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Comovement between Africa and advanced economies, 1980-2011

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There is a saying which holds that, when America sneezes, the rest of the world catches a cold. This concept interests economists particularly with regard to business cycle comovement between countries – do individual country business cycles follow those of the US and other leading economies? With the Great Recession of 2008 this question regained new prominence as it originally seemed that emerging market economies were not catching the cold that had originated in the US. This phenomenon, known as decoupling, soon received significant research attention. With the focus on emerging markets, however, the impact on African countries received very little attention in the more recent literature and debates. This is true in general, where a general lack of research into business cycle comovement between Africa and advanced economies is evident. Since 2000 only six research papers have been published on the topic, with only three covering the Great Recession years including more narrow sets of countries. None of these studies have used dynamic factor analysis or looked at SSA countries on the basis of income groups rather than regions.

This paper addresses that gap by analyzing business cycle comovement between Sub-Saharan Africa (SSA) and the G7 group of advanced economies using dynamic factor analysis covering the period 1980 to 2011 Given that SSA is so diverse, African countries are grouped together in different categories, namely, middle-income economies, low-income economies, fragile states, and oil exporters.

SSA has made remarkable economic strides since the lost decade of the 1980s and in general had shown improved economic growth and economic integration with the rest of the world since the mid- to late 1990s onwards. The continent has managed to continue positive growth during the most intense crisis years of 2008 and 2009. Low-income and fragile African economies in particular experienced higher average growth rates during these years than the averages achieved during the preceding seven years. Although average growth in oil exporting countries experienced large declines, their growth still exceeds 4 percent on average in 2008 and 2009. Growth in middle-income economies declined sharply, but still remained resilient during the crisis years. The varying growth rates on the continent throughout the crises reflect the fact that policy responses to the crises varied between counter-cyclical policies for countries with reserves surpluses (oil exporters and some middle-income economies)coupled with expansionary policies in mostly middle-income economies. The fragile states and low-income economies were the ones without available policy response maneuvering capabilities.

Empirical analysis finds evidence differences in comovement between these groups for the entire period under investigation. Middle-income African business cycles show the highest and most consistent levels of comovement or coupling with advanced economies between 1980 and 2011. Middle-income countries are more diversified and integrated with the global economy and therefore more susceptible to shocks from advanced countries. In the case of low-income and oil-exporting economies, the variance shares are so low as to suggest decoupling. Fragile African countries show a different pattern, with lower levels of business cycle comovement with advanced economies and a higher reliance on trade with other African countries. However, when controlling for advanced economies in the model, indications of coupling is evident.

In total, international trade is the predominant factor driving comovement between SSA and the advanced economies during the period under investigation. For oil-exporting and fragile African states, comovement with the G7 is low due to the fact that idiosyncratic factors, such as political stability, outweigh the international links created by trade.

These results emphasise the importance of trade for African policymakers. In the modern global economy, transmission mechanisms such as international trade and financial linkages make African economies more susceptible to crises in advanced economies. This is particularly true for middle-income countries. For low-income and fragile states, policy emphasis can be more inward-looking, given that idiosyncratic factors dominate in explaining the business cycles of these groups.