

Africa: Growth is on the horizon but where should you look?



At a glance...

CEOs are increasingly recognising the long-term untapped potential of Sub-Saharan Africa (SSA).

Figure 1 below shows that SSA's population is projected to grow faster than in any other region in the world. As a result, by 2040, the African continent is projected to have the biggest labour force in the world and could have faster economic growth than any other region.

Cities as a gateway to new markets

So where should businesses focus if they want to expand their activities in SSA? Traditionally large cities have been the main entry points for companies trying to establish a presence in new markets.

Most large Western corporations are already active in at least one of the three largest cities of SSA: Kinshasa, Johannesburg and Lagos (the 'Top 3'). However, we think that the real opportunity lies in the Next 10 largest cities of SSA (see Figure 4). Our analysis of United Nations projections shows that the 'Next 10' are projected to add around 34 million people to their populations by 2030.

More people, bigger business opportunities

One of the key factors that drive economic growth is the number of people of working age. We therefore expect a bigger and younger urban population to be associated with strong GDP growth. Our analysis shows that, by 2030, the 'Next 10' SSA cities have the potential to triple their combined GDP, rising by around \$140 billion

(in 2012 prices), which would be roughly equivalent to the annual output of Hungary. This is a comparatively conservative estimate as we've assumed no real exchange rate appreciation despite relatively strong projected growth in these SSA economies.

Three big hurdles need to be addressed

However policymakers in SSA face three hurdles to overcome if this growth potential is to be realised. These are:

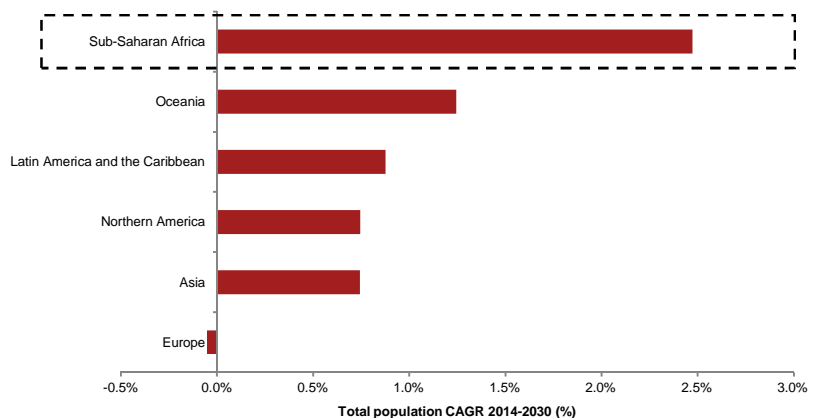
- Low quality 'hard' infrastructure like roads and railways;
- Inadequate 'soft' infrastructure like schools and universities; and
- Growing pains arising from the inability of political, legal and regulatory institutions to deal with bigger and more complicated economies.

A new beginning for the Indian economy?

India is also an example of an emerging economy that has been experiencing growing pains in recent years. The new government's first budget in July included some measures to address these structural and fiscal weaknesses.

Even though the budget wasn't a game changer it was a move in the right direction. There is more to do in the longer term but, for now, the key challenge for policymakers will be to implement the recently announced reforms in order to re-establish credibility with local and international businesses.

Fig 1: Population growth in different regions of the world



Source: PwC analysis of UN data. Note continents have been defined by the UN

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Economic update: Contrasting E7 and G7 investment trends

G7 investment was hit the hardest...

In the aftermath of the global financial crisis, investment levels among the advanced and emerging economies fell. Figure 2 shows that investment by households, businesses and governments in the G7 dropped by around 15% in real terms between 2007 and 2009 and still remain below pre-crisis levels. This contrasts with the experience of the E7 (the seven largest emerging economies), which also suffered a temporary drop in investment activity, but rebounded strongly soon after the peak of the crisis in late 2008.

In part these diverging trends can be explained by the policy response. In the E7, most governments adopted stimulus measures to counter the slowdown. They could do this because, at the time, they had relative low public debt to GDP ratios. In China, for example, the government measures that were announced were in excess of half a trillion US dollars, centred around large scale infrastructure projects.

