

# Recover and adapt

Context-driven policy options in a  
post-COVID-19 Africa

Report | July 2020



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## Recover and adapt

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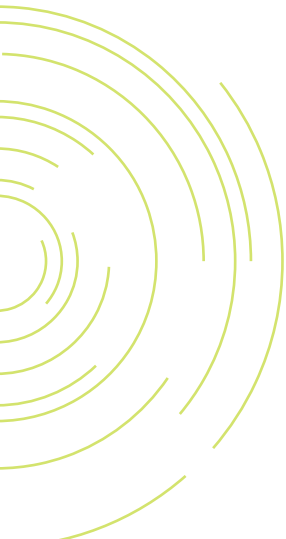
# 1 Introduction

**Severe economic impact.** COVID-19 is leaving no country unaffected. The global scale of the pandemic is affecting trade, capital flows, tourism and remittances, while lockdown or other measures<sup>1</sup> to contain the spread of the virus are affecting domestic output and livelihoods. Sub-Saharan Africa (SSA), where most economies were already in a precarious position prior to COVID-19, is likely to be hit particularly hard. The UN Economic Commission for Africa (UNECA) estimates that, at best, Africa's average GDP growth for 2020 will drop by 1.4 percentage points, with the worst-case scenario seeing Africa's economy contracting by up to 2.6% and real per capita GDP dropping by 3.9%<sup>2</sup>. The result is an estimated 5 million to 29 million people being pushed below the extreme poverty line, erasing five years of poverty reduction gains<sup>3</sup>.



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- 1 By the end of April 2020, 17 countries in SSA had implemented a nationwide lockdown to curb the spread of COVID-19, 9 countries had implemented a localised or partial lockdown and a further 12 had implemented a night curfew.
  - 2 <https://www.odi.org/blogs/17013-impact-covid-19-africa-s-banking-system>
  - 3 [https://www.uneca.org/sites/default/files/PublicationFiles/eca\\_covid\\_report\\_en\\_24apr\\_web1.pdf](https://www.uneca.org/sites/default/files/PublicationFiles/eca_covid_report_en_24apr_web1.pdf)

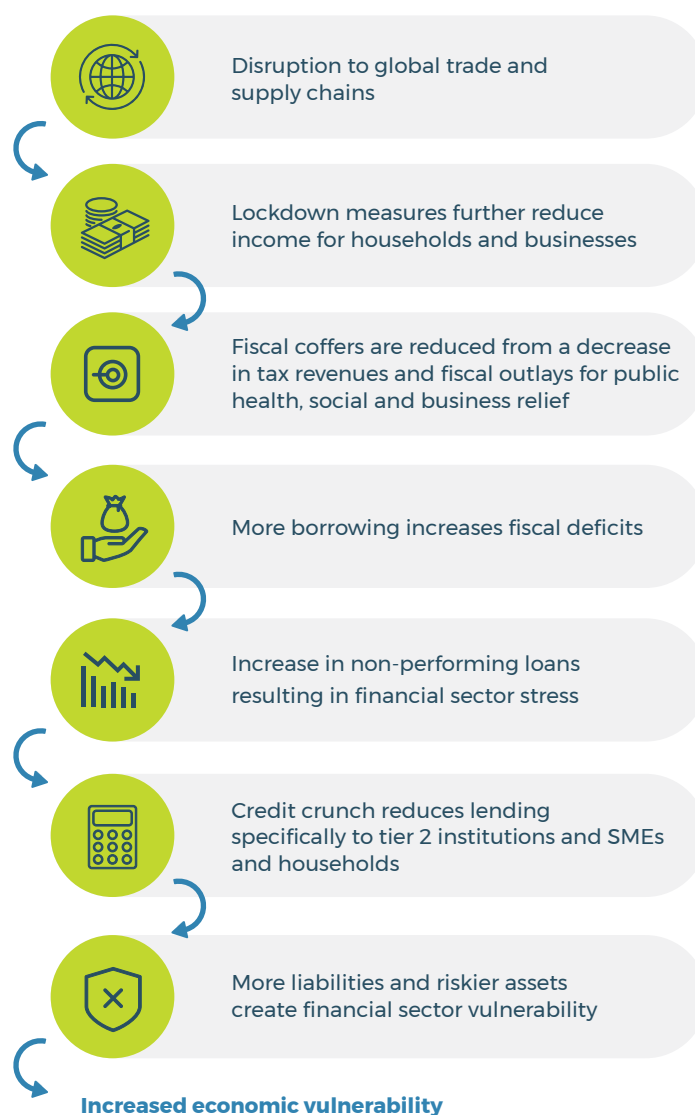
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### A downward spiral – from real economy to fiscal and financial impact.

As the economic effects of the pandemic unfold, the external sector was the first to be impacted. Next, households and businesses bore the brunt of lockdown measures. Government suffers a knock-on drop in tax revenues, while facing fiscal outlays for public health, social and business relief measures. Reserves are depleted and additional debt is incurred as countries borrow to maintain livelihoods and keep economies going, resulting in larger fiscal deficits<sup>4</sup>. The result is that, by the end of May 2020, 26 SSA countries had been approved by the IMF for emergency financing to deal with the economic impact of the COVID-19 pandemic<sup>5</sup>.

As domestic economies contract and slip into a recession, an increase in non-performing loans makes a credit crunch likely, with sharp reductions in new lending. Second-tier financial institutions like MFIs that support harder-to-reach entrepreneurs and households are likely to be the first to come under pressure. More broadly, constrained liquidity will result in financial sector vulnerability<sup>6</sup> and may, under a worst-case scenario, see a full-scale collapse of many countries' banking systems<sup>7</sup>. Ultimately, any financial sector crisis will again impact livelihoods, thereby creating a downward spiral, as illustrated in Figure 1.



4 For non-oil exporting countries, the IMF estimates fiscal deficits to be on average 2.5% of GDP higher in 2020 than in 2019. For oil exporters, this could be above 3%.

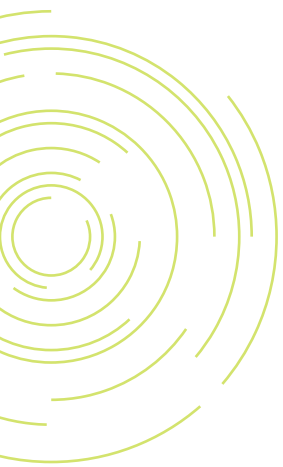
5 [https://www.uneca.org/sites/default/files/PublicationFiles/eca\\_covid\\_report\\_en\\_24apr\\_web1.pdf](https://www.uneca.org/sites/default/files/PublicationFiles/eca_covid_report_en_24apr_web1.pdf); <https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker#REGION>

6 <https://www.imf.org/en/Publications/REO/SSA/Issues/2020/04/01/sreo0420>

7 For an overview of the effects on the banking sector and, with that, livelihoods, see <https://www.odl.org/blogs/17013-impact-covid-19-africa-s-banking-system>

**Figure 1: From real economy to fiscal and financial impact – downward spiral illustration**

Source: Authors' own



**What can be done?** For the development community and national policymakers, this creates a clear imperative: Wield whatever tools will be most effective to provide immediate relief; but also, more importantly, support longer-term adaptation to break the downward spiral. This is easier said than done in SSA, where economies were already severely constrained before the crisis. What, then, are the policy options for mitigation, recovery and adaptation?

**A sense-making framework.** When we started to grapple with these questions, we identified a gap in evidence around how different countries or clusters of countries in Africa could be affected by COVID-19 and what adaptation is required, given that their contexts and starting points differ quite substantially.

In this note, we explore the vulnerability of different groups of countries in SSA to the impact of COVID-19 as a starting point to inform meaningful, context-relevant responses for different countries to mitigate, recover and adapt for a post-COVID-19 world.

