Managing Export Commodity Price Shocks

Kupukile Mlambo

Advisor to the Chief Economist

African Development Bank Group

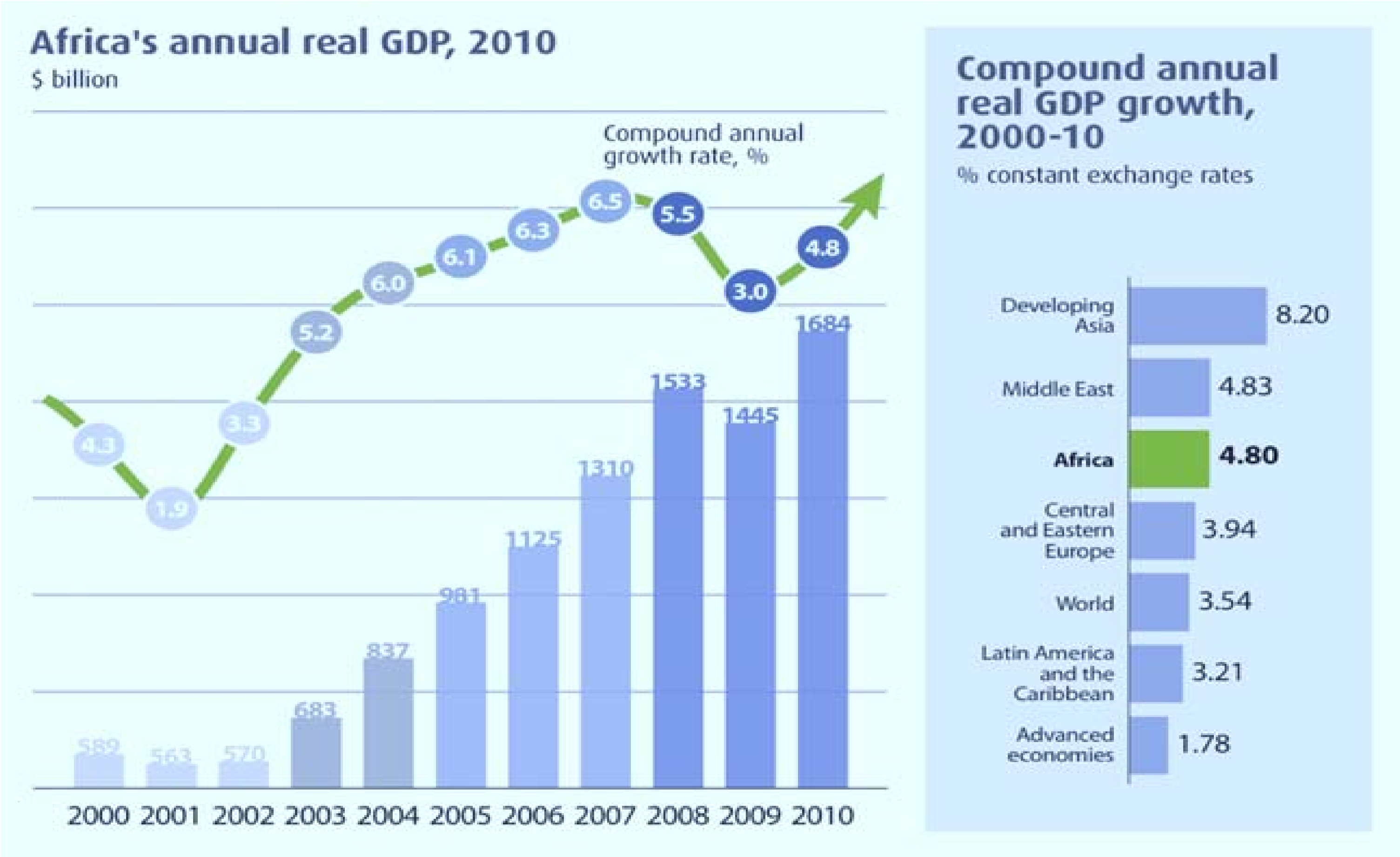
AfDB

September 2011

Presentation Outline

- Introduction: Good Growth News,…But
- Africa's Exposure to Commodities
- Recent Price Developments in Key Commodity Markets
- Managing Commodity Price Shocks
- Some Challenges to Managing Commodity Price Shocks

Africa experiencing 10 years of dynamic growth



- Fastest growing economies: Angola, Nigeria, Ethiopia, Chad, Mozambique, and Rwanda

But….

