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# **NOTE ON THE IMPACT OF COVID-19 ON THE ECONOMY OF MADAGASCAR**

Scenarios and recommendations



april 2020

# INTRODUCTION

Madagascar is exposed to the consequences of Covid-19 in several ways, including through its integration into the global economy, regardless of the endogenous implications of the containment and lockdown measures taken at the national level.

The countries most affected by the pandemic, China, Italy, the United States and France, are those with which Madagascar has the strongest trade links. In 2019, exports to these four countries account for 46percent of Madagascar's total exports. In the same year, imports from these countries represent 33% of

Madagascar's total exports. In the same year, imports from these countries represent 33% of Madagascar's total imports. The economic impact of Covid-19 in the above countries will undoubtedly affect Madagascar's economic dynamics in 2020.

Figure 1: Main countries of origin of Imports

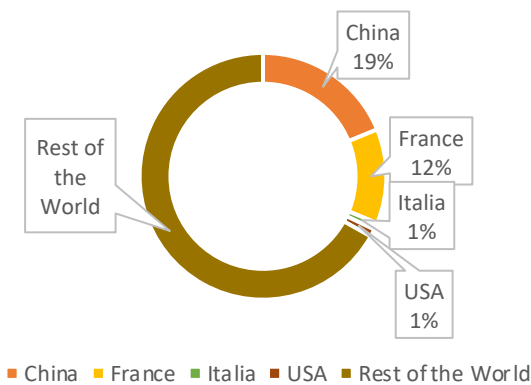


Figure 2: Main export destination countries

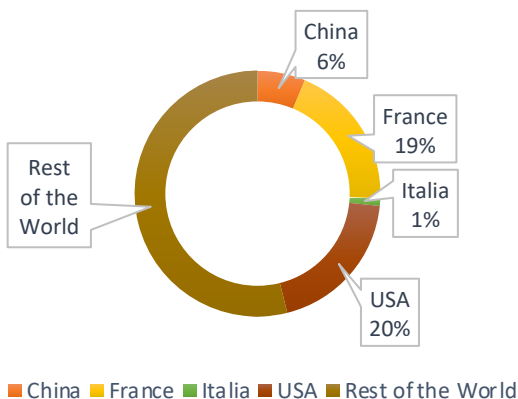
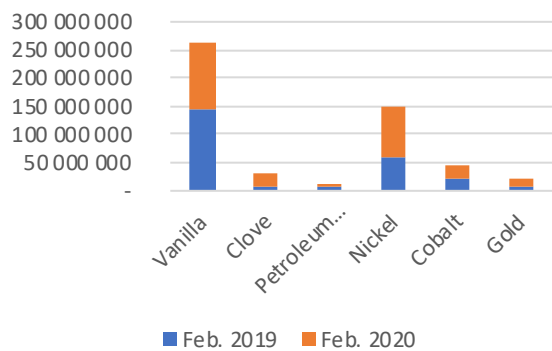


Figure 3: Exports of main products year-on-year from February 2019 to February 2020 in US Dollars