We do this by mapping countries in SSA across three dimensions:

- The susceptibility of their economy to changes in the global economy
- The ability to access finance to respond to the crisis
- The ability of the domestic economy to bounce back – across both the formal and informal sector

The first dimension is an exogenous driver of the economic ramifications of the pandemic, whereas the latter two are endogenous drivers. We use this mapping to derive a framework on the policy options for different clusters of countries. The focus is on the economic and financial impacts and responses, rather than public health or health financing. Based on this mapping, we identify four clusters of countries, each named for the policy options arising from the categorisation across the dimensions:

- |                        |                      |
|------------------------|----------------------|
| ● Limited options      | ● Some leeway        |
| ● Externally hamstrung | ● Room for manoeuvre |

Each cluster will be defined and discussed in Section 3.

**A heuristic for development partners and policymakers.** A number of further factors will shape actual impact and policy options in any given country. These include the level of integration into the global financial ecosystem, the quality and integrity of public institutions, the presence and severity of conflict or terrorism, the state of the health and social protection systems and the trust in, or credibility of, the legal system and public institutions. Thus, this framework cannot sketch a complete picture of the complexity of factors affecting economies and societies or provide ready-made answers for how to respond. Rather, it is intended as a heuristic to help policymakers and development partners understand the choices that they have in how they respond in country context across the next phases of the COVID-19 pandemic.

“

We identified a gap in evidence around how different countries or clusters of countries in Africa could be affected by COVID-19 and what adaptation is required, given that their contexts and starting points differ quite substantially.

”

# 2 Framework

Figure 2 maps SSA countries and a selection of developing and developed comparison countries (denoted by rhombuses), according to the first two dimensions in our framework, namely external sector vulnerability and ability to borrow:

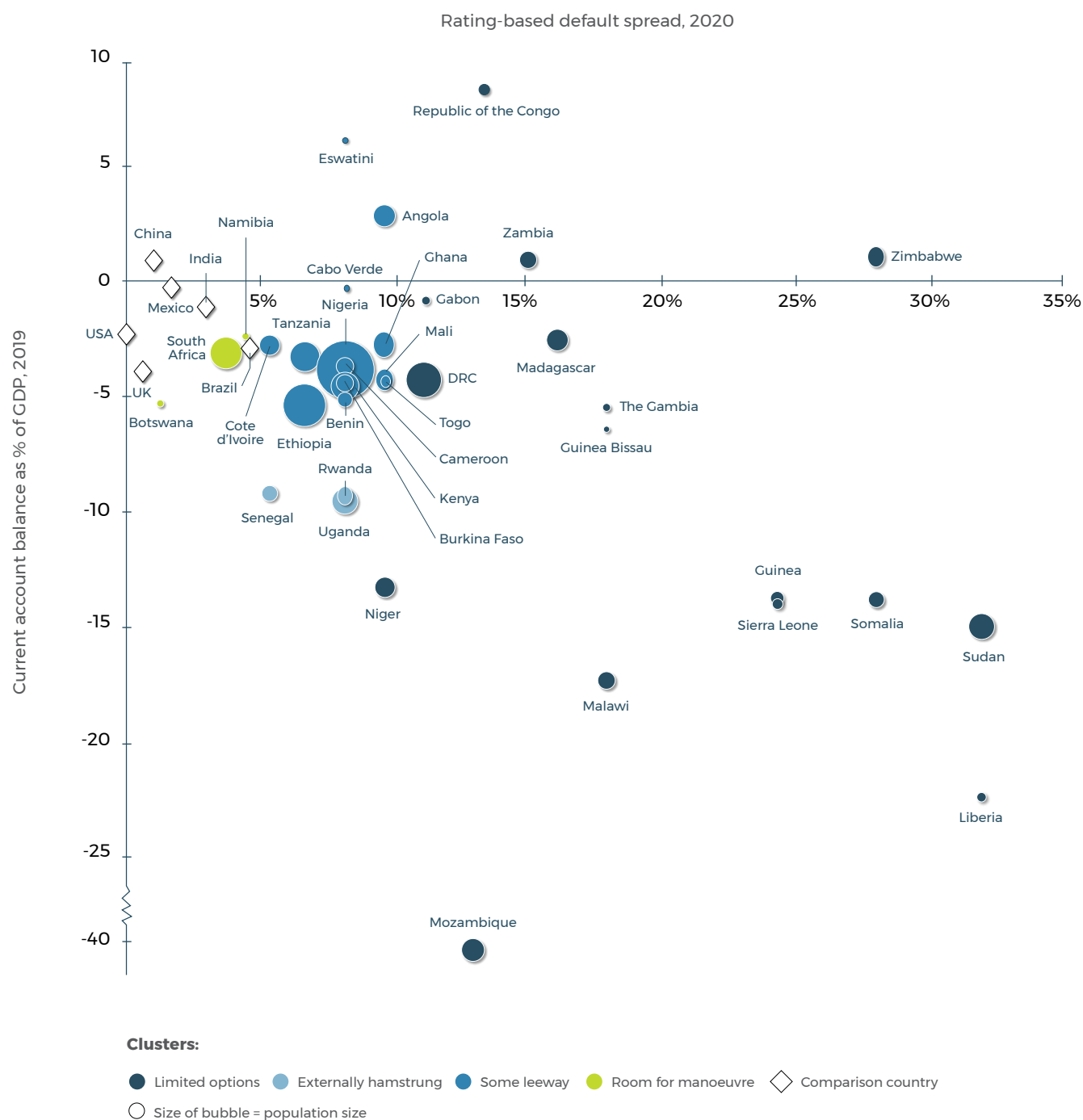


Figure 2: Plotting of SSA and select global comparison countries

Source: IMF, 2020; Damodaran, 2020; World Bank, 2020

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## External sector vulnerability

**External sector a leading indicator.** The vertical axis is a proxy for the external sector vulnerability of an economy. Given the effects of the pandemic on the movement of people and goods across borders, industries that rely on such movement were the first to be affected by the pandemic and will likely remain affected for the foreseeable future. Economies that are more interconnected are more vulnerable to synchronised global shocks as they generate growth from external sources. As a result, there may be more pressure on these economies to adapt. We therefore consider the impact on the external sector as one of the primary categorisations across SSA countries.

**Current account deficit indicative of net position.** The proxy indicator used for external sector vulnerability is the current account (CA) balance<sup>8</sup> for 2019, based on data from the IMF World Economic Outlook 2020. Countries that have a current account deficit import more than they export and therefore require capital inflows to generate forex – otherwise they are building up liabilities vis-à-vis the rest of the world<sup>9</sup>. The current account also reflects remittances and overseas development assistance, both of which are important sources of funding for many SSA countries<sup>10</sup>. Effects may offset each other, however. For example, high oil exports and high food imports create a balanced current account, when actually the country is highly vulnerable. Hence, any current account balance position should be interpreted in context.

### Box 1. Effect of the pandemic on the current account

Countries that have either a large current account deficit or surplus are more vulnerable to the COVID-19 shock, because they have a larger dependency on the external economy<sup>11</sup>. A growth slowdown among key trading partners reduces external demand, while disruptions to global supply chains lower the availability of imported goods and create inflationary pressure. Countries that have a high commodity export dependence<sup>12</sup> – which holds true for most of SSA – will be particularly vulnerable. The effect is compounded by tightening global financial conditions, which reduce investment flows, meaning that governments are less able to finance food imports and health spending, plus to use fiscal measures to support growth (UNCTAD, 2020). The pandemic is also estimated to lead to a sharp decline in remittances to SSA (World Bank, 2020<sup>13</sup>).

