Changing Sub-Saharan Africa's Growth Trajectory

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Context

At Bridgewater, we have spent nearly 50 years mapping out the cause-and-effect linkages that underpin the world's economies and markets, from shorter-term drivers like credit cycles to longer-term ones like productivity, demographics, and debt cycles. That mapping helps us understand where the world is going, which we use to advise our clients and manage investment portfolios. It also helps us see how different decisions—by policy makers, businesses, consumers, etc.—could send us down alternative paths.

Today, global demographic disparities are creating significant ripples. Over the coming decades, this will only become more pronounced as most countries face aging and declining populations. In contrast, Sub-Saharan Africa's population is projected to explode. While Africa's population boom will increase growth in the region, absent a change in the current trajectory, high poverty levels will persist. This means that an ever-growing share of the world's population will be left behind, creating larger and larger ripples across the rest of the world.

To change this trajectory, developed economies need to dramatically increase financial support for the region and the private sector needs to increase allocations, which will require action by policy makers in the region and in developed economies. Both are critical complements to efficient domestic resource mobilization, and both are required to adequately address the infrastructure gaps that are a frustrating headwind to the region's economic outlook.

Mobilizing those resources will be challenging. Most developed economies face difficult fiscal backdrops and rising populism, and significant private sector action is unlikely unless it is first incentivized by public sector action. Failing to do so, however, would be incredibly shortsighted and would have second- and third-order consequences across the globe.

While this will play out over the coming decades, a key litmus test is whether policy makers increase their allocations to the International Development Association as part of this year's replenishment. The World Bank is aiming for a modest—though, given the circumstances, ambitious—increase to the program to expand its support of development goals, such as funding healthcare, building core infrastructure, and expanding energy access, including making electricity accessible to an additional 300 million people on the continent by 2030. We are committed to supporting these efforts, and in partnership with Global Citizen and Harith General Partners, we will be convening global leaders and policy makers, private investors, and the World Bank team at the Economic Development Assembly in Abidjan in October to discuss the necessity of rising to this moment.

We gratefully acknowledge the contributions and thought partnership of Harith General Partners, whose insights and regional expertise played a meaningful role in the production of this research.

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Executive Summary

- **A huge demographic transformation is coming in Sub-Saharan Africa.** The population will boom in the region as it stagnates elsewhere. In the coming decades, the region will grow from 10% to 25% of the global working-age population. **(See pages 4–5)**
- **How that plays out will be a big driver of economies and geopolitics over the coming decades.** Ideally, the region gets on a steeper productivity path and becomes an engine of global economic growth. However, the region's path is currently closer to one of anemic economic development, which will result in a growing share of the world being left behind, and cause ripples in the region and globally. **(See pages 6–8)**
- **While there are a lot of dimensions to the challenges the region faces, it is clear to us as investors that changing the region's trajectory will require addressing the infrastructure and human capital gaps, which means (a) raising the amount of investment in the region and (b) creating a virtuous investment cycle** (i.e., ensuring that investments generate returns in excess of cost). Currently, the amount of investment is inadequate, and such a virtuous cycle is generally not playing out—e.g., debt levels and debt service are outpacing growth in output and productivity. **(See pages 9–13)**
- **Attracting international private capital has major potential to help close the funding gap, but there are big barriers to that happening at scale.** The potential pool of foreign investors is massive, but allocations are currently small. The key barriers are high perceived risk (political, currency, default, etc.), underdeveloped core infrastructure and capabilities (institutions, physical infrastructure, etc.), and immature capital markets (limited investability, low liquidity, etc.). We are watching these barriers closely—they are evolving over time and vary significantly across the region (for instance, several of the bigger economies are already feasible destinations for high-risk, medium-to-long-horizon private investment in infrastructure, PE, or even VC). Lowering these barriers is an active forward-looking area of focus for the World Bank (e.g., their Private Sector Investment Lab) and policy makers as they push to "crowd in" more private capital. How that materializes bears watching by international investors. Beyond high growth, the region has the potential to offer diversification to typical global portfolios, and it is a good destination for investors prioritizing development goals (though allocations would be small unless or until the markets grow). **(See pages 14–19)**
- **There is huge variation among the many countries and regions of Sub-Saharan Africa, and there is no one-size-fits-all answer.** While low productivity, insufficient investment, and high debt burdens are prevalent on average, there are countries where these dynamics do not apply, and the degree of these challenges varies materially. Moreover, the appropriate investments and policies also vary depending on local dynamics, including politics, history, natural resource distribution, and many others.
- **Multilateral development banks (MDBs) have a big role to play in achieving these goals, both through their direct financing actions and in helping to create the right conditions for private flows.** Development banks direct investment flows at high ROI projects in the region, particularly more foundational projects that either (a) are too risky for private investors or (b) don't generate reliable cash flows to incentivize the private sector, and they do so at favorable terms that avoid exacerbating debt burdens. The size of their lending pool is ultimately reliant on financial support from donor countries (with the associated budget and political constraints), though we believe the long-term "return" on such commitments is significant and spending on official development assistance (ODA) remains a small share of developed world budgets (well under 1% of GDP in most countries). Expanding the size of MDBs, including a strong replenishment of the International Development Association (IDA) this year, makes sense. MDBs can help lower the major barriers to larger international private capital flows by (a) financing core infrastructure, such as energy initiatives, and the development of human capital, (b) helping create the regulatory certainty and the right policy frameworks, and (c) helping the private sector manage and insure against political, currency, and other macro risks. **(See pages 20–24)**

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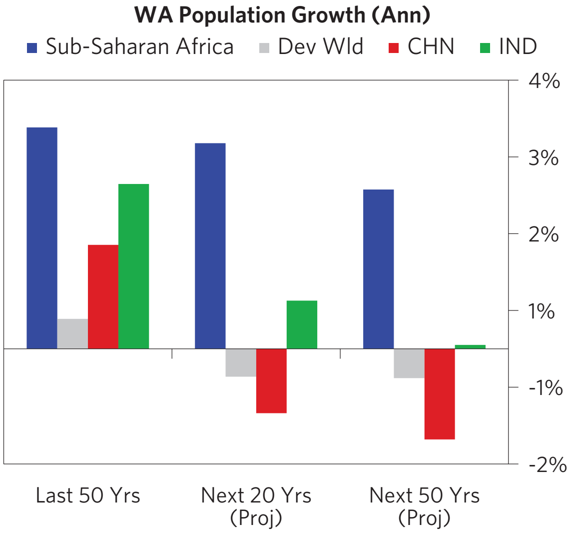
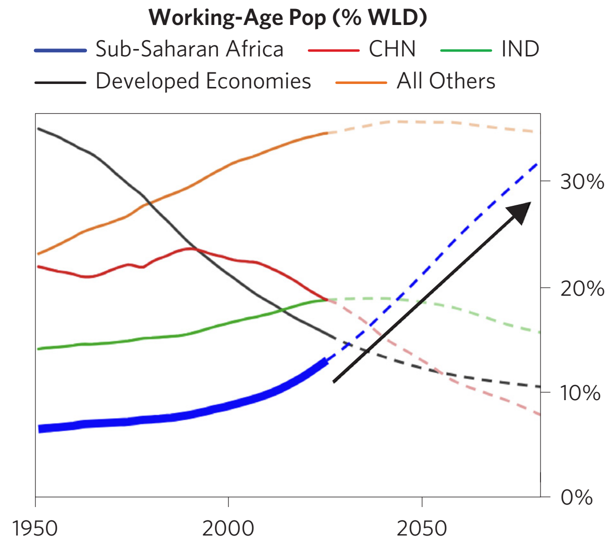
- **There are four big things we are watching to see if and how the investment and development trajectory of the region shifts.** First is the trajectory of productivity and the return on investments that are made, including how policy and governance evolve. Second is how hard-currency debt burdens are resolved (and whether overstretched countries undergo fast and orderly restructurings without long-term growth drags or inflationary spiral dynamics). Third is if new policies, investment structures, or growth strategies emerge that can reduce the barriers to investing in the region (and, accordingly, whether there is a pickup in interest from major investors to allocate to the region). Fourth is how the role of MDBs develops (starting with IDA replenishment this year) and how the reforms they are undertaking improve the scale and effectiveness of their financing. **(See page 25)**

Big Demographic Shifts

Sub-Saharan Africa's working-age population is booming. This is happening as the population in most of the rest of the world is flat or declining (especially for people of working age). As a result, the region will account for a quarter of the world's working-age population in a few decades and have more people of working age than China in about 10 years. The economic context in which this population surge plays out will have huge consequences for the world in the coming decades.

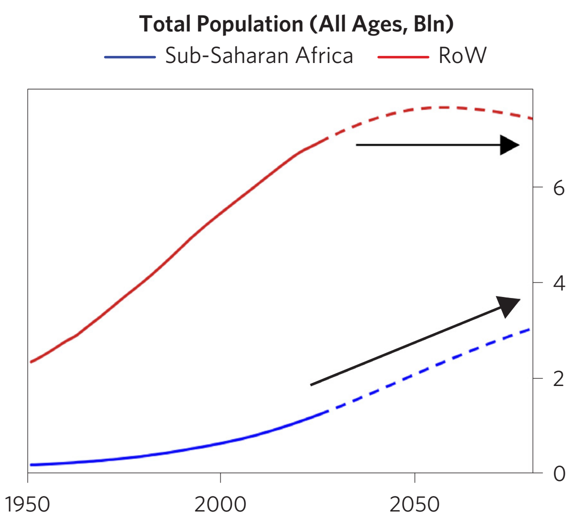


The working-age population is projected to grow at 2%+ in Sub-Saharan Africa and shrink in China and most developed economies

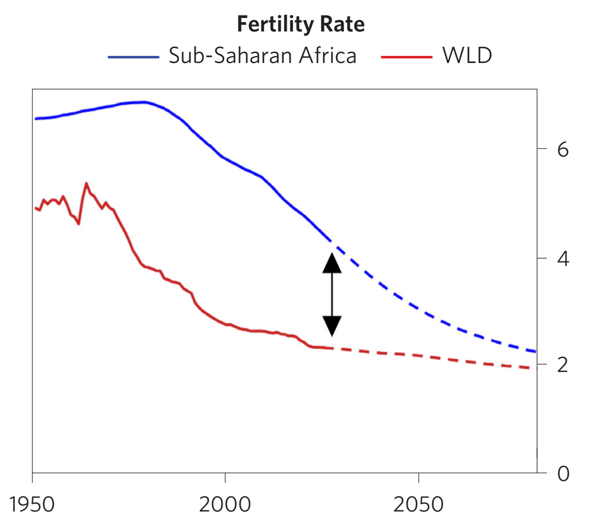


The region's share of the world's working-age population is starting to rise rapidly and will be larger than China's in about a decade

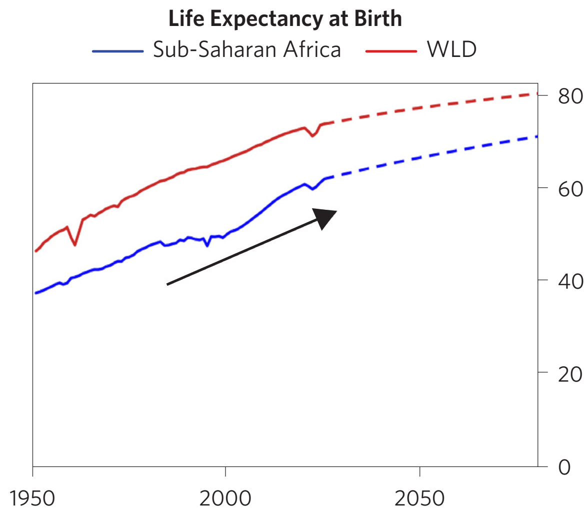
This rapid growth reflects the combination of a fertility rate that is much higher than that in any other region and rising life expectancies, especially as a result of declining infant mortality rates. Moreover, the share of the region's population that is of working age is rising rapidly (while falling in the rest of the world). Its median age is just 18, well below the global median of 31.



