International Monetary Fund

IMF Executive Board Concludes 2006 Discussion on Common Policies of Member Countries with CEMAC

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On July 10, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the discussions on Common Policies of Member Countries with the Central African Economic and Monetary Community (CEMAC).[1]

Background

Recent macroeconomic developments in the CEMAC benefited from oil windfalls and improved implementation of macroeconomic policies, but structural problems continue to hamper non-oil growth. The fiscal surplus, excluding grants, quadrupled to 7.9 percent of GDP, as a result of an increase in revenues to GDP from 21 percent in 2004 to almost 26 percent in 2005. About half the improvement in revenues was on the non-oil side because of measures taken in several of the CEMAC countries to broaden the tax base and reduce fraud and tax evasion. In addition, lower debt service obligations helped reduce expenditures from 19.3 percent to 17.9 percent of GDP, despite higher investment in infrastructure. The regional non-oil fiscal deficit, excluding grants, was reduced by 2 percentage points to 11 percent of non-oil GDP.

The region's external current account balance turned positive for the first time since 2000. The surplus of 2.7 percent of GDP in 2005 followed a deficit in 2004 of 3.1 percent. Higher prices for oil, coffee, timber, and aluminum raised export receipts by more than 20 percent. In spite of some real effective exchange rate (REER) appreciation, import growth slowed as the previous import boom (related to oil investments) came to an end. Foreign reserves increased to 4 months of imports of goods and services from 2.4 months at end-2004. CEMAC members used some of the oil windfalls to repay domestic and external debt. External debt fell from 59.8 percent of regional GDP in 2004 to 40.6 percent-half the 2000 level-in 2005. Domestic debt declined by about 1.5 percent of regional GDP.

Oil-related reserve inflows also helped accelerate regional broad money, leading to somewhat higher inflation and a small further appreciation of the REER. With no active sterilization policy, oil-related liquidity was only partly absorbed through government deposits at the central bank, which by November 2005 further increased excess liquidity in the commercial banking sector to 18 percent of broad money. Fueled by increases in commercial banks' net foreign assets and rapid credit growth in Chad, Congo, Equatorial Guinea, and Gabon, regional broad money growth increased to almost 18 percent from 10 percent in 2004. Inflation increased from about 1 percent to 3.8 percent, partly because adverse weather conditions continued to raise food prices. The pick-up in inflation largely accounted for a further one percent real appreciation of the REER, which followed appreciating REERs in the past four years.

Low per capita growth and limited regional integration remain a concern. Despite the rapid increases in oil prices, which greatly supported real income growth, poverty remains a challenge. Five CEMAC countries still rank in the lowest third of the U.N. Human Development Index. Region-wide real GDP growth fell from 8.4 percent in 2004 to 4.3 percent in 2005, mainly because oil production in Chad and Equatorial Guinea steadied after recent rapid expansions. Non-oil output growth declined slightly, from 4.4 percent in 2004 to 4.2 percent in 2005, continuing a pattern that began in 2001. As a result of oil windfalls, compliance with macroeconomic convergence criteria improved in 2005. However, further regional integration is hampered by the lack of full implementation of regionally agreed structural policies, notably in the area of financial and trade reforms.

Macroeconomic prospects for 2006 are positive, despite persistent structural challenges. Real GDP growth is forecast to slow to 3.2 percent because oil production in Chad and Equatorial Guinea is steadying, and inflation is expected to be about 3 percent. Higher oil prices are expected to support a further increase in the external current account surplus (including grants) to 5 percent of GDP. The fiscal surplus (excluding grants) is expected to continue at about 9 percent. Among the risks to the forecast are the following: a further exchange rate appreciation; the lack of significant steps to ease structural constraints to non-oil growth; and strong wage pressures in some countries.