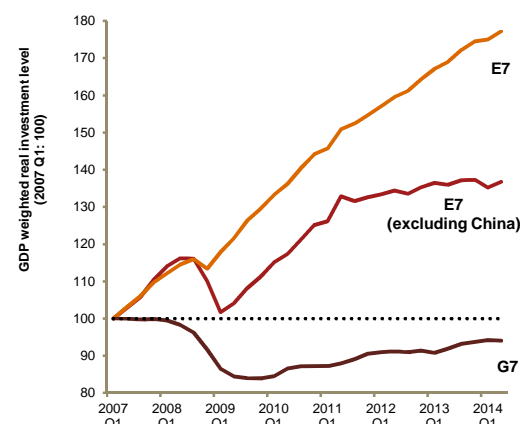
However, in the G7, households, businesses (and later governments) reacted by cutting down on their investment expenditure and using the proceeds to pay down their high levels of debt.

...but is staging a modest rebound

After years of private and public balance sheet restructuring, our analysis shows that there has been some modest pick-up in investment in the G7 in recent years. Sustaining this will be key to keeping the recovery going. At the same time, excluding China, Figure 2 shows that E7 investment growth has largely stalled in recent years as some emerging economies have run into headwinds since 2011.

For G7 businesses, stronger demand growth and rising capacity utilisation levels mean that investment will need to continue to rise, not just in machines and buildings but also in people and skills, which are key to corporate success in increasingly services-driven economies.

Fig 2: Real investment levels in the E7 and G7



Source: PwC analysis using National Accounts

Will the Modi Budget jump start India's economy?

Arun Jaitley, India's Finance Minister, presented the Modi government's first budget in July. In his speech, he outlined his road map for the economy, which included measures to improve infrastructure, reform the tax system and allow more foreign investment in the defence and insurance sectors.

However, he steered away from announcing any large-scale changes to the economy. This budget, he said, was only the beginning of a journey towards achieving a target 7%-8% rate of GDP growth within the next 3-4 years.

State of the economy: low growth, high inflation

The new government, which came to power following a landslide victory in the elections held in May, inherited a slowing economy afflicted by high inflation. Specifically, in 2013, GDP grew by 4.7% while the inflation rate (for wholesale prices) was around 6%.

The Annual Economic Survey (AES), which was released by the government a day before the budget, presented a mixed but improving picture. Specifically, according to the AES, the economy was projected to expand by around 5.4%-5.9% in the 2014-15 fiscal year (FY), which is a small improvement over previous years and similar to our projections.

While we think the GDP growth target for this year is achievable, this is a long way off India's target growth rate of closer to 7%-8% per annum. In our main economic projections, we expect GDP growth to be around 6.5% in the medium-term unless more fundamental reforms are pushed through in future years.

Fig 3: Fiscal and current account balances (as a proportion of GDP)



Source: Annual Economic Survey 2014, Government of India

Similarly, inflation remained above the government's comfort zone due to higher food prices. However, we expect the inflation rate to stabilise in the region of around 5-6% this year on the back of monetary tightening at the beginning of 2014.

The twin deficits

As we pointed out in the May edition of the Global Economy Watch, quick and decisive action on structural reforms are key factors that could help boost investment levels in India and increase its medium term growth prospects. However, this is challenging as India faces persistent high fiscal and current account deficits (see Figure 3), which in turn reduces the government's policymaking flexibility.

However, the new government has already started to put in place measures to bring down the fiscal deficit from 4.5% of GDP in FY2013-14 to 4.1% in FY2014-15 and further down to 3.6% in FY2015-16, as shown in Figure 3.

Similarly, government projections show that the current account deficit is expected to stabilise at around 2% of GDP, as compared to 4.2% in FY 2011-12.