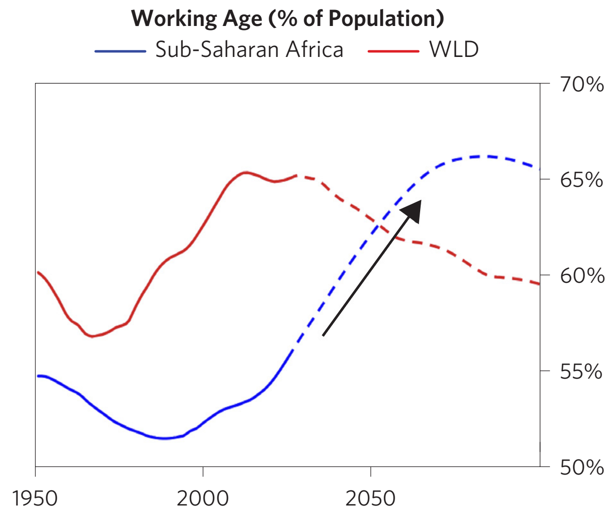
Sub-Saharan Africa accounted for about a quarter of the growth in the world's population over the last 50 years; over the next 50 it is projected to contribute three-quarters of the growth



Though declining, fertility rates remain higher than they are in the rest of the world



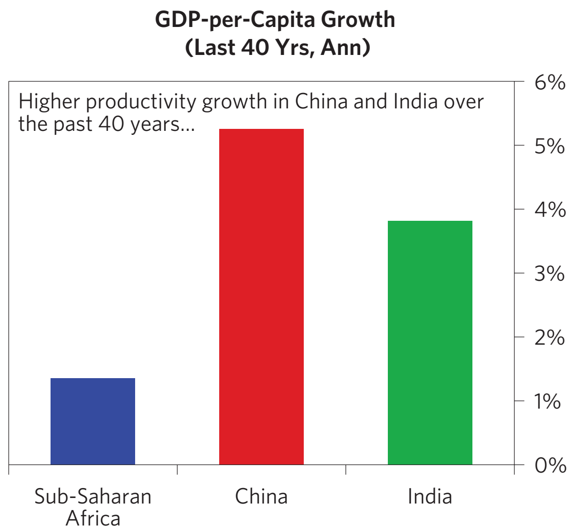
Life expectancy is rising (off a lower base than the global average)

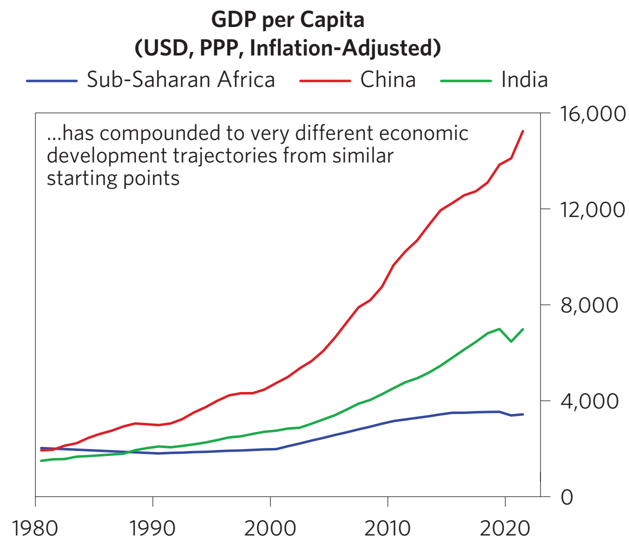


The region's population is increasingly of working age

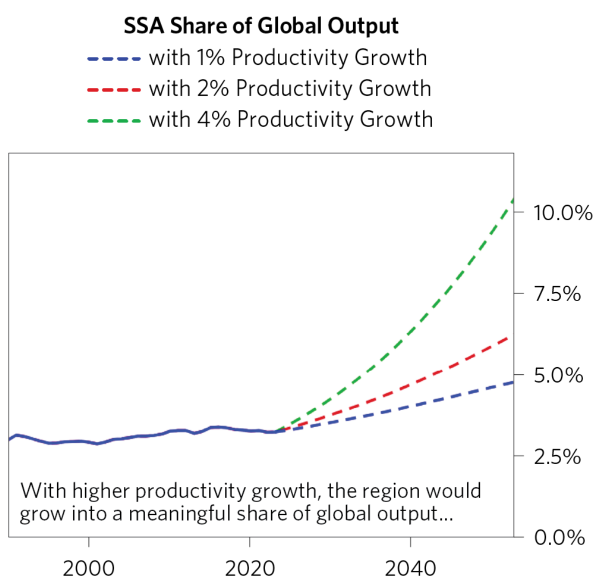
Development Trajectories

The economic context in which this demographic shift plays out will have huge consequences for the world in the coming decades. Looking back over the past 40 years, GDP per capita in Sub-Saharan Africa has been relatively flat, and it has not experienced the same upward swing in development, productivity, and standard of living as other major emerging population centers (notably China starting around 1980, and then in more recent decades, India).

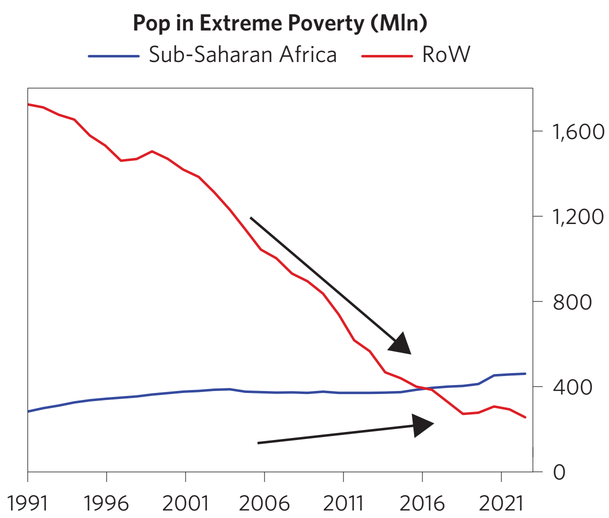




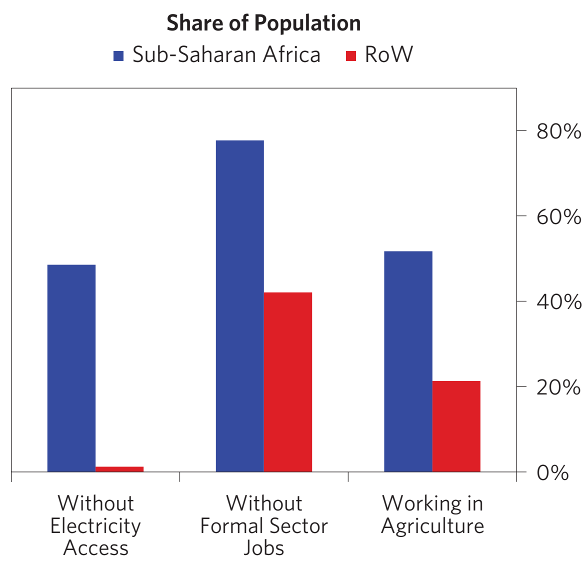
Looking forward, **if this demographic explosion can be accompanied by the big pickup in productivity and development that has played out elsewhere, Sub-Saharan Africa will become the next major engine of global growth**. Currently, Sub-Saharan Africa accounts for just 3% of global output and around 5% of global growth. That will likely increase based on demographics alone. But if the region raised its productivity growth to 3–4% (similar to that of India) for the next 25 years, its share of global output would grow to around 10% and its share of global growth would grow to around 20%.



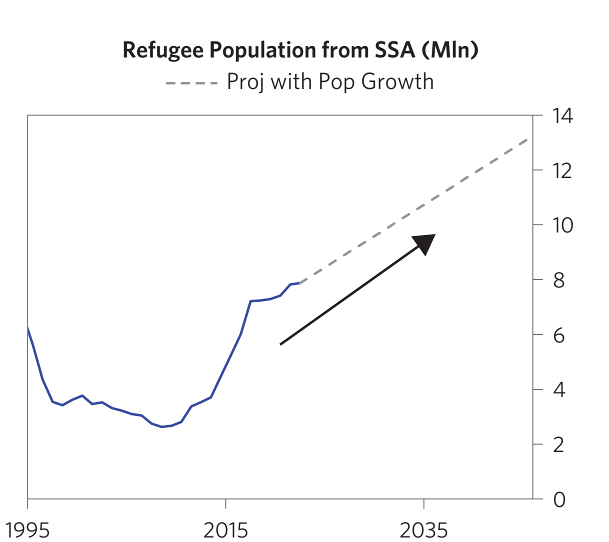
On the other hand, **if the region remains as undeveloped as it is today, the significant increase in population will result in a growing share of the global population being left behind.** Today, incomes in the region remain low, food insecurity is relatively widespread, and as much as 80% of employment is in the informal sector. About half a billion people in the region live in extreme poverty (a majority of the world's remaining extreme poor).