**Deteriorating outlook.** Figure 2 sketches the pre-pandemic picture. When we consider the current account forecasts available for 2020, in Figure 3, a dynamic picture emerges where many countries are expected to see a further deterioration in their current account positions. It is only the countries in green that are forecasted to see an improvement in their current accounts:

8 Current account balance is the sum of net exports of goods and services, net primary income, and net secondary income. Net secondary income includes remittances under “personal transfers”. Net secondary income includes parts of ODA (overseas development assistance) under “current international cooperation”. Thus, the current account balance includes transfers between government that are used by the recipients to finance current expenditures, but excludes transfers intended for purposes of capital formation.

9 According to the OECD, “Large and persistent current and capital account deficits may constitute a cause for economic concern, particularly when sustainability issues are being raised, questioning the economic prospects of a country. Regardless of the origins, when a country runs current and capital account deficits on a structural basis, it is building up liabilities vis-à-vis the Rest of the World that eventually need to be repaid. In that sense, the extent of the foreign liabilities of a given economy, and their respective servicing costs, may be important aspects to consider when analysing the vulnerabilities of an economy.” <https://data.worldbank.org/indicator/BX.TRF.PWKR.DT.GD.ZS>; <https://data.worldbank.org/indicator/DT.ODA.ODAT.GN.ZS>

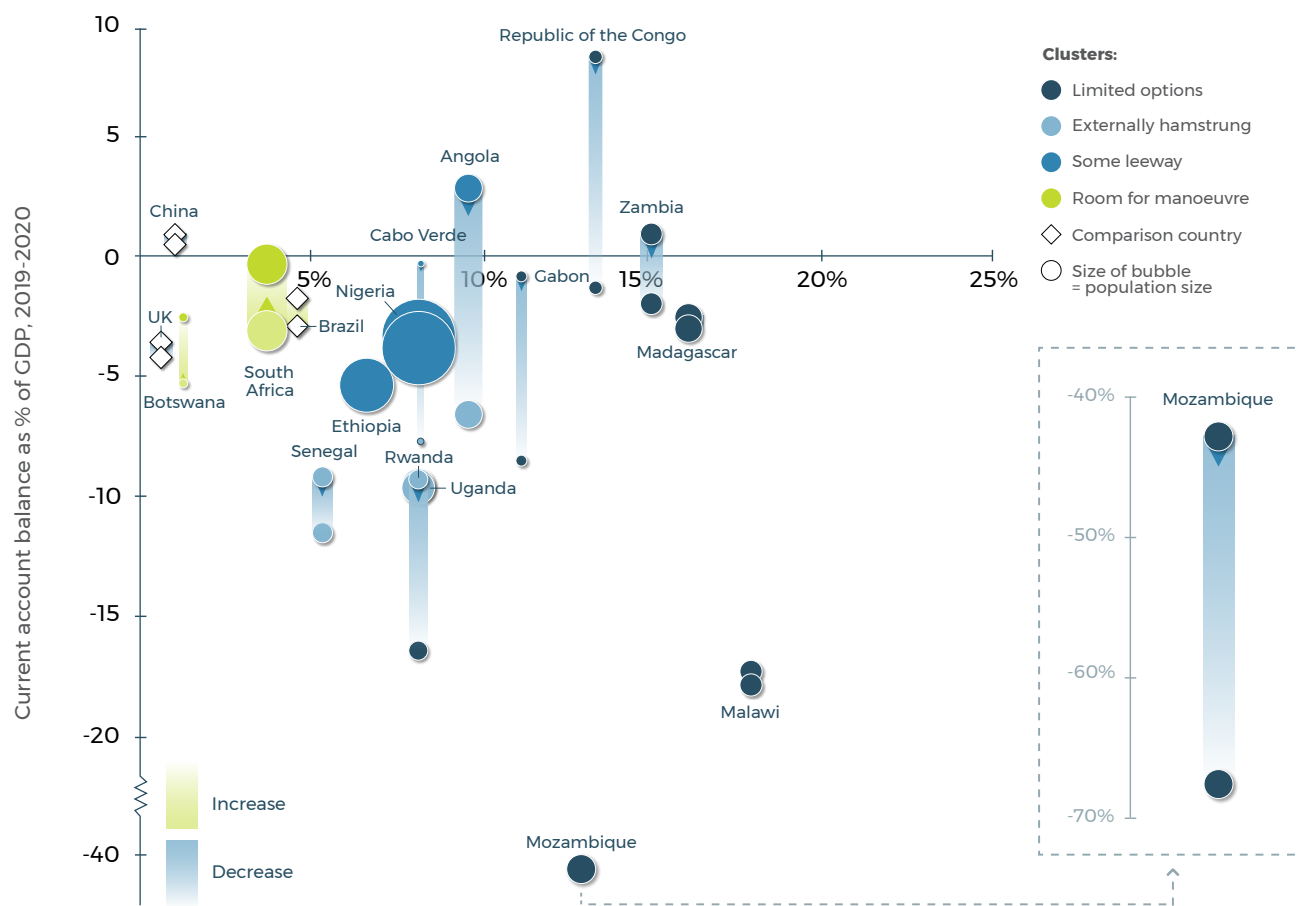
10 <https://data.worldbank.org/indicator/BX.TRF.PWKR.DT.GD.ZS>; <https://data.worldbank.org/indicator/DT.ODA.ODAT.GN.ZS>

11 This is, however, only valid for countries where the effects do not offset each other.

12 Commodity exports as % of GDP, commodity exports as % of GDP and natural resource rent as % of GDP have been considered and the ratios are generally high across SSA. Data source: [https://unctad.org/en/PublicationsLibrary/ditccom2019d1\\_en.pdf](https://unctad.org/en/PublicationsLibrary/ditccom2019d1_en.pdf)

13 <https://www.worldbank.org/en/news/press-release/2020/04/22/world-bank-predicts-sharpest-decline-of-remittances-in-recent-history>

## Rating-based default spread, 2020



**Figure 3: Current account balance changes from 2019 to 2020**

Source: IMF, 2020; Damodaran, 2020; World Bank, 2020

**Range of businesses impacted.** Formal sector businesses that are serving the foreign market or that are reliant on imported inputs are the main actors impacted by effects on the external sector. This includes that part of the tourism sector that is focused on foreign tourists, SMEs that are part of the tourism value chain, domestic manufacturing or services interconnected with foreign markets, and commodities and agricultural production for export. The foreign tourism sector has been brought to a halt for most markets, whereas the impact on other sectors is likely to be determined by the growth prospects in global markets.

### Ability to borrow

**Government as prime agent.** The government sector is one of the most important “agents” in the COVID-19 response. Government is responsible for fiscal stimulus, household and business relief, as well as for making the policy decisions that will set the country’s course for medium- to longer-term adaptation to a post-COVID world. Salaries in the public sector are also an important driver of the rest of the economy. All of the above requires funding. Thus, the ability of governments to access funding is one of the core drivers of the way that the effects of the pandemic will transpire across different countries in SSA.



**Ability to borrow.** The horizontal axis of Figure 1 provides a proxy for governments' ability and cost to borrow on the open market. It denotes the rating-based default spread for different countries as of April 2020<sup>14</sup>. The rating-based default spread is a proxy for the country risk premium that investors charge governments for buying their debt – an indication of the premium that governments would have to pay to access financing at the international bond markets. Hence, this indicator points to the differential cost of credit faced by different governments. It is an imputed indicator based on the sovereign risk rating that international rating agencies assign to a country<sup>15</sup>. This risk rating is, in turn, determined by a range of political and economic risk factors.

