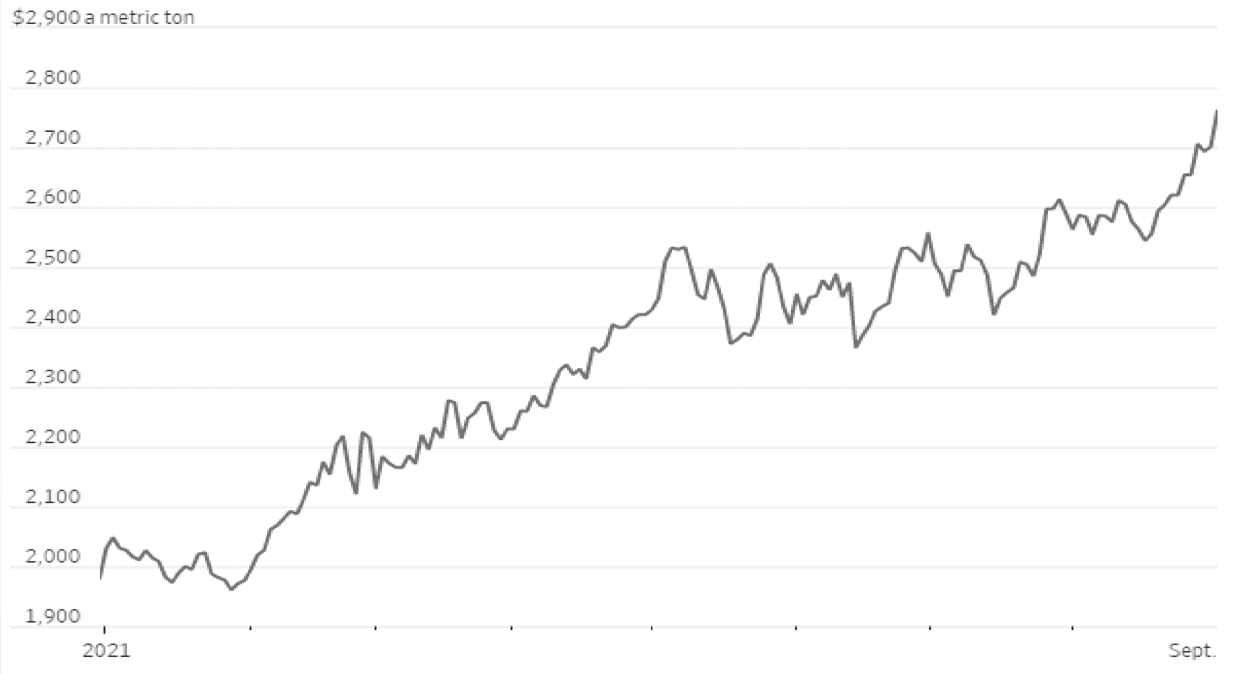
In our September 2021 SHIELDWatch Newsletter, we look at just a few of the many countries in Africa as a way to start shaping our view of the diverse impact this region has on the global economy. Many initiatives, including the African Continental Free Trade Area (AfCFTA) depend on an understanding of the economic differences between each country to determine their overall impact on global supply chain and foreign investment. In our first article, the US Geological Survey's data on bauxite stores and the global refineries dependent on them provides insight into the impact of Guinea's coup and transitional government on the global aluminum supply chain. The concerns about a shortage have been critical enough for the Chinese government to publicly take a side in the internal affairs of another country – calling for the end of the coup and reinstatement of the previous Presidency. The second article looks at the recovering economy of South Africa, moving faster than originally expected, carried by close trading relations with both the US and China. Following that, the UN looked at African nations' economic recovery prospects following COVID-19 as a whole, identifying the role foreign investment would play in the economies that depend on commodities, labor, or tourism for GDP. In the final article, the China Africa Institute examines the impact of foreign investment from different parties – specifically the World Bank and China – and how the emphasis on loans to specific sectors, such as infrastructure and transportation, expands overall global supply chain engagement.