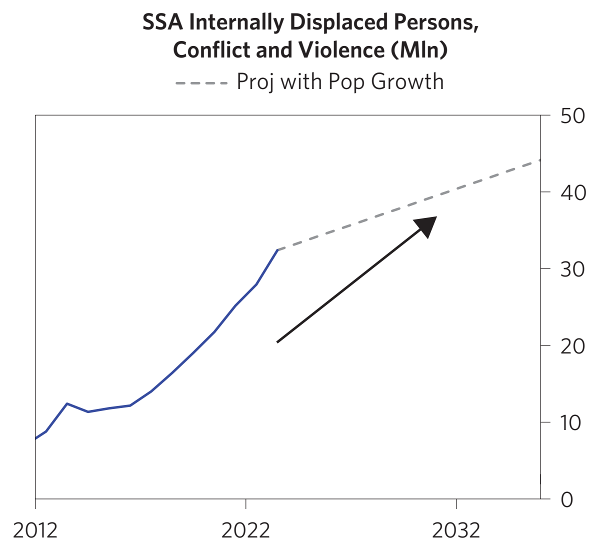


For the past 30 years, extreme poverty has dramatically fallen in most of the world, with Sub-Saharan Africa as a major exception

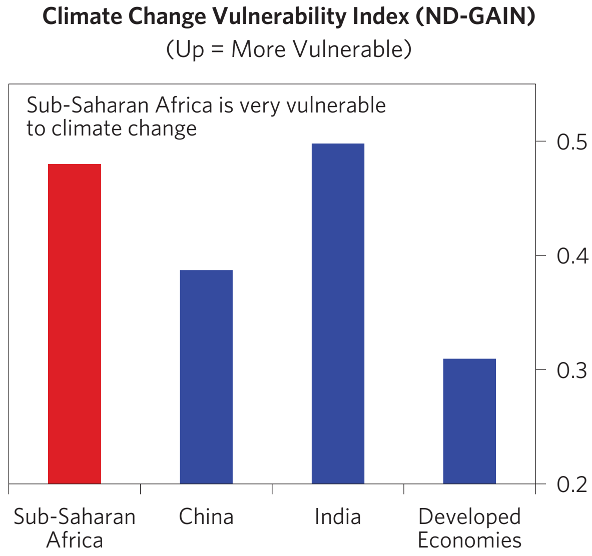


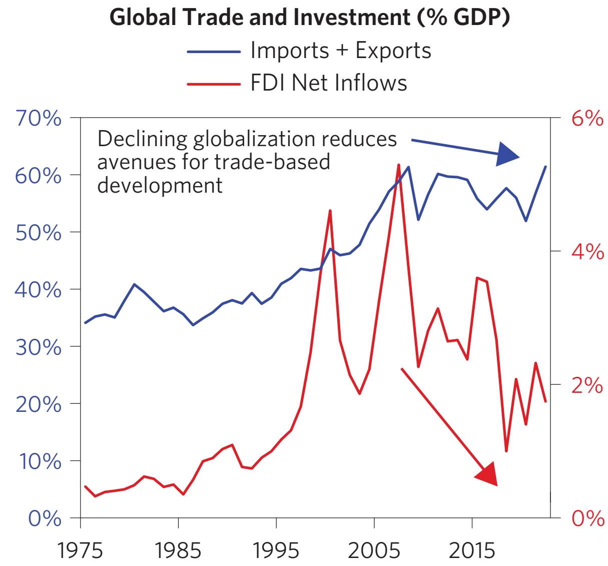
A rapidly growing young population without economic opportunity would have significant geopolitical consequences. Rising inequality, both within and across countries, is a major driver of populism and conflict. These dynamics have already been significant drivers of migration, largely within Africa and to Europe (where migration from Africa and other regions has had meaningful knock-on effects on European politics). These pressures are also drivers of political instability within the region.





Global trends such as rising climate risks, deglobalization and onshoring, and the rise of AI all raise the urgency and stakes here. Climate shocks will likely continue to increase in frequency and intensity, and Sub-Saharan Africa is one of the most vulnerable regions. The flattening and reversal of globalization and the push to onshoring limit the opportunity for typical manufacturing and trade-based development paths that capitalize on large, low-cost labor pools (such as those paths followed by East Asian countries). And the rise of AI increases the risk of winner-takes-all productivity boom dynamics and of countries without the infrastructure and capabilities to capitalize being left behind.





The Quality Investment Gap

Our long-term growth estimates suggest that, unless there is significant and persistent additional action, the region will not achieve the growth levels needed to meaningfully address the current imbalances. Mechanically, growth is driven by growth in working-age population and growth in output per worker (which, alongside other factors, drive incomes). Output per worker is in turn driven by productivity growth, which is in turn driven by competitiveness (cost of labor, investment levels, core infrastructure, human capital, etc.), the quality of institutions (governance, stability, innovation, etc.), and indebtedness (which impacts how much swings in credit can be a headwind or a tailwind). Applying this framework to the economies of Sub-Saharan Africa, our base case for long-term output-per-worker growth in the region is positive but low at around 2%. Combined with working-age population growth of about 3%, this yields a future growth estimate of 4.5–5.5%.

Sub-Saharan Africa Growth Estimate

Long-Term Future Growth Estimate	**4.5-5.5%**
Output-Per-Worker Growth	1.5-2.5%
Working-Age-Population Growth	2.9%

Generally speaking, the key tailwinds the region has are favorable demographics (both growing working-age population and improving dependency ratio), a large and competitively priced potential labor pool, and a great endowment of natural resources. On the other hand, the region faces headwinds from weak institutions, underdeveloped physical and human capital, less flexible and diversified economies, and high debt burdens. These are undermining the region's ability to take advantage of extremely competitively priced labor, capture the demographic dividend, and experience a pickup in "catch-up" growth.

Sub-Saharan Africa Growth Drivers

Competitiveness	
Relative Cost of Labor	**Very Bullish**
Dependency Ratio	**Very Bullish**
Investment and Savings	Neutral
Core Infrastructure (Transportation, Logistics, Electricity)	**Very Bearish**
Human Capital (Education, Healthcare, Nutrition)	**Bearish**
Institutions	
Governance (Corruption, Bureaucracy, Rule of Law)	**Bearish**
Innovation and Achievement Orientation	Neutral
Indebtedness	
Debt Levels and Debt Service Burden	**Bearish**
Monetary Policy Flexibility	Neutral

Favorable labor pricing and demographics...

...offset by insufficient investment and infrastructure, weaker institutions, and high debt burdens

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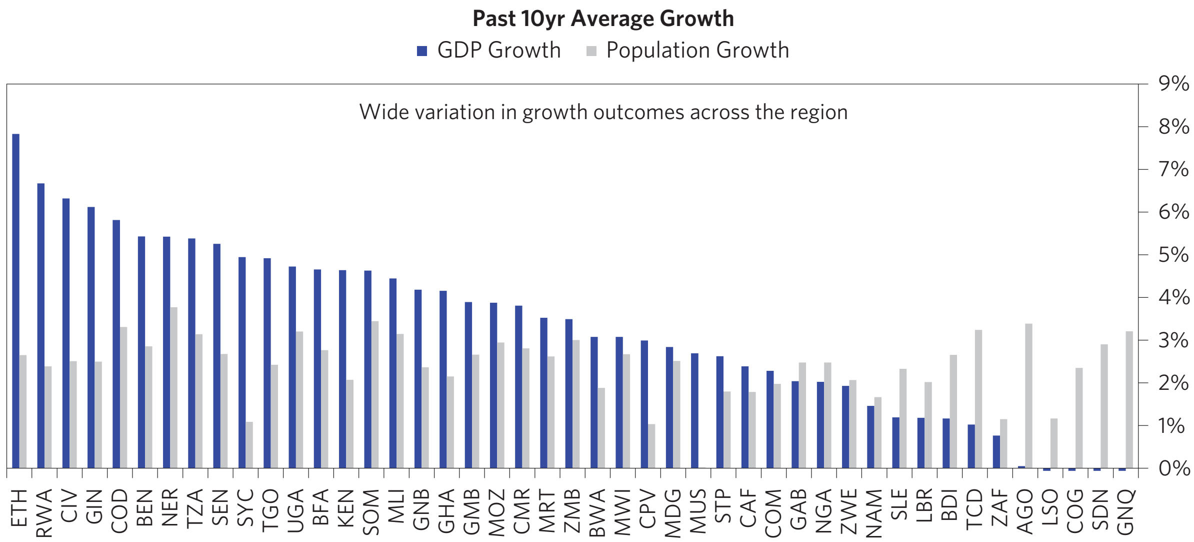
Of course, there is wide variation among the many countries of the region, and this is a description of what is true on average versus what applies to all cases (some have more versus less infrastructure, stronger versus weaker institutions, higher versus lower natural resource endowments, etc.). For instance, in terms of headline growth rates, Ethiopia, Rwanda, and Côte d'Ivoire have all been on steep development trajectories and have grown at 6% or more for the past decade. At the other end of the spectrum are several countries whose economies have barely grown or even shrunk.



While there are a lot of dimensions to the challenges the region faces, it is clear to us as investors that changing the region's trajectory will require addressing the infrastructure and human capital gaps. That means (a) closing the investment gap and (b) increasing the quality of investment. By "quality," we mean investments that will generate positive cash flows or social benefits in excess of the costs to service them (recognizing that there is also an important role for concessionary projects). This would mean the region could build needed infrastructure and develop human capital (such as education and healthcare) without taking on unsustainable debt burdens (which lead to disruptive deleveragings and restructurings).

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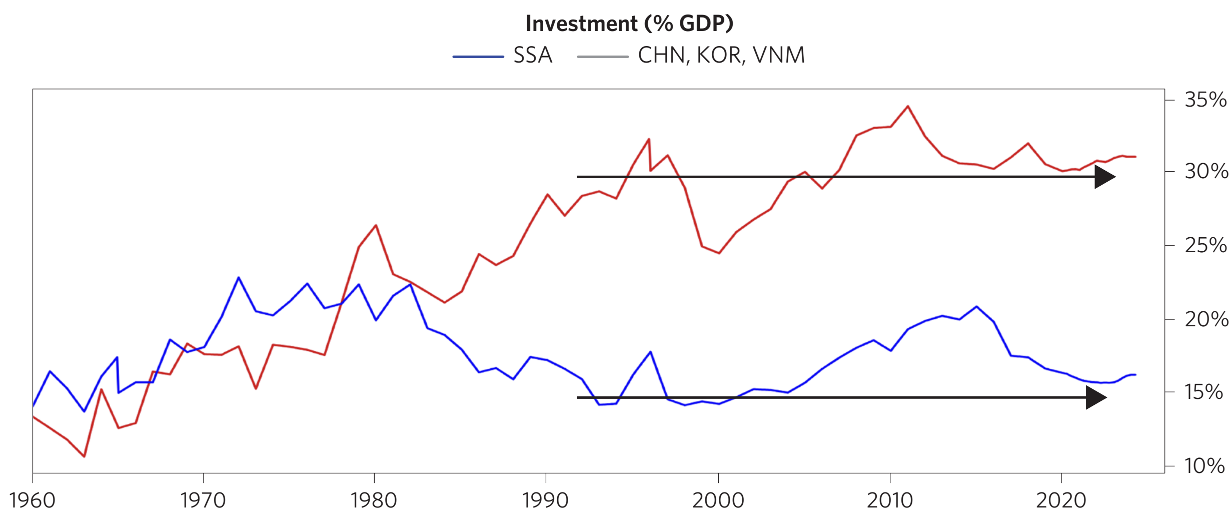
Regarding (a), the region has only about half the development financing resources needed to drive steeper, sustainable development. On the sources side, the current size of annual development financing is about 16% of GDP. Of that, about 9% comes from domestic resources, about 3% comes from multilateral and bilateral aid and lending, and about 3% comes from foreign private investment. On the needs side, our rough estimate is that the region's needs are about 30% of GDP—or 2x the current levels of investment—to achieve a much steeper development trajectory, spread across human development, core infrastructure, production, and disaster preparedness and response. There is no precision to this 2x, and as a point of reference, the range of sensible external estimates by others is 1.5–3x (a big driver of the variation in the estimates is how much climate change adaptation and mitigation spending is needed). What is very clear to us is that the levels need to rise significantly.

