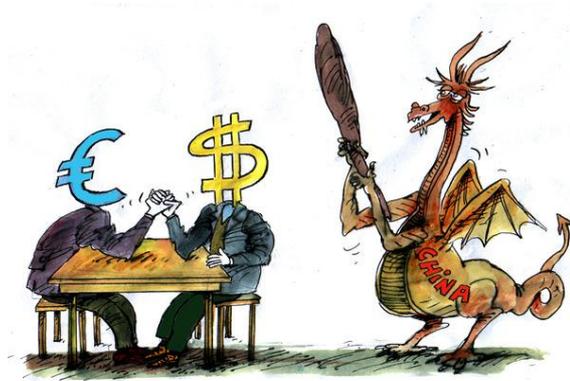


CURRENCY WAR CLOUDS OVER AFRICA

By Sanou MBAYE¹

As a result of chronically deficient demand in the aftermath of the 2008-2009 financial and economic crises, global imbalances are on the rise again, as is the risk of protectionism. The US accuses China of undervaluing its currency to support its industry. The situation could lead to an “international currency war”. What does this herald for African countries?

If history is any guide, we might look into previous currency conflicts to gauge the future. In the 30s, currency wars led to competitive devaluations, protectionism, high inflation, economic collapse, the rise of Hitler and national-socialism in Germany, and eventually the Second World War. Africans were drafted in their thousands to fight along the allied forces against the Axis armies. Many of them died. Africa’s consolation prize came with the political awakening, the fight for freedom, and the independence that followed



Post-war international euphoria did not last long before another currency conflict struck. In 1971, US president Richard Nixon levied a 10 per cent import surcharge and ended dollar convertibility into gold. This is how the debt-economy was born, further compounded and universalised by the “Big Bang”, the fall of the Berlin Wall, the repealing of the “Glass-Steagall act”, China’s embrace of the model: “one state, two systems” – totalitarian politics and economic liberalism, and globalisation. Cheap money flooded the world, leaving out African countries which, except for white-ruled South Africa and Rhodesia (Zimbabwe) were locked out of capital market borrowings. Again, their consolation came when, devoid of toxic assets, they escaped nearly unscathed the current twin woes of financial turmoil and economic downturn.

Quantitative easing (QE) adopted by the US Federal Reserve, the Bank of England, the European Central Bank and the Bank of Japan – printing hundreds of billions of dollars of electronic money – is the current weapon of choice in an escalating global currency war. Since the official interest rates set up by these central banks are close to zero, QE is flooding emerging market economies as investors search for higher yields. As a result, the exchange rates of their currencies are rising. This invokes the 1985 Plaza agreement, whereby the US pressurised Japan into an appreciation of the yen. Japan never recovered from the huge monetary expansion that followed. China is unlikely to follow the footsteps of Japan. With its huge population, immense foreign exchange reserves and capital control, it still has considerable scope to thwart speculative capital inflows and expand domestic demand to ward off western currency bullying.

Africa is being caught in the cross-fire of this currency clash. In South Africa, the continent’s biggest economy, capital inflows induced a rally in the rand which reached in October, its strongest level against the US dollar in almost three years, undermining key export-led industries.

The CFA franc which is freely convertible in hard currency at a grossly overvalued parity pegged to the euro is still more vulnerable. The franc zone, which gives France control of 65 per cent of the African member-countries' foreign-exchange reserves deducted directly from their oil, gold, cocoa, coffee and other commodities exports earnings will be a first choice for hot money inflows. A foreign exchange cover of 110 per cent, combined with soaring interest rates, low inflation and free capital movement, fuels capital flight to the benefit of France and French private companies. Moreover, the franc zone is particularly attractive to speculative capital inflows. Speculators transfer huge amounts of money to high-interest-bearing local deposit accounts, collect their tax-free gains every three months, and take the no-risk plunge over and over again.

The brewing currency war is all the more unwelcome in Africa when one considers that the continent is enjoying particularly good economic outlooks. According to McKinsey & Company, Africa was the third-largest contributor to world economic growth in 2009, after China and India. It, also, credits the continent as delivering the highest rate of return on foreign investment.

Several factors have contributed to this upturn. Rapid urbanisation - 40 per cent of Africans live in cities - has created a dynamic informal sector. This cash-based economy is a major contributor to the continent's productive capacity. It employs over 90 per cent of the workforce, is home to three quarters of retailers and plays a leading role in increasing intra-regional trade. By 2015, Africa will be the only continent where the working age percentage of the population will still be growing. The number of households with earnings over \$5,000 – a threshold for consumption spending – will rise from 85 million to 128 million in the next decade.

Increased demand from emerging countries such as Brazil, India and China has pushed up commodity prices and increased export revenues. Economic reforms implemented throughout the 70s and 80s have improved the macroeconomic environment. Annual foreign direct investment flow in Africa rose from \$9-billion in 2000 to \$62-billion in 2008.

The scrambles for large-scale purchases and leases of hundreds of thousands of hectares farmland in the region have made the headlines in a flurry of media reports across the world. There is no doubt that the opacity and the dubious conditions surrounding part of these deals are causes for concerns. However, the fact remains that investment to harness Africa's barely exploited huge agricultural potential – 60 per cent of the world's total amount of uncultivated arable land -, is one of the answer to global rising food prices, "Food Riots" and climate change-induced food security concerns.

This is all these bright development prospects that the present currency sabre rattling is in danger of jeopardising. However, Africa might find consolation in the fact that when the world's major economies are in trouble, wary investors find solace in 'refuge values' like gold, silver and other commodities such as oil and base metals in which Africa abounds.

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