-- Adam Murphy, Sourceree President

Mineral Industry Surveys: Bauxite and Alumina in the Second Quarter 2021

US Geological Survey
Author: E. Lee Bray
Third Quarter 2021

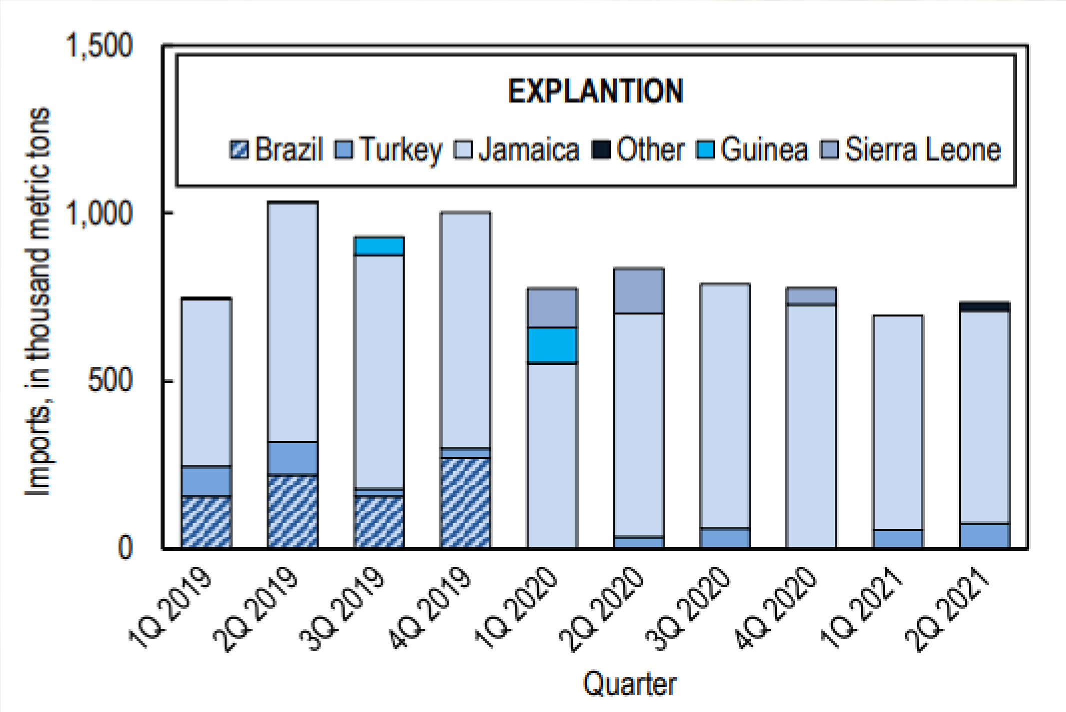
The US Geological Survey's Mineral Industry's 2021 third quarter study of bauxite and alumina production provides some context for why investors are focused on the coup in Guinea, which might cause a shortage from the world's leading producer of bauxite. The European futures market for bauxite is high in anticipation of the supply chain disruption of the mineral, which is essential for aluminum production. NASDAQ shows the price of aluminum hitting the highest peak in over 10 years. China is the most likely to be affected by the outcome of this conflict, as they import half of their bauxite from Guinea (the remainder from Australia and Indonesia), the United States is unlikely to be affected directly, as US bauxite imports are primarily sourced from Jamaica and Turkey. Overall, the United States has used less bauxite and alumina in 2021 than were utilized in the same period of 2020, and China has cited shortages of the resource as the reason it has shuttered portions of alumina refineries.



<u>Select excerpts from the piece:</u>

Imports of crude and dried bauxite in the second quarter of 2021 were 734,000 metric tons (t), 6% more than those in the first quarter of 2021, 12% less than those in the second quarter of 2020, and 29% less than those in the second quarter of 2019. Jamaica (86%) and Turkey (10%) were the leading sources of crude and dried bauxite imports in the second quarter of 2021.

The leading sources of imported alumina in the second quarter of 2021 were Brazil (66%) and Jamaica (23%).



The Alumar alumina refinery in Brazil temporarily shut down about one-third of its 3.5 million-metric-ton-per-year (Mt/yr) capacity on July 19, citing damage to equipment used to unload bauxite from ships. A restart date was not announced.

Flooding in Henan Province, China was cited for several alumina refineries temporarily shutting down production during the last two weeks of July. Service on several railroads in the province was disrupted, interfering with alumina shipments from the refineries and shipments of bauxite and caustic soda to the refineries.

On July 10, Chinalco temporarily shut down production from 500,000 metric tons per year of capacity at the 2.5 Mt/yr alumina refinery in Shanxi Province. A shortage of bauxite was cited for the shutdown. The refinery had been producing at a rate of 1.7 Mt/yr since the start of 2021 because of bauxite shortages. Plans to restart capacity were not available but it was expected that a restart will not happen until after year end.