Estimated Available Sources of Financing (% GDP)

Domestic Sources	
Govt Revenue (ex-Debt Service and Defense)	9%
External Sources	
Official Channels	
Multilateral	1%
IDA	*0.6%*
Bilateral	2%
Private Channels	
Foreign Direct Investment	1.5%
Private Creditors	2%
Total Today	**16%**

A notable point of comparison is the East Asian growth booms. While other factors were also at play, very high levels of investment and savings (versus consumption spending) were a big driver of their growth over the past 40 years. By contrast, the investment rates in Sub-Saharan Africa were and are much lower, around only half of the amount in places like China, Korea, and Vietnam.



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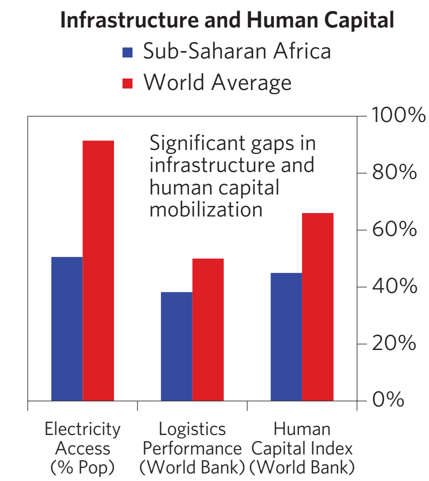
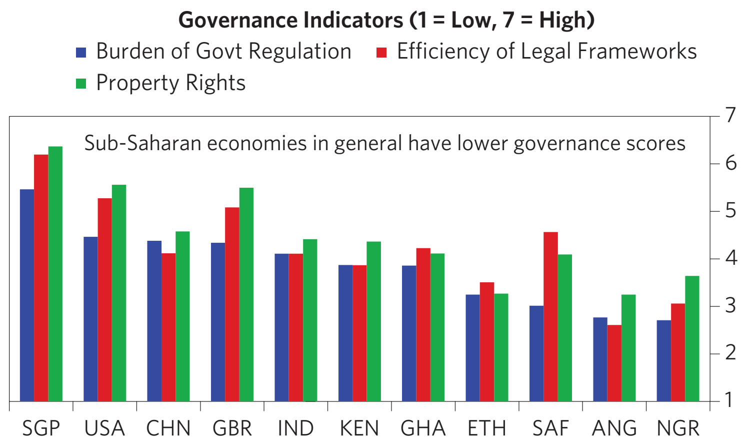
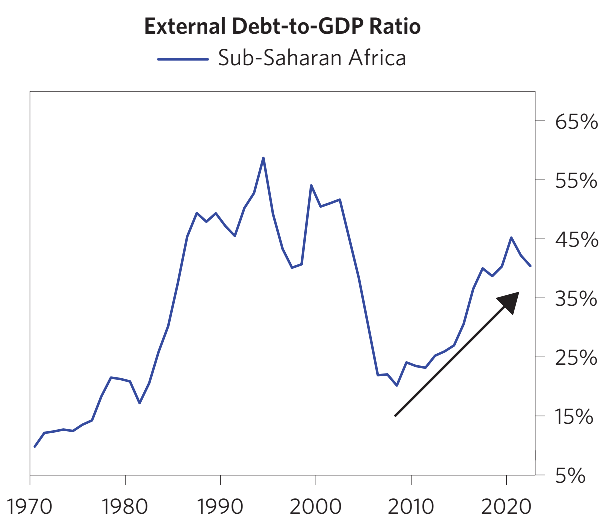
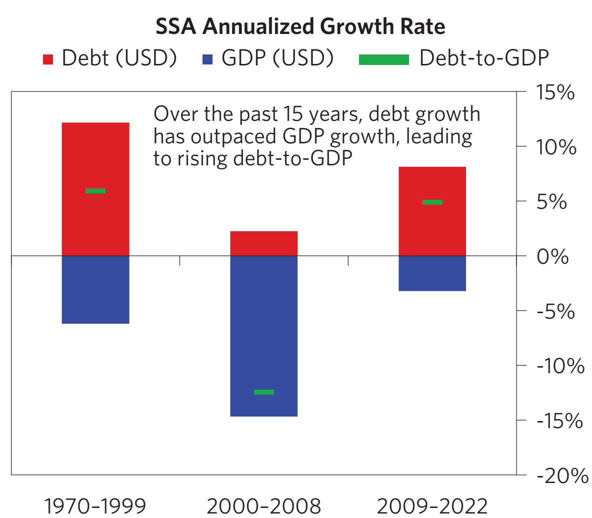
Regarding (b), increasing the quality of investment, there are frictions that undermine money flowing freely to the highest ROI investment projects and impede investing and doing business. Governance and institutions are generally weaker in the region than in middle-income countries (though there is variation), which manifests as greater risk of corruption, more bureaucracy, and weaker rule of law (such as difficulty in enforcing property rights and upholding contracts). In addition, core infrastructure and human capital is less developed, which undermines the very competitive pricing of labor (though again, there is a lot of variation by country and industry).





Moreover, debt and debt service are approaching levels that are unsustainable in many places. Debt growth is not necessarily bad. The flow of capital from savers to borrowers with high-returning opportunities is a key ingredient for growth and development (even if overall debt levels rise). What is bad is unproductive debt, which will not produce future cash flows that cover its costs. Looking at the region, over the past 15 years, debt growth has significantly exceeded output growth. As a result, debt-to-GDP (what you owe versus what you are capable of producing) has doubled and is nearing all-time highs.





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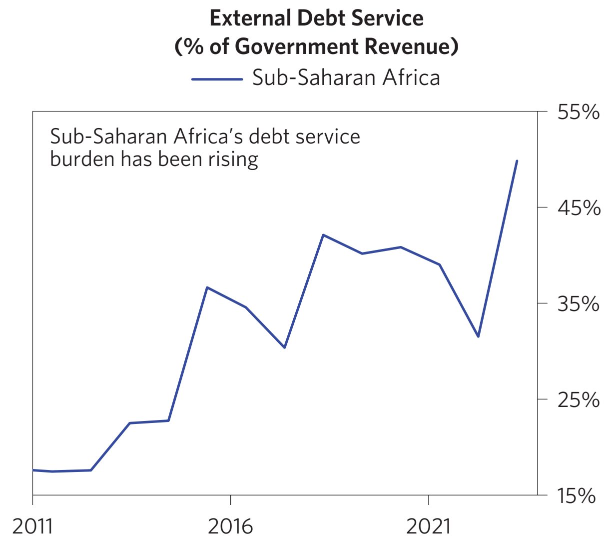
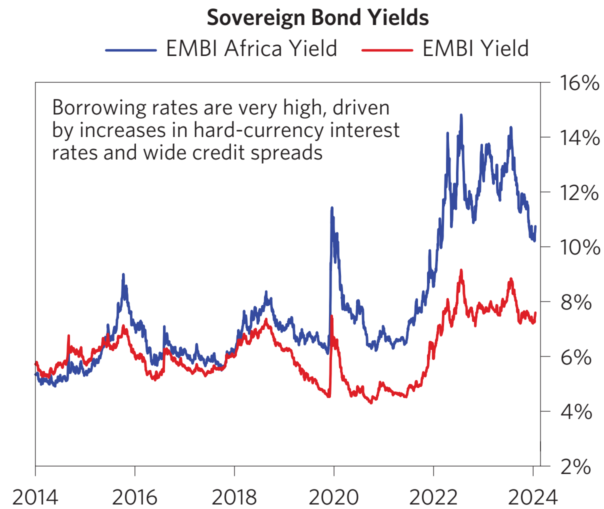
Consistent with this, external debt service accounts for almost half of government revenues, far in excess of IMF guidelines on what is sustainable (i.e., debt service that is 15–25% of government revenue) and, in many places, more than is spent on education or healthcare. Rising interest rates in the developed world have compounded this through higher hard-currency borrowing rates (reflecting the need for tighter monetary policy in places like the US but creating an undesirable headwind for Sub-Saharan African countries, many of which are barely above pre-COVID output levels). On top of that, Sub-Saharan African countries face much higher credit spreads than typical emerging market borrowers.





These pressures have come to a head in recent years. Numerous Sub-Saharan African countries are grappling with temporary liquidity challenges due to substantial interest payments, significant debt redemptions, and more limited access to international capital markets. Net flows from bilateral and private creditors have turned negative, and only multilateral creditors are providing positive net flows in several countries. Apart from increasing domestic revenues to create more fiscal space, some of these countries will likely require additional external support. Since 2020, Ghana, Zambia, and Ethiopia have all defaulted on foreign debt.

How these imbalances get resolved will be an important determinant of growth in the region in the coming years. In recent months, there has been a reduction in the restructuring timelines for ongoing cases (due to efforts of creditor committees, the Paris Club, and the work of the Global Sovereign Debt Roundtable co-chaired by the World Bank, the IMF, and the G20 presidency). Despite this progress, there is still a need for further acceleration and more predictability of these processes.

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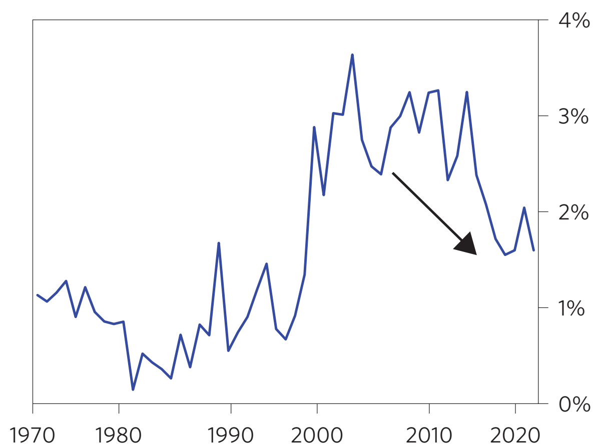
The Need for International Private Capital

Attracting international private capital has major potential to help close the funding gap, but there are big barriers to that happening at scale. The key barriers to larger private inflows are high perceived risk, underdeveloped core infrastructure and capabilities, immature capital markets, and fragmentation across the region. Lowering these barriers would not only help the region finance its development, but it would also open up a high-growth and diversifying region for international investors (albeit at small size unless or until the markets grow).

