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WEST AFRICAN ECONOMIC AND MONETARY UNION (WAEMU)

Staff Report on Common Policies for Member Countries

This staff report on discussions with regional institutions of the West African Economic and Monetary Union (WAEMU) was prepared by a staff team of the International Monetary Fund in the context of the periodic regional surveillance of the WAEMU. The regional perspective of such discussions is intended to strengthen the bilateral discussions that the IMF holds with the members in the region under Article IV of the IMF's Articles of Agreement. The following documents have been released and are included in this package:

- **Staff Report** on Common Policies for Member Countries, prepared by a staff team of the IMF, following discussions that ended on January 20, 2012, with the officials of WAEMU on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 27, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its March 14, 2012 discussion of the staff report.
- **Executive Director's Statement**

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WEST AFRICAN ECONOMIC AND MONETARY UNION (WAEMU)

STAFF REPORT ON COMMON POLICIES OF MEMBER COUNTRIES

February 27, 2012

KEY ISSUES

Context. The region faced a number of challenges in 2011, with the intensification of the political crisis in Côte d'Ivoire and a large increase in global food and fuel prices early in the year, and a severe drought affecting the Sahel later on. As a result, regional growth decreased sharply in 2011 and inflation spiked in early 2011.

Near-term outlook and risks. Growth is expected to rebound in 2012 with the postcrisis recovery in Côte d'Ivoire. Risks to growth, however, are to the downside. The main risk is that the external environment weakens further, particularly in the euro area if the debt crisis is not resolved quickly. With the euro area remaining the region's largest trading partner, this could affect the region through trade, remittances, terms of trade, foreign direct investment, and possibly aid.

Maintaining macroeconomic stability. Fiscal policies for 2012 strike an appropriate balance between addressing infrastructure needs and maintaining debt sustainability. Monetary policy has been appropriate. A materialization of downside risks could require a monetary policy relaxation for the union and differentiated fiscal responses across member countries. The drought in the Sahel may also require a more active fiscal policy in the affected countries.

Strengthening the stability of the union. Lessons can be drawn from the euro area experience. Market flexibility and regional integration facilitate adjustment to asymmetric shocks; fiscal discipline is essential; more attention to competitiveness and external imbalances is desirable; a crisis management system should be established, and regional surveillance should be strengthened. The stability of the financial sector could be further increased, including through better prudential regulation and better observance of prudential rules.

Raising potential growth. Regional integration should be accelerated to make the most of the opportunities created by the end of the crisis in Côte d'Ivoire. Financial deepening should be pursued resolutely and will require accelerating reform implementation, starting with developing the interbank market and strengthening the public debt market (including debt management capacity at the country level).

Approved By
Roger Nord (AFR) and Tom Dorsey (SPR)

Discussions were held in the region January 9-20, 2012 with the regional central bank (Banque Centrale des Etats d'Afrique de l'Ouest, BCEAO), the Banking Commission, the WAEMU Commission, and the West African Development Bank (BOAD). The staff team comprised Mr. Joly (head), Messrs. Garcia-Verdu and Kireyev, Mesdames Kolerus and Trasino (all AFR), Mr. Youm (MCM), as well as the resident representatives in Dakar (Ms. Fichera), Ouagadougou (Ms. Adenauer), and Abidjan (Mr. Camard). Mr. Nord (AFR) joined the team in Abidjan and Dakar. Mr. Allé (OED) accompanied the mission. The mission was assisted by Ms. Snyder and Mr. Shapiro.

WAEMU countries are Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal, and Togo.

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INTRODUCTION

1. **2011 was a challenging year for the WAEMU.** Côte d'Ivoire experienced a political crisis and armed conflict for several months after the presidential election held in November 2010. This crisis was the culmination of a decade of political instability, which had a major impact on its development. The crisis ended in April 2011 when President Ouattara took control of the country, but it had a severe economic impact. Subsequently, the new government embarked on an ambitious investment-led recovery. The early part of 2011 was also marked by rising food and fuel prices, which have a major economic and social impact on WAEMU countries. The second half of 2011 was marked by a drought that affected severely cereal production in the Sahel countries.

2. **This context has hindered the implementation of some of the recommendations made last year**. Macroeconomic policies have been broadly in line with Fund advice, mostly in the context of WAEMU countries' Fund-supported programs. However, progress on certain structural reforms has been slower than expected. In the financial sector, the priority of the authorities in 2011 was to contain the risk of a contagion from the Ivorian crisis, an objective that they successfully met. The situation in Côte d'Ivoire also prevented significant progress in the area of regional integration.

RECENT DEVELOPMENTS AND OUTLOOK

3. **Regional growth in 2011 (0.8 percent) was affected by the Ivorian crisis and the drought in the Sahel countries.** Côte d'Ivoire's economic activity contracted sharply in early 2011 as a result of the crisis, which led to an estimated annual GDP decline of 5.8 percent despite the subsequent recovery (Figure 1). The drought had a large impact on cereal production in Burkina Faso, Mali, Niger, [and Senegal] with estimated declines ranging from 7 to 27 percent. As a result, growth in these countries was significantly curtailed. The shortfall in the production of these traditional food crops also exposes millions of persons to food insecurity.

4. **Fuel and food prices had a significant impact on regional inflation.** The surge in international fuel and food prices pushed inflation up to a peak in the spring of 2011. The subsequent easing of these prices was accompanied by a quick drop in year-on-year inflation, which was below 3 percent at year-end. On average, annual consumer price inflation is estimated at 3.8 percent in 2011.

Figure 1. WAEMU: Recent Economic Developments, 2007—2011 [1]

Sources: IMF, African Department database, and Regional Economic Outlook database.

[1] Aggregate values for Sub-Saharan Africa exclude Nigeria, South Africa, and Zimbabwe.

5. The overall fiscal deficit (excluding grants) for the area as a whole widened in 2011. It is estimated to have increased from 5.5 percent of GDP in 2010 to 7.9 percent of GDP, mainly on account of the impact of the crisis in Côte d'Ivoire. Other factors include higher subsidies to the electricity sector in Senegal, the use of privatization revenue for investment projects in Mali, and lower tax revenue in Benin. Average public debt is estimated to have remained at about 42 percent of GDP in 2011.

6. The region's current account deficit rose to 5.7 percent of GDP in 2011. This increase (from about 5 percent of GDP in 2010) partly reflects lower worker remittances, larger imports related to mining in Burkina Faso and Niger, and higher food and fuel prices. However, thanks to strong capital inflows, the union's foreign exchange reserves increased and amounted to about six months' imports (excluding intra-WAEMU trade) at end-2011.

7. Progress in the area of convergence was mixed in the recent period. Although all the countries met the inflation criterion in 2009, only a minority of them still did so in 2011, because of the increase in international food and fuel prices. Most of the countries did not meet the key criterion on the fiscal deficit in 2011. On the other hand, progress was made regarding the indebtedness criterion, as a result of the debt relief granted to Togo and Guinea-Bissau in the context of the HIPC Initiative and MDRI.

WAEMU: Compliance with Convergence Criteria, 2008-2011
(Number of countries violating)

	2008	2009	2010	2011 Est.
First-order criteria				
Basic fiscal balance/GDP (≥ 0 percent) [1]	7	6	4	5
Average consumer price inflation (≤ 3 percent)	8	0	1	5
Total debt/GDP (≤ 70 percent)	3	2	0	0
Change in domestic arrears (≤ 0)	2	0	0	0
Change in external arrears (≤ 0)	2	2	0	1
Second-order criteria				
Wages and salaries/tax revenue (≤ 35 percent)	4	5	4	5
Capital expenditure domestically financed/tax revenue (≥ 20 percent)	3	3	4	3
External current account balance, excluding grants/GDP (≥ -5 percent)	7	7	7	7
Tax revenue/GDP (≥ 17 percent)	6	7	7	7

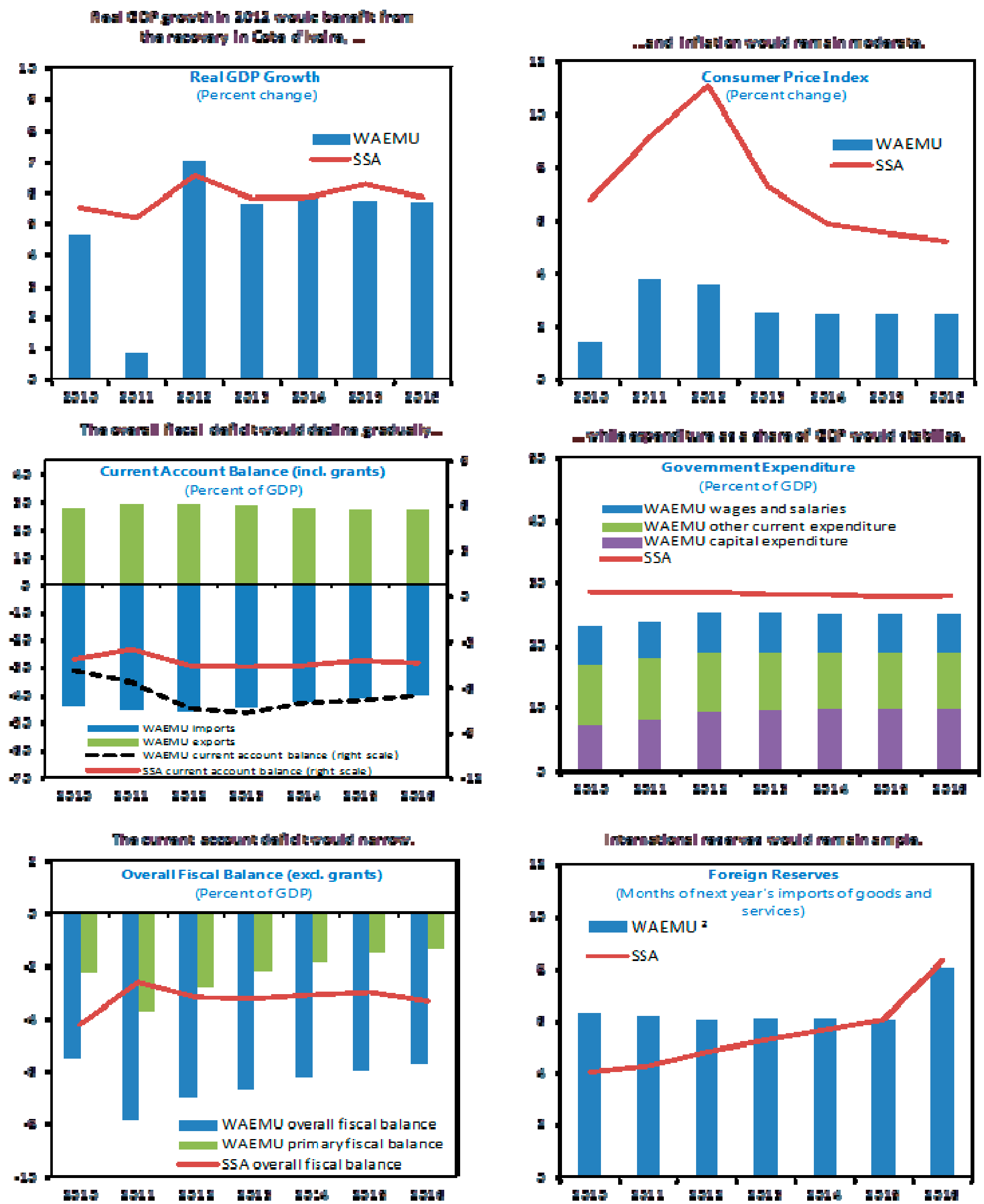
Sources: WAEMU; Central Bank of West African States (BCEAO); and staff estimates.