Building back better from COVID-19, with a special focus on jobs

South Africa Economic Update: Edition 13

World Bank
Authors: Benedicte Baduel et al.
7 September 2021

This is the 13th edition of the South Africa Economic Update (SAEU) report—a biannual World Bank flagship publication on the state of South Africa's economy. This report focuses on the impact of the COVID-19 crisis on South Africa, which has exposed severe structural weaknesses. Export prices surged because of demand, but the manufacturing, construction, transport, among other industries contracted, their recovery hindered by ongoing restrictions after the initial lockdowns. The report suggests a sequenced set of interventions to strengthen job recovery, including structural support programs to boost private sector competitiveness. South Africa's recovery is being buoyed by close trading relationships with both China and the US, which have thrived going into 2021. By utilizing their current market climb and enacting the government incentives, South Africa will be poised to gain fiscal solidarity in the coming years. Something the country desperately needs to reacquire international investors and allow for much needed infrastructure upgrades.

Select excerpts from the piece:

Real Sector Developments South Africa entered the pandemic in a weak position
South Africa's low growth is predominantly structural. Many factors contributed to the country's lack of economic dynamism over the past decade. Some are external, such as the end of the commodity super cycle that lasted from the early-2000s to the aftermath of the global financial crisis. However, domestic constraints have played a significant role.

South Africa was hit hard by the COVID-19 crisis
Manufacturing, construction, transport and communication, and trade and hospitality were severely affected by the lockdown restrictions. They contracted by 25–30 percent quarter-on-quarter in the second quarter of 2020. When the lockdown was eased in the second half of the year, these sectors recovered to some extent. However, the recovery was limited by ongoing restrictions, especially on international tourism, and persistently weak domestic demand.

The pandemic brought the first current account surplus in 18 years
Driven by weak imports and favorable export prices, the current account registered a large surplus in 2020. South Africa's current account surplus reached 2.2 percent of GDP in 2020. Favorable price dynamics supported exports of goods: net gold exports increased by 61.2 percent and other merchandise exports by 4.1 percent. Merchandise imports contracted by 12.2 percent because of the collapse in domestic demand and lower crude oil prices (the Brent crude oil spot price fell by 33.1 percent year-on-year). The services trade balance worsened from 0.3 percent of GDP in 2019 to 0.8 percent in 2020, mainly because of the devastating impact of the pandemic on the tourism sector. The primary income balance likewise remained negative, albeit smaller

(1.9 percent of GDP, as against 2.8 percent in 2019), driven by lower gross dividend payments. The secondary income balance was also negative, at 0.9 percent of GDP.

Global market volatility tested the robustness of the financial sector
Global financial market conditions have improved since late 2020, broadly benefiting emerging economies such as South Africa. Progress in the rollout of vaccines, higher global growth forecasts, and high global liquidity have all contributed, but the markets remain volatile. Thus far in 2021, the rand has outperformed other emerging currencies; in fact, it has appreciated to its pre-pandemic level, supported by favorable trade balance dynamics and a benign global financial environment. Having risen since late 2020, the JSE All Shares Index is now above its pre-pandemic level. Nonetheless, in a climate of high uncertainty, portfolio investment flows are still volatile and vulnerable to shifts in global risk sentiment. South Africa's yield curve remains steep because of the weak fiscal situation.

South Africa, 2020 was characterized by net financial outflows. For the first time since 2003, its financial account balance was negative, at 3.8 percent of GDP, excluding variation in reserves. Foreign investment outflows from bond and equity markets reached US$9.7 billion in 2020, whereas South Africans repatriated US$2.8 billion. Net inflows of foreign direct investment decreased from US$5.1 billion in 2019 to US$3.1 billion; however, the net foreign direct investment balance increased, driven by residents' divestments from foreign subsidiaries of US$2 billion (as against investments of US$3.1 billion in 2019). Financial derivatives registered net outflows of US$0.7 billion, slightly higher than the year before (US$0.4 billion). Other investment saw outflows of US$8.9 billion, as domestic banks increased their deposits at nonresident banks. The SARB's international reserves amounted to US$55 billion, broadly unchanged from 2019. The net international investment position remained largely positive at about US$110 billion as of December 2020.