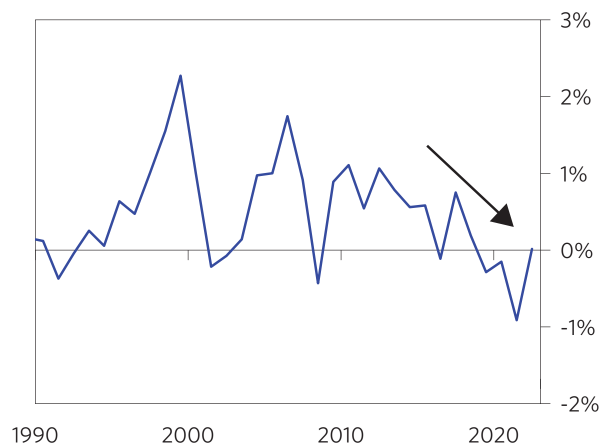
Low Inflows and High Barriers to Foreign Private Investment

The overall pot of global capital controlled by institutional investors is enormous (tens of trillions in USD), and even a very small reallocation to the region would be a huge inflow. In theory, there should be a good opportunity for capital to flow from wealthy countries to developing regions with high ROI uses. **But so far, the reality is that material private inflows are not happening.** Foreign direct investment inflows make up a low share of GDP and have actually decreased over the past decade (even in dollar terms). Similarly, foreigners invest very little in the region's public equity markets. Of course, there are pockets of exceptions (specific countries or projects), but not at the scale needed.

FDI Inflows (% GDP)



Portfolio Equity Inflows (% GDP)



There are three major kinds of barriers to investing in the region, though the degree of these varies materially by country or project and has evolved over time. First, the region has high (perceived and actual) macro risk. Currency risk (depreciation, convertibility), political risk (regulatory regime, tax regime, stability), and economic risk (growth, inflation, economic diversification) are all elevated relative to most emerging countries, and investing in the region requires understanding how to mitigate and manage them where possible (utilizing political risk insurance, managing currency exposures, etc.). Second, the region has less developed human and physical capital, and generally weaker institutions. The nature of the challenges varies significantly across countries and even specific projects, and therefore requires country-specific expertise and an on-the-ground presence to navigate. Third, the capital markets are very immature, which limits flows into both public and private markets. Outside of South Africa, public equity market capitalization is tiny, turnover is low, and the markets are not part of emerging indices, which means even public investments feel more like privates in terms of risk and liquidity, and the region is not yet a suitable destination for public passive allocations.

Barriers to Private Investment	Metrics to Assess
Macro Risk Factors	
Growth and Inflation	Inflation Level, Growth Volatility
Currency	FX Volatility, FX Depreciation, FX Policy, Reserves, Convertibility, BoP
Political, Regulatory, Tax	Governance, Transparency, Stability
Sovereign Default	Credit Rating, Credit Spread
Core Infrastructure and Capabilities	
Quality of Institutions	Rule of Law, Bureaucracy, Corruption, Political Stability
Human Development	Education, Healthcare, Human Capital Index
Physical Infrastructure	Logistics Scores, Electricity Rates
Capital Market Maturity	
Public Equity Investability	Index Categorization (No Exchange, Stand-Alone, Frontier, Emerging)
Public Market Liquidity	Free Float, Turnover, B/O Spread
Private Market Size	PE, VC, Real Estate, Infrastructure
Bank Financing	Credit Flows

There is obviously huge variation in the region. At one end of the spectrum are countries that are reasonably investable, albeit as high-risk "emerging" or "frontier" destinations. Outside of South Africa (which is already a middle-income country with developed markets in major emerging indices), Kenya and Côte d'Ivoire are large economies in the region with relatively stabilized macro conditions, relatively convertible currencies, B-range credit ratings, improving human and physical infrastructure (albeit off a low base), and stock exchanges with listed equities (albeit with very little trading activity). These are feasible destinations for high-return-seeking, high-risk, medium-to-long-horizon private investment in infrastructure, PE, or even VC or public equities, though doing so requires on-the-ground expertise and the appropriate structuring of deals (for instance, the use of political risk insurance). At the other end of the spectrum are countries where it would be harder to imagine private investors operating at scale (beyond select projects), and official channels—either direct official financing or multilateral financing—need to be the main avenue.

	Macro Risks		Core Infrastructure			Capital Markets		
Country	**Average Inflation (10yr)**	**Sovereign Credit Rating**	**Electricity Access (% Pop)**	**Logistics Index**	**Human Capital Index**	**MSCI Index Category**	**IMF Financial Index**	**Domestic Bank Credit (% GDP)**
South Africa	5%	B-Range	87%	3.7	0.43	Emerging	0.55	58%
Kenya	6%	B-Range	76%	2.8	0.55	Frontier	0.16	32%
Côte d'Ivoire	2%	B-Range	70%	3.1	0.38	Frontier	0.13	22%
Nigeria	15%	B-Range	61%	2.6	0.36	Stand-Alone	0.22	13%
Ghana	17%	Default	85%	2.5	0.45	None	0.18	9%
Angola	20%	B-Range	49%	2.1	0.36	None	0.14	8%
Ethiopia	18%	Default	55%	2.4	0.38	None	0.12	N/A
Uganda	4%	B-Range	47%	2.6	0.38	None	0.10	13%
Tanzania	4%	B-Range	46%	3.0	0.39	None	0.10	16%
DRC	12%	B-Range	22%	2.5	0.37	None	0.07	7%

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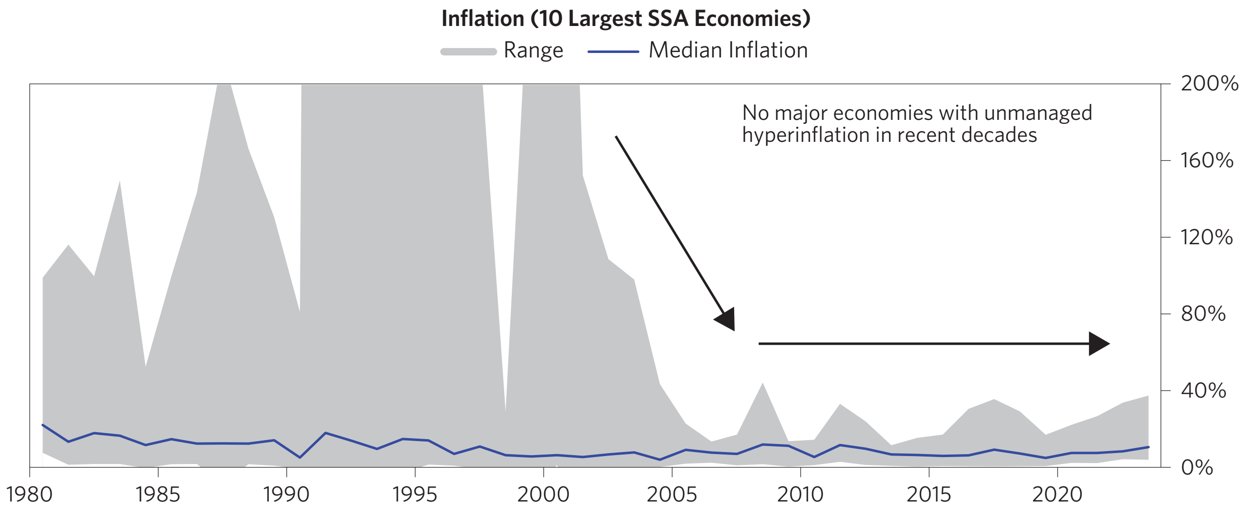
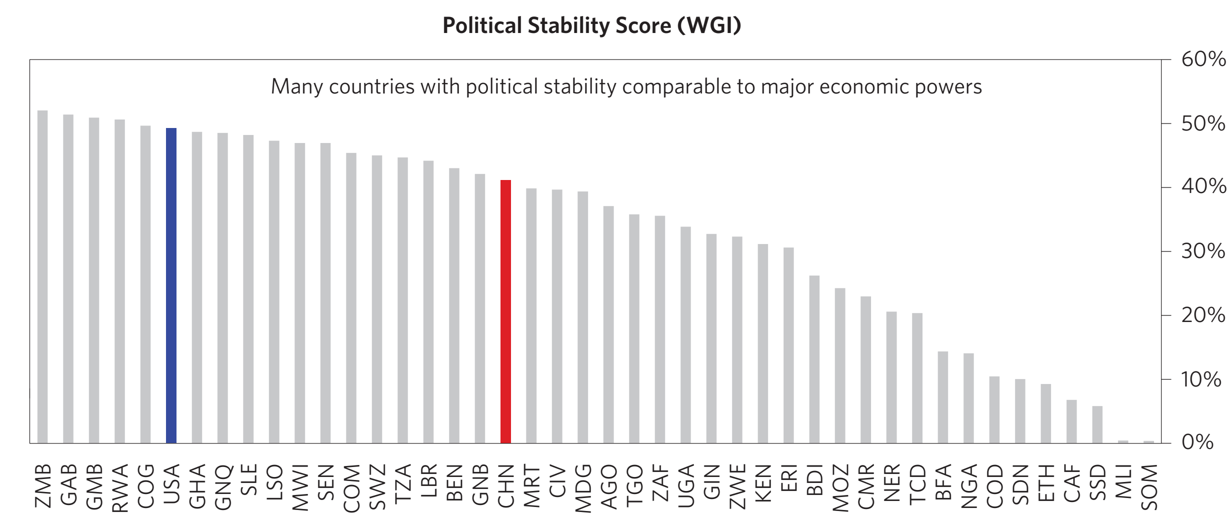
It is also worth highlighting how some of these factors have evolved over time and where perception might be lagging reality, especially for investors who do not monitor the region closely. For instance, macro stability has improved significantly over time, and while inflation is generally still higher than in other emerging regions, there have not been any bouts of unmanaged hyperinflation in the larger economies in recent decades (though if the high debt burdens are not well managed, that could reintroduce macro instability, including unmanaged inflation). Additionally, political stability has improved in many countries in the region, at the same time that tensions within and between major economies in the world have picked up (though the most stable Sub-Saharan African countries tend to be among the smaller economies).