Source : Ministry of Economy and Finances

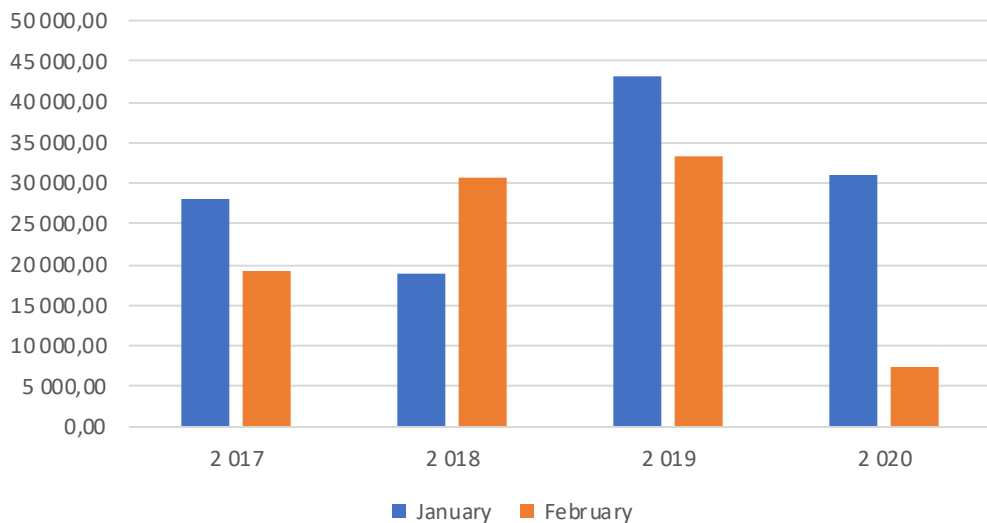
Year-over-year, February 2020 exports, in value terms, show an increase of 5.2percent (75.7 billion Ariary) compared to 2019. This performance is marked by an increase in shrimp exports (+ 30.4 billion ariary), and Nickel (+109.5 billion ariary), despite a drop in vanilla exports (-103.1 billion ariary).

Similarly, the tourism sector showed signs of slowing down in February. Thus, the number of tourists coming to Madagascar was 40,654 in February 2020 compared to 78,367 for the same period in 2019, a 48.4percent decline

Source : Ministry of Economy and Finances

from the previous year. It should be noted that most tourists visiting the Big Island come from France (22.5 percent), China (2.4 percent), Italy (2.0 percent), the USA (2.1 percent) and other countries accounting for 71 percent of the total.

Figure 4: Number of tourist arrivals for the months of January and February from 2017 to 2020



Source : Ministry of Economy and Finances

Three scenarios are considered in order to deal with the uncertainties related to the current evolution of the pandemic. Different situations are taken into account, ranging from a limited spread that would be contained by the measures in place (as of 31 March 2020) until April, to a pronounced spread that would extend the measures in place until May-June, to a catastrophic situation that would require much more drastic measures, a containment that would extend well beyond Tananarive and Toamasina, affecting multiple new sectors.

# 1. A significant impact under different scenarios

Madagascar, like most countries, introduced measures in mid-March to restrict international flights and then internal urban and regional transport, particularly in the two main centres of infection, Antananarivo and Toamasina. These measures, in addition to disrupting world trade, air transport, domestic trade and the habits and behavior of economic agents, will have a significant impact on Madagascar's economic growth.

In this scenario, with moderate human impacts and limited duration of the restrictions, the economic impact is nevertheless very significant with growth declining from 5.3 percent (forecast for 2020 before the crisis) to 0.17 percent.

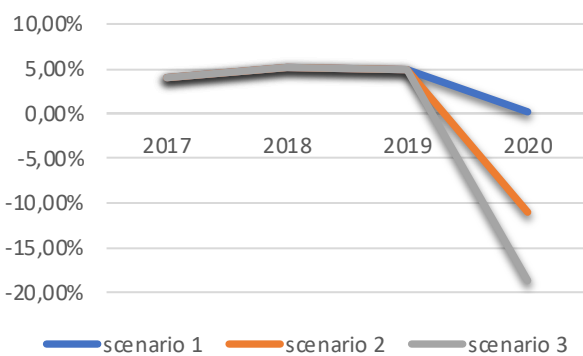
The economic slowdown in Madagascar will be driven by the impact of the measures on the Services sector, which accounts for almost 54 percent of GDP. Thus, the decline in Services (-3.3 percent), while agriculture (+3.2 percent) and especially industry (+1.3 percent) slow down, will be marked by the reduction in tourism, hotels and restaurants (-14 percent) and trade (-5.7 percent). Containment and partial lockdown measures (school closures, transportation restrictions, cancellation of events) are expected to have limited effects on the Administration's performance (-1.4 percent), provided they do not persist.

Demand would be supported by increased public spending, particularly on health and social programmes, to support public consumption to offset the fall in private consumption. Gross investment (-2.7 percent) is expected to fall by 8.7 points compared to pre-crisis projections for 2020. The revival of public investment (+7.2 percent) would help mitigate the expected decline in private investment (+4.6 percent).