Outlook and Risks Recovery in 2021 will be supported by the favorable global environment
Higher growth in its trade partners and favorable global commodity prices will support growth in South Africa. Globally, the COVID-19 pandemic continues to spread, but vaccination programs have made substantial progress in several countries. South Africa should benefit from stronger external demand. According to the June 2021 Global Economic Prospects (World Bank 2021b), China and the United States, which are among South Africa's main trading partners, are expected to grow by 8.5 and 6.8 percent, respectively, in 2021, and the economy of the Euro Area is projected to grow by 4.2 percent. Global commodity prices are expected to remain high, translating into favorable terms of trade that will support the external sector.

Commodity prices have increased substantially from end 2020 and are now above their pre-pandemic levels, supported by better global growth prospects and in some cases, supply-side factors. Metal prices are expected to rise by 36 percent in 2021, before falling back in 2022. The demand for base metals is likely to remain strong, given the push toward greener growth (e.g., electric vehicles). Oil prices are projected to average US$62/bbl in both 2021 (+35.6 percent year-on-year) and 2022. Agricultural prices are expected to rise by 16 percent in 2021, before stabilizing in 2022 (World Bank 2021a, 2021b). Commodities play a big role in South Africa's economic trajectory. The mining sector accounts for only 7 percent of GDP but for over half of all merchandise exports (mostly platinum group metals, gold, iron ore, and coal). Economic growth outcomes have long been linked to commodity cycles. The most dynamic periods of growth in South Africa have been associated with the discovery of diamonds, gold, and more recently, the 2000s commodity super cycle (Havemann and Kerby 2021). Commodity cycles also affect financial variables, such as investment flows, the exchange rate, and the performance of the stock market (Sachs 2021).

Better growth prospects require addressing long-standing structural constraints
Structural reforms are needed to boost private sector competitiveness and productivity and support higher growth. The recent World Bank Enterprise Survey for South Africa (World Bank 2020) shows that access to electricity remains the most severe constraint to private sector activity, with 55 percent of surveyed firms reporting it as the biggest obstacle to their business. This needs to be addressed by reforming the electricity sector. The reforms to improve costs and efficiency in network industries (electricity, digital communications, transport, and logistics, etc.) described in the Economic Reconstruction and Recovery Plan and supported by Operation Vulindlela should be fully implemented. Implementing reforms to increase private sector competitiveness will also be necessary to improve business confidence, increase private investment, and catalyze private funding for infrastructure needs, as envisaged by the Infrastructure Fund. Stimulating private investment will be essential to restart growth after the pandemic, especially as public finances are constrained. South Africa's potential needs to be unlocked to support fiscal consolidation and mitigate its impact on economic growth. Although structural reforms take time, the signaling effect of reform can immediately boost confidence. In this context, as noted, the recent announcement of the increase in the licensing threshold for embedded electricity generation from 1 MW to 100 MW is a very important and encouraging first step. It could both improve business confidence and raise economic potential in the medium run. These reforms would also support external competitiveness, which could enhance growth. In addition to reforms behind the border (e.g., electricity supply, business regulations, and competition), public policies to improve firms' competitiveness at the border (e.g., logistics and transports costs, trade facilitation, and trade policy) would support economic growth. The global outlook is driven by a strong recovery in the country's trading partners; thus, increasing its participation in trade and global value chains would allow South Africa to benefit from global growth. A larger role for the external sector in driving the economic recovery would be especially important, as the traditional drivers of growth (household and government consumption) are hampered by a depressed labor market and tighter fiscal policy, which constrains the government's ability to boost aggregate domestic demand.

Fiscal policy priorities are to preserve macro-stability and increase the impact of budget spending
he government's strategy rests on rebalancing expenditure toward investment and development. It plans to support the recovery by improving the composition of public expenditure. According to the 2021 Budget Review (National Treasury 2021b), the bulk of budget spending is allocated

to learning and culture, health, and social development. Capital spending is budgeted to be the fastest-growing category among non-interest expenditure, increasing by about 12.5 percent annually in 2021–23 (excluding COVID-19-related spending), after contracting by 6.1 percent per year in 2015–19. However, a more granular analysis reveals trade-offs between programs. For example, social grants are to contract in real terms, and this would affect the most vulnerable people at a time when the economic outlook remains difficult.