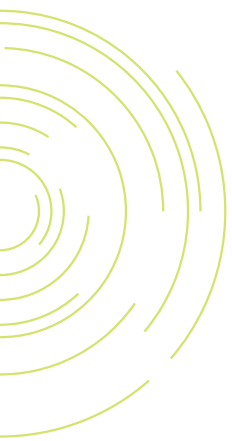
Countries that have a high rating-based default spread may face constraints in raising debt, as it might be perceived as too risky to buy bonds from this government; and, hence, they would have to rely only on loans from multilateral funders. This is also, to some extent, applicable to countries that are not active in the international bond market, as a high-risk rating indicates that the country is already facing serious debt servicing issues, potentially deterring domestic investors from buying government bonds. One of the determinants implied by the rating-based default spread, namely institutional quality, has furthermore been found to be a significant driver of both the cost of borrowing and the likelihood of bond issuance by governments<sup>16</sup>. Thus, the further to the right on the spectrum, the less “runway” governments have to access funding from both international and domestic markets to respond to the economic effects of the pandemic.

14 The dataset was developed by NYU Prof Aswath Damodaran. It is the most complete and up-to-date dataset available to proxy the market's pricing of the likelihood of debt default at a country level. Nevertheless, for many countries in SSA, there is no traded bond rate available, as governments borrow from multilateral agencies below market rates. In such cases, the data is estimated by assuming a similar default spread as for other countries with the same sovereign debt rating. See [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3427863](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3427863) for the published paper to outline the approach and [http://pages.stern.nyu.edu/~adamodar/New\\_Home\\_Page/datafile/ctryprem.html](http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/ctryprem.html) for the page with the data.

15 It is calculated by transforming the sovereign bond credit rating (using the Moody's rating) into a default spread by using traded government bond rates. So, when a government issues bonds denominated in a foreign currency, the interest rate on the bond can be compared to a rate on a riskless investment in that currency to get a market measure of the default spread for that country. To illustrate, the Brazilian Government had a 10-year dollar denominated bond outstanding in July 2019, with a market interest rate of 4.02%. At the same time, the 10-year US treasury bond rate was 2.1%. If we assume that the US treasury is default free, the difference of 1.92% between the two rates ( $4.02\% - 2.1\% = 1.92\%$ ) can be viewed as the market's assessment of the default spread for Brazil – the risk that Brazil would default on its debt.

16 Presbitero et al (2016) has found that institutional quality influences both the cost of borrowing in the international bond market and the likelihood of a country to issue bonds in SSA. They analysed the drivers of bond issuance and spreads for SSA countries. Their findings reveal a statistically significant negative relationship between government effectiveness and government bond spreads. Additionally, they find a statistically significant and positive relationship between government effectiveness and the likelihood of bond issuance. See: <https://www.sciencedirect.com/science/article/pii/S1879933716300483>





**Pandemic further reducing ability to borrow.** The World Bank<sup>17</sup> projects that the pandemic will give rise to widening fiscal deficits amid falling government revenues<sup>18</sup>. It heightens risk sentiment, thereby weakening African currencies and amplifying fiscal risks. In some countries, this is leading to bigger sovereign spreads. However, the low interest rate environment in developed countries does still imply appetite for higher-return sovereign debt on international debt markets.

**Proxy for corporate foreign investment.** While government is the prime agent considered on this axis, the data indicated also provides a proxy for the ability of the corporate sector to attract foreign investment into equities<sup>19</sup> – which, in turn, is important in determining the path of the formal sector through the effects of the pandemic.

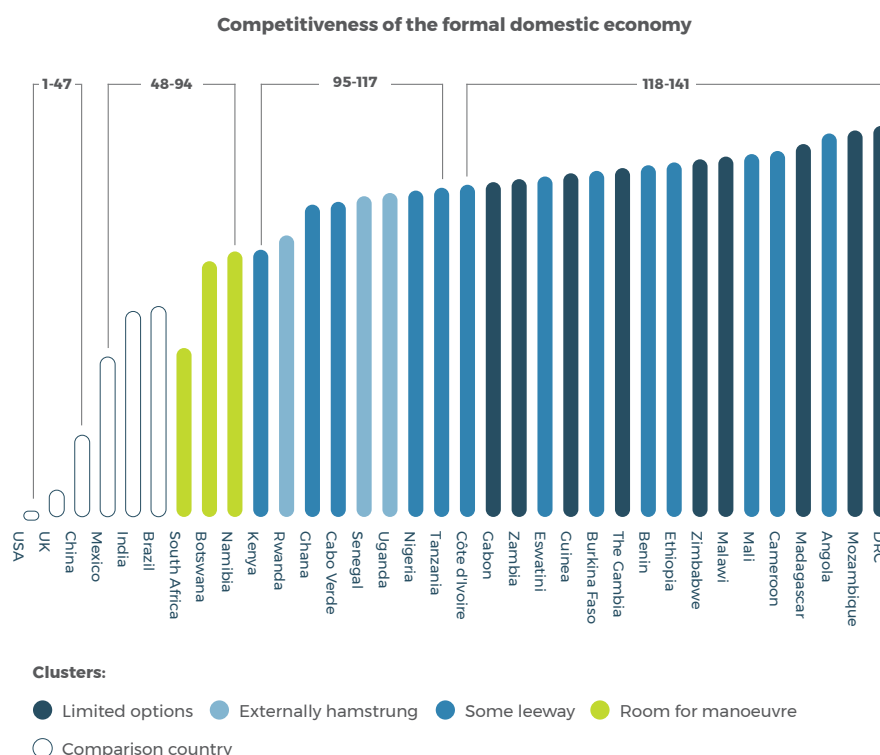
**Interdependency with current account deficit.** Presbitero et al (2016) has found that the current account balance influences the bond spread of SSA countries that are active in the international bond markets – countries with a lower current account deficit face lower spreads and, hence, lower costs of borrowing. Hence there is an interrelationship between the first two dimensions of our framework.

## Ability to respond

The third dimension against which we map SSA countries is the ability of economies to mitigate, respond and adapt to the economic impact of COVID-19. We consider this across both the formal and informal sectors.

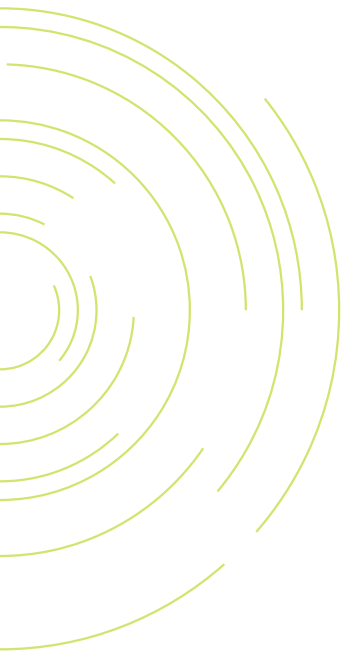
**Efficiency driving economic response.** Figure 4 indicates the sample countries' ranking on the global competitiveness index (GCI)<sup>20</sup> as reflected in the World Economic Forum (WEF) Global Competitiveness Report for 2019. It is a composite indicator of the efficiency of the domestic economy to generate output for long-term economic growth<sup>21</sup> and, hence, the ability of the domestic economy to recover from the COVID-19 crisis based on its internal capabilities rather than external inflows.

- 17 <https://openknowledge.worldbank.org/bitstream/handle/10986/33541/9781464815683.pdf?sequence=16&isAllowed=y>
- 18 This deterioration will be particularly hard-felt in countries with a high reliance on the external sector in the form of commodity export or tourism dependence – showing the interconnectedness between the two axes.
- 19 The ratings-based default spread also signals ability to attract investment for market players. Foreign investors look at a country's risk and, based on that, decide on the risk premium they need to invest into the local stock market/equity market. Thus, if a country has a high default risk, foreign investors might not invest into the local equity market.
- 20 A composite indicator comprising 12 fields covering four pillars: enabling environment (institutions, infrastructure, ICT adoption, macroeconomic stability); human capital (health, skills); markets (product market, labour market, financial system, market size) and the innovation ecosystem (business dynamism, innovation capability). See: <https://www.weforum.org/reports/how-to-end-a-decade-of-lost-productivity-growth>
- 21 The index is anchored in growth accounting economic literature and aims to measure the drivers of 'total factor productivity' (TFP), the part of economic growth that is not explained by the growth in the factors of production. TFP can be interpreted as how smartly these factors are used and is the main determinant of long-term economic growth.