[1] Total fiscal revenues, excluding grants, minus total expenditures excluding foreign-financed investment expenditure. From 2009, total fiscal revenues plus budget support grants plus counterpart of HIPC/MDRI-related spending for both current and capital spending less current expenditure and capital expenditure financed by own resources.

8. Regional growth is expected to increase sharply in 2012 despite the deterioration in the international environment (Figure 2). The global slowdown in 2012 is expected to curtail growth, especially in countries most exposed to the advanced economies and notably to Europe (e.g., Côte d'Ivoire and Senegal). However, those same countries will benefit from strong domestic sources of growth, with the postcrisis recovery in Côte d'Ivoire, the increase in infrastructure investment, and the end of electricity outages, particularly in Senegal. Other domestic factors, such as new oil production facilities in Niger, are expected to boost regional growth, which could reach 7 percent in 2012 before easing in the medium term. With the global economic slowdown, international food and commodity prices would further decrease and help keep inflation around 3.5 percent in 2012, despite the impact of the drought on cereal prices in the affected countries.

9. The risks weighing on growth are to the downside. The main risk is that the external environment weakens further, particularly in the euro area if the debt crisis is not resolved quickly. Staff and the authorities discussed how the region would be affected if the downside scenario of the January 2012 World Economic Outlook (WEO) update materialized. There was broad agreement that the region's trade exposure to Europe remained substantial, although on the decline. Trade, worker remittances, foreign direct investment, and the terms of trade would be the main channels of transmission to the WAEMU. The authorities also expressed concern that aid from traditional donors might be significantly reduced. The financial sector, however, is mostly domestically funded and therefore has only limited direct exposure to Europe. Overall, the impact on growth in the region would be substantial (about 1.5 percentage point, see Appendix I). Insecurity and sociopolitical risks in the area, as well as the impact of the drought in the Sahel countries, are other sources of uncertainty for the macroeconomic environment.

Figure 2. WAEMU: Medium Term Outlook, 2010—2016 [1]



Sources: IMF, African Department database, and Regional Economic Outlook database.

[1] Aggregate values for Sub-Saharan Africa exclude Nigeria, South Africa, and Zimbabwe.
[2] Historical series based on BCEAO data, projections based on Regional Economic Outlook database.

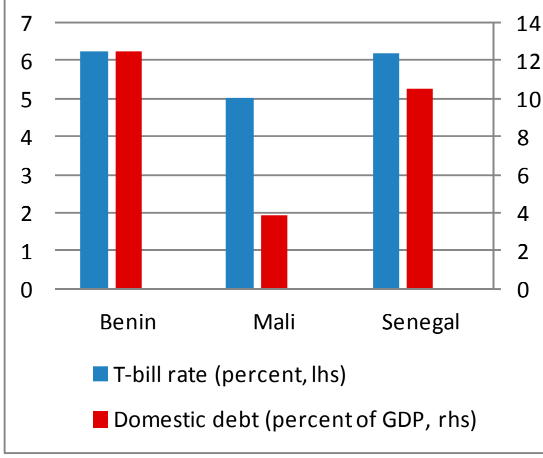
MACROECONOMIC POLICIES IN A HIGHLY UNCERTAIN ENVIRONMENT

10. The area-wide fiscal deficit is expected to narrow somewhat in 2012 (Figure 3). This evolution would largely reflect the normalization of the situation in Côte d'Ivoire and the reduction of its deficit, which the crisis had substantially increased. The deficit in the rest of the region is also expected to shrink, although less markedly.

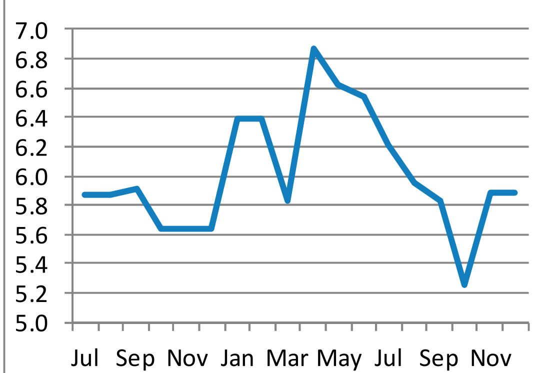
11. Monetary policy faced a challenging environment in 2011. The BCEAO had to manage the implications for the regional banking system of the Ivorian crisis, which led to the closing of Ivorian banks for several weeks. At the same time, inflation was rising. The BCEAO responded to these conflicting developments for monetary policy by maintaining its key interest rate at 4.25 percent while making large liquidity injections. It also coordinated, with the Ivorian authorities, the rollover (and eventual restructuring) of Ivorian debt. These measures helped prevent the crisis from spreading to other countries. Money supply continued to increase steadily, with year-on-year growth at about 13 percent in September 2011, reflecting a substantial increase in credit to the economy and to governments. Inflation eventually receded in the second half of 2011, confirming that the BCEAO's approach was appropriate (Figure 4).

12. Interest rates on government debt rose in early 2011 and subsequently eased. This pattern may reflect concerns about the impact of the crisis in Côte d'Ivoire and the impact of subsequent liquidity injections by the BCEAO. The level of interest rates at issuance across countries was highly correlated

Domestic debt and cost of borrowing, 2011



T-bill rates[1]



Source: BCEAO.
1/ Simple average rates on 12-month T-bills.

with the level of debt outstanding on the regional market.

Staff's advice

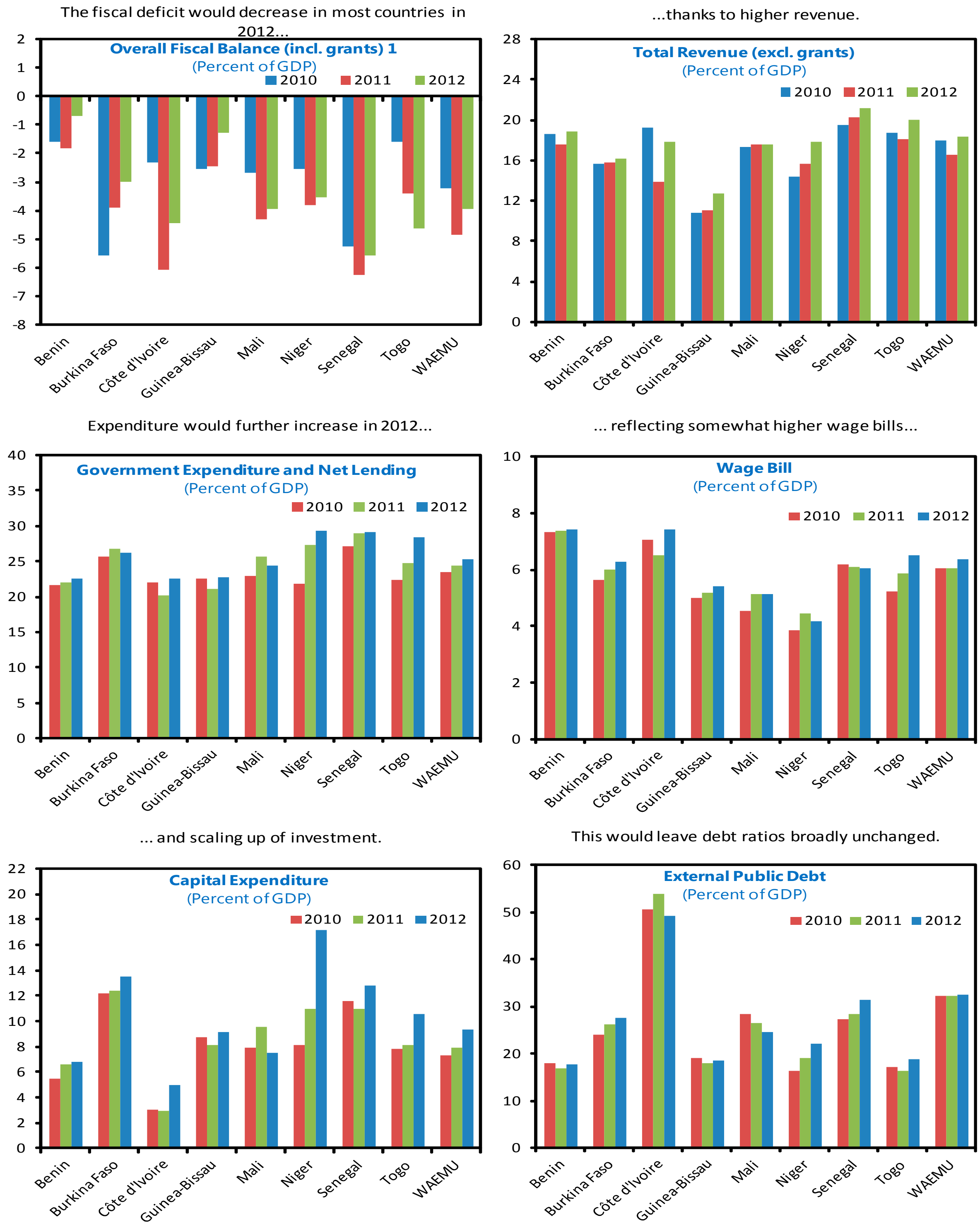
13. The regional fiscal position strikes an appropriate balance between the need

to increase public investment and fiscal sustainability considerations. Indeed, a number of countries in the region have set out to address their infrastructure gaps, particularly in energy and transportation, which represent major constraints to higher growth and faster poverty reduction. Reconstruction in Côte d'Ivoire will also require higher public investment. Finally, the drought is likely to require higher food security expenditures in Sahel countries. These temporary factors justify that the area-wide fiscal deficit will decrease only moderately in 2012 despite the expected sharp increase in growth.

14. The materialization of downside risks would likely require differentiated fiscal policy responses. While a monetary policy response might be needed for the region (see below), fiscal policy would have a key role to play in achieving the appropriate policy mix at the country level. Countries more affected by a further (temporary) global slowdown or by the drought may need to run higher deficits, provided they have enough fiscal space and financing available; those with limited or no space—such as the fragile states in the union—should try to mobilize more grants or concessional financing from the international community, In all cases, priority expenditure (e.g., for social safety nets and infrastructure investment) should be preserved to avoid exacerbating the economic and social effects of shocks.