Still a long way to go

So what were the key measures included in the budget? Here are a few that are relevant for business:

- Liberalising the defence and insurance sectors by raising foreign investment caps to 49%;
- Plans to develop roads, railways and improve infrastructure in cities in partnership with private sector players; and
- Tax reforms to hasten a uniform Goods and Services Tax (GST) regime across the country.

Realistic but not bold

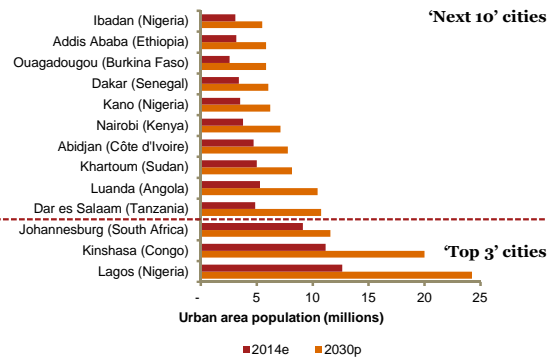
The new government's maiden budget is realistic, but lacks the bold measures that some commentators expected after the landslide election victory. We think this is because the government wants to focus on implementing and consolidating these reforms before introducing any other major changes.

However, we also think that the announced measures are insufficient to push GDP growth rates to the target rate of 7%-8% within the next 3-4 years as a lot more needs to be done to improve manufacturing productivity and output.

For a more detailed discussion on the Indian budget please read our Economics in Business blog post: [Can Modi's budget boost India's economy?](#)

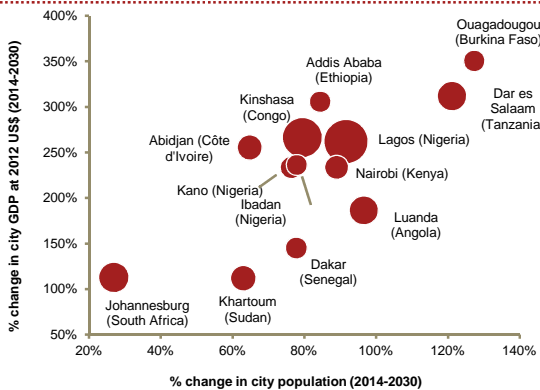
Which cities hold the key to unleashing growth in Sub-Saharan Africa?

Fig 4: Population trends in the 'Top 3' and 'Next 10' cities in Sub-Saharan Africa (SSA)



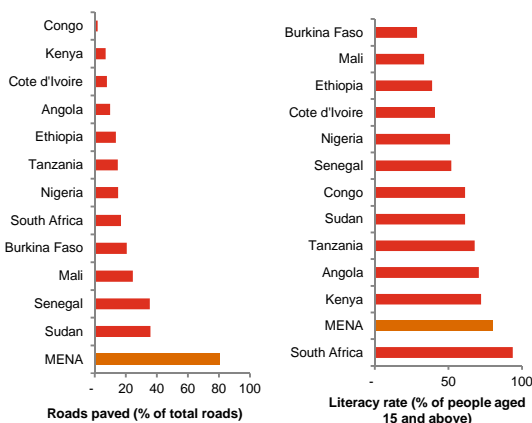
Source: UN Urbanisation Prospects 2014 revision

Fig 5: Bigger cities lead to bigger economic opportunities...



Note that size of bubble reflects estimated city GDP as at 2030
Source: PwC analysis

Fig 6: But some SSA countries face significant gaps in their 'hard' and 'soft' infrastructure compared to the MENA



Source: World Bank

Sub-Saharan Africa is moving on to the C-suite's agenda

As labour costs in Asia start to increase and pressure remains to keep prices competitive, CEOs are increasingly recognising the untapped potential of the Sub-Saharan African (SSA) countries.

This is mainly driven by Africa's unparalleled demographic edge compared to other parts of the world: Africa is the world's youngest continent and is expected to have the biggest labour force in the world by 2040. So where should businesses focus their attention within SSA?

Cities are hubs of commerce, investment and production

Cities are the typical entry points for businesses trying to expand in new overseas markets. This is because they enable closer interaction with customers in a relatively small geographic space which in turn helps contain distribution costs.