Key to overcoming these investment barriers will be finding ways to address the challenge of fragmentation. Because the region consists of so many countries (with unique histories, dynamics, and considerations) and because risks are high while capital markets are thin, there is a high hurdle to operating or investing in a new country relative to the potential size of the investment opportunities. A majority of global institutional investors have zero allocation to the region (outside of South Africa), as overcoming the barriers to investing is not worth it for what would be very small portfolio allocations. Crucial to attracting more inflows will be addressing the fragmentation. On the policy side, putting the agreement to establish the African Continental Free Trade Area into effect and figuring out areas of shared cooperation or regulatory regimes

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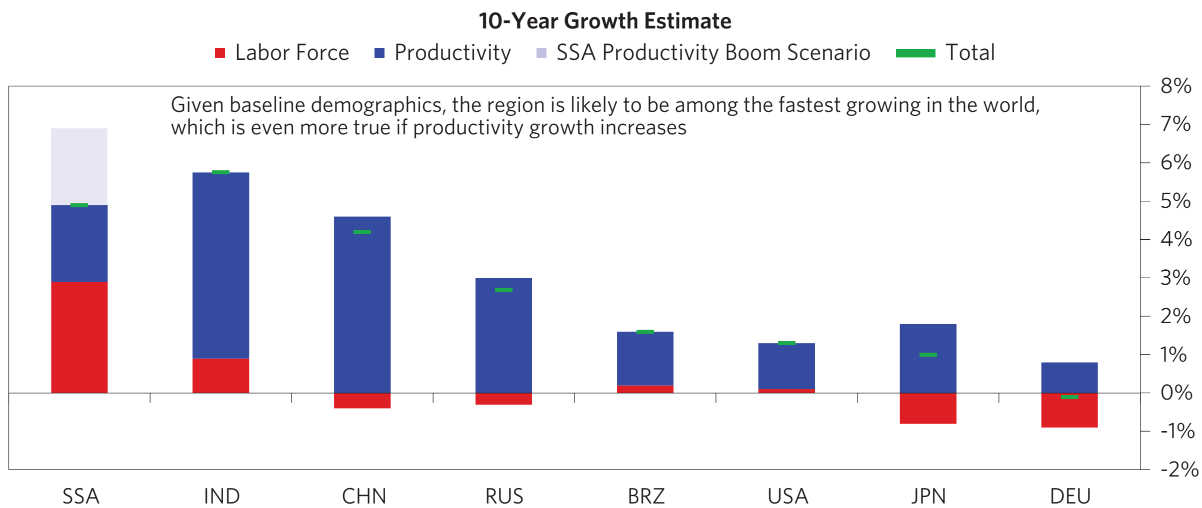
would help. On the private side, the key thing is structures that can connect global PE, VC, or infrastructure allocators with on-the-ground practitioners in the various countries in a vehicle that is pooled and familiar (paired with investors wanting allocations to the region, which will create demand for the right investment vehicles).

High Return and Diversification Potential

Lowering these barriers to foreign investment is currently a focus of MDBs and policy makers, and how this develops bears watching. Of course, even successful policy changes would play out very slowly, and the markets are growing from small and immature baselines. But we see a few things that make the region structurally interesting to investors.

First, in the years ahead, Sub-Saharan Africa is likely to experience some of the fastest growth in the world. As discussed above, demographics are a huge tailwind with working-age population growth of nearly 3% when it is close to zero in much of the rest of the world. This means that, even with a modest productivity growth rate of about 2%, the region will be one of the fastest-growing. Of course, the potential here will be even higher if the region can raise its productivity relative to past decades and unlock "catch-up" growth of closer to 4% (though, as mentioned above, that is not our current base case unless there are material changes).



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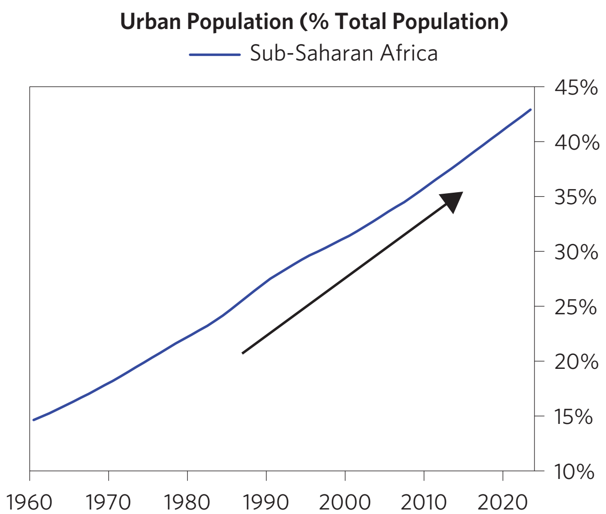
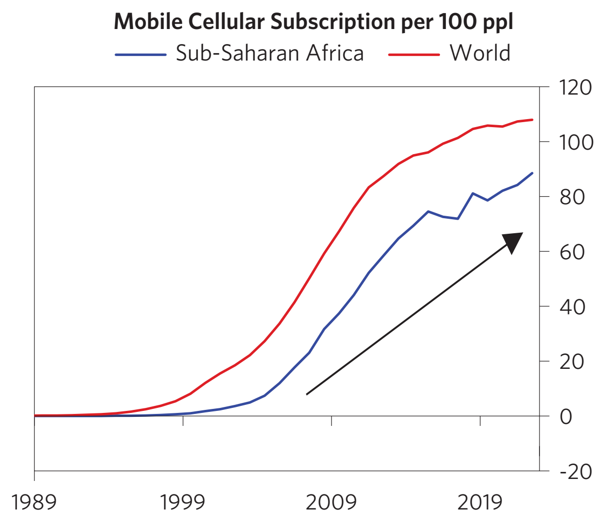
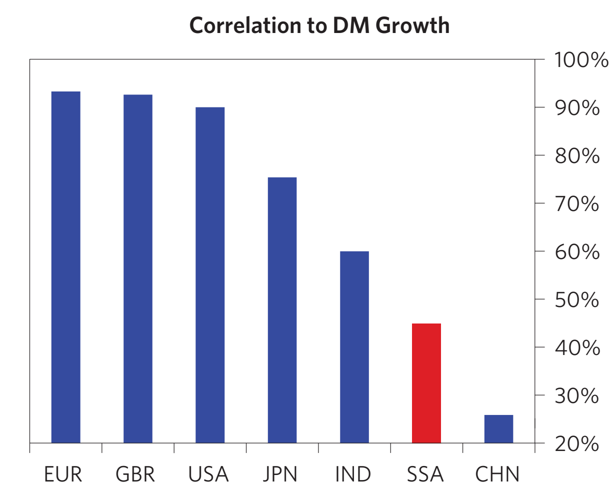
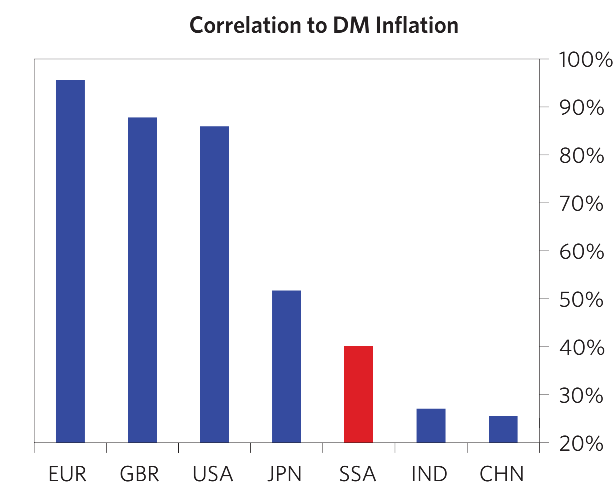
The region's population boom is happening in the context of strong migration trends from less accessible and less productive rural areas to more accessible and more productive urban areas. The share of people living in cities has risen from under 30% in 1990 to over 40% today and is projected to continue rising rapidly. Additionally, the region has high digital connectedness—while only half of the region has access to electricity, almost everyone owns a cellphone. This adds up to a rapidly growing and readily accessible consumer market.





Second, the region offers high potential for diversifying return streams for international investors. Its macro conditions are relatively lowly correlated to the developed world, whose assets make up the majority of major institutional portfolios.





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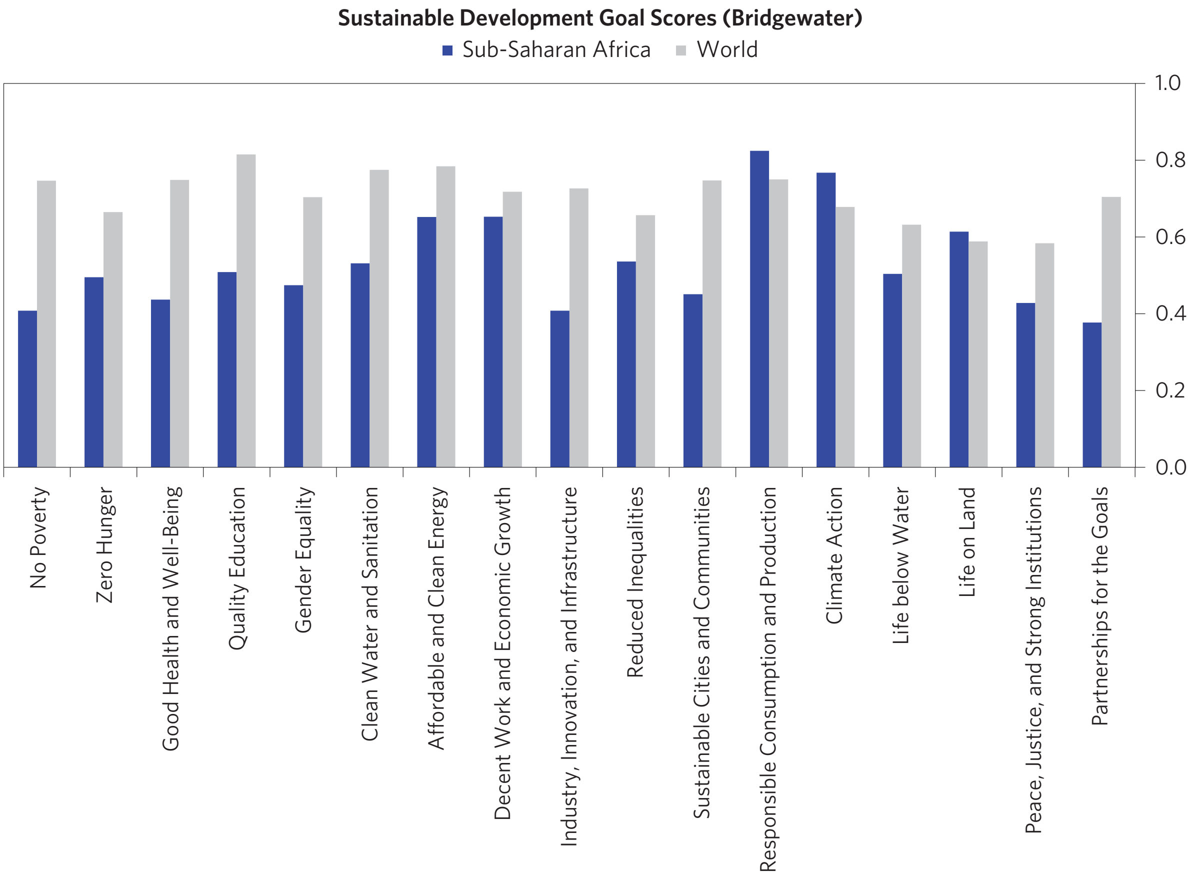
Third, the region is a great destination for investors who have sustainable development goals beyond maximizing return relative to risk. The region is generally further behind the rest of the world on sustainable development goals, and while its emissions are low relative to population, it is among the most exposed to climate change. Given this, the region needs more investment to close the gaps, and marginally allocated dollars are likely to be especially impactful there.