15. Maintaining debt sustainability will require a reduction of fiscal deficits beyond 2012 in a number of countries. The area-wide public debt position would improve this year if, as currently expected, Côte d'Ivoire reaches the HIPC Initiative's completion point. In most WAEMU countries, the risk of debt distress is low or moderate according to the latest debt sustainability analyses. However, this assessment assumes that countries with large fiscal deficits reduce them over the medium term. This would also allow these countries to reconstitute the fiscal buffers required to implement countercyclical policies in the future. Maintaining debt sustainability will also require strengthening debt management capacity.

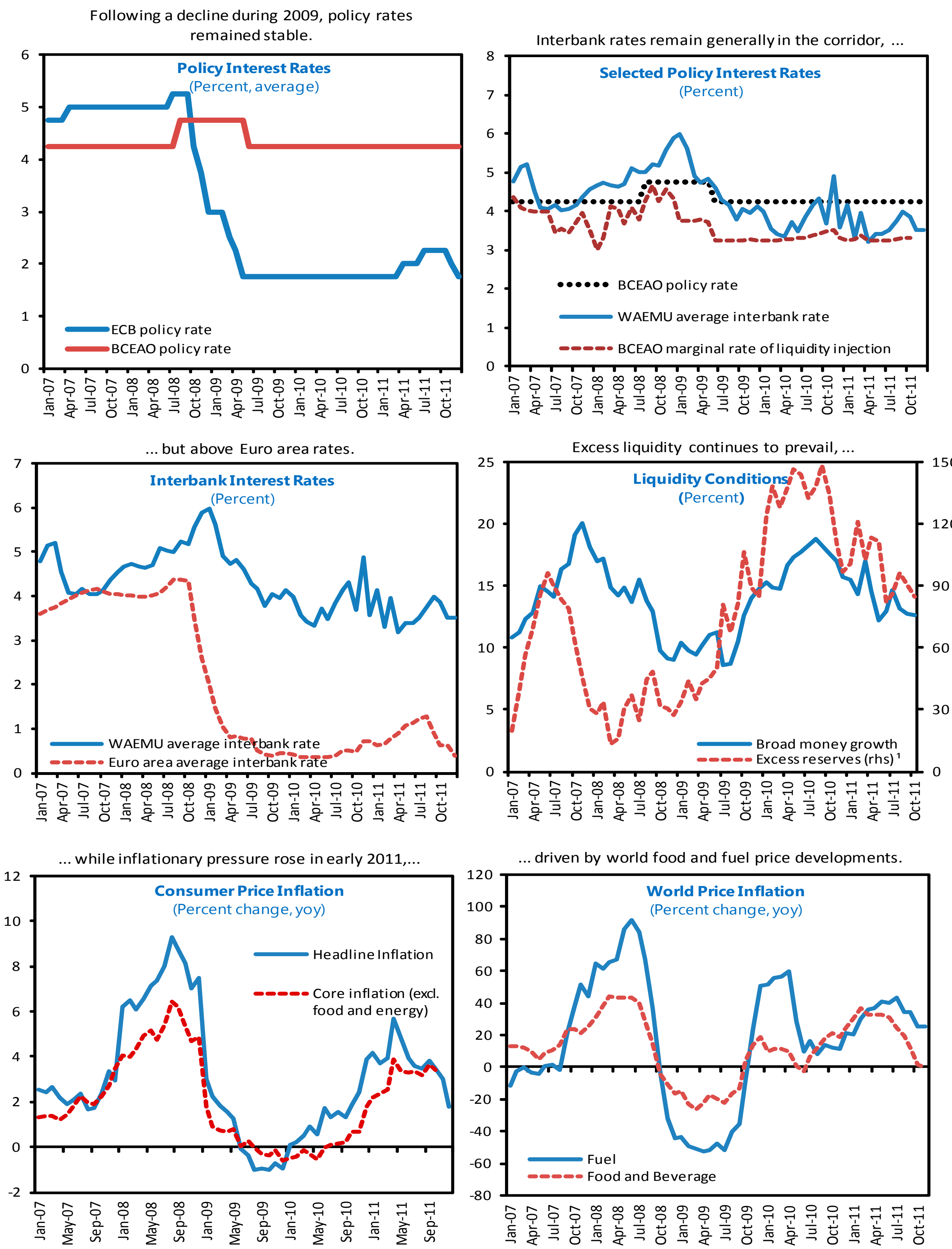
Figure 3. WAEMU: Fiscal Developments, 2010—2012



Sources: IMF, African Department database, and Regional Economic Outlook database.

[1] Does not include HIPC and MDRI debt relief in 2010 for Guinea Bissau and Togo, which record their fiscal accounts on cash basis. Preliminary data for Cote d'Ivoire in 2011.

Figure 4. WAEMU: Monetary Policy and Inflation, 2007—2011



Sources: BCEAO, IMF, African Department database, and Regional Economic Outlook database.

[1] Excess reserves as a percentage of required reserves.

16. The monetary policy stance remains appropriate, but a relaxation may be necessary if downside risks materialize. Inflation is expected to remain moderate for a number of reasons (e.g., output gap in Côte d'Ivoire, softening of international prices), and therefore the current monetary policy stance could be maintained in 2012. However, the possible impact on core inflation of the drought in the Sahel countries, and any inflationary pressure in Côte d'Ivoire if the recovery proves stronger than expected, must be closely monitored. Conversely, if a further global slowdown and decline in commodity prices occurs, monetary policy could be relaxed, and the BCEAO should stand ready to meet banks' liquidity needs.

17. Developing the interbank market and improving liquidity management should remain priorities for the BCEAO. Monetary policy implementation is seriously hampered by the presence of excess liquidity. While this phenomenon has many complex reasons, an important one is the limited development of the interbank market. A deeper market would enable banks to trade liquidity and would greatly reduce the need for injections by the BCEAO; it would also foster the emergence of a benchmark rate for the conduct of monetary policy. Effective liquidity management will also require more accurate liquidity forecasts. A critical issue here is to improve the capacity to forecast net government positions with the banking system. This will require a coordinated effort by the BCEAO and country authorities. Indeed, governments have significant scope to improve the management of their own liquidity, including by setting up, with BCEAO assistance, single treasury accounts. Good progress has been made in the past year in modernizing the BCEAO's tools for analyzing and forecasting inflation, but there is scope for pursuing these efforts further with IMF technical assistance.

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Authorities' views

18. The authorities broadly agreed with these recommendations. On fiscal policy sustainability, they expressed concern about the new risks raised by the rapid increase in domestic/regional borrowing (related to higher public investment and deficits in some countries) and emphasized the need for all member countries to persist with revenue mobilization efforts. Regarding the infrastructure gaps, they underscored that not only more investment was needed, but also that improving the quality of public expenditure was desirable.

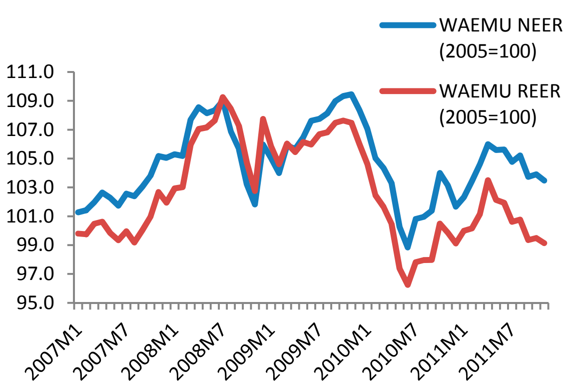
19. The BCEAO expects the interbank market reforms to be implemented in 2012. Substantial progress has been made in developing a technical platform, which is being tested. The BCEAO also indicated that significant legal work had been required to prepare the introduction of repurchase operations among banks. Repos will allow for collateralization of operations, which is required to overcome the reluctance of certain banks to trade with other banks.

STRENGTHENING THE STABILITY OF THE MONETARY UNION

20. The real effective exchange rate is broadly aligned. The equilibrium approach, the macroeconomic balance approach and the external sustainability approach all suggest that the exchange rate is broadly in line with fundamentals for the region. Other indicators closely monitored by the authorities do not suggest any area-wide price-competitiveness problem either. Foreign exchange reserves have continued to increase, are managed prudently, and are adequate given shocks likely to affect the region (Box 1). A devaluation rumor spread in late 2011, possibly fed by concerns about the future of the euro expressed at the time by some analysts. Staff analysis suggests that devaluation is not required by fundamentals. Also, the crisis in the euro area does not affect directly the franc zone, which is fundamentally an arrangement with the French treasury.

Box 1. WAEMU External Stability

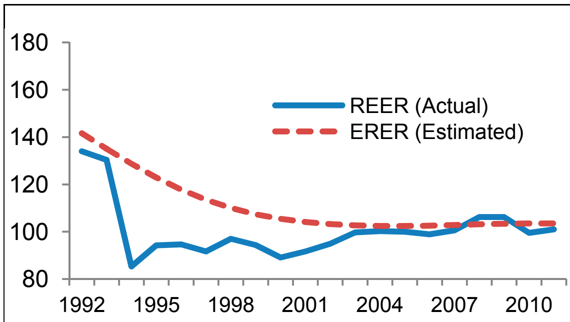
The real exchange rate is broadly in line with the region's fundamentals.



Both the nominal and the real effective exchange rate (NEER and REER) trended upward until end-2009, contributing to an erosion of price competitiveness. In 2010, however, the NEER and REER decreased markedly in the wake of the depreciation of the euro vis-à-vis third currencies. In 2011, both the NEER and the REER recorded a modest appreciation on average (less than 2 percent).

The REER was assessed in 2011 based on the three methodologies traditionally used by the Fund: the equilibrium real exchange rate (ERER) approach, the macroeconomic balance (MB) approach, and the external sustainability (ES) approach. The ERER approach estimates an equilibrium relationship between the REER, terms of trade, public consumption, the productivity differential, investment, and openness (see table for the coefficients of this relationship). The MB approach and the ES approach rely on current account norms. For the MB approach, the norm depends on underlying fundamentals such as the fiscal balance or demographics. In the ES approach, the current account norm stabilizes the net foreign asset position at a given level.

	Coefficients
Terms of Trade	0.46
Publice Consumption	0.60
Productivity Differential	0.28
Investment to GDP	-0.51
Openness	-0.01



All three methodologies suggest that the real exchange rate (and the current account) is broadly in line with its fundamentals. They indeed generate only small deviations from equilibrium, ranging from -2 percent (ERER approach) to +4 percent (ES approach).

The level of foreign exchange reserves looks adequate for the union as a whole.

Reserve adequacy is another important element in the assessment of external stability, because reserves are a way to insure against shocks. Reserves amounted to CFAF 7,445 billion (about $15 billion) at end-2011. By the traditional metrics of the coverage of imports (with more than 6 months) or broad money (60 percent), international reserves look ample. Reserves also cover close to 100 percent of short-term domestic liabilities.