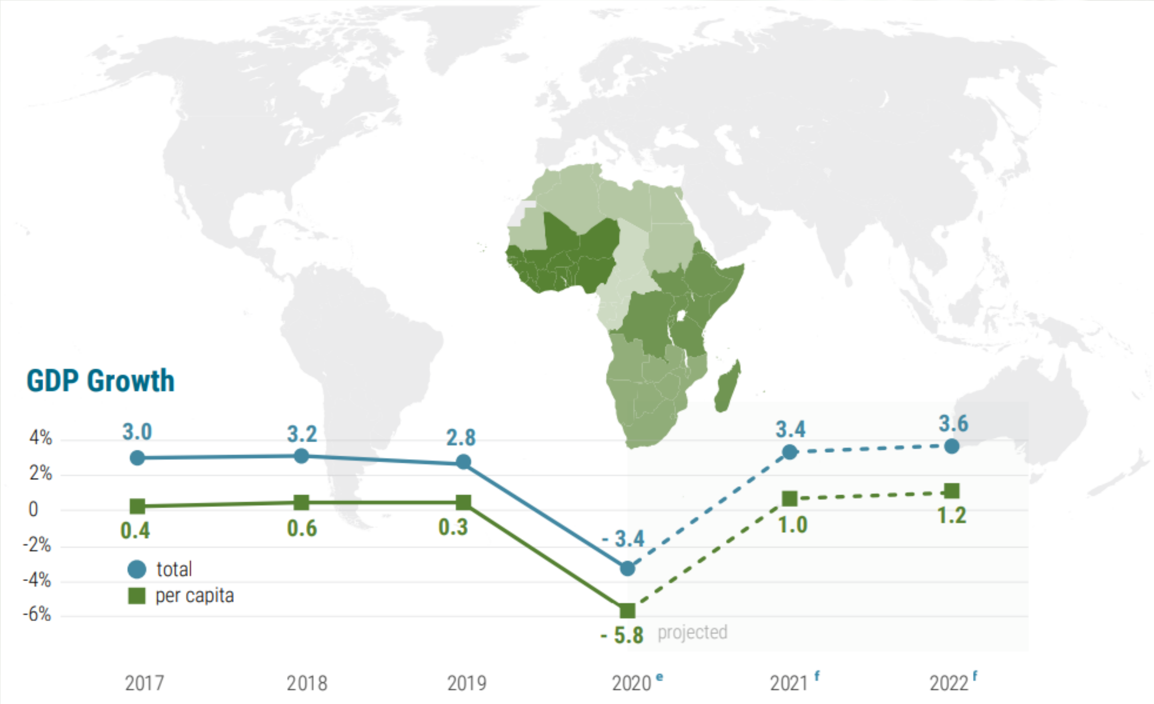
World Economic Situation and Prospects 2021

United Nations Department of Social and Economic Affairs (DESA)
January 2021

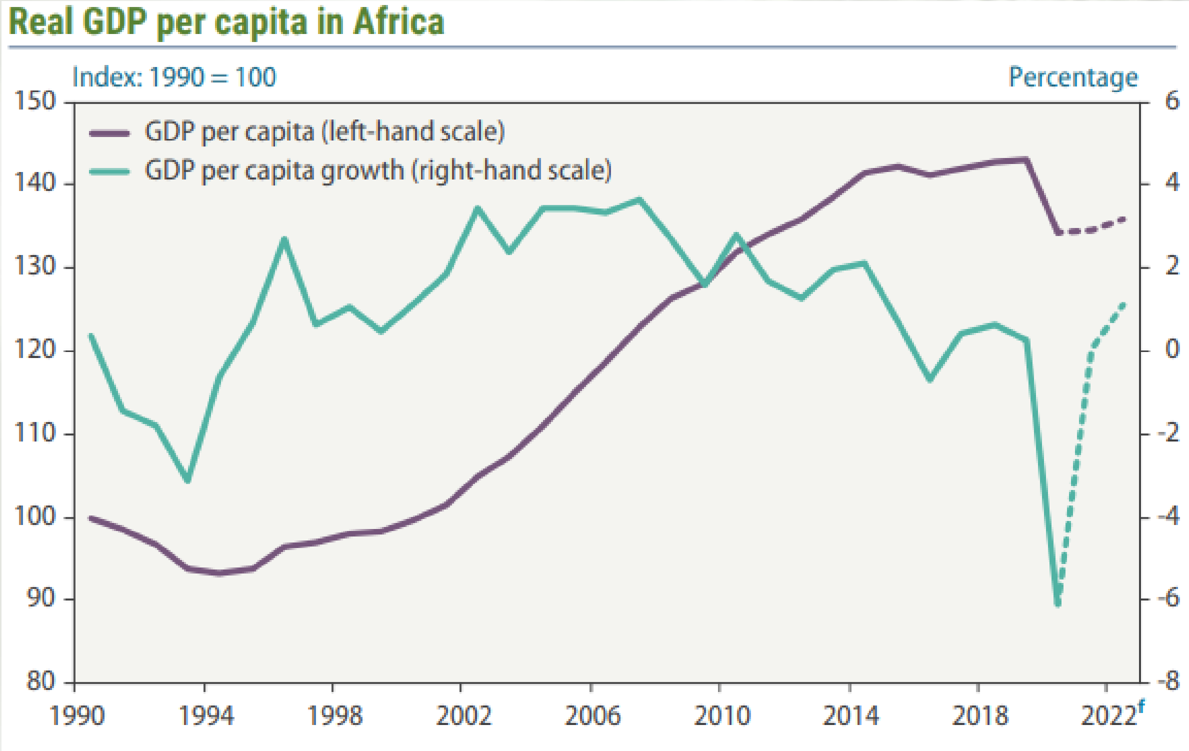
The United Nations Department of Social and Economic Affairs (UN DESA) provided an overview of African countries' prospects following a year of unprecedented global crises included natural disasters and the COVID-19 pandemic. The piece identifies commodity, tourist, and labor-based economies within African countries, and outlines how each element has affected both GDP and growth. Debt distress has left many commodities-dependent African countries in a vulnerable position, requiring foreign investment, and inviting accompanying outside influence. UN DESA recommends prioritizing diffuse digital technologies and adopting an effective implementation strategy for the African Continental Free Trade Agreement to mitigate the predicted slow economic recovery on the continent in 2021 and beyond.