**Figure 4: Global competitiveness index rankings**

Source: WEF, 2019



**Very few competitive economies.** Figure 4 indicates that South Africa and neighbouring Botswana and Namibia are the best ranked in SSA on the competitiveness scale (scoring 60<sup>th</sup>, 91<sup>st</sup> and 94<sup>th</sup>, respectively). They are also best ranked among the sample countries in terms of the current account and default-based debt spread classifications. As indicated by the colour coding, this makes them the best able among the sample countries, relatively speaking, to respond to the economic effects of the pandemic. A handful of countries (Kenya, Rwanda, Tanzania and Uganda in East Africa; Ghana, Mali and Nigeria on the West Coast) have mid-to-lower-range competitiveness rankings (between 95 and 117). The bulk of SSA countries for which data is available rank in the bottom of the spectrum (above 117).

**Internal economy effects vary by sector.** The competitiveness index represents the ability of the formal sector to survive and respond to the effects of the pandemic. If we consider the internally faced economy, specifically, we see that different categories of players will experience the effects of the pandemic differently:

- **The manufacturing and services sector serving the domestic market.** The composition of this sector will depend on the country context. It is distinguished by the bulk of the market being domestic. Businesses in this segment are likely to be exposed to imports of capital goods to maintain production, plus they are likely to suffer the consequences of lockdown or containment measures, with the severity depending on the sector in which they operate, and the duration of the measures imposed. The quality of their loans will have an impact on the health of the domestic financial sector.
- **The commercial agriculture sector producing for the domestic market is important for national food security.** This sector tends to have a greater reliance on commercial funding, but in virtually all countries less so than the rest of the private sector.
- **The financial sector** merits separate treatment due to the impact of the rest of the economy on its balance sheet. Ironically, financial institutions with large portions of their assets in government bonds may be more resilient in the pandemic – private companies are more likely to default than governments.
- **The digital economy** cuts across all the above categories. The COVID-19 imperative for social distancing accelerates the move to digitisation and digitalisation<sup>22</sup>, globally.

**Large informal sector may serve as mitigating factor.** The competitiveness of the formal economy as expressed in the GCI shows only part of the picture, however. According to IMF estimates (2017), the informal economy accounts for close to half of GDP in many countries in SSA. This means that most people earn their livelihoods not in the formal economy, but in the informal sector. As indicated in Figure 5, the informal sector is estimated to account for 90%-plus of employment in the majority of SSA countries:

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22 We use “digitisation” to refer to when an engagement or object is converted into digital format (for example scanning a photo or, in the case of financial inclusion, converting payments that were previously made in cash into digital payments). “Digitalisation” refers to business processes becoming digital, such as a business moving from a paper-based to a digital management information system.



**Figure 5: Informal employment as % of total employment**

Source: ILO, 2018<sup>23</sup>

**Small-scale agriculture particularly relevant.** The informal sector comprises two main categories, each of which will experience the effects of the pandemic differently:

- **Smallholder agriculture**, whether subsistence or for cash crops, accounts for around two-thirds of adults' livelihoods in many SSA countries<sup>24</sup>. Apart from relying on public health and receiving inputs from government, they operate relatively independently of state support or external funding and provide their own sustenance. If their farming inputs are maintained through the pandemic, they are likely to continue as before, unaffected by lockdown measures and remaining an important source of food security.
- **The micro-retail, services and informal manufacturing sector.** Their market consists of both informal sector and formal sector clients. They will therefore be affected by containment measures imposed on the formal sector, but less so than the formal sector itself.

**Vulnerable to containment measures.** The fact that most Africans make their living in the subsistence agriculture and informal sector means that the resilience of the informal sector is crucial to cushion the initial effects of the pandemic. The informal sector will also play an important role alongside the competitiveness of the formal sector in the longer-term recovery and adaptation of the economy. Many businesses and individuals operating in the informal sector are cash-based, with limited reserves and a short-term income cycle. That makes them vulnerable to the effects of lockdown or other containment measures that inhibit their ability to trade or conduct their business.

<sup>23</sup> [https://www.ilo.org/global/publications/books/WCMS\\_626831/lang--en/index.htm](https://www.ilo.org/global/publications/books/WCMS_626831/lang--en/index.htm)

<sup>24</sup> See, for example: <https://www.mckinsey.com/industries/agriculture/our-insights/winning-in-africas-agricultural-market#> and <http://www.fao.org/3/a-i6056e.pdf>



# 3 Country classification

The discussion so far has built up a layered picture of the position of different countries across SSA at the outset of the pandemic according to three dimensions:

1. The exposure to the international economy (viewed through the lens of the current account – with the vertical axis in Figure 2 indicating the snapshot and Figure 3 the dynamic picture)
2. Government's capacity to raise funding to mitigate, recover and adapt to the effects of the pandemic (viewed through the lens of the cost of raising debt, internationally, given the default risk, as indicated on the horizontal axis in Figure 2)
3. How “set” the domestic economy is to shoulder the initial effects and respond and adapt beyond COVID-19 (viewed through the lens of formal sector competitiveness, as well as the role of the informal sector in supporting livelihoods – Figure 4 and Figure 5)

This categorisation renders four clusters of countries in SSA, each of which will be discussed below. Figure 6 provides a summary overview:



Figure 6: Cluster framework



## ● Cluster 1: Limited options

**Key features.** The first cluster, indicated in navy-blue on the figures, represents all the countries to the right and bottom of Figure 1. They either have a large current account deficit of more than 10% of GDP or very limited access to funding based on their sovereign debt spread, or both. Their local economies are very uncompetitive, achieving the lowest global competitiveness rankings. Not surprisingly, this cluster includes most of the fragile states in SSA.

**Ability to respond.** Countries in this cluster are characterised by macroeconomic instability. They are mostly net food importers and, with one or two exceptions, commodities account for the bulk of export revenues. While some fragile states are so insulated that limited current account effects are forecasted, others (notably Mozambique, Zambia and the DRC) are expected to suffer a large deterioration in their current accounts in 2020 on the back of drops in tourism, export commodity prices, remittances, ODA and FDI. Thus, those industries that rely on foreign markets will be severely impacted. Poor competitiveness means that their local economy will not be able to recover quickly after the pandemic (with specific effects to vary by sector), implying a large risk to livelihoods.

The effect on livelihoods will be partially offset by the large informal sector and especially the size of the subsistence agriculture<sup>25</sup> sector, but it will depend on the extent to which informal sectors are impacted by containment measures.

Their default risk spreads mean that all countries in this cluster have limited fiscal breathing space. Debt sustainability is extremely low, and governments are unlikely to be able to access capital other than from multilateral funders. That means that they have limited scope to fund the public health implications of the pandemic without emergency funding or relief from abroad. Nor can they afford much fiscal stimulus.

## ● Cluster 2: Externally hamstrung

**Key features.** The second cluster is in the lower-middle band of the diagram, shaded light blue. Countries in this cluster all have a large current account deficit of more than 5% of GDP, plus limited access to government funding. They have a more competitive domestic economy than countries in Cluster 1, but competitiveness is still low.

**Ability to respond.** Like Cluster 1, countries in Cluster 2 rely strongly on imports and high commodity export dependence. Food security is likely to be a front-of-mind concern for countries where the large current account deficit is due to food imports. Their large current account deficit implies serious implications for the sustainability of their balance of payments, which could negatively impact the provision of public health services to respond to COVID-19. Countries for which forecasts are available (Senegal and Rwanda) are expected to see a large drop in their current account balance. In contrast to Cluster 1, however, their local economies have some potential to recover, and they are in a comparatively better position regarding their ability to borrow and the sustainability of their government debt. As with Cluster 1, informal employment is high, the majority of which in subsistence agriculture, and this could potentially dampen the effects of the economic shock.