For investors pursuing impact and sustainability goals, there is a suite of more "traditional" asset classes that they can invest in to support economic growth and development in the region (companies with operations in or with sales concentrated in the region, domestic government bonds, infrastructure, etc.). Increasingly, there are also innovative financial instruments that are targeted at specific outcomes like health or education, such as green and social bonds (which support specific development outcomes) and sustainability-linked bonds (which incentivize borrowers to meet certain measurable sustainability or development goals). For instance, last year the Development Bank of Rwanda launched a sustainability-linked bond, and this year Côte d'Ivoire issued a sustainable bond.

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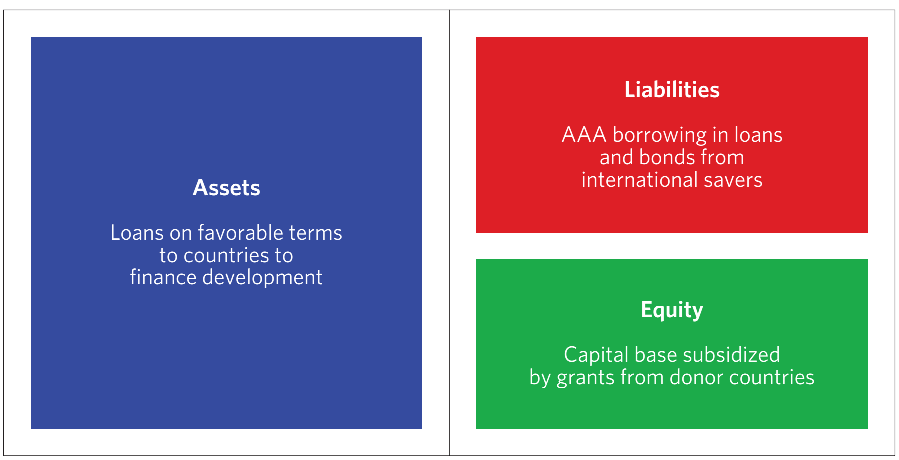
Multilateral Development Banks Have a Big Role to Play

Doubling the amount of investment in the region is an extremely ambitious goal and will require significant action. Multilateral development banks have a big role to play, especially in the poorest countries where domestic resources are very limited, and in projects and sectors where there are high social returns but limited capturable profits (and therefore little incentive for the private sector to finance). **A strong replenishment of IDA is a sensible step, though that alone will not be enough to close the financing gap. Crucial will be facilitating private sector flows at scale** (where the potential size is enormous). MDBs can contribute to lowering the major barriers by (a) financing core infrastructure, such as energy and developing human capital, (b) helping to create regulatory certainty and the right policy frameworks, and (c) helping the private sector manage and insure against political, currency, and other macro risks.

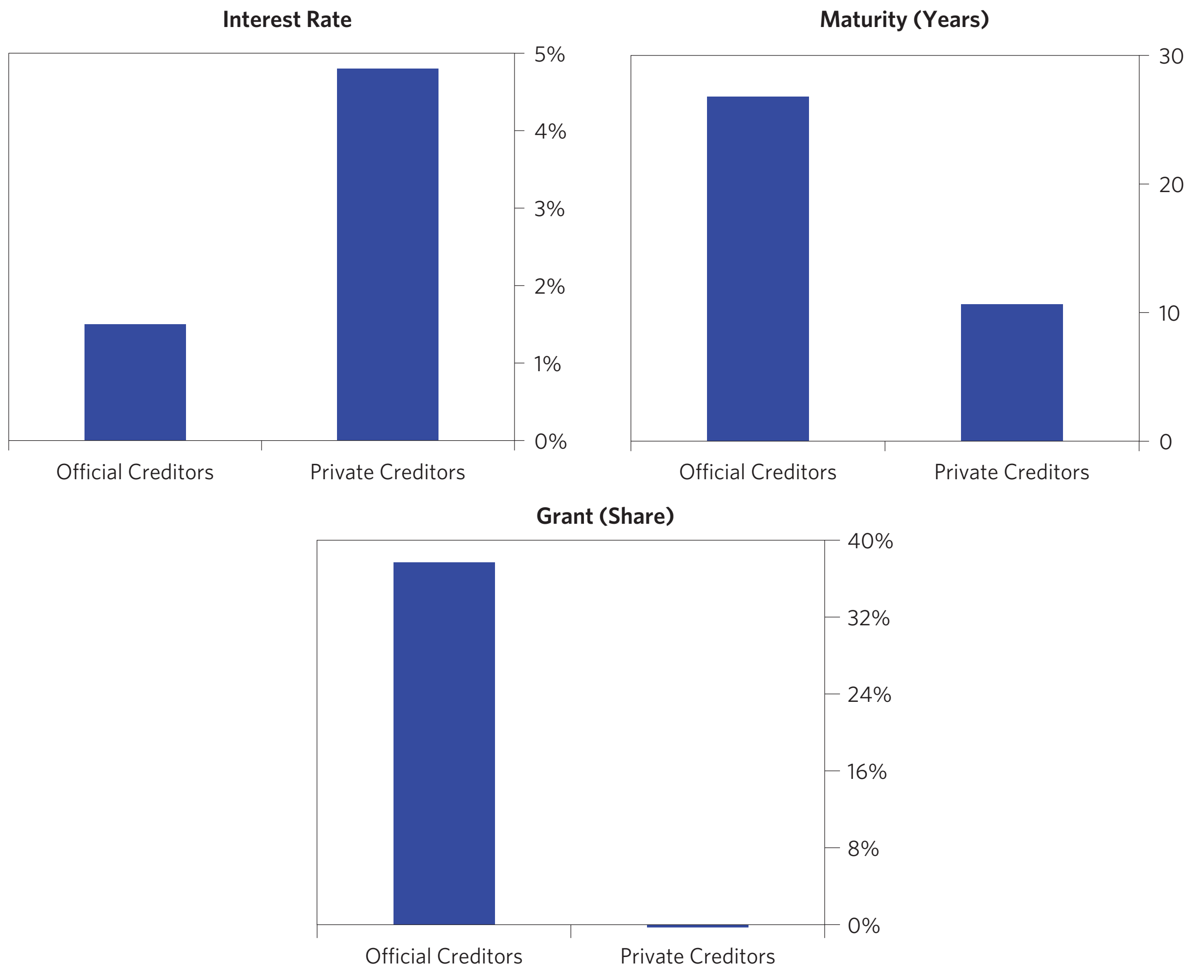
The Unique Role of Multilateral Development Banks

The MDB structure helps address many of the key financing challenges we have discussed. In concept, what MDBs do is make loans, generally at favorable terms, to finance development (the assets side of their balance sheet), which they in turn finance by borrowing at market rates and raising capital from donor countries (the liabilities and equity side of their balance sheet). This intermediation role is powerful, as it essentially lets savers hold safe, AAA debt, but still indirectly finance development lending to risky borrowers (which they would be unlikely to do directly). A key reason MDBs are able to do this is (a) their capital is subsidized by donors and (b) they are not prioritizing maximizing profits with their investment decisions. Beyond this, however, they are also in a good position to make these risky loans given their preferred creditor status in restructuring and defaults and their ability to shape policy decisions (in a way that private creditors are not). As a result, **they (a) direct investment flows to the region, including navigating the challenges of operating in less developed regions and (b) offer favorable lending terms or grants that do not exacerbate existing debt burdens**.

Multilateral Development Bank Stylized Balance Sheet

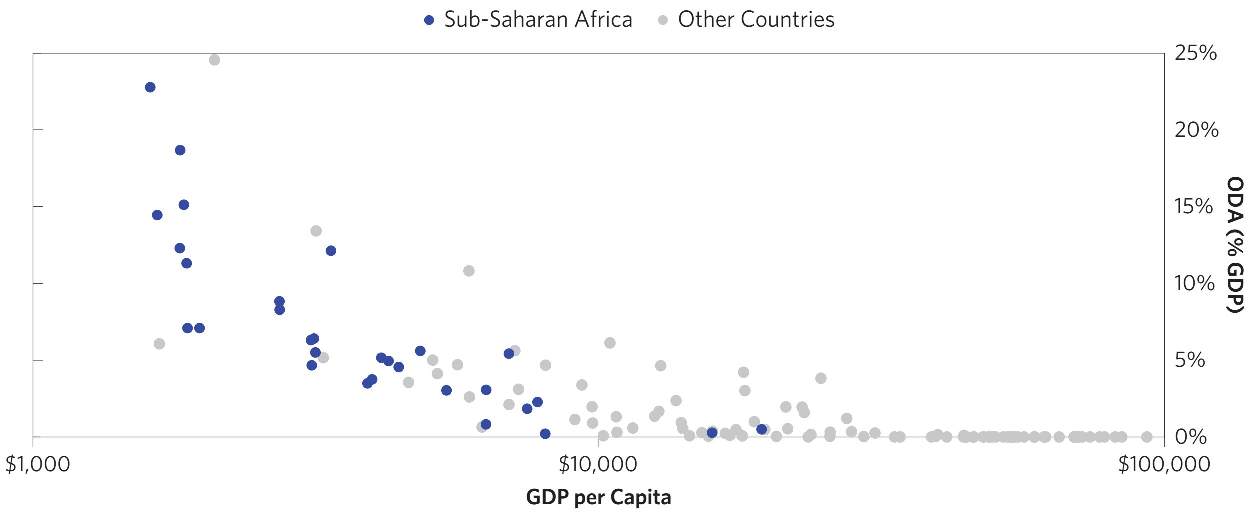


Zooming in on their lending terms, loans from official creditors (which include MDBs and bilateral aid) are at much lower rates and for much longer terms than private sector loans. Additionally, a large portion comes in grant form, especially in the poorest countries.



This subsidized lending plays an especially big role in the least developed countries, where domestic resources are limited and external private financing is much less feasible. In these countries, official channels of development financing and aid account for as much as 10–25% of GDP.

Official Development Assistance (% GDP) vs GDP per Capita (USD, PPP)



Additionally, there are many investments that have high social returns, but due to externalities, time frame, or risks are not suitable to be financed by profit-maximizing private investors (e.g., education, healthcare, protecting the environment, preserving natural resources, etc.). Concessional financing has a big role to play in supporting these types of investments (in developed countries, these investments are financed through government revenues, which are much higher than in Sub-Saharan Africa, even as a share of GDP).