Select excerpts from the piece:

The challenges related to external financing and debt levels pose a major risk. The elevated public debt is limiting the capacity to boost spending at this critical juncture. At the same time, meager growth prospects mean less capacity to sustain debt levels, as foreign reserves, remittances, and capital flows falter and depreciations constrain the capacity to service foreign currency-dominated debt. In this regard, gross debt-to-GDP ratios are projected to have increased in 2020 by, on average, about 8 percentage points and by over 20 percentage points in the Congo, Seychelles, the Sudan, and Zambia. Indeed, six African countries are in debt distress (Mozambique, Republic of Congo, Sao Tome and Principe, Somalia, Sudan, and Zimbabwe), while 14 other countries are at high risk.



African countries need further support from the international community in averting a debt crisis, protracted low growth and high-debt trap. A debt crisis would not just cause a brutal further deterioration of current conditions, making for a dire outlook, but also force painful fiscal adjustments, thereby worsening development prospects. In the absence of international assistance, some countries might find themselves facing extreme difficulties in their attempts to revive economic activity, which would make debt servicing more arduous. Against such a backdrop, social unrest and political tensions may easily escalate, which could in turn increase insecurity, violence, internal displacement, migration, and food insecurity.



Among the largest economies, Nigeria was dealt a severe blow by the twin shocks of low oil prices and COVID-19-related restrictions. In 2020, GDP is estimated to have contracted by 3.5 per cent, amid lockdowns, lower oil production and weak oil prices. Although output is projected to expand by 1.5 per cent in 2021, tighter foreign exchange liquidity, mounting inflationary pressures and subdued global and domestic demand are clouding the medium-term outlook. After a strict lockdown which led South Africa's economy to contract by what is estimated to have been 7.7 per cent in 2020, GDP is projected to expand by 3.3 per cent in 2021. However, it remains uncertain whether, amid power shortages, elevated public debt and policy challenges, a strong and sustained recovery will materialize in the medium-term. Raising potential output in South Africa is a step critical to tackling the strong impacts of the crisis on the labor market. In Egypt, higher fiscal expenditures supported by foreign currency financing secured through multilateral institutions and an easing monetary stance helped prevent a contraction on a yearly basis in 2020. Egypt's GDP is estimated to have grown by 0.2 per cent in 2020; and in 2021, GDP growth is projected to climb to 5.4 per cent, underpinned by a strong recovery of domestic demand and facilitated by the absence of severe balance-of-payments constraints.