The assumptions under this scenario assume, inter alia, that the agricultural sector will not be affected, that from May onwards, most of the affected sectors will restart.

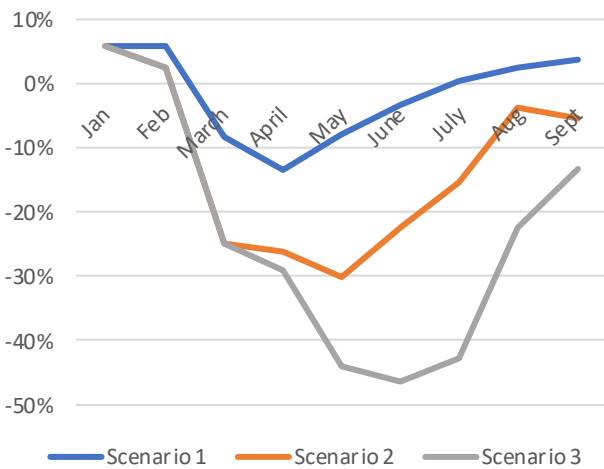
With the sharp drop in oil prices since the beginning of the year, the import bill will be lighter, improving Madagascar's terms of trade,

Figure 5: Evolution of real GDP under the impact of Covid-19 according to scenarios



Source: Our own calculations and hypothesis

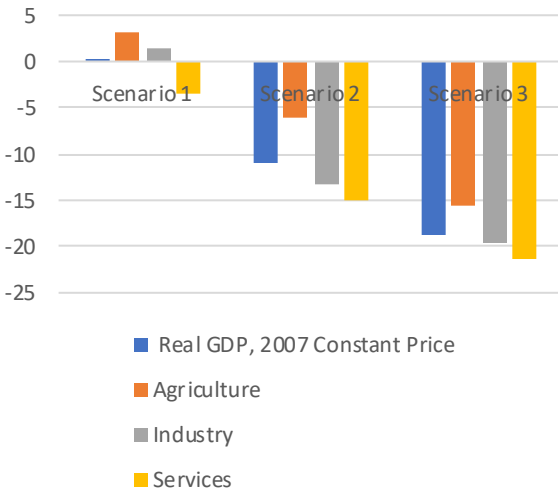
Figure 6: Impact of Covid-19 on monthly real GDP according to scenarios



Source: Our own calculations and hypothesis

with exports nevertheless declining by 15 percentage points compared to initial forecasts for 2020.

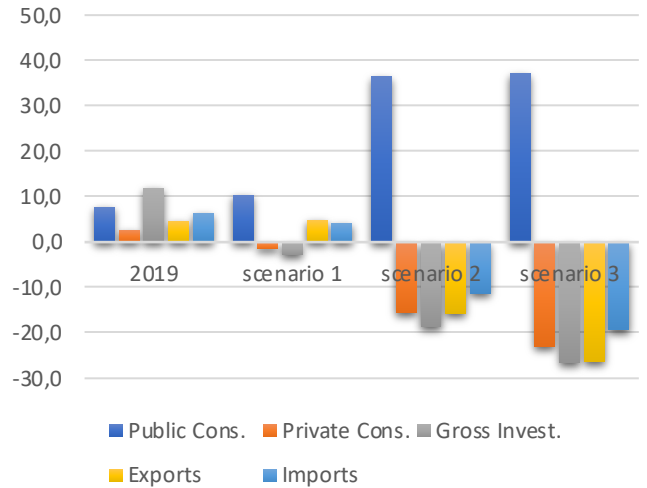
Figure 7: Evolution of real GDP and by sector according to the scenarios



Source: Our own calculations and hypothesis

Tax relief measures, lower public revenue due to the economic slowdown and increased social spending, should contribute to a widening of the budget deficit (5 percent), cushioned by the support of development partners. Automatic stabilizers would thus buffer the impact on economic activity.

Figure 8: A shock on demand



Inflation, estimated at 4.9 percent in 2020, taking into account the fall in the price per barrel, could however accelerate if pressures is put on basic food prices.