In conjunction with the 2006 discussions on Common Policies of Member Countries with CEMAC the region participated in the joint World Bank/IMF Financial Sector Assessment Program (FSAP). The regional FSAP found that financial sector soundness had improved but important stability and developmental challenges remained. Key weaknesses include protracted noncompliance by several banks with critical prudential norms, insufficient capitalization to cope with credit risks, and the limited independence and constrained human and financial resources of the regional banking supervision agency (COBAC). In addition, the FSAP found that access to financial services is limited for both households and medium-sized enterprises (SMEs). Underscoring the importance of structural reforms in the financial sector, the FSAP outlined regional reform priorities for liquidity management by the regional central bank, banking supervision, resolution of remaining weak banks, and strengthening CEMAC financial integration to support the stability and enhancement of the regional financial system. Implementing the FSAP recommendations will require concerted actions at both regional and national levels.

Executive Board Assessment

Directors commended the positive macroeconomic performance in the Central African Economic and Monetary Community (CEMAC) region in 2005. Oil-related inflows and improved fiscal policy administration, including revenue enhancements, have led to significant improvements in national fiscal balances, external current accounts, and reserve accumulation, while supporting a reduction in external debt levels and helping achieve closer adherence to macroeconomic convergence criteria. Directors observed, however, that per capita income in most CEMAC member countries remains low and that they face significant challenges in meeting the Millennium Development Goals. They therefore urged the authorities to take advantage of the improved macroeconomic and financial conditions to address long-standing structural issues that are critical for raising non-oil growth and employment, and reducing poverty.

Directors underscored the macroeconomic challenges arising from the current oil-related inflows. They stressed, in particular, the need to balance carefully critical spending needs against the limited absorptive capacity and possible risks of Dutch disease. At the regional level, this will require coordination of fiscal policies and careful investment of oil-related savings. In this regard, Directors welcomed the recent agreement allowing member countries to save oil-related inflows in country-owned Funds-For-Future-Generations and Oil-Stabilization-Funds at the BEAC. However, Directors recommended that the rules be amended to allow these funds to be invested in longer-term assets, while ensuring that their remuneration reflects actual investment returns. At the same time, it will also be important to maintain sufficient monetary reserves to support the continued credibility of the fixed exchange rate regime. Directors also welcomed recent efforts to improve the transparency of oil-related inflows by establishing a permanent secretariat for the Extractive Industries Transparency Initiative at the BEAC.

Directors welcomed the region's participation in the FSAP. While recognizing the region's success in achieving reasonably sound financial sectors, they urged the authorities to further strengthen financial stability and accelerate reforms, particularly as the financial sectors in the region remain among the least developed in the world. Directors emphasized the need to address the commercial banks' low capitalization in relation to credit risk, and to enhance the institutional independence and staffing of the Central African Banking Commission. To improve monetary policy implementation and help deepen financial markets, Directors recommended dismantling restrictions on interest rates, and lowering the excessively high-required reserves. They also recommended absorbing excess liquidity through marketable central bank bills, although this would require careful monitoring of the BEAC's income position. The authorities should also ensure the effective implementation of AML/CFT legislation.

Directors emphasized that medium-term financial sustainability in the region will require prudent macroeconomic policies and broad improvements in competitiveness. Given that oil reserves are limited, greater urgency should be accorded to addressing the structural impediments that constrain the competitiveness of the non-oil sectors. This will require strong efforts to overcome regional structural rigidities, including through more flexible labor markets, trade facilitation and liberalization, and a business and legal environment that is more conducive to private sector growth. Directors also noted that inflation must be kept low and fiscal spending contained to avoid the risk of an exchange rate overvaluation.

Directors noted the potential for regional integration to increase market size and help foster growth. They regretted the very low degree of trade and financial integration, and pointed to the lack of infrastructure and insufficient financing for some regional institutions that continue to constrain integration. In this respect, Directors welcomed recent commitments at the highest political level to strengthen regional integration, including clearing arrears to the CEMAC and ensuring better funding of regional institutions, enhancing regional policy coordination in the face of oil-related inflows, and promoting regional projects.

Directors called for a renewed focus on the promotion of trade to realize the potential benefits from economic integration. They underscored the need to overcome the continuing difficulties in applying agreed trade policies within the customs union, which hinder external and intraregional trade. Directors called for a more ambitious external trade reform, pointing in particular to the need to lower the common external tariff. Directors noted the recent progress in the negotiations for an economic partnership agreement with the European Union. They indicated that trade reforms should be designed with a view to minimizing trade distortions, and be accompanied by strong efforts to mobilize alternative fiscal revenues.