Most Western companies already have some presence in at least one of SSA's 'Top 3' populous cities: Lagos, Kinshasa and Johannesburg (see Figure 4). However, we think the real opportunity lies in the 'Next 10' large cities in SSA, the populations of which are projected to almost double in size by 2030, growing by around 32 million people. In fact, the latest United Nations projections* show that, by 2030, two out of the 'Next 10' cities (Dar es Salaam and Luanda) could have bigger populations than London has now.

By 2030, the 'Next 10' cities are projected to triple their economic size

Urban population growth is expected to lead to more economic activity. Figure 5 shows that, on average, the 'Next 10' cities are expected to almost double their population and triple their economic output by 2030. Specifically, we estimate that economic activity in the 'Next 10' cities could grow by around \$140 billion dollars by 2030 (at constant 2012 dollars). This is roughly equivalent to the current annual output of Bangladesh. These estimates are based on the following key assumptions:

- National GDP growth rates follow those projected by the IMF in its latest World Economic Outlook report (which do not take into account the latest Nigerian GDP rebasing);
- City GDP per capita grows in line with the rest of the country (which may be a conservative assumption);

- Constant real exchange rates, which could also be a relatively conservative assumption given that real exchange rates might be expected to rise in the long run in dollar terms for emerging economies with relatively rapid productivity growth.

Key hurdles to be overcome to realise growth potential

However, we see three key hurdles which could derail the pace at which the 'Next 10' grow. These are issues that most SSA countries have been trying to tackle for many decades with limited success:

- **Low quality of 'hard' infrastructure** like highways, airports and trains, which increases the cost of doing business, eats away at business profits and discourages investment. Figure 6 shows that most SSA economies have sub-standard roads compared, for example, to countries in the Middle East and North African (MENA) region.
- **Inadequate 'soft' infrastructure** like schools and universities, which could lead to a persistent skills gap that hampers long-term business growth. Figure 6 shows that this is a real risk in countries like Burkina Faso, Mali and Ethiopia where literacy rates remain low.
- **Growing pains** stemming from the inability of regulators and policymakers to manage effectively a larger and more complex economic system as growth proceeds. These problems could, for example, manifest themselves in the form of credit or property bubbles developing as a result of rapid economic growth, or a failure to tackle issues relating to corruption and excessive bureaucracy that deter international investment.

The challenge that policymakers are faced with is to convert Africa's demographic dividend into economic reality by overcoming these hurdles, but history suggests this will not be a quick or easy process. Potential investors should therefore form their own plans to mitigate these problems (e.g. by supporting infrastructure and skills development programmes).