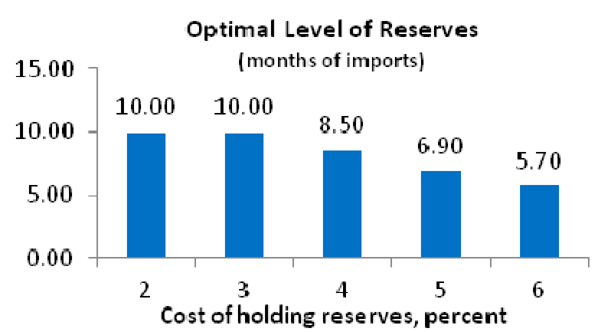
A more recent approach to assessing reserve adequacy (see Dabla-Norris et al., 2011) relies on a cost benefit-analysis of holding reserves, taking into account country-specific vulnerabilities. On the one hand, reserves mitigate the impact of macroeconomic volatility; the higher this volatility, the larger the benefits of holding reserves. On the other hand, holding reserves has an opportunity cost, which is often measured by the difference between the rate of remuneration of these reserves and the domestic interest rates.

This approach suggests that in countries with a fixed exchange rate and facing significant volatility (e.g., because of the importance of commodities in their production and export structure), the optimal level of reserves may exceed 3 months of imports. Applied to the WAEMU's actual data (see table below), the model suggest optimal levels ranging from 5 to 10 months, depending on the opportunity cost of holding reserves (with 4-5 percent probably constituting a credible range for the WAEMU).

Variables	
Government balance as a share of GDP	-3.97
CPIA	3.24
Flexible exchange rate regime	0
IMF program	1
(bottom 10 percentile over the past 10 years)	
External demand growth, percent	1.85
Terms of trade growth, percent	-6.40
Change in FDI as a share of GDP	-0.38
Change in aid as a share of GDP	-0.11

This is somewhat larger than for the full sample of low-income countries, and shows that external demand growth for the WAEMU was lower in the past 10 years than for other LICs because of the WAEMU's higher exposure to the euro area.

All these metrics, however, do not take into account the fact that the peg to the euro is guaranteed by the French Treasury. This guarantee constitutes an important risk mitigation factor.



21. Stress tests suggest that the regional banking sector is resilient but compliance with prudential regulation remains weak. It appears well capitalized on average, although about a third of the banks did not observe yet the new minimum capital requirement at end-2011. Nonperforming loans are high, at about 17 percent of all loans, although relatively well provisioned. Compliance with certain prudential norms remains low and some of these norms are not in line with international standards (e.g., on risk concentration). Stress tests confirmed that, on average, banks are vulnerable mainly to credit risk (Box 2).

22. The euro area crisis provides important lessons for the governance and stability of currency areas. The crisis has demonstrated the importance of: market flexibility, regional integration (including labor mobility), and the existence of fiscal space to facilitate adjustment to asymmetric shocks; fiscal discipline (and, ultimately, some form of fiscal integration); close monitoring of divergences in competitiveness and external balances (including with countries in the currency area); having an operational crisis management framework; and having an effective regional surveillance framework, including for the financial sector (see Appendix II). Given this experience, and keeping in mind some important differences between the euro area and the WAEMU, staff and the authorities initiated broad-ranging discussions on reforms that may strengthen the stability of the WAEMU.

Staff's advice

23. The ongoing review of the convergence criterion on public debt is welcome. As indicated in the previous consultation, the ceiling of 70 percent of GDP may be too high given current debt ratios. It is also high compared with the sustainability thresholds estimated in empirical studies and used, for example, in the debt sustainability analyses conducted by the IMF and the World Bank. The most recent estimates made in the context of the 2012 review of the Debt Sustainability Framework suggest thresholds generally below 70 percent. These empirical thresholds should be seen as ceilings beyond which the probability of debt distress becomes significant, rather than optimal levels to target. They could inform the authorities' ongoing review of the criterion.

24. More generally, the regional surveillance framework could be further strengthened. The recent introduction of new indicators to monitor real convergence and regional integration is. The scope, quality, and availability of economic and financial information in the union should be further enhanced. Recent efforts by the WAEMU Commission to centralize the information it collects and to coordinate and harmonize the region's statistics systems are steps in the right direction. Implementation of the six new directives on public financial management should be completed as soon as possible. Their transposition into national legal frameworks, which should have occurred by end-2011 is expected in the first half of 2012. Implementation of the directives will help harmonize the rules on budget preparation, presentation, approval, execution, and control, and encourage efficient, transparent public financial management in all the member countries. It will also facilitate the conduct of regional surveillance. The move toward

Box. 2. WAEMU: Banking System Soundness

Available financial soundness indicators suggest that the banking system is generally healthy. The authorities' assessment indicates that at end-2010, the WAEMU banks were on average well capitalized, with a risk-weighted capital adequacy ratio of 13 percent. Nonperforming loans (NPLs) stood at a high level (17 percent) and reflect to some extent legacy issues and the reluctance of banks to write down assets out of concern it could affect recoverey prospects. However,the rate of provisioning is relatively high (65 percent).

Stress tests were conducted by the mission to provide a more nuanced picture of vulnerabilities. These stress tests used the most recent data available for individual banks in each WAEMU country, which were provided by the authorities.[1] The degree of detail and the quality of data varied significantly across countries.[2] This limited staff's ability to perform some stress tests and to analyze some of the results. For instance, to examine the role of the government in the banking sector or assess the influence of foreign banks, it would have been useful to have information on banks' ownership in all countries. Similarly, it would have been useful to assess the macroeconomic risk stemming from banks' high exposure to governments.[3] Weaknesses in the bank data should also be kept in mind when interpreting the results. However, the exercise still provides useful insights, and staff welcomes the BCEAO's willingness to share information and develop expertise in this area.

The stress tests suggest that the banking system is mostly vulnerable to credit risk. This reflects that banks are mostly involved in lending (at fixed rates) to governments and the private sector. Six shocks were tested based on three broad categories of credit risk (Table 1). Under the most damaging scenario, the cost of recapitalization to meet minimum capital requirements would remain limited (at most 1.5 percent of GDP, in Senegal). This reflects, to a large extent, the small size of the banking sector (and more generally financial intermediation) in the WAEMU.

Table1. Stress Test—Credit Risk

	Shocks	Provisioning
Sectoral risk concentration	Default by the largest individual exposure	100%
	Non-extracative industry sector	100%
	Trade sector	100%
	Construction and public work sector	100%
Overall credit risks	Downgrade NPLs by one category	Current average rate
	50 percent increase in total NPLs	Current average rate
Credit risk related to public finance	Default on bank credit to the government and to public enterprises	100%
	Default by the largest individual public sector	100%

Liquidity risks vary across countries. Liquidity shocks were applied by simulating a run on the banks for 10 consecutive business days, giving the banks no recourse to emergency funds (from other banks or from the central bank). The same daily rates of deposit flight were calibrated. Results show that some national banking systems (e.g., Mali, Senegal) are more liquid than others and would show high resilience to a run on deposits, while others would be comparatively more vulnerable (e.g., Benin, Guinea Bissau, Togo). Overall, however, the liquidity position is rather strong.

[1] June 2011, except for Benin, Guinea-Bissau, Mali, and Niger (December 2010).

[2] NPL loans classification and required provisions data were not available for most of countries.

[3] In measuring capital adequacy, sovereign risk is weighted zero in the WAEMU, an issue which may need to be revisited in light of the recent Côte d'Ivoire crisis. Exposure to government contractors was not identifiable in the data provided and should be considered as a factor of sovereign risks.

accrual-basis accounting will, in particular, make it easier to monitor domestic arrears.

25. Some aspects of the financial crisis prevention and resolution system could also be reinforced. The system was severely tested with the Ivorian crisis, whose impact on the rest of the region the authorities managed to contain. However, this success should not preclude exploring how to improve the system further. A number of measures could be considered on the prevention side. Transparency should be increased, in particular through the compilation and routine publication of financial soundness indicators. An early warning system could be established, with regular stress tests performed. From this perspective, while the provision of detailed information to staff to conduct such tests was welcome, the authorities should accelerate the establishment of an electronic platform for reporting by credit institutions, which would make the data available more quickly. Prudential regulation could be enhanced by aligning some rules with international best practices (see Appendix II), pushing banks to strengthen their credit risk analysis, and improving compliance with prudential rules. The latter will require allocating more resources to bank supervision, which should also be strengthened for banking groups operating in the union and in other regions The financial crisis management system can also be further improved, in particular by introducing a deposit insurance system in due course and strengthening of the regulator's role in the bank resolution process.

Authorities' views

26. The authorities welcomed the discussion on convergence criteria, and suggested that a broader review of fiscal criteria might be needed. The WAEMU Commission presented ongoing work on the issue, which illustrated that both the debt and the fiscal deficit criteria have a key role to play in preventing excessive debt accumulation. The WAEMU Commission underscored the need to find criteria that would achieve this goal, while leaving sufficient space to member states to address their development needs and conduct counter-cyclical policies when needed. The authorities welcomed the staff's proposal to support their work in this area.

27. The authorities also broadly agreed with the need to explore how to strengthen the stability of the financial system. They welcomed the technical exchanges with staff on how to conduct stress tests. They indicated that prudential regulation would be reconsidered in their plan to move to Basel II, and that the resources of the Banking Commission would be increased substantially. Finally, the authorities said that they were considering the creation of a financial stability fund to address systemic crises, such as the one experienced recently in Côte d'Ivoire.

RAISING POTENTIAL GROWTH

A. Maximizing the Benefits of Côte d'Ivoire's Recovery Through Deeper Regional Integration

28. The end of the crisis in Côte d'Ivoire improves growth prospects for the region. Trade between Côte d'Ivoire and the rest of the region was severely affected by the 2011 crisis, and more broadly by a decade of political instability in the largest economy of the WAEMU. The flow of goods, services, and production factors is expected to rebound and especially benefit the landlocked countries. Over time, the entire area could become more attractive to foreign investors, especially if regional integration deepens (see Appendix III).

29. Regional integration remains limited. Nontariff barriers to intraregional trade persist in the union, but also at the West African level in the context of Economic Community of West African States (ECOWAS). Insufficient transportation and energy infrastructures are obstacles to reaping the full benefits of the common market.

Staff's advice

30. The national and regional authorities need to accelerate regional integration to make the most of Côte d'Ivoire's recovery. All barriers to intra-WAEMU trade, including non-tariff, import fees and export licensing, should be eliminated and labor mobility should be further facilitated. The elimination of obstacles to trade within the ECOWAS should also be pursued forcefully.

31. The study on the impact of an economic partnership agreement (EPA) between West Africa and the European Union should be completed as soon as possible. This study will assess the impact of such an agreement on businesses in the region and on public finances. It will be critical to prepare businesses for stronger competition and plan for a smooth tax transition. The WAEMU and the EU should then agree on the amount of financial support for the region during the transition.