This is largely a commodity-driven growth

- Asia’s (principally China and India) growing demand for raw materials and rising commodity prices

- Paul Collier: the commodity boom in 2005 and 2006 added 2.5% to the growth of a typical African country

Commodity driven growth subject to booms and busts:

- Prices of commodities volatile
- Commodity prices in long-run circular decline vis-à-vis manufacturing and services

Commodities also subject to other challenges

- Market access
- Value chain

II. Africa’s Exposure to Commodities

Africa highly dependent on commodities

- In 2008, petroleum oils and natural gas accounted for 59.7% of total exports

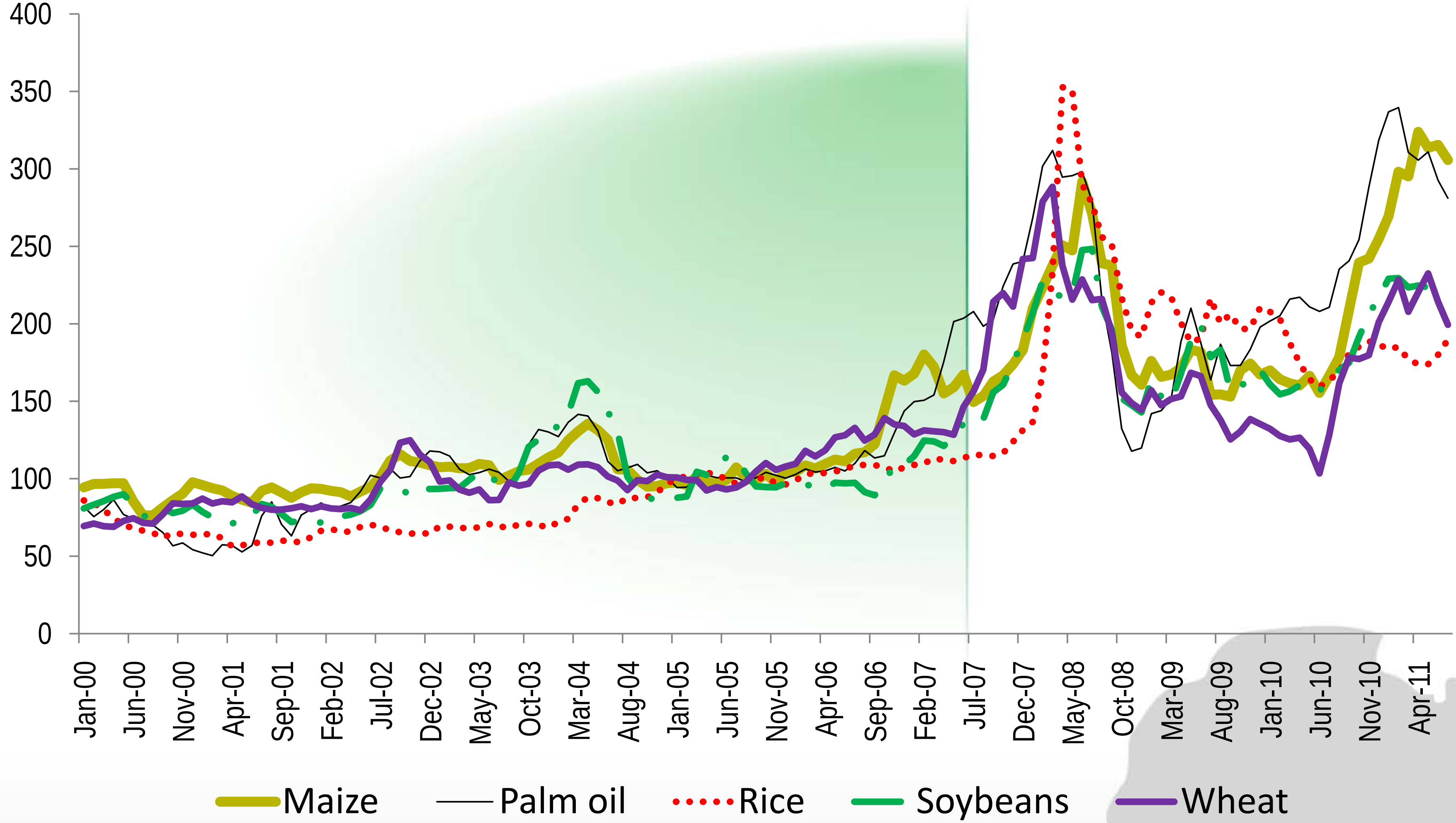
- In 14 countries less than 3 products accounted for more than 75% of exports; and in 29 countries less than 5 products