* World Urbanisation Prospects: The 2014 Revision

Projections: August 2014

	Share of 2012 world GDP		Real GDP growth				Inflation			
	PPP*	MER*	2013	2014p	2015p	2016-2020p	2013	2014p	2015p	2016-2020p
Global (market exchange rates)		100%	2.5	2.8	3.2	3.2	4.8	5.1	5.6	4.7
Global (PPP rates)	100%		3.0	3.3	3.7	3.6				
United States	19.5%	22.5%	2.2	2.1	3.1	2.4	1.5	1.8	2.2	1.9
China	14.7%	11.4%	7.6	7.4	7.3	7.0	2.6	2.3	2.5	3.4
Japan	5.5%	8.3%	1.5	1.5	1.5	1.2	0.4	2.1	2.1	1.5
United Kingdom	2.8%	3.4%	1.7	3.0	2.6	2.4	2.6	1.8	1.9	2.0
Eurozone	13.5%	16.9%	-0.5	1.1	1.5	1.5	1.4	0.8	1.1	1.5
France	2.7%	3.6%	0.1	1.0	1.1	1.7	1.0	0.7	1.0	1.5
Germany	3.8%	4.7%	0.5	2.0	1.9	1.3	1.6	1.2	1.4	1.7
Greece	0.3%	0.3%	-3.9	0.4	1.8	3.0	-0.9	-0.8	-0.1	1.3
Ireland	0.2%	0.3%	0.2	3.1	2.9	2.5	0.5	0.4	1.4	1.5
Italy	2.2%	2.8%	-1.8	0.1	0.9	1.0	1.3	0.7	1.0	1.4
Netherlands	0.8%	1.1%	-0.8	0.2	1.5	2.0	2.6	0.8	1.2	1.4
Portugal	0.3%	0.3%	-1.0	0.7	1.7	1.8	0.4	0.4	0.9	1.5
Spain	1.7%	1.8%	-1.2	1.1	1.5	1.5	1.5	0.3	0.9	1.0
Poland	1.0%	0.7%	1.6	3.1	3.3	3.5	1.2	0.7	2.2	2.5
Russia	3.0%	2.8%	1.2	0.5	1.2	2.5	6.8	6.4	5.5	5.0
Turkey	1.3%	1.1%	4.0	2.6	3.8	4.5	7.5	8.3	6.8	4.8
Australia	1.2%	2.1%	2.4	3.3	2.7	3.1	2.2	2.6	2.6	2.7
India	5.7%	2.6%	4.6	5.3	6.6	6.5	6.3	5.7	6.0	6.0
Indonesia	1.4%	1.2%	5.8	5.3	5.8	6.3	6.4	6.1	5.8	5.1
South Korea	1.9%	1.6%	3.0	3.5	3.7	3.8	1.3	2.3	3.0	2.9
Argentina	0.9%	0.7%	5.0	0.7	1.8	3.3	10.6	11.9	13.3	9.7
Brazil	2.8%	3.1%	2.3	1.3	2.0	4.0	6.2	6.6	5.7	4.8
Canada	1.8%	2.5%	2.0	2.1	2.5	2.2	1.0	1.8	1.8	2.1
Mexico	2.2%	1.6%	1.3	2.6	3.7	3.6	3.8	3.9	3.7	3.6
South Africa	0.7%	0.5%	1.9	1.7	2.5	3.8	5.8	6.1	5.5	4.8
Nigeria	0.5%	0.4%	5.5	6.0	5.9	5.7	8.5	8.5	8.6	7.3
Saudi Arabia	1.1%	1.0%	4.0	4.3	4.4	4.3	3.5	3.1	3.5	4.0

Sources: PwC analysis, National statistical authorities, Thomson Datastream and IMF. All inflation indicators relate to the Consumer Price Index (CPI), with the exception of the Indian indicator which refers to the Wholesale Price Index (WPI). Argentinian inflation figures are based on the old price index which measure CPI in Greater Buenos Aires. A new index the 'National and urban Consumer Price Index' (NuCPI) has now been released by INDEC the Argentinian statistical agency. We will monitor this new price index and will base our projection on this once we have several months of data available. Our Nigeria GDP projections relate to the new rebased GDP figures but are subject to high margins of error. Also 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	0-0.25% (December 2008)	QE tapering to continue during 2014	16-17 September
European Central Bank	0.15% (June 2014)	On hold following easing in June	7 August
Bank of England	0.5% (March 2009)	Rate to rise gradually from late 2014 or early 2015	7 August



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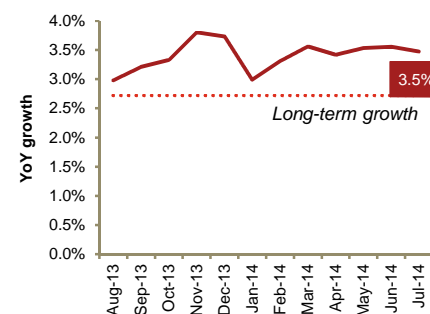
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PwC's Global Consumer Index

Global consumer spending growth falls slightly to 3.5% this month, but remaining above long-term trends.

Recent data suggests that industrial production in key economies such as China and the US have improved. Business confidence has increased slightly, which should contribute to further consumption growth in the coming months.



The GCI is a monthly updated index providing an early steer on consumer spending and growth prospects in the world's 20 largest economies. For more information, please visit www.pwc.co.uk/globalconsumerindex

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