Private vs Official Sources of Development Financing

Uses of Development Financing	Private Investment	Public Finances and ODA
	• Well-defined returns • Capturable profits • Shorter time frames, manageable risks	• Non-monetizable returns • Positive externalities • Long time frames
Production (Industry, Agriculture, etc)	X	
Real Estate	X	
Core Infrastructure (Energy, Transport, etc)	X	X
Human Capital (Education, Healthcare, etc)		X
Disaster Preparedness and Response		X

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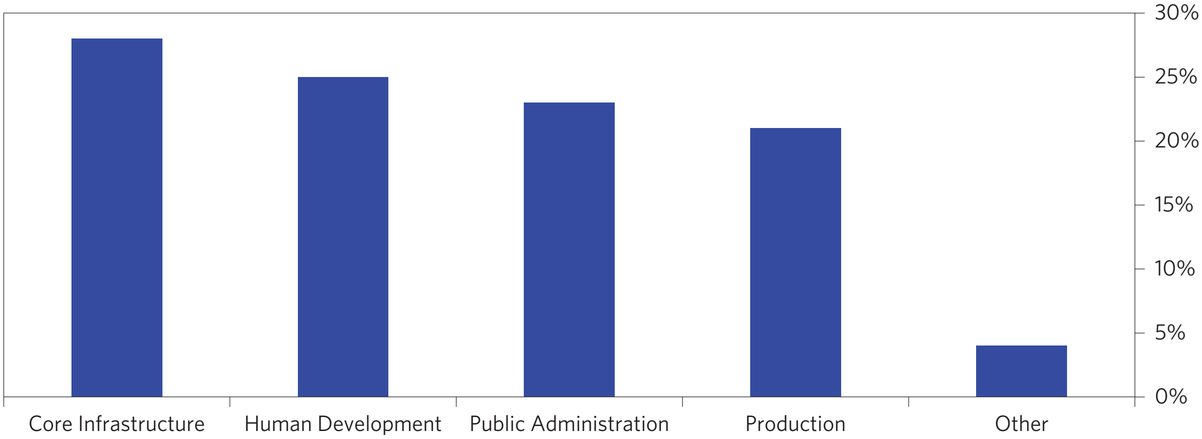
IDA Replenishment and Multilateral Development Bank Reforms

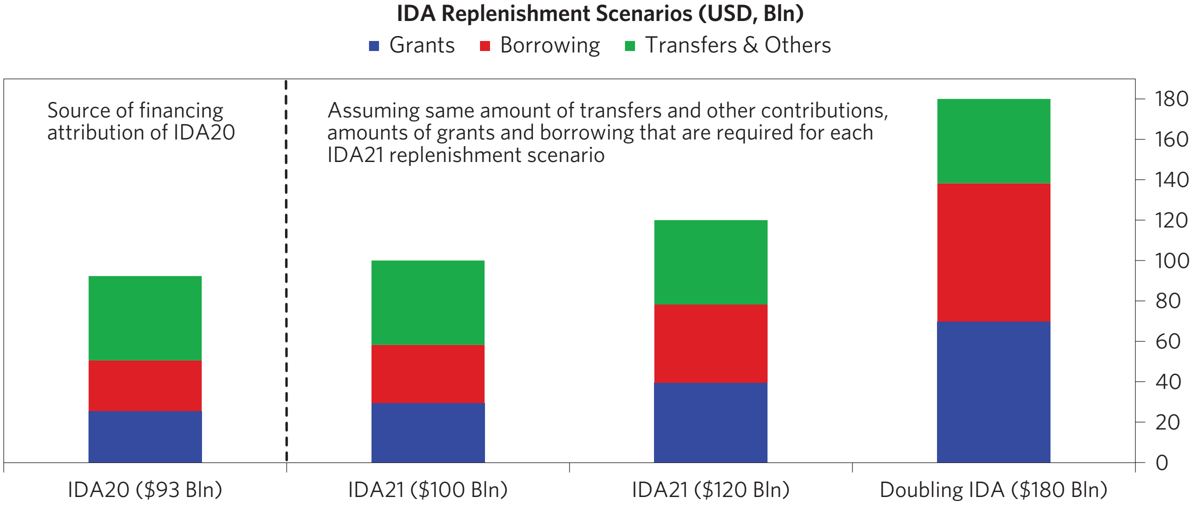
IDA is the biggest source of multilateral concessional finance for Sub-Saharan Africa and is currently undergoing its triannual replenishment cycle, which will determine the size of its forward-looking financing capacity. Consistent with the framework we laid out earlier, IDA lending skews toward sectors that are less suitable for private investment (due to externalities, risks, or time frames). Looking backward, social services and core infrastructure were the largest allocations, and looking forward these are likely to remain priority areas into the next cycle.

IDA Lending by Sector (2023)

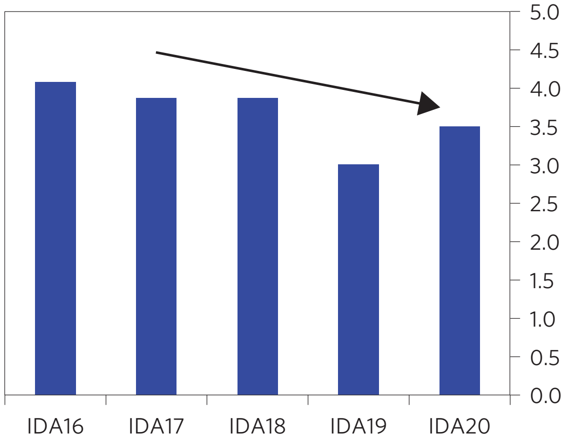


IDA finances this activity from three key sources, which determine the overall size of its lending activity. First are grants from donor countries that make up the capital base of IDA. Second is the borrowing to lever this up, though the leverage ratio is constrained by the concessional nature of IDA lending (it borrows on market terms) and the lower credit ratings of the countries it lends to (which means it needs to hold enough capital against default risk, especially given the need for IDA to maintain its own AAA credit rating). Third are reflows (repayment of prior lending) and some other small sources. For IDA20 (the 2021 replenishment that is funding lending from mid-2022 to mid-2025), the total available lending pool was $93 billion (for a total of roughly $4 of lending for every $1 in grants), which supported electricity services, social safety net programs, immunization and other health programs, and nutrition for tens of millions of people in the region. At the April 2024 Africa Heads of State Summit in Nairobi, African leaders outlined the importance of the IDA replenishment to support their development goals. They pushed for IDA21 to surpass $100 billion and encouraged an increase of up to $120 billion. Doubling the level of development financing over the coming cycles would mean a lending pool of roughly $180 billion.

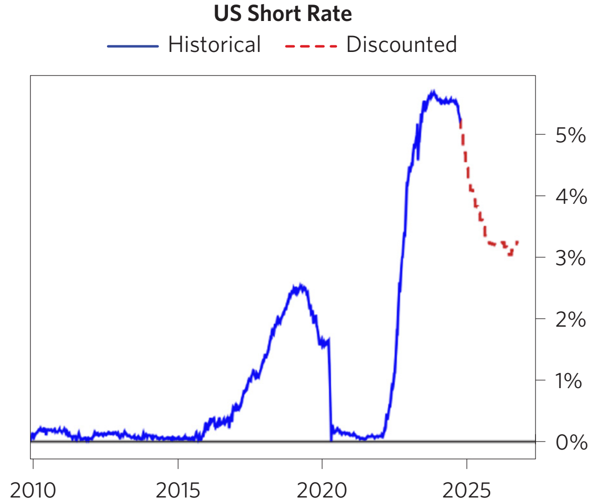
IDA Replenishment Scenarios (USD, Bln)



Achieving a big increase will be challenging. Most importantly, there does not seem to be the political appetite for very big increases in donations, which are the foundation of the capital base. Pledges by the US (the largest single donor in the last replenishment) have generally declined, even in nominal terms, over the past 15 years (though pledges have risen elsewhere). The outcome of November's US election will be a big determinant—while the Biden administration will make the IDA21 pledge in December, it will be on the next administration, and Congress, to deliver. Another headwind is the increase in interest rates. IDA lends at zero or near-zero rates but must borrow at market rates. The drag from this spread did not matter for much of the past 15 years when rates were ultra-low, but with rates above 5% (and discounted to remain high going forward relative to pre-COVID levels), it matters now.



US pledges to IDA have decreased over time, even in nominal terms



Higher rates mean funding costs have risen relative to concessional lending rates

In recent years, there have been internal and external calls for MDBs to reform (e.g., the Triple Agenda laid out at the 2023 G20). Broadly, there are three types of proposed changes. First is calls to scale up the amount of financing supplied by MDBs through increasing the capital base and finding ways to use available capital more efficiently (without losing AAA ratings). Second is improving the operating efficiency of MDBs, such as speeding up the time for approvals and integrating better into country platforms, including offering more flexibility on how funds are used. Third is engaging more deeply with the private sector to pull in more private capital per dollar of MDB financing deployed. The World Bank has already begun enacting a large portion of these proposed changes. These reforms make sense to us as ways to scale the impact of the key development financing role MDBs play (and time will tell if they are successful).

Examples of Reforms Being Undertaken by the World Bank

Scale Up Financing	Improve Operational Efficiency	Grow Private Sector Engagement
• Working to maximize benefits of callable capital, including sharing key insights with rating agencies • Embraced recommendations of Capital Adequacy Framework • Began offering 50-year financing through IBRD for projects with cross-border benefits • Pursuing a strong IDA replenishment campaign	• Cementing new Knowledge Bank structure to better support country development goals • Cut project approval time by 3 months; aiming to cut by another 6 months • Implementing outcome-oriented corporate scorecard	• Launched Private Sector Investment Lab composed of private sector CEOs/chairs to understand and address barriers to private investment • Exploring potential for an originate-to-distribute model • Simplifying guarantee business, targeting tripling size in next 5 years • Exploring risk-sharing options and local currency financing to mitigate FX risks

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What We Are Watching

Whether the region's demographic boom is matched by a productivity miracle will have substantial impacts on the world's economies and markets, both directly (e.g., potential source of deflationary global growth) and indirectly (e.g., geopolitical implications). There are four major considerations we are watching to see how the region evolves and if investment levels can rise to what is needed to move the needle on development.

First is the trajectory of productivity and the return on investments that are made. Do flows to countries result in fundamental improvements, or just spending and debt reduction? Do policies and governance evolve to facilitate this? Do investments generate returns in excess of the cost of capital? Does the region become a more attractive place for private capital?

Second is how debt burdens are resolved. We will be watching how debt-to-GDP (growth in debt relative to growth in output) and debt service costs evolve. Importantly, how do current sovereign restructurings get resolved, and how long does resolution take? How well can policy makers stabilize currencies, control inflation, and close fiscal imbalances? How well is the money spent, and crucially, does that spending generate faster growth?

Third is the movement of private capital. Ultimately, the overall level of capital flows matters most, but we would expect that to coincide with indicators of macro stability and capital market access and depth. On the private markets side, do structures emerge that can connect developed world allocators to on-the-ground practitioners? On the public market side, do countries continue to take development steps to advance their inclusion in major indices? And most importantly, is there a pickup in interest and demand from major investors to allocate to the region, either for classic return and diversification reasons, or for the goal of facilitating sustainable development?

Fourth is how the role of MDBs develops. The size of the IDA replenishment this year is a litmus test of whether global policy makers can rise to even constrained aspirations. Beyond that, do they grow their capital base more generally? Are they able to find ways to better leverage their capital to extend more lending? Do the reforms that they have made result in better operations, such as reducing the time and the friction involved in approving projects and integrating with country goals and platforms? Do they advance their goal to "crowd in" more private capital?

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