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<sup>25</sup> Subsistence agriculture is largely unaffected by the direct effects of lockdown and remains at least a partial source of food security throughout the ensuing global and domestic economic turbulence.



### ● Cluster 3: Some leeway

**Key features.** Cluster 3 is indicated in bright blue. Most of these countries have a relatively small current account deficit of around 5% of GDP, but some also have a balanced current account or even a surplus. While the net effect on the current account balance is forecasted to be small for some countries in the cluster, others, notably Angola, will see a marked drop in their current account balance due to the slump in oil exports – once again indicative of the vulnerability that the high share of commodities in exports brings across virtually all countries in the sample. They have some access to funding based on a moderate government debt spread. While some countries in this cluster show some (still limited) domestic economic competitiveness, others have highly uncompetitive local economies. The share of the informal economy in employment remains high across the board.

**Ability to respond.** This group is quite diverse: Some countries are as compromised as countries in Cluster 2 or are in an even worse position due to the projected impact on their current account, but others are less vulnerable to balance of payment challenges. Local context matters: How the crisis will pan out depends largely on how competitive the local economy is and what the relative strength of different sectors is. It is also important to consider the commodity export dependency of some of these countries (such as Nigeria and Angola). Combined with food import dependency, sharp drops in oil or other commodity prices can create a double shock to the local economy.

### ● Cluster 4: Room for manoeuvre

The only SSA countries ranking in Cluster 4 are Botswana, Namibia and South Africa.

**Ability to respond.** The last cluster, though still vulnerable in an absolute sense, are relatively well placed to respond and adapt, compared to SSA peers. This is due to a small current account deficit, comparatively good access to funding, and local economies that have relatively good potential for recovery based on their competitiveness ranking. The 2020 forecast is for the current account deficit to be converted into a balanced or slightly positive position. This could be due to the effects on exports of the substantial currency depreciation at the onset of the pandemic, as well as a contraction in imports on the back of the impact on domestic demand. While the pandemic will still have severe economic implications, governments in this cluster have more options to consider in the immediate, medium and longer term.

“

While the pandemic will still have severe economic implications, the governments of Botswana, Namibia and South Africa have more options to consider in the immediate, medium and longer term.

”

## ○ Comparison countries

**Emerging economies cluster together.** It is interesting to note that the G20 comparison countries (Brazil, India and Mexico) all cluster together with South Africa. All of these countries have a fairly large and competitive domestic economy and a comparatively low government default risk spread. Domestic policy therefore really matters in determining the course that their economies will take through and beyond the pandemic. Current account projections for 2020 show a trend that is similar to projections for South Africa, with India and Brazil both seeing improvements in their current accounts. However, there is likely to be a growing divergence between G20 countries as they struggle to retain or regain their productive capacity.

**Large economies have the most runway.** The other economies included for comparison purposes (namely the United States, the United Kingdom and China) are clustered to the top left of the diagram, predictably placing them in a less vulnerable position compared to the SSA region. They all have large, competitive economies, a limited current account deficit or, indeed, a surplus (in the case of China), as well as a low government default risk spread, indicative of broad and affordable access to government debt. As “hard currency” countries, they are forecasted to see a drop in their current account balances for 2020 as their exports become more expensive to the rest of the world.





# 4 Policy options

Not surprisingly, the analysis above points out severe vulnerabilities for most countries in SSA in both their external and domestic sectors. This creates a strong imperative for governments and development partners to respond. The plotting shows that there will be no one-size-fits-all solution: A context-specific response will be integral. How should the best course of action be decided? Here, we outline the parameters for decision-making, rather than trying to make specific recommendations.

**Key questions for a context-relevant response.** At least five dimensions set the decision-making parameters for determining what interventions to prioritise:

1. **Objectives and timeframe.** What are the policy objectives of SSA countries as they consider their response to the COVID-19 pandemic across different timeframes? We see three time horizons playing off in parallel<sup>26</sup>:
  - **Mitigation: short term.** The immediate emphasis during the pandemic is on public health (restricting movement to contain the spread of the virus), the physical and economic survival of individuals and households, and leveraging the financial sector and government to support that (e.g. digitisation and disbursement of cash relief).
  - **Recovery: medium term.** Over the medium-term horizon, the focus is on economic recovery: ensuring that individuals and households can earn and that the country can maintain or regain some macroeconomic health.
  - **Adaptation: long term.** In the longer term, individuals, enterprises and governments need to adapt to the post-COVID world – one that is likely to be more digital and driven by the local economy. Structural changes will be needed to position the country for long-term prosperity. The long-term focus is thus on building the foundations for a more resilient post-COVID-19 economy.
2. **Sector focus.** Which sectors among those discussed in Section 2<sup>27</sup> should receive priority attention, and which do not require intervention in the particular time horizon? The relative size in terms of population and GDP contribution as well as the resilience of the different sectors should be a major determinant of how governments respond. For example: A country with a large informal sector should consider the resilience of that sector very carefully in terms of the effects of lockdown measures on this sector and its input supply chains. Or: a country with a large tourism sector would pay particular attention to this sector and how to repurpose it domestically, while a country with a high commodity export dependence would consider the diversification of the economy as an adaptation priority.
3. **Levers.** What is the suite of potential interventions that government or development partners can implement? For example, a national government may extend lockdown measures or not, provide social cash transfers or implement sector-specific industrial policy, whereas a development organisation may provide grants to Tier II financial institutions or implement value chain digitisation measures and digital skills training to assist with adaptation. The suite of options will differ depending on the time horizon.

26 All three horizons should be considered from the outset, as even policy options for longer-term effect need to be initiated already in the short term.

27 The formal sector focusing on the domestic or foreign market, respectively, the smallholder or commercial agricultural sector, informal businesses, the financial sector or the government sector.

For example:

	Indicative policy options
<b>Mitigation</b> (short term)	<ul style="list-style-type: none"> <li>Using the imperative for social distancing to encourage a move to remote (digital) services</li> <li>Providing cash relief to households and businesses</li> <li>Keeping the informal and subsistence agriculture sectors functioning by ensuring that their supply chains are not disrupted</li> <li>Maintaining civil service salaries for the ripple effect on the economy<sup>28</sup></li> </ul>
<b>Recovery</b> (medium term)	<ul style="list-style-type: none"> <li>Stimulating the economy through tax-relief, government spending or borrowing – depending on the fiscal “runway” of government, this may require multilateral assistance</li> <li>Supporting local economic development, with particular emphasis on informal sector ecosystems and the emerging digital economy</li> <li>Support access to funding for informal sector players/entrepreneurs by supporting liquidity for Tier II financial institutions</li> </ul>
<b>Adaptation</b> (long term)	<ul style="list-style-type: none"> <li>Enabling environment changes to promote endogenous growth in a post-COVID-19 economy</li> <li>Investing in mass skills training to support shifts to new (digital) industries</li> <li>Manage financial sector knock-on effects of the pandemic</li> </ul>

**Table 1: Indicative policy options over time**

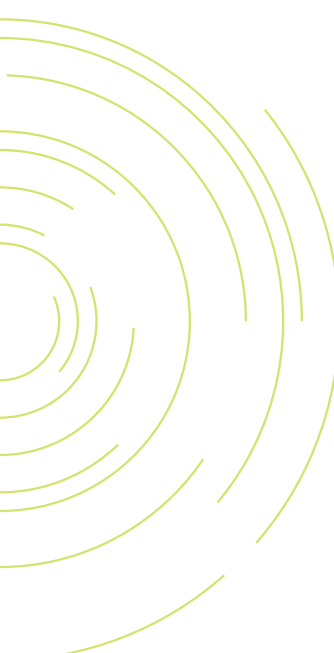
Source: Authors' own

- 4. Constraints.** What are the parameters for, or constraints to, interventions set by the positioning of the country on the spatial plotting in this note, i.e. by its external position, government's fiscal position, the competitiveness of the domestic economy and the relative size of the informal sector? What context-specific constraints or determinants are added to this? For example:
  - The pre-existing economic structure of the economy
  - The current level of digital exchange in the economy and the ability to digitise further
  - The productivity of the agriculture sector, with an emphasis on domestic food production capacity
  - The availability of multilateral financial support in response to the crisis
- 5. Funding instruments.** Policy implementation requires resources. All governments are experiencing a reduction in revenue due to economic contraction. Sources of funding include domestic savings and investments, domestic debt, foreign debt, multilateral loans, overseas development assistance, private foreign remittances and fiscal revenue, all of which will be impacted by the pandemic.

