

Stock markets in Africa: bidding for growth amid global turmoil



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‘Stock market development could well be a means to help Africa overcome the current growth impasse caused by the global financial crisis’

Stock markets in several African countries are at risk as a result of the global financial crisis, and the implications for economic growth are worrying. Market capitalisation as a share of GDP – a better measure of the development of stock markets than changes in the share price index – has fallen more than 40% in some African economies, as shown in Figure 1. But does stock market development really matter for economic growth? People often tend to regard stock markets as glorified casinos. However, if supported by adequate policies and reforms, stock markets could well play a key role in fostering economic growth in African countries, helping the continent recover from the current crisis.

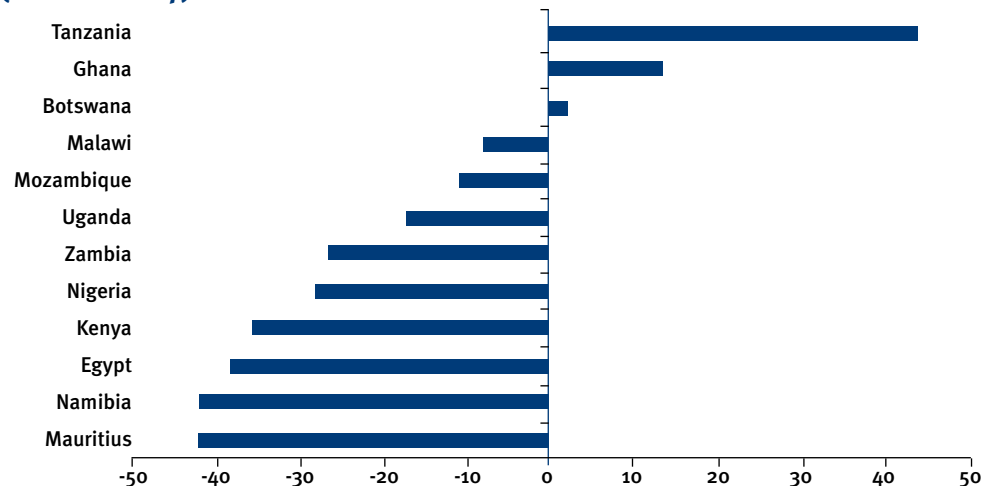
Stock market development in Africa

Before the global financial meltdown, Africa had developed and expanded the equity market sector in a very short time. The number of operating stock exchanges rose from just eight in 1989 to 23 in 2007, reaching a total market capitalisation of over \$2.1 trillion. And despite

their small size and low liquidity, many African markets offered dramatic returns to investors over time. There has been at least one African stock market in the top 10 best-performing markets in the world every year since 1995. In 2004, six African countries (Ghana, Uganda, Kenya, Egypt, Mauritius and Nigeria) were among the world’s 10 best-performing stock markets, while in 2005, Egypt, Uganda and Zambia were in the top five. In 2006, Malawi outperformed every other market in the world.

The shock waves of the global financial crisis have reached Africa, hitting some of the key drivers of stock market development. First, tighter credit conditions and gloomy growth prospects worldwide, plus increased risk aversion, have reduced foreign investors’ appetite for investment in African markets. Foreign direct investment (FDI) slowed in 2008, and portfolio equity flows have slowed down or even reversed alongside the sharp fall in equity prices (Brambila Macias and Massa, 2009). The Nigeria stock exchange, for example, fell 46% in 2008, becoming the world’s worst performing market. In addition to the drying up of external resources, anecdotal evidence shows

Figure 1: Selected African markets: losses in market capitalisation as a % of GDP (2008 vs. 2007)



Source: Adapted from African Securities Exchanges Association (ASEA) Yearbook 2008.

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Box 1: Pathways between stock market development and economic growth

In theory, stock markets spur economic growth by increasing the level and productivity of investment. They increase the savings rate and enhance the efficient allocation of savings. As a result, more savings go to the corporate sector, accelerating economic growth. The evidence favours a positive relationship between stock market development and economic growth, but the issue of which comes first remains an open question.

that private sector credit growth has decreased in some African countries like Nigeria, while domestic bank lending conditions have become more stringent in other countries like Zambia. This had a negative impact on banking sector development, which plays a complementary rather than a substitute role for stock market development in Africa. Remittances, which are positively related to stock market development (Billmeier and Massa, 2009), grew at a lower rate in 2008 and are forecast to decline by more than 8% in sub-Saharan Africa in 2009 alone. The financial crisis has also cut growth prospects in the region. After several years of robust economic expansion, GDP growth was 5.2% in 2008, a percentage point lower than in 2007. In 2009 it is forecast to be 1.8%, 3.4 percentage points below the previous year. Finally, the sudden fall in oil prices in mid-2008 has played its part, especially in resource-rich African countries.

An engine for growth – time for reform

Several studies have found a strong positive relationship between stock market development and economic growth in Africa. In the long-run, a 1% increase in the liquidity, rather than in the size of the stock market, could account for up to 3.7 percentage points of African economic growth (Yartey and Adjasi, 2007). In the short term, there is evidence in favour of the finance-led growth hypothesis in countries like Egypt and South Africa (Enisan and Olufisayo, 2009). In Egypt, the increased importance of stock market development in economic growth before the financial crisis reflects, in part, the success of gov-

ernment reforms to promote the liquidity of the stock market, enhancing incentives for investment and, in turn, boosting economic growth. However, some believe that few African economies are developed sufficiently to benefit from stock market development and advocate a focus on other sectors of the economy rather than wasting time and resources on fostering stock markets.

Stock market development could well be a means to help African countries overcome the current growth impasse caused by the global financial crisis. Indeed, developed and healthy stock markets could be a key ingredient to promote high and sustainable private sector-led growth (see Box 1). Therefore, the traditional barriers to stock market development in African countries need to be removed, namely, small size, low liquidity, lack of transparency, and inadequate infrastructures and institutions. Only if these bottlenecks are overcome, will the efficiency of African stock markets be enhanced and investor confidence in the region restored. The crisis itself could thus offer a new opportunity to African policy-makers to launch an appropriate mix of fiscal, legal and regulatory reforms to develop stock markets. Possible options include a technological upgrading of the trading systems, a reduction of controls on private capital flows, an enhancement of the participation of local institutional investors and an improvement of transparency and enforcement procedures. In Egypt, between the early 1990s and 2007, some of these changes, alongside business environment reforms, bore fruit and the Egyptian stock market has skyrocketed. Improved financial literacy, demutualisation of stock exchanges and regional integration might also help develop African stock markets.

With appropriate and country-specific reforms, African countries will be able to exploit the full potential of stock market development in fostering economic growth, fast tracking its way out of the global crisis.

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ISSN 1756-7629

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