32. The planned introduction of a fifth tariff band at 35 percent in the context of broadening the common external tariff to include all the ECOWAS countries is regrettable. This band will apply to products deemed sensitive on the basis of five relatively vague criteria (product vulnerability, economic diversification, regional integration, sectoral promotion, and producer effort). The adoption of these criteria, instead of the degree-of-processing criterion hitherto used in the WAEMU, reduces the consistency of the tariff from an incentives perspective. The fifth band may also lead to a substantial increase in the weighted average rate of the union's tariff and have a negative impact on the efficiency of resource allocation in the region. The list of products subject to this tariff band should be as short as possible.

Authorities' views

33. The authorities stressed the importance for the region of the recovery in Côte d'Ivoire and concurred on the need to accelerate regional integration. They hoped that Côte d'Ivoire would quickly reach the HIPC Initiative's completion point and benefit from debt relief, which would support the recovery. They underscored that regional integration is one of the main purposes of the Regional Economic Program (PER). They have drawn lessons from the relatively slow and incomplete implementation of the PER's first phase and made progress in preparing the second phase. The latter is scheduled for 2012 and will be reflected in the medium-term budgetary frameworks prepared by member countries.

B. Deepening Further the Financial Sector

34. Despite recent progress, the WAEMU financial sector remains shallow and access to financial services limited. Credit to the private sector amounts to only about 18 percent of GDP on average in the union. Although better information is needed concerning access to financial services, in particular through regular surveys, access is known to be low, with bank accounts held by only about 5 percent of the population. These ratios are low even by sub-Saharan Africa standards. Transactions on the regional interbank and stock markets are limited, and there is no secondary market in government securities. Although the banking system has excess liquidity, small and medium-sized enterprises experience difficulties in access to bank loans, with financing provided mostly to a few large enterprises and governments. Banks do limited maturity transformation (Box 3 and Appendix IV).

Staff's advice

35. Financial sector deepening is desirable. It would help raise potential growth and reduce poverty. The 2008 Financial Sector Assessment Program (FSAP), and the authorities' own analyses, diagnosed of the situation clearly and led to a series of recommendations. A number of measures have been implemented in recent years, but an acceleration of reform implementation is needed (Appendix V). The priority actions for 2012 should be to develop the interbank market, strengthen the public debt market, and review certain prudential rules that may excessively restrict access to credit, such as the transformation ratio. A more accommodating regulatory approach to financial innovation, at least in the early stages of development, could also be considered, to facilitate the diffusion of new financial services such as mobile banking.

Authorities' views

36. The authorities saw further financial deepening as a priority. They noted that access to financial services in the region is greater if microfinance is taken into account. They reported a number of new reforms, for instance on securitization and the development of a mortgage market, as concrete steps within their remit to develop the financial system.

37. The authorities also emphasized the need to preserve financial stability. They see the government debt market as an illustration of the challenges of increasing financial depth while maintaining stability. This market has developed very quickly in recent years, and enabled governments to diversify their financing sources and to raise funds denominated in local currency in a relatively flexible and predictable way. However, this new kind of financing creates new challenges for all the stakeholders. Borrowers have to develop their capacity to manage debt with higher costs and shorter maturities. Investors need to develop their capacity to assess sovereign risk. For the institutions in charge of the market, the challenges are to improve the functioning of the market (for example, through better issuance predictability an coordination, as well as the creation of a secondary market, led by primary dealers) and to broaden participation to nonbank institutions and, over time, to nonresidents.

Box 3. WAEMU: Financial Deepening Since 2006

The financial system in WAEMU has deepened since the last Financial Sector Stability Assessment (FSSA) was performed in 2008, despite the adverse impact of the global financial crisis. The ratio of broad money to GDP in the WAEMU increased from 24 percent in 2006 to 31 percent in 2010. In fact, all WAEMU countries experienced an increase, albeit at different rates (Mali too when 2011 is taken into account). In terms of annual percentage growth, Guinea-Bissau experienced the fastest rate, followed by Côte d'Ivoire, Togo, Benin, Burkina Faso, Niger, and Senegal (Figure 1). The ratio of domestic credit to the private sector to GDP, another measure of financial depth, recorded a similar evolution, with the highest annual growth rates in Guinea-Bissau, Niger, Benin, Togo, Côte d'Ivoire, and Senegal (Figure 2).

Figure 1: Broad Money (% of GDP)

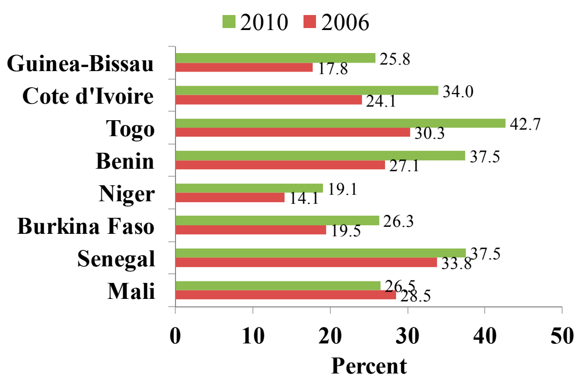
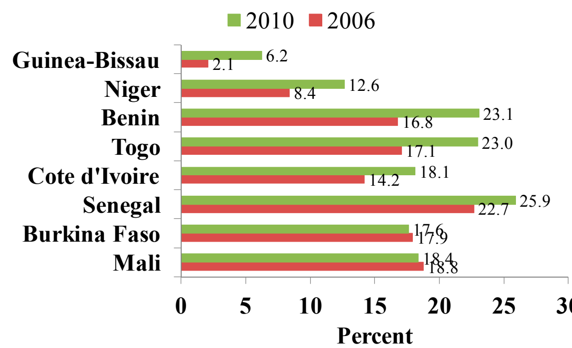


Figure 2: Domestic credit to private sector (% of GDP)



Source: World Development Indicators 2011, World Bank.

The regional stock market registered modest growth during the period and remains small. Market capitalization as a share of GDP increased from 24 percent in 2006 to 31 percent in 2010, although the number of listed firms declined from 40 to 38. Liquidity in terms of the value of stocks traded as a share of GDP remained very low compared to other stock exchanges in the SSA and decreased marginally.

A very dynamic segment of the financial sector in recent years has been the government securities market. By end-2011 annual issuances of government securities represented almost 10 percent of GDP. The fastest growth was observed in 2009–11, when the issuances of government securities increased sixfold, both in nominal terms and as a share of GDP and tax revenue. Despite the growth in this segment, government borrowing in the regional market is mainly short term.

Despite the deepening in 2006–2010, the financial system in the WAEMU continues to be characterized by very low levels of financial intermediation, even when compared with countries which have similar levels of GDP per capita. For instance, the ratio of broad money to GDP was 38 percent in 2010 in sub-Saharan Africa on average (excluding WAEMU and South Africa; see Appendix IV), against 31 percent in the WAEMU.

C. Other Reforms to Improve Economic Efficiency

38. Nonprice competitiveness must increase for potential growth to rise. This requires firm action on several fronts to improve the quality of institutions and infrastructures, reduce factor costs, and deepen the regional market. Sectoral policies in the union, especially those designed to ensure energy security, the free flow of the workers, and investment in human capital, contribute to these objectives.

39. Tax harmonization has progressed swiftly since the establishment of the union in 1994, with on average about 75 percent of the tax revenue of member countries stemming from harmonized or coordinated taxes. This reflects a shared conviction at the national and regional levels that the proper functioning of the common market requires a certain level of tax harmonization.

40. Energy price subsidies remain significant in most countries. Although most countries have automatic adjustment pricing policies for petroleum products, these policies have not been fully implemented. Implicit subsidies vary by products and countries, and can be significant. In addition, price disparities in the region and with neighboring countries (e.g., Ghana, Nigeria) foster informal trade and arbitrage. Electricity price subsidies further affects the fiscal accounts.

Staff's advice

41. Further tax harmonization could be considered in certain areas. A recent IMF technical assistance mission suggested a number of measures, for instance to prevent excessive tax competition among member states to attract foreign investment.

42. Work on the pricing of petroleum products should continue in a coordinated way at the regional level. This work could be done in the context of implementing the recommendations of the regional workshop organized by the WAEMU Commission with IMF support in August 2011. In particular, any subsidization in favor of petroleum products should take into account the need to prevent distortions in the common regional market and the incidence of the subsidy; in this regard, direct transfers are often more efficient and equitable than price subsidies.

Authorities' views

43. The WAEMU Commission wishes to play a more active role in these areas. In tax harmonization, it already plays a major role in the dissemination of analytical and factual information to encourage countries to comply with regional directives and raise their awareness about the costs of noncompliance. The Commission expressed interest in continued TA from the Fund on these topics.

STAFF APPRAISAL

44. After a sharp decline in 2011, regional growth is expected to experience a rebound in 2012. Growth in 2011 was severely affected by the Côte d'Ivoire crisis and, to a lesser extent, by the drought in Sahel countries. Despite a weakening external environment, a strong postcrisis recovery in Côte d'Ivoire and other domestic factors are expected to lead to high regional growth in 2012. Regional inflation would remain moderate in 2012 and over the medium term.

45. The macroeconomic policy stance remains appropriate. The fiscal stance was looser in 2011, but the area-wide deficit is expected to narrow somewhat in 2012. These developments reflect, to a large extent, developments in Côte d'Ivoire. Maintaining fiscal sustainability in the medium term will require a further reduction of deficits beyond 2012. Monetary policy was appropriate in 2011 and remains so; contagion from the Ivorian crisis was prevented and inflation receded in the second half of the year.

46. Risks are to the downside and, should they materialize, could require a loosening of macroeconomic policies. A sharper than envisaged slowdown in the euro area could require a loosening of monetary policy and differentiated fiscal policy responses, because it could affect countries asymmetrically and fiscal space varies across countries.

47. The stability of the union could be strengthened given the euro area experience. At about six months of regional imports, reserves are adequate and staff estimates suggest there is no area-wide real exchange rate misalignment. Improvements to the regional surveillance framework should be explored, starting with the provision and publication of better and timelier data. The ongoing review of the convergence criterion on debt is welcome, and a broader approach to fiscal sustainability could be considered. Although stress tests and the recent crisis in Côte d'Ivoire suggest that the regional financial sector is well capitalized overall and highly liquid, its stability could be increased through better prudential regulation, better observance of prudential rules (which will require strengthening supervision), and a more formal crisis management framework.

48. Regional integration and financial sector deepening offer opportunities to raise the region's potential growth. Côte d'Ivoire's growth prospects are strong. The return of stability there could be a game changer for the whole region, but reaping the full benefits will require rekindling the regional integration agenda. Financial deepening would also help increase potential growth and inclusion. Progress was made in the past few years, but the financial system remains shallow. The authorities' plans to make the interbank market operational and to broaden the government debt market in 2012 are important steps in the right direction. Other regional reforms aimed at improving nonprice competitiveness and increasing economic efficiency should be pursued, for instance in the area of tax harmonization and petroleum product pricing.