**Cluster application.** The most feasible policy options across these parameters will differ between clusters, depending on the features of that cluster. So, for example:

- The economic vulnerability and compromised fiscal position of countries in **Cluster 1** mean that there is not much scope for government-provided humanitarian support or for trade policy to alleviate the external shocks. This highlights the acute costs of lock-down policies to the economy and a need for keeping supply chains to the informal and subsistence agricultural sectors operational. It also implies an imperative for overseas development assistance and remittances as external injections of liquidity, while working towards structural changes needed to reduce current account vulnerability and improve the creditworthiness of the government in the adaptation phase.

<sup>28</sup> Via the spending power of the formally employed, plus transfers to family and friends.



- Economies in **Cluster 2** are in a better position to respond to business continuity or stimulus measures. The weak current account position highlights the need to keep remittances flowing as a lifeline to individuals and the economy in the mitigation and recovery phases. In the adaptation phase, debate is required on which sectors to prioritise for structural change to lower the current account deficit and build the competitiveness of the economy. The digitisation of the economy – including the informal sector – may warrant specific attention, as the case of Rwanda illustrates.

## Box 2. The pandemic as trigger for digitisation – the case of Rwanda<sup>29</sup>

### Pre-COVID-19: Policy emphasis on digitisation

Despite its small size, Rwanda has distinguished itself as a country that has “bet big” on digitisation as means to accelerate growth and reduce poverty<sup>30</sup>. Economic growth exceeded 10% in 2019, driven mostly by large public investments for implementation of the National Strategy of Transformation, which has also led to improvements in the competitiveness of the economy. Rwanda gained eight places on the global competitiveness index between 2018 and 2019, making it one of the top competitiveness “climbers” globally<sup>31</sup>.

### Vulnerability to the effects of the pandemic

Nevertheless, as a Cluster 2 country, Rwanda’s dependence on the external sector made it vulnerable to the global effects of COVID-19. This is driven by a high reliance on ODA (12% of GNI for 2018), tourism (26% of exports in 2019<sup>32</sup>) and coffee (27% of exports in 2017<sup>33</sup>). The result is mounting balance of payments and fiscal pressures, which, according to the World Bank, could negatively impact the provision of public health services to respond to COVID-19<sup>34</sup>. According to the IMF World Economic Outlook, the current account deficit is projected to increase from around 10% in 2019 to more than 16% in 2020.

### Mitigation and recovery

The Rwandan authorities responded promptly to provide **food relief**, ease repayment conditions on borrowers, support small businesses and provide an extended loan facility and other measures to commercial banks. This was in part made possible through the approval of **emergency credit by the IMF** to help cushion the effects of the pandemic. **Other social protection measures** are in the pipeline as part of the Economic Recovery Plan.

### Adaptation

Importantly, government also instituted measures that, while providing immediate benefits as part of the mitigation response, already serve the broader adaptation imperative. Notably, as part of its digitisation drive, it instituted **zero charges** on mobile money transfers and lifted the maximum transactions possible using this means of payment. The results have been astounding. The number of unique subscribers sending a P2P transfer doubled from 600,000 in the week before lockdown to 1.2 million in the week after lockdown. In the final week of April, 1.8 million individuals sent a P2P transfer. Digital transactions at merchants have also ballooned. From mid-February to mid-April, the weekly value of funds being spent digitally at merchant outlets has increased 700%<sup>35</sup>.

29 For a case study example outside of SSA, see Appendix 1, which outlines the growth and digitisation experience of Vietnam.

30 <http://documents.worldbank.org/curated/en/912581580156139783/pdf/Rwanda-Economic-Update-Accelerating-Digital-Transformation-in-Rwanda.pdf>

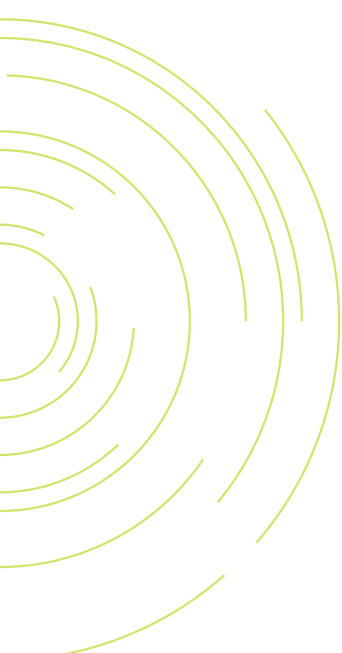
31 [http://www3.weforum.org/docs/WEF\\_TheGlobalCompetitivenessReport2019.pdf](http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf)

32 <https://data.worldbank.org/indicator/ST.INT.RCPT.XP.ZS>

33 <https://set.odii.org/wp-content/uploads/2020/04/Economic-impacts-of-and-policy-responses-to-the-coronavirus-pandemic-early-evidence-from-Rwanda.pdf>

34 <https://www.worldbank.org/en/country/rwanda/overview>

35 <https://cenfri.org/articles/covid-19s-impact-on-mobile-money-in-rwanda/>



Government has also implemented a number of sector-specific initiatives. For example:

- In the construction industry, the City of Kigali is now using a new digital system dubbed the electronic Building Permit Management Information System (eBPMIS) to make it easier and faster to process construction permit applications. The city has also introduced a product it calls The Package Service, which offers a number of services under one application, including applying for electricity, water and a certificate for Environmental Impact Assessment. Additionally, a live chat system is being used to allow immediate communication in case of an issue with building permits and/or any other services the city offers.
- Rwanda is investing heavily in education technology – to facilitate online learning during the lockdown phase, but also more broadly to boost digital skills development for the longer-term priority on the digitisation of the economy<sup>36</sup>.

- It is important to consider the specific country context when planning interventions for **Cluster 3** countries, as measures need to be designed according to the potential of the domestic economy, which in turn will depend on the sector composition. Where the formal economy is less likely to respond to stimulus measures, it may be more impactful to support resilience in the informal sector. In designing adaptation interventions for a specific country, it is important to be on the lookout for food security concerns or specific high export dependencies. As with Cluster 2, remittances can be an important source of foreign exchange and can play a direct role in supporting livelihoods in the mitigation and recovery phases.
- Governments in **Cluster 4** should have the fiscal space to implement some stimulus measures. The domestic economy has the potential to recover and to use the crisis as a push for innovation towards adaptation. Comparatively low reliance on subsistence agriculture may mean that livelihoods are more starkly affected by lockdown measures and the expected economic downturn, so household support would be needed as part of the recovery package. More broadly, the focus would lie on getting economies back to work in the mitigation phase, to support businesses to innovate and digitise in the recovery phase and making the economy more competitive as an adaptation goal.

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<sup>36</sup> <https://www.worldbank.org/en/topic/edutech/brief/how-countries-are-using-edtech-to-support-remote-learning-during-the-covid-19-pandemic>



# 5 Conclusion

This note clustered countries in SSA across three dimensions: (i) external sector vulnerability, (ii) the ability of governments and the private sector to raise capital from abroad to respond to the impacts of the pandemic, and (iii) the ability of the economy to respond – across both the formal and informal sectors. It is intended as a working input for engagement and debate, rather than an exhaustive framework.