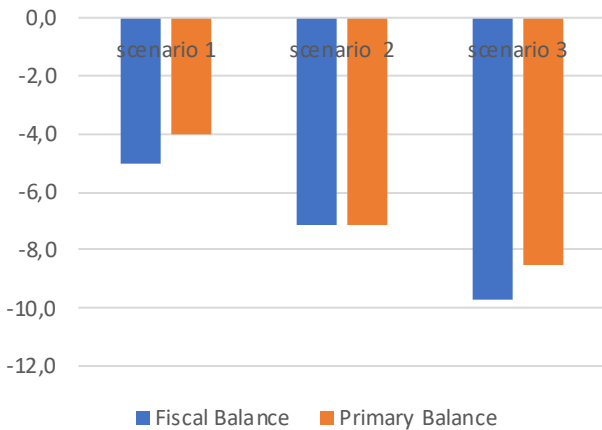
Under Scenario 2, the health crisis would be of greater magnitude, resulting in a longer containment and lockdown period, lasting until June, with a recovery only starting in July.

In this scenario, the impact on growth would be very large, with real GDP falling by 15 percentage points to -11 percent growth. The agricultural sector would be more affected with growth of -6 percent, as would the industrial sector (-13.2 percent), accentuating the impact on the service sector (-15 percent). Hotels & Restaurants (-28.5 percent), Transport (-16.3 percent) and Household Services (-20.3 percent) are the sectors most affected by this scenario.

Economic activity will be supported mainly by automatic stabilizers fueled by public expenditure, notably transfer expenditure for public consumption of +36.5 percent.

Gross investment is expected to decline (-18.5 percent) while the trade deficit is expected to widen with a fall in demand for Madagascar's exports (-15.6 percent). The budget deficit is expected to worsen to more than 7 percent.

Figure 9: A worsening deficit



Source: Our own calculations and hypothesis

A third scenario (disaster) is envisaged, in which the health crisis would last until July with more restrictive measures. In this configuration, the loss of GDP would be close to 19 percent (see figure 1). The economy would be totally stall. All sectors would be severely affected by the crisis (see Figure 2). Only public spending could sustain activity, with an aggravated decline in global demand (-26.3 percent) for Madagascar, a drop in private investment (-35.6 percent) and private consumption (23 percent).

The government will have to let the budget deficit (-9.7 percent) slip to allow the automatic stabilizers to play their role more than fully.

## 2. An informal sector in distress

With the containment and lockdown measures putted in place, the informal sector, which employs more than nine out of ten workers and contributes to 24percent of GDP (ENEMPSI 2012), will be the most affected by this crisis. Indeed, employment in the informal sector is characterized by vulnerability, difficult working conditions and disparities in income and social protection.

Only 1percent of workers in Individual Production Units (IPUs) benefit from official social security coverage through the National Social Security Fund (CNaPS), and only 2.9percent of workers in informal IPUs have a written contract. Thus, most informal sector workers are suddenly deprived of their daily sources of income, making the lockdown an economically unviable option in the long run for this segment of the population.

# 3. Strong measures to mitigate the severity of the crisis and its impact

The government has enacted a partial lockdown, where only goods can circulate, and food markets are open until midday (12:00 PM) during the 15 days decreed until April 4.

The private sector is supported through fiscal measures deferring the payment of some taxes. Thus, the private sector will benefit from a deferral of the declaration and payment of synthetic taxes until May 15. Similarly, the payment of employers' contributions to social security and health funds, CNAPS and OSTIE, is deferred. The State has also decided to suspend tax audits and notices to third party holders.

Other measures are under consideration, such as the suspension of the collection of charges such as income tax on wages and salaries and taxes (Value-Added Tax).

In addition, the State is negotiating with the Bank Owners Association to extend bank maturities and real estate loans to businesses and individuals.

The cost of the envisaged emergency economic measures is estimated at 115 billion Ariary (USD 30 million). The objective is to ensure that no Malagasy employee loses his job because of the lockdown, the Head of State explained.