CEMAC: Selected Economic and Financial Indicators, 2001-2006

	2001	2002	2003	2004	2005 Est	2006 Proj.
	(Annual percentage change)					
National income and prices						
GDP at current prices	4.8	6.0	4.4	14.1	16.3	11.4
GDP at constant prices	8.1	4.8	4.6	8.4	4.3	3.2
Oil GDP 1/	12.1	5.1	5.4	17.1	4.3	0.3
Non-oil GDP 1/	6.4	4.7	4.2	4.4	4.2	4.7
Consumer prices (average)	3.7	4.6	1.8	1.0	3.8	3.1
Terms of trade	-5.6	2.9	4.9	0.9	15.8	7.6
Nominal effective exchange rate	0.7	2.4	5.8	2.9	-0.2	...
Real effective exchange rate	3.0	4.0	5.2	1.8	1.4	...
	(Annual changes in percent of beginning of period broad money)					
Money and credit						
Net foreign assets	-11.3	10.3	-1.4	26.4	50.4	...
Net domestic assets	18.6	4.2	3.1	-16.1	-32.6	

						...
Broad money	7.2	14.4	1.7	10.3	17.8	...
	(In percent of GDP, unless otherwise indicated)					
National accounts						
Gross domestic savings	36.1	26.2	37.0	39.4	47.2	48.2
Gross domestic investment	27.8	25.2	27.3	24.2	22.6	21.2
Government financial operations						
Total revenue, excluding grants	22.9	20.9	20.5	21.1	25.8	26.8
Government expenditure	21.3	21.2	20.3	19.3	17.9	17.9
Primary basic fiscal balance 2/	9.7	6.2	7.0	7.2	13.7	13.5
Basic fiscal balance 3/	5.1	2.4	2.7	4.3	10.1	11.6
Overall fiscal balance, excluding grants	1.6	-0.3	0.2	1.8	7.9	8.9
Non-oil overall fiscal balance, excluding grants 4/	-13.5	-14.4	-13.2	-13.2	-11.0	-11.9
Overall fiscal balance, including grants	2.3	0.9	1.3	2.5	8.5	9.6
External sector						
Exports of goods and nonfactor services	45.7	43.3	43.3	49.7	58.4	61.7
Imports of goods and nonfactor services	38.1	40.8	36.8	37.3	35.6	34.9
Balance on goods and nonfactor services	7.7	2.5	6.5	12.5	22.8	26.8
Current account, including grants	-6.6	-10.5	-7.0	-3.1	2.7	5.2
External public debt	82.7	71.2	68.2	59.8	40.6	35.7
Gross official reserves (end of period,						
In millions of U.S. dollars)	1,143.3	1,678.2	1,908.3	3,188.7	5,315.7	...
In months of imports of goods and services	1.4	1.8	1.6	2.4	3.9	...
Memorandum items:						
Nominal GDP (in billions of CFA francs)	15,756	16,700	17,431	19,895	23,140	25,784

CFA francs per U.S. dollar, average	733.0	697.0	581.2	528.3	526.6 550.0
Oil prices (in U.S. dollars per barrel)	24.3	25.0	28.9	37.8	53.4 61.3
Oil prices (in CFA francs per barrel)	17,835	17,390	16,793	19,947	28,096 33,689

Sources: IMF, World Economic Outlook database; and IMF staff estimates and projections.
1/ The weighted average of oil and non-oil real GDP growth rates does not always add up to real GDP growth because of the nonadditivity of the underlying index.
2/ Excluding grants and foreign-financed investment and interest payments.
3/ Excluding grants and foreign-financed investment.
4/ In percent of non-oil GDP.

[1] The IMF holds annual regional discussions with the CEMAC region. A staff team visits the region, collects economic and financial information, and discusses with officials the region's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the region's authorities. This PIN summarizes the views of the Executive Board as expressed during the July 10, 2006 Executive Board discussion based on the staff report.

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