Countries dependent on a single commodity for exports

Commodity	>50% of Exports	20-49% of Exports	10-19% of Exports
Energy	Algeria (61.6) Angola (76.5) Cameroon (53.8) Eq. Guinea (76.5) Gabon (65.8) Libya (88.4) Nigeria (85.2) Sudan (91.6)	DRC (25.5) Djibouti (21.1%) Egypt (20.4) Liberia (23.2) Senegal (29.9)	Tunisia (12.3)
Metals	CongoR(85.5-cobalt) Guinea(50.2, aluminium) Zambia (56.4, copper)	Botswana (38.2-diamonds) Mauritania (45.2-iron ores) Mozambique(36.6 alum) S-Leone(25.1%-diamonds)	Namibia (18-natural uranium) Zimbabwe(13.4-ferro-chromium)
Agric	BFaso(54.4-cotton) Chad(94-wood) G-Bissau(92.9-cashew) Malawi (50.4-tobacco) SaoTome&P(64.1-cocoa beans	Benin(25.7 cotton) Burundi(45.7-cofee) Ethiopia(32.9-coffee) Rwanda (30.4-coffee) Uganda (32.5-coffee) Cote d'Ivoire(28.6-cocoa) Ghana(42.8- cocoa) CAR(28.3-logs/wood)	
Fisheries	Seychelles (54.7)	Cape Verde(36)	

BANQUE AFRICAINE DE DEVELOPPEMENT
AFRICAN DEVELOPMENT BANK
AFRICAN DEVELOPMENT FUND
FONDS AFRICAIN DE DEVELOPPEMENT

FAO food indices 2000-2010



Consequences of Commodity Price Shocks

- Increase private investment uncertainty
- Increase banking sector fragility
- Adverse impact on Public Finances
- Governance and Political instability

BANQUE AFRICAINE DE DEVELOPPEMENT
AFRICAN DEVELOPMENT BANK
AFRICAN DEVELOPMENT FUND
FONDS AFRICAIN DE DEVELOPPEMENT

IV. Managing Commodity Price Volatility

- Africa is exposed to different commodity classes: no one-size fits all
- Management of commodity price shocks not to be restricted to a single strategy
- Interventions should cover both supply and demand
- For Africa, capacity building and technical assistance critical as well

IV. Managing Commodity Price Volatility

Measures can be divided into

- Short to medium term measures
  - ➢ Stabilising markets (either through price or stock management)
  - ➢ Market based approaches

- Longer term measures
  - ➢ Export diversification

Supply or Stock Management

Price stabilisation through supply or stock management

- Countries set up buffer stock schemes: buy during slump in prices, and release stock when price rises

- OPEC is the most well known such scheme, which allocates quotas to member states. But also national schemes (marketing boards)

- Building of stocks hasn't always worked well
  - Can be costly to manage
  - Difficult to assess the long-term equilibrium prices

Stabilisation Funds and SWF

1. Stabilisation funds act as a hedge against fluctuations in in the price of commodity exports
   - They insulate public finances from commodity price volatility
   - they can act as a form of saving for the future

2. Sovereign wealth funds are special purpose investment vehicles created to stabilise fiscal revenues and/or save for future generations
   - Africa has at least 15 SWF (incl. Algeria, Chad, Angola, etc)
   - Mostly sourced from oil, gas, minerals, and other natural resources
   - African SWFs are predominantly driven by stabilisation motives

3. Challenges: most suffer from poor design and governance

Market-Based Approaches

A. Commodity Derivatives: of two types

- ✓ Futures and Forwards
- ✓ Options, including Swaps

Example:

- Cocobod (Ghana) has been successful in using derivatives to stabilise cocoa revenues
- Kilimanjaro Native Cooperative Union(Tanzania) also experimented with hedging in 2000-2002
- SAFEX is the largest; others in Kenya, Mauritius and Botswana

Most commodity derivatives in Africa (except for SAFEX) have small trading volumes

B. Other Instruments

Commodity-linked bonds

- Can provide an opportunity for commodity-producing countries to hedge against large variations in export earnings—e.g. oil-linked bonds
- Example: Standard Bank Group launched South Africa's first commodity-linked exchange traded notes (ETNs) in 2010
- But markets for these instruments may be difficult to access for most African countries

ADB COMMODITY LINKED LOAN

The AfDB has developed a COMMODITY LINKED LOAN instrument which so far is only available to countries able to borrow from the ADB Window.

The commodity link loan may apply either to:

- Interest payments only;

Or

- Principal payments only;

Or

- Both the interest and the principal payments.

Some Challenges facing Africa

- Small size
- Lack of Capacity
- Poor Market Infrastructure
- Regulatory barriers

THANK YOU

Office of the Chief Economist
African Development Bank