The commodity-dependent economies are experiencing the full force of the crisis, and its impact has been exacerbated by the fall in the prices of commodities, especially oil. Algeria's GDP is projected to undergo an expansion of 5.2 per cent in 2021, underpinned by the recovery in crude oil production after a contraction of 7.7 per cent in 2020. Still, Algeria's fiscal position has weakened, and austerity measures planned by the government may hamper the recovery. A key challenge is the implementation of a reform agenda that can promote private investments. Angola's economic difficulties are continuing after a prolonged downturn, with GDP growth projected at only 1.2 per cent in 2021. There are also significant downside risks associated with the inability of recent macroeconomic policies and structural reforms to ensure external and fiscal sustainability. In Central Africa, West Africa, and Southern Africa, many oil and mineral exporters-the Central African Republic, the Congo, Equatorial Guinea, Namibia and Zimbabwe-face a bleak outlook. After its first contraction in almost three decades, in 2020, Cameroon's economy is projected to recover in 2021 underpinned by strengthened external and domestic demand. Risks are tilted towards the downside, however, owing to domestic political tensions and lingering conflict in English-speaking regions. Following a contraction of 0.5 per cent in 2020, the economy of Ethiopia, among agricultural exporters, is projected to expand by 2.3 per cent in 2021, which is well below the potential level of growth. While agricultural exports are showing resilience, the tourism sector's performance will likely remain restrained throughout 2021.

African countries should prioritize in particular, the use and diffusion of digital technologies, supported by the expansion of affordable and universal digital infrastructure. In addition, an effective framework for the implementation of the African Continental Free Trade Area could become a major tool for promoting intra-African trade, food security, and productivity.

International Development Lending and Global Value Chains in Africa

China Africa Research Initiative
Author: Vito Amendolagine
21 May 2021

In this article, the China Africa Research Initiative identifies the role of foreign investment – in the form of Chinese and World Bank loans – on Africa nations' ability to participate in the global value chains (GVCs). Participating in more GVCs – any production process that is undertaken in more than one country – in upstream stages would expose African producers to larger global markets, increasing access to technology transfer from global buyers. A series of studies focusing on Chinese companies found that financial restraints affect chances of accessing GVCs and taking upstream positions within them. China continues to invest in the continent – especially in the communications and infrastructure sectors.

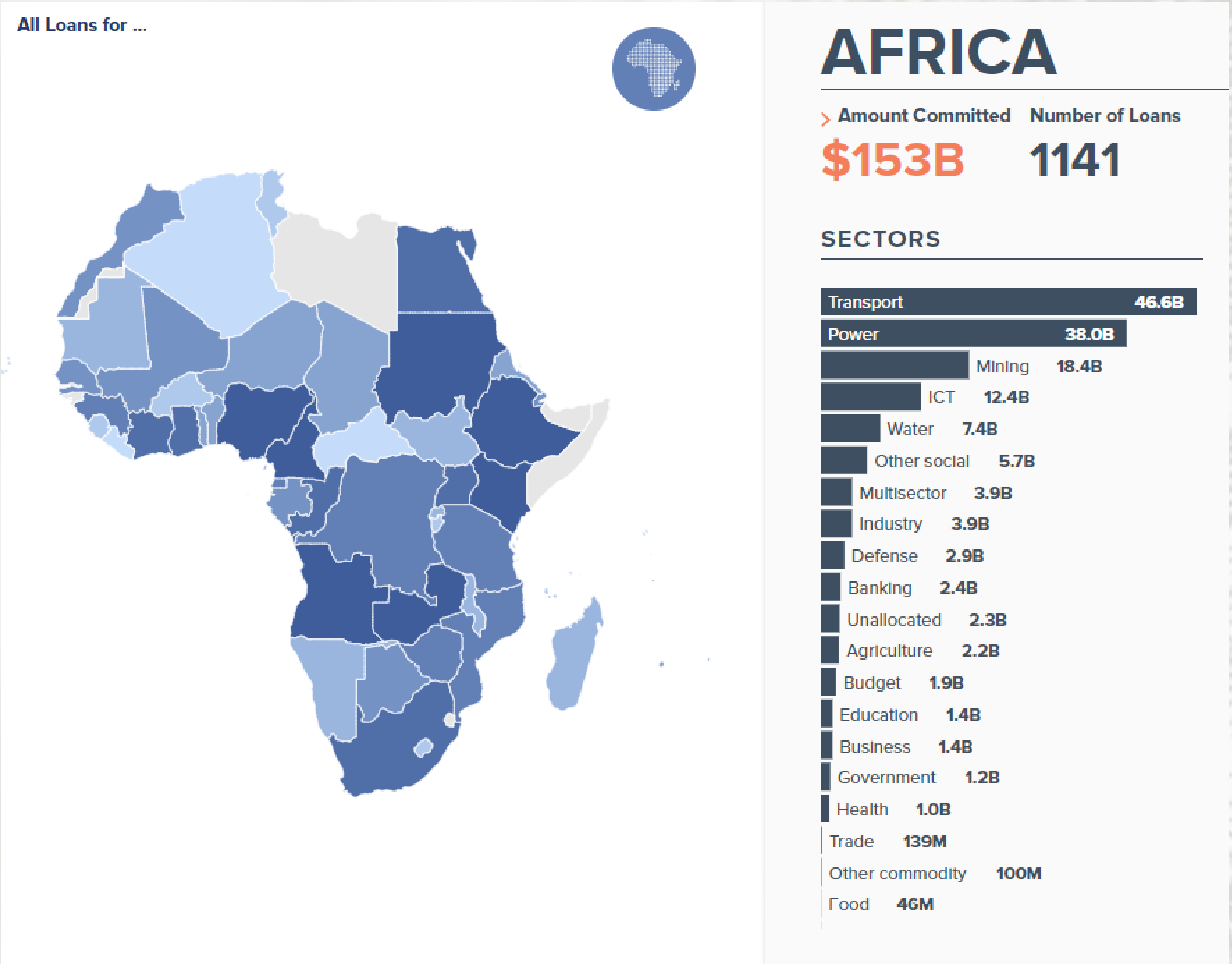
Select excerpts from the piece:

The reasons for the recent rise in African indebtedness to foreign lenders are related to both the demand and the supply side. On the demand side, African economies have increased borrowing because of recent declines in commodity prices and, at the same time, their desire to improve infrastructure and investment climate. On the supply side, international creditors are increasingly attracted by the high-risk and high-return loans to African countries (the average return on African loans is six percent, higher than those directed to other developing economies).

Over the past several years China has become one of the most important lenders worldwide: according to Horn et al. in 2018 China's direct loans and trade credits accounted for about two percent of world gross domestic product (GDP).

GVCs represent an opportunity for developing countries to participate in the global market by specializing in some specific stages of the production process. Given that a limited manufacturing base prevents African countries from developing comparative advantages through the entire value chain, the access to GVCs represents a golden opportunity to take advantage of technological spillovers from global players.

The empirical analysis led to the following results: (1) Chinese Direct Lending (CDL) affects African countries' participation in GVCs, while World Bank Direct Lending (WBDL) has a stronger effect on borrowing countries' specialization as exporters of intermediate goods. (2) CDL in transport and communication sectors enhance the involvement of African countries in GVCs. And (3) African countries enhanced involvement in GVS, as a result of CDL in transport and communication sectors, becomes stronger over time and is more significant in the case of concessional loans.



Source: China Africa Research Initiative and Boston University Global Development Policy Center. 2021. Chinese Loans to Africa Database, Version 2.0. Retrieved from https://chinaafricaloandata.bu.edu/.

GVCs can provide a crucial opportunity for developing countries. First, GVCs facilitate engagement in international markets by specializing and exploiting comparative advantages in certain stages of production. This is particularly relevant for African economies, which are often prevented from developing comparative advantages along the entire value chain due to their limited manufacturing capacities. Second, GVCs expose local producers to the international markets' more sophisticated demand, giving those local producers the opportunity to benefit from technological transfers by global manufacturers, thereby improving productivity.

Additional positive effects can come from taking a more advantageous position along the GVCs, by specializing in upstream (i.e., far from the final demand) rather than downstream (i.e., close to the final demand) stages of the production process. Moving toward a GVC's upstream stage means increasing the exports of local inputs that foreign companies use in their production process. In the African case, such inputs can move beyond natural resources to include, for instance, primary/processed foods and beverages, primary/processed industrial supplies, or parts and accessories for capital goods and transport equipment. Taking a more upstream position along GVCs requires local producers in developing markets to specialize in the production of intermediate goods that meet international standards. Conversely, specializing in downstream stages of GVCs, by importing intermediate goods produced abroad, implies a focus on low value-added assembly tasks that rely on low-cost labor force.

With a focus on African economies, the Organization for Economic Co-operation and Development (OECD), African Development Bank, and the International Monetary Fund (IMF) highlights gaps in infrastructure, institutional, and industrial capabilities as the main problems to fix to increase chances to access international value chains. Particularly, developing communication and transport infrastructure is crucial to manage and coordinate geographically dispersed production activities.

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