In addition, the Head of State's social emergency plan provides for the distribution of food donations and subsidies to support workers directly affected by the containment and lockdown measures, including taxi-be drivers, taxi drivers and itinerant workers. This plan will reach 240,000 vulnerable households in the Fokontany (district) of Antananarivo and Toamasina. The government will allocate 10 billion Ariary (USD 2.7 million) to implement the social emergency plan.

Nine hundred and twenty-one (921) homeless people living in the streets of the capital were transferred to a shelter by the Ministry of Population, Social Protection and the Advancement of Women and the City Hall of Antananarivo.

Measures are being taken to ensure strict price control in order to avoid speculation on basic necessities - such as rice, the country's most consumed product - with the establishment of a joint brigade responsible for checking the state of stocks and the level of prices on the markets.

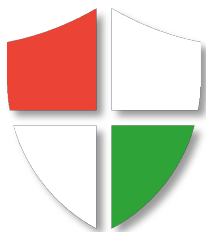
## 4. Rapid support from development partners

The World Bank has committed support of US\$20 million to the country as part of its pledged funding mechanism for the country's response to Covid-19. An amount of US\$3.7 million is already committed through a contract with WHO and up to US\$6 million would be disbursed under an escalation scenario and in case of emergency (emergency component of the nutrition project). In total, Madagascar will receive US\$13.9 million under the new APL in response to Covid-19 (indicative country allocation). Budgetary support and additional measures are being prepared to help mitigate the impact on the most affected households and businesses. The IMF is in the process of finalizing its support under the RCPF for 50percent of the country's quota.

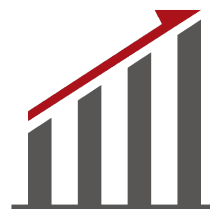
UNDP has already confirmed the mobilization of US\$ 4.5 million to support the Government's efforts to deal with the pandemic. United Nations agencies have started to mobilize resources to support the country, with US\$ 800,000 from WHO, US\$ 610,000 from UNICEF and US\$ 500,000 from UNFPA. Other support is being discussed with the State as part of the social protection plan, which is currently being drawn up, to help vulnerable families. An additional US\$ 2.3 million has been pledged, including US\$ 1 million from the World Bank, \$ 800,000 from WFP and \$ 500,000 from UNICEF.

## 5. Major short-term risks if the situation worsens

The crisis is also an indicator of the Madagascar's vulnerability, highlighted by different types of risks:



The security risk with threats of popular revolt and acts of banditry in some regions due to the social impact of the lockdown that deprives daily workers of income.



Risk of inflationary crisis linked to speculation on the prices of essential goods and foodstuffs and the retention of stocks despite the measures taken by the Ministry of Commerce.





Food insecurity risk linked to the government's ability to rationally and optimally manage strategic stocks of essential products and to secure supply chains abroad, especially in the event of an acute global crisis.



Corruption risk linked to the political economy of the country dominated by powerful private interests diverting public decisions in favor of their private interests and parasitizing any optimal response to the crisis.

## 6. Recommendations

Some major recommendations can be put forward, which will have to be adjusted according to the evolution of the crisis:

1. **Respond to the enormous challenges of providing appropriate medical equipment** at all levels of the health crisis;
2. **Develop a fiscal stimulus plan**: reorganize the budget to strengthen support to severely affected sectors and vulnerable households;
3. **Expand the social protection system**, including the informal sector;
4. **Develop targeted fiscal measures**: postponement of corporate tax payment deadlines in the tourism, hotel and transport sectors, etc.; reduction of the tax burden on employers in return for preserving jobs; tax incentives for companies that minimize job cuts;
5. **Adjust monetary policy** to avoid a liquidity crisis and strengthening the stability of the financial and banking system;
6. **Ease credit conditions for businesses** and support SMEs in financial difficulty through the provision of guaranteed bank loans;
7. **Reduce taxes** for additional social spending on disease control.
8. **Mobilization of resources**: creation of a National Solidarity fund by mobilizing resources from public institutions and Agencies, technical and financial partners, and by appealing to the solidarity of the favored social classes.