49. Although data are adequate for Fund surveillance purposes, transparency and information availability should be further improved. They help make policies and markets more effective. Staff welcomes the efforts initiated by the BCEAO and the WAEMU Commission and urges them to continue their actions vigorously and help make best practices more widespread within the union. The directives on public financial management should be implemented by WAEMU countries as soon as possible. Financial soundness indicators should be compiled and published routinely.

50. Staff welcomes the regional authorities' interest in closer relations with the Fund, and will explore ways to assist them most effectively. It is proposed that regional discussions with the WAEMU authorities remain on the standard 12-month consultation cycle.

Table 1. WAEMU: Selected Economic and Financial Indicators, 2008—2016

	2008	2009	2010	2011 Est.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
	(Annual percentage change)								
National income and prices									
GDP at constant prices	4.2	2.9	4.6	0.8	7.0	5.6	5.8	5.7	5.7
excluding Côte d'Ivoire	4.9	2.6	5.5	3.2	6.5	5.5	5.8	5.8	5.9
GDP per capita at constant prices	1.4	0.2	1.8	-1.9	4.1	2.8	3.0	2.9	2.9
excluding Côte d'Ivoire	2.2	0.0	2.8	0.5	3.7	2.8	3.0	3.1	3.1
Broad money to GDP	-3.5	9.5	8.9	6.6	…	…	…	…	…
Consumer prices (average)	7.4	0.4	1.4	3.8	3.6	2.5	2.5	2.4	2.4
Terms of trade	12.0	4.0	-4.5	1.3	2.8	1.8	-0.1	0.9	0.8
Nominal effective exchange rates	3.4	0.9	-4.3	1.7	…	…	…	…	…
Real effective exchange rates	5.8	0.2	-6.4	0.9	…	…	…	…	…
	(Percent of GDP)								
National accounts									
Gross domestic savings	12.8	15.5	13.5	13.5	13.5	13.8	14.6	15.3	15.9
Gross domestic investment	19.8	18.6	19.1	19.3	20.9	21.6	21.7	22.2	22.5
Of which: public investment	5.9	7.1	6.6	7.0	8.2	8.5	8.6	8.6	8.7
Resource gap	-7.0	-3.1	-5.5	-5.7	-7.5	-7.8	-7.1	-6.9	-6.6
	(Annual changes in percent of beginning-of-period broad money)								
Money and credit [1]									
Net foreign assets	0.3	5.8	3.1	5.5	…	…	…	…	…
Net domestic assets	12.4	10.8	14.6	8.9	…	…	…	…	…
Broad money	9.0	14.7	15.7	12.7	…	…	…	…	…
	(Percent of GDP, unless otherwise indicated)								
Government financial operations									
Government total revenue, excl. grants	17.6	17.4	18.0	16.5	18.3	18.7	19.0	19.2	19.4
Government expenditure	22.4	23.9	23.5	24.4	25.3	25.4	25.3	25.2	25.1
Overall fiscal balance, excl. grants	-4.8	-6.5	-5.5	-7.9	-7.0	-6.6	-6.3	-6.0	-5.7
Official grants	2.9	3.0	2.3	3.1	3.0	3.1	3.1	3.1	3.1
Overall fiscal balance, incl. grants	-1.9	-3.5	-3.2	-4.8	-3.9	-3.5	-3.1	-2.8	-2.7
Basic fiscal balance, incl. grants & HIPC	-1.8	-1.3	-0.8	-2.5	-1.9	-1.3	-0.9	-0.7	-0.5
External sector									
Exports of goods and services [2]	22.1	26.6	27.7	29.0	29.0	28.4	27.7	27.1	26.9
Imports of goods and services [2]	35.8	32.0	34.8	36.8	37.9	37.1	35.8	34.9	34.3
Current account, excl. grants[3]	-8.7	-5.7	-6.8	-7.7	-9.2	-9.2	-8.5	-8.3	-7.9
Current account, incl. grants[3]	-7.1	-3.6	-4.9	-5.7	-7.4	-7.7	-7.1	-6.9	-6.6
External public debt	33.8	35.6	32.3	32.2	32.6	32.8	33.3	33.0	32.4
Broad money	29.5	32.3	35.2	37.5	…	…	…	…	…
Memorandum items:									
Nominal GDP (in billions of CFA francs)	31,205	32,551	34,660	35,977	39,800	42,988	46,490	50,162	54,169.7
Nominal GDP per capita (in US dollars)	750	722	713	757	754	791	828	865	905
CFA franc per US dollars, average	448	472	495	471	…	…	…	…	…
Euro per US dollars, average	0.68	0.72	0.76	0.72	…	…	…	…	…
Foreign exchange cover ratio [4]	96.8	98.9	99.9	97.2	…	…	…	…	…
Reserves in months of imports (excl. intra-WAEMU imports)	5.7	6.2	6.3	6.2	6.0	6.1	6.1	6.0	7.9

Sources: IMF, African Department database; World Economic Outlook; IMF staff estimates.

[1]The estimates for 2011 refer to annual change at end-Oct, with the beginning-of-period referring to end-Oct 2010.

[2]Excluding intra-regional trade as estimated by BCEAO up to 2013.

[3]Data up to 2010 are corrected for intra-regional trade discrepancies by BCEAO.

[4]Gross official reserves divided by short term domestic liabilities (IMF definition). For 2011, the estimate refers to end-Oct.

Table 2. Sub-Saharan Africa: Cross-Group Comparison, 2008—2016

	2008	2009	2010	2011 Est.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
	(Annual percentage change)								
Real GDP									
WAEMU	4.2	2.9	4.6	0.8	7.0	5.6	5.8	5.7	5.7
CEMAC [1]	4.3	2.4	5.1	4.6	4.7	4.8	4.3	3.4	2.9
Sub-Saharan Africa [2]	5.7	2.8	5.3	4.9	5.5	5.3	5.5	5.7	5.4
Inflation (annual averages)									
WAEMU	7.9	1.0	1.2	3.4	3.6	2.5	2.5	2.4	2.4
CEMAC [1]	5.7	4.7	2.4	3.5	3.9	3.8	3.6	3.5	3.4
Sub-Saharan Africa [2]	11.7	10.6	7.5	8.3	9.2	6.8	5.7	5.5	5.4
Terms of trade									
WAEMU	12.0	4.0	-4.5	1.3	2.8	1.8	-0.1	0.9	0.8
CEMAC [1]	10.1	-17.5	12.3	10.2	-1.6	-0.6	-0.3	0.7	-1.3
Sub-Saharan Africa [2]	4.9	-7.1	13.2	4.4	-5.5	-1.5	-0.7	0.6	-0.5
	(Percent of GDP, unless otherwise indicated)								
Gross national investment									
WAEMU	19.8	18.6	19.1	19.3	20.9	21.6	21.7	22.2	22.5
CEMAC [1]	21.1	27.8	27.7	25.4	24.6	23.9	23.3	23.2	23.9
Sub-Saharan Africa [2]	22.2	22.5	22.0	21.5	22.0	22.4	22.7	22.8	22.7
Overall fiscal balance, incl. grants									
WAEMU	-1.9	-3.5	-3.2	-4.8	-3.9	-3.5	-3.1	-2.8	-2.7
CEMAC [1]	10.4	-0.6	1.3	3.3	1.3	1.6	1.6	1.5	1.0
Sub-Saharan Africa [2]	1.6	-5.6	-4.4	-2.4	-2.0	-2.0	-1.9	-1.7	-1.5
External current account, incl. grants									
WAEMU	-7.1	-3.6	-4.9	-5.7	-7.4	-7.7	-7.1	-6.9	-6.6
CEMAC [1]	7.3	-6.0	-7.2	-2.0	-2.2	-2.0	-2.2	-2.4	-3.5
Sub-Saharan Africa [2]	-0.2	-3.2	-2.5	-1.6	-2.8	-3.6	-3.9	-3.9	-4.0
External public debt									
WAEMU	33.8	35.6	32.3	32.2	32.6	32.8	33.3	33.0	32.4
CEMAC [1]	13.0	13.8	9.7	9.9	10.9	11.1	10.7	10.3	10.1
Sub-Saharan Africa [2]	10.7	11.6	9.5	9.4	9.8	10.0	10.0	10.0	9.9

Sources: IMF, African Department database; and staff estimates.

[1] Central African Economic and Monetary Community (CEMAC).

[2] Including Nigeria and South Africa.

[3] Gross official reserves divided by (base money plus government deposits).