While the expected impact is severe across SSA, all countries will in some way see through the crisis to face a post-COVID-19 world. The cluster findings highlight that one should not only focus on mitigation and recovery in the face of the pandemic. Rather, the crisis creates a strong imperative for longer-term adaptation to the world after COVID-19. This would require policymakers and development partners to focus on the structural challenges that correspond to the plotting of a particular country across the three dimensions, as well as the proactive measures needed to build a strong, diverse and digitised local economy.

While we venture some indicative options appropriate to each cluster, we cannot make any definitive policy recommendations. Ultimately, a country-level solution is needed based on the specific position of that country. This note provides a framework for positioning the parameters that will drive such a decision.



# Appendix:

## Vietnam case study

Vietnam's transformation from one of the world's poorest countries in the 1980s to middle-income status by 2010 is celebrated globally. In 1986, the Doi Moi reforms opened the economy and attracted high levels of foreign investment. Since the 1990s, Vietnam has achieved among the world's fastest GDP and GDP per capita growth rates. This growth has been remarkably inclusive, with millions being lifted out of poverty.<sup>37</sup>

### Pre-COVID situation

**Already competitive.** With comparatively cheap labour, a young population and an open investment climate, Vietnam is often seen as a good alternative for mass production in China.<sup>38</sup> Between 2018 and 2019, Vietnam moved up 10 ranks in the Global Competitiveness Index, the second-highest rank move out of all countries.<sup>39</sup>

**External sector vulnerability.** A notable trait of the Vietnamese economy since its accession to the WTO in 2007 has been its substantial and increasing interconnection with the global economy. Two of the major drivers of growth and development have been: (i) the level of FDI, and (ii) the country's capacity for export. Indeed, a large chunk of the FDI has been directed towards export-heavy sectors. For instance, the manufacturing sector, which is largely aimed at exports, accounted for about 57% of the total registered FDI in 2019. The emphasis on FDI and exports has, however, also made the economy susceptible to the impacts of the pandemic on the external sector, driven by a projected drop in consumption in Vietnam's main export destinations.<sup>40</sup>

### COVID response

Vietnam was able to effectively manage the spread of the pandemic, with limited infection numbers. By June 2020, the country had only 335 reported cases and no deaths, and lockdown and social distancing measures had all but been lifted<sup>41</sup>. Nevertheless, the economy has suffered a severe setback, with many jobs affected and GDP growth (while still expected to be positive) forecasted to reach its lowest level since 2010.

### Mitigation and recovery

**Fiscal measures aimed at business stimulus.** Government responded immediately by introducing a fiscal support package to the tune of 3.6% of GDP – including tax deferment, cutting or exempting various fees and charges and public investment disbursements. The emphasis of the fiscal measures has therefore been on business stimulus via an improved enabling environment. Monetary policy was also used to cut interest rates. In this way, the mitigation and recovery measures continue governments' longer-term commitment to structural change of the economy, thereby simultaneously serving the adaptation imperative.<sup>42</sup>

37 <https://research.csiro.au/aus4innovation/foresight/>

38 <https://www.dw.com/en/coronavirus-vietnam-upbeat-about-economic-recovery/a-53531222>

39 [http://www3.weforum.org/docs/WEF\\_TheGlobalCompetitivenessReport2019.pdf](http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf)

40 <https://www.pwc.com/vn/en/publications/2020/pwc-vietnam-covid-19-vietnam-economy-and-export.pdf>

41 <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>

42 Ibid



## Adaptation

**Adaptation through digital transformation.** More broadly, the Vietnamese Government has continued its emphasis on digital transformation as anchored in the National Strategy on Digital Transformation for 2021–2025. It has further expanded its e-government platforms<sup>43</sup>, which have been a driver of substantial efficiency gains in the economy. The prime minister also recently mandated a move to digital signatures<sup>44</sup> and authentication on all e-government portals. The pandemic therefore triggered leapfrogging progress in digital transformation: The rate of online transactions in public services increased from 12% to 24% during the two-month lockdown<sup>45</sup>.

**Efficiency gains.** In line with the Government's broader emphasis on enhancing efficiency in the economy, it has also moved fast to reduce red tape and fees and put in place the infrastructure for rapid digitalisation and promotion of e-commerce:

- Ministries have removed and simplified 3,451 out of 6,191 business conditions, and they have reduced 6,776 out of 9,926 categories of goods subject to specialised inspection. This is estimated to save 18 million working days per year, equivalent to over VND6.3 trillion (USD271.24 million) annually.<sup>46</sup>
- The National Payment Corporation of Vietnam slashed the electronic switching fees for local banks.<sup>47</sup>
- The Government developed new software to prevent and fight COVID-19, including expedited commercialisation of 5G.<sup>48</sup>
- The Government is developing e-commerce infrastructure, including a national e-commerce payment system, an online management system for order and delivery services, an electronic invoice system for online sales transactions, a corporate prestige rating system in e-commerce and an electronic authentication system.<sup>49</sup>

The results have been remarkable. Vietnam is among the fastest-growing e-commerce markets in the world with an annual growth rate of 35%. The pandemic did not cause these reforms; rather, it provided renewed emphasis for acceleration of existing policy plans.

**Emphasis on education.** Education has been a cornerstone of the economic transformation achieved in Vietnam. There is a strong emphasis on building tech skills. For example, through a public-private partnership with Microsoft, relevant government ministries have increased digital skills training, created a new ICT curriculum, and promoted digital inclusion for rural students and ethnic minorities. This emphasis on education is continuing through the pandemic: **e-learning** and distance learning were successfully implemented and the Government is organising e-commerce training programmes in conjunction with large domestic and foreign e-commerce businesses.<sup>50</sup>

## Conclusion

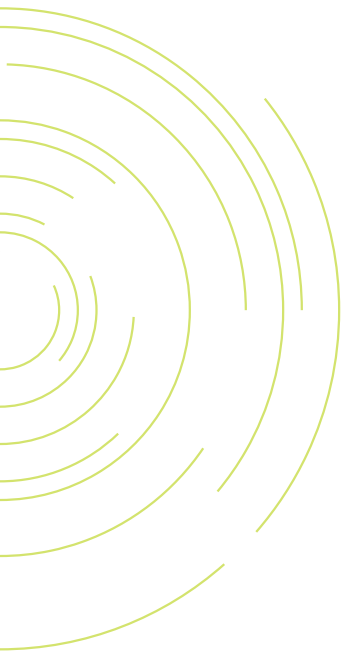
Vietnam provides a powerful demonstration case of how a committed and agile government can leverage mitigation and recovery measures for longer-term adaptation of the economy in line with its existing policy objectives.

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- 43 <https://vietnamnews.vn/economy/538398/e-commerce-key-area-of-the-digital-economy-says-expert.html>
- 44 <https://www.opengovasia.com/vietnam-to-unveil-national-strategy-on-digital-transformation-2020/>
- 45 <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>
- 46 <http://hanoitimes.vn/vietnams-efforts-towards-e-government-to-help-contain-covid-19-pm-301041.html>
- 47 <https://en.vietnamplus.vn/central-bank-asks-for-cut-in-electronic-fund-transfer-fees/171059.vnp>
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- 49 <https://en.vietnamplus.vn/vietnams-e-commerce-market-to-rocket-to-13-billion-usd-in-2020/166718.vnp>
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#### **About Cenfri**

Cenfri is a global think tank and non-profit enterprise that bridges the gap between insights and impact in the financial sector. Cenfri's people are driven by a vision of a world where all people live their financial lives optimally to enhance welfare and grow the economy. Its core focus is on generating insights that can inform policymakers, market players and donors seeking to unlock development outcomes through inclusive financial services and the financial sector more broadly.