Table 3. WAEMU: Selected National Accounts and Inflation Statistics, 2008—2016

	2008	2009	2010	2011 Est.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
				(Annual percentage change)					
Real GDP									
Benin	5.0	2.7	2.6	3.1	3.5	4.7	4.8	4.8	4.9
Burkina Faso	5.2	3.2	7.9	5.6	5.8	6.4	6.8	6.8	7.0
Côte d'Ivoire	2.3	3.8	2.4	-5.8	8.5	6.0	6.0	5.5	5.2
Guinea-Bissau	3.2	3.0	3.5	5.3	4.5	4.7	4.7	4.7	4.7
Mali	5.0	4.5	5.8	-0.3	8.9	6.0	5.6	5.8	5.6
Niger	9.6	-0.9	8.0	2.3	14.2	6.6	7.3	6.9	7.0
Senegal	3.2	2.2	4.2	3.6	3.6	4.5	5.0	5.4	5.5
Togo	2.3	3.4	4.0	4.1	4.4	4.6	4.8	4.4	4.3
WAEMU	4.2	2.9	4.6	0.8	7.0	5.6	5.8	5.7	5.7
Real GDP per capita									
Benin	2.2	-0.1	-0.2	0.3	0.7	1.9	1.9	2.0	2.0
Burkina Faso	2.8	0.8	5.5	3.2	3.4	4.0	4.4	4.4	4.6
Côte d'Ivoire	-0.7	0.7	-0.6	-8.6	5.3	3.0	2.9	2.4	2.2
Guinea-Bissau	1.0	0.7	1.2	3.1	2.2	2.5	2.4	2.4	2.4
Mali	1.8	1.3	2.7	-3.4	5.6	2.8	2.4	2.6	2.4
Niger	6.3	-3.9	4.7	-0.8	10.8	3.4	4.0	3.7	3.8
Senegal	0.8	-0.2	1.8	1.2	1.2	2.0	2.6	2.9	3.0
Togo	-0.2	0.9	1.5	1.6	1.8	2.0	2.2	1.8	1.7
WAEMU	1.4	0.2	1.8	-1.9	4.1	2.8	3.0	2.9	2.9
Inflation									
Benin	8.0	2.2	2.6	2.7	7.0	3.5	3.4	3.3	3.2
Burkina Faso	10.7	2.6	-0.6	1.9	2.0	2.0	2.0	2.0	2.0
Côte d'Ivoire	6.3	1.0	1.4	4.9	2.0	2.5	2.5	2.5	2.5
Guinea-Bissau	10.4	-1.6	1.1	4.8	3.5	2.5	2.0	2.0	2.0
Mali	9.1	2.2	1.3	3.0	7.0	2.8	2.8	2.9	2.9
Niger	10.5	1.1	0.9	2.9	4.5	2.0	2.0	2.0	2.0
Senegal	5.8	-1.7	1.2	3.4	2.8	2.1	2.1	2.1	2.1
Togo	8.7	1.9	3.2	3.6	2.0	3.2	2.9	2.7	2.6
WAEMU	7.4	0.4	1.4	3.8	3.6	2.5	2.5	2.4	2.4
				(Percent of GDP)					
Gross domestic savings									
Benin	10.1	11.9	9.1	9.8	12.0	12.5	13.3	13.8	14.3
Burkina Faso	9.0	12.3	15.4	13.6	10.3	10.6	11.1	11.4	11.9
Côte d'Ivoire	12.1	15.9	10.1	10.9	9.6	9.6	11.0	12.0	13.1
Guinea-Bissau	3.9	3.7	1.6	3.9	3.3	3.0	3.6	5.3	5.8
Mali	6.9	13.0	11.0	13.2	13.0	15.4	16.5	18.0	18.2
Niger	19.3	7.9	17.7	10.5	14.8	15.3	14.6	13.5	14.4
Senegal	20.0	23.1	25.3	22.6	24.0	23.2	23.8	24.6	25.2
Togo	10.5	11.3	11.7	11.1	11.7	12.3	12.9	12.7	12.2
WAEMU	12.8	15.5	13.5	13.5	13.5	13.8	14.6	15.3	15.9
Gross domestic investment									
Benin	18.1	20.8	16.3	17.6	18.3	18.8	18.7	19.0	19.5
Burkina Faso	20.2	16.7	19.0	17.6	17.5	17.4	17.3	17.7	18.8
Côte d'Ivoire	10.1	8.9	9.0	8.2	11.5	14.1	16.0	17.1	17.9
Guinea-Bissau	8.7	10.1	9.8	10.1	10.6	10.0	10.0	9.8	9.9
Mali	19.0	20.3	18.4	21.0	20.0	21.5	22.9	24.2	24.3
Niger	32.3	33.0	38.6	39.0	41.4	36.1	28.6	26.9	25.9
Senegal	34.1	29.8	31.4	30.7	32.6	32.5	32.7	32.8	32.8
Togo	17.3	18.0	18.8	18.6	20.9	21.9	22.5	21.5	20.8
WAEMU	19.8	18.6	19.1	19.3	20.9	21.6	21.7	22.2	22.5

Sources: IMF, African Department database; and staff estimates.

Table 4. WAEMU: Fiscal Balances, 2008—2016

	2008	2009	2010	2011 Est.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
				(Percent of GDP)					
Primary fiscal balance									
Benin	-1.4	-3.8	-1.0	-1.4	-0.1	-0.3	0.2	0.4	0.5
Burkina Faso	-4.1	-4.3	-5.1	-3.5	-2.6	-2.3	-2.0	-1.8	-1.7
Côte d'Ivoire	1.2	0.0	-0.6	-4.1	-2.7	-1.3	-0.8	-0.6	-0.4
Guinea-Bissau	-0.5	2.8	-1.9	-2.3	-1.2	-0.9	-0.7	-0.5	-0.6
Mali	-1.9	-3.9	-2.3	-3.7	-3.3	-2.0	-1.7	-1.7	-1.7
Niger	1.7	-5.2	-2.3	-3.4	-3.2	-4.4	-4.7	-4.2	-3.7
Senegal	-4.2	-4.3	-4.3	-5.0	-4.1	-3.2	-2.9	-2.3	-2.2
Togo	-0.1	-1.9	-0.6	-2.6	-3.8	-5.1	-4.1	-2.1	-1.7
WAEMU	-1.1	-2.6	-2.2	-3.7	-2.8	-2.2	-1.9	-1.5	-1.4
Overall fiscal balance (including grants)									
Benin	-1.7	-4.3	-1.6	-1.8	-0.7	-0.9	-0.3	0.0	0.1
Burkina Faso	-4.5	-4.8	-5.6	-3.9	-3.0	-2.7	-2.5	-2.3	-2.1
Côte d'Ivoire	-0.6	-1.6	-2.3	-6.1	-4.4	-3.7	-3.2	-3.2	-3.0
Guinea-Bissau	1.7	2.7	-2.5	-2.4	-1.3	-1.3	-1.1	-0.8	-0.9
Mali	-2.2	-4.2	-2.7	-4.3	-3.9	-2.6	-2.3	-2.3	-2.3
Niger	1.5	-5.5	-2.6	-3.8	-3.5	-4.8	-5.1	-4.6	-4.0
Senegal	-4.6	-4.8	-5.2	-6.3	-5.6	-4.7	-4.4	-3.8	-3.7
Togo	-0.9	-2.8	-1.6	-3.4	-4.6	-5.9	-5.0	-3.1	-2.8
WAEMU	-1.9	-3.5	-3.2	-4.8	-3.9	-3.5	-3.1	-2.8	-2.7
Government revenue (commitment basis, excluding grants)									
Benin	19.6	18.5	18.6	17.6	18.9	19.3	19.7	19.9	19.9
Burkina Faso	13.1	13.7	15.6	15.8	16.2	16.1	16.4	16.7	17.0
Côte d'Ivoire	18.9	18.9	19.2	13.9	17.8	18.8	19.2	19.6	19.8
Guinea-Bissau	9.2	9.0	10.8	11.0	12.7	12.9	13.1	13.3	13.4
Mali	15.5	17.1	17.3	17.6	17.5	17.7	18.0	18.0	18.1
Niger	18.4	14.7	14.4	15.7	17.9	18.8	19.1	19.8	20.6
Senegal	19.4	18.6	19.4	20.3	21.2	21.2	21.2	21.2	21.0
Togo	15.6	16.9	18.8	18.0	20.0	18.8	18.9	19.0	19.0
WAEMU	17.6	17.4	18.0	16.5	18.3	18.7	19.0	19.2	19.4
Government expenditure									
Benin	23.0	26.0	21.6	21.9	22.5	22.3	22.1	21.9	21.8
Burkina Faso	21.6	24.4	25.7	26.7	26.1	25.3	25.1	25.1	25.1
Côte d'Ivoire	21.1	21.1	22.0	20.2	22.6	23.5	23.5	23.8	23.9
Guinea-Bissau	26.1	22.4	22.5	21.0	22.7	23.0	23.0	22.9	22.9
Mali	21.2	25.9	22.9	25.6	24.4	23.5	23.6	23.8	23.9
Niger	22.8	24.6	21.8	27.3	29.3	31.3	31.7	31.6	31.7
Senegal	26.5	26.7	27.2	28.9	29.1	28.2	27.8	27.2	26.7
Togo	17.9	21.2	22.4	24.8	28.5	28.5	28.1	26.7	25.9
WAEMU	22.4	23.9	23.5	24.4	25.3	25.4	25.3	25.2	25.1
Government current expenditure									
Benin	15.7	15.9	15.5	15.0	15.6	15.6	15.5	15.4	15.3
Burkina Faso	12.3	12.7	12.2	13.5	12.8	12.1	11.9	11.9	11.9
Côte d'Ivoire	17.9	17.9	18.6	17.3	17.6	17.8	17.4	17.5	17.4
Guinea-Bissau	13.9	12.1	11.9	12.2	13.2	13.6	13.6	13.5	13.5
Mali	11.7	13.0	12.9	14.7	15.5	14.0	13.8	13.7	13.7
Niger	12.5	12.1	13.7	14.8	12.2	13.4	13.9	14.1	14.2
Senegal	16.5	16.6	15.6	17.4	16.4	15.8	15.6	15.1	15.0
Togo	14.7	15.7	14.6	16.7	17.9	16.7	16.1	16.2	16.2
WAEMU	15.4	15.6	15.6	16.0	15.8	15.5	15.3	15.2	15.1
Government capital expenditure [1]									
Benin	5.9	9.7	5.5	6.6	6.8	6.7	6.6	6.5	6.5
Burkina Faso	8.9	11.6	12.2	12.4	13.5	13.2	13.2	13.2	13.2
Côte d'Ivoire	3.0	3.1	3.1	2.9	5.0	5.6	6.0	6.2	6.4
Guinea-Bissau	10.6	9.2	8.8	8.1	9.2	9.2	9.2	9.2	9.2
Mali	7.5	10.8	7.9	9.5	7.5	8.0	8.4	8.7	8.8
Niger	10.3	12.5	8.1	11.0	17.2	17.9	17.8	17.6	17.6
Senegal	10.0	10.1	11.6	10.9	12.8	12.4	12.3	12.1	11.7
Togo	3.2	5.5	7.8	8.1	10.6	11.8	12.0	10.5	9.6
WAEMU	6.6	7.9	7.3	7.9	9.4	9.6	9.8	9.8	9.8

Sources: IMF, African Department database; and staff estimates.
[1] Excludes net lending.

Table 5. WAEMU: External Balances, 2008—2016

	2008	2009	2010	2011 Est.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
				(Percent of GDP)					
Exports of goods and services									
Benin	17.8	16.7	17.8	18.0	18.8	18.1	18.1	17.9	17.8
Burkina Faso	10.0	12.4	18.1	24.3	24.7	24.4	24.4	23.1	21.7
Côte d'Ivoire	48.7	50.9	51.5	52.4	48.9	45.9	43.6	42.2	42.0
Guinea-Bissau	15.5	15.4	17.7	23.5	19.5	19.5	19.3	19.2	19.2
Mali	29.2	23.7	24.9	28.9	31.0	31.3	29.4	27.7	26.2
Niger	19.4	20.9	21.4	23.3	27.0	27.6	28.7	30.5	30.4
Senegal	26.3	24.4	24.8	23.8	23.4	23.5	22.9	22.4	22.5
Togo	35.5	36.7	37.1	37.5	37.5	37.7	37.7	37.8	37.8
WAEMU[1]	22.1	26.6	27.7	29.0	29.0	28.4	27.7	27.1	26.9
Imports of goods and services									
Benin	31.1	30.0	29.1	29.1	28.7	27.9	27.0	26.6	26.5
Burkina Faso	26.6	23.3	27.2	34.5	36.5	35.9	34.9	33.5	32.4
Côte d'Ivoire	41.2	39.0	44.1	44.1	45.0	44.3	42.8	41.7	41.3
Guinea-Bissau	31.1	29.1	28.6	31.2	28.4	27.3	26.1	24.7	23.9
Mali	43.0	31.4	33.5	36.6	38.1	36.1	34.7	33.0	31.7
Niger	36.3	48.1	50.3	56.1	55.2	49.0	43.3	43.2	40.6
Senegal	52.8	41.3	41.2	41.8	41.0	41.5	40.1	38.7	38.2
Togo	52.0	52.3	53.5	55.5	57.4	57.6	57.9	57.6	56.9
WAEMU[1]	45.9	41.5	44.0	45.7	45.9	44.5	42.6	41.3	40.2
External current account (excl. grants)									
Benin	-11.1	-12.8	-10.2	-9.8	-8.6	-8.4	-7.5	-7.2	-7.3
Burkina Faso	-14.7	-8.8	-7.5	-8.7	-10.4	-10.2	-9.3	-9.3	-9.6
Côte d'Ivoire	0.8	4.9	0.4	1.6	-2.7	-4.6	-5.1	-5.2	-5.0
Guinea-Bissau	-11.3	-14.4	-11.8	-9.1	-10.8	-10.5	-9.9	-9.3	-8.8
Mali	-13.4	-9.2	-9.2	-9.3	-9.2	-7.4	-7.6	-7.4	-7.4
Niger	-15.2	-25.7	-26.8	-32.6	-30.0	-24.1	-17.2	-16.4	-14.3
Senegal	-14.7	-7.1	-6.4	-8.7	-9.1	-9.9	-9.4	-8.8	-8.2
Togo	-8.3	-8.2	-9.2	-10.9	-13.0	-13.3	-13.8	-13.4	-11.9
WAEMU	-8.7	-5.7	-6.8	-7.7	-9.2	-9.2	-8.5	-8.3	-7.9
External current account (incl. grants)									
Benin	-8.1	-8.9	-7.2	-7.9	-6.2	-6.3	-5.4	-5.2	-5.2
Burkina Faso	-11.2	-4.4	-3.6	-4.0	-7.2	-6.9	-6.2	-6.3	-6.8
Côte d'Ivoire	1.9	7.0	1.1	2.7	-2.0	-4.5	-5.0	-5.1	-4.9
Guinea-Bissau	-4.9	-6.4	-8.3	-6.2	-7.3	-7.0	-6.3	-4.7	-4.4
Mali	-12.2	-7.3	-7.5	-7.8	-7.0	-6.2	-6.4	-6.2	-6.2
Niger	-13.0	-25.0	-21.1	-28.5	-26.6	-20.8	-14.1	-13.5	-11.5
Senegal	-14.2	-6.7	-6.1	-8.2	-8.6	-9.3	-8.8	-8.2	-7.6
Togo	-6.8	-6.6	-7.1	-7.5	-9.2	-9.5	-9.6	-8.8	-8.0
WAEMU	-7.1	-3.6	-4.9	-5.7	-7.4	-7.7	-7.1	-6.9	-6.6

Sources: IMF, African Department database; and staff estimates.

[1]Includes intraregional trade

Table 6. WAEMU: Government Debt, 2008—2016

	2008	2009	2010	2011 Est.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
	(Percent of GDP)								
External Debt									
Benin	15.6	16.2	17.9	17.0	17.7	17.9	17.8	17.7	17.7
Burkina Faso	19.7	23.1	24.0	26.2	27.5	28.0	28.4	28.8	29.0
Côte d'Ivoire	61.9	53.9	50.6	53.8	49.1	49.5	49.1	46.1	42.8
Guinea-Bissau	122.8	127.8	19.0	17.9	18.5	18.3	17.2	17.3	16.6
Mali	18.9	20.7	28.5	26.3	24.6	21.6	22.4	23.2	24.0
Niger	13.9	15.7	16.4	19.0	22.0	25.4	28.5	31.5	34.0
Senegal	19.7	27.0	27.5	29.8	31.5	31.8	32.8	33.6	34.1
Togo	56.0	55.1	17.1	16.4	18.7	20.8	22.1	22.1	21.8
WAEMU	33.8	35.6	32.3	32.2	32.6	32.8	33.3	33.0	32.4
Domestic Debt									
Benin	10.0	11.8	12.1	13.4	12.1	10.7	9.5	8.3	7.1
Burkina Faso	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Côte d'Ivoire	13.4	12.6	15.8	15.4	14.4	13.7	13.6	13.7	13.7
Guinea-Bissau	34.8	36.0	29.9	26.3	24.4	22.2	20.2	18.3	16.6
Mali	2.5	3.0	3.6	3.8	3.1	2.7	2.3	2.0	1.8
Niger	7.0	8.1	6.8	5.9	4.5	3.5	2.6	1.8	1.2
Senegal	5.3	7.6	8.4	10.6	11.6	12.4	12.5	12.3	12.0
Togo	22.2	15.1	15.0	13.5	13.3	12.4	11.8	11.4	11.1
WAEMU	8.7	8.9	9.9	10.0	9.5	9.1	8.7	8.4	8.1
Total Debt									
Benin	25.6	28.0	30.0	30.4	29.8	28.6	27.3	26.0	24.8
Burkina Faso	19.7	23.1	24.0	26.2	27.5	28.0	28.4	28.8	29.0
Côte d'Ivoire	75.3	66.5	66.4	69.2	63.5	63.3	62.7	59.8	56.6
Guinea-Bissau	157.6	163.8	49.0	44.3	42.9	40.5	37.3	35.6	33.2
Mali	21.4	23.7	32.1	30.2	27.7	24.3	24.7	25.2	25.8
Niger	20.9	23.8	23.2	24.8	26.5	28.8	31.1	33.3	35.2
Senegal	25.0	34.6	35.9	40.4	43.1	44.2	45.4	45.8	46.1
Togo	78.2	70.2	32.1	29.9	32.0	33.2	33.9	33.5	32.9
WAEMU	42.6	44.5	42.2	42.3	42.0	41.9	42.1	41.4	40.5

Source: IMF, African Department database.

Table 7. WAEMU: Monetary Survey , Dec 2009—Sep 2011

	2009 Dec.	2010 Mar.	2010 Jun.	2010 Sep.	2010 Dec	2011 Mar.	2011 Jun.	2011 Sep
	(Billions of CFA francs)							
Net foreign assets	5,061	5,047	5,188	4,980	5,385	5,144	5,423	5,549
Net domestic assets	5,287	5,260	5,670	6,050	6,587	6,916	6,847	6,886
Domestic credit	7,193	7,218	7,450	7,987	8,643	8,993	9,004	9,262
Net credit to government	1,077	1,439	1,402	1,625	1,842	2,215	1,903	2,111
Net credit to the economy	6,116	5,779	6,049	6,362	6,801	6,778	7,101	7,150
Claims on private sector	6,114	5,778	6,046	6,357	6,796	6,775	7,097	7,149
Claims on other financial institutions	1.59	1.56	2.93	5.15	4.19	2.27	3.91	1.11
Other items, net	1,906	1,959	1,781	1,937	2,056	2,077	2,157	2,375
Broad Money	10,348	10,306	10,858	11,030	11,972	12,060	12,270	12,435
Money	6,741	6,677	6,947	6,933	7,709	7,779	7,914	7,992
of which: Currency in circulation	3,118	2,967	2,992	2,971	3,559	3,447	3,397	3,232
Quasi-money	3,607	3,629	3,911	4,097	4,263	4,280	4,355	4,443
	(Year on year percent change)							
Net foreign assets	11.6	14.6	19.5	14.0	6.4	1.9	4.5	11.4
Net domestic assets	17.9	15.0	16.2	21.9	24.6	31.5	20.8	13.8
Domestic credit	18.3	15.5	15.2	19.5	20.2	24.6	20.9	16.0
Net credit to government	137.7	122.2	75.8	93.2	71.0	53.9	35.8	29.9
Net credit to the economy	8.7	3.1	6.7	8.9	11.2	17.3	17.4	12.4
Claims on private sector	8.7	3.1	6.7	8.9	11.2	17.3	17.4	12.5
Claims on other financial institutions	60.6	57.6	55.0	294.5	163.8	45.5	33.6	-78.4
Other items, net	19.4	16.8	12.1	12.8	7.9	6.0	21.1	22.6
Broad Money	14.7	14.8	17.7	18.2	15.7	17.0	13.0	12.7

Source: IMF, *International Financial Statistics* .

Table 8. WAEMU: Financial Soundness Indicators for the Banking Sector, 2006-2010
(In percent)

	2006 Dec.	2007 Dec.	2008 Dec.	2009 Dec.	2010 Dec.
Solvency ratio					
Regulatory capital to risk weighted assets	8.4	6.8	9.8	10.2	13.0
Tier I capital to risk-weighted assets	8.0	6.0	9.4	9.8	12.8
Provisions to risk-weighted assets	14.2	12.8	12.2	11.0	11.3
Capital to total assets	5.5	4.3	6.1	6.2	6.5
Quality of assets					
Total loans to total assets	61.9	59.1	59.4	57.6	59.2
Concentration loans to 5 largest borrowers to capital	173.8	212.0	135.6	135.6	…
Gross NPLs to total loans	18.5	18.9	19.2	17.9	17.2
Net NPLs to total loans	7.8	7.4	7.1	7.3	6.9
Provisioning rate	62.5	65.7	68.0	63.6	64.5
Liquidity					
Total loans to total deposits	37.9	38.4	83.3	78.5	82.0
Total deposits to total liabilities	85.7	78.9	35.8	37.3	76.1
Sight deposits to total liabilities	47.8	40.5	-1.1	1.2	40.5
Term deposits to total liabilities	37.9	38.4	36.9	36.1	35.6
Profitability					
ROE	23.4	4.8	1.9	11.2	10.4
Net intermediation margin to total assets (NIMA)	7.4	7.5	8.0	7.6	8.0

Source: BCEAO

Table 9. WAEMU: Main Features of WAEMU Economies in 2010 [1]

	Benin	Burkina Faso	Côte d'Ivoire	Guinea-Bissau	Mali	Niger	Senegal	Togo	WAEMU Total
Population (millions)	8.8	16.5	19.7	1.5	15.4	15.5	12.4	6.0	95.9
Land area (thousands of sq.km.)	110.6	273.6	318.0	28.1	1220.2	1266.7	192.5	54.4	3464.2
GNP (billions of U.S. dollars)	6.9	9.0	23.0	0.9	9.1	5.7	13.5	3.0	71.2
GNP per capita (current U.S. dollars)	780	550	1160	590	600	370	1090	490	704
Agriculture, value added (percent of GDP) [2]	32.2	34.1	22.9	n.a.	36.5	39.6	16.7	43.5	32.2
Industry, value added (percent of GDP) [2]	13.4	22.4	27.4	n.a.	24.2	17.1	22.1	23.9	21.5
Services, etc. value added (percent of GDP) [3]	54.4	44.4	49.7	n.a.	39.1	43.2	61.1	32.4	46.3
Exports of goods (billions of U.S. dollars)	0.8	1.4	10.9	0.1	2.0	1.0	2.2	0.9	19.3
Imports of goods (billions of U.S. dollars)	1.4	1.7	7.5	0.2	2.3	1.8	4.2	1.3	20.4
Intraregional trade [4]									
Exports (in percent of total)	15.9	9.0	10.5	7.3	5.0	1.9	33.7	41.3	14.6
Import (in percent of total)	3.9	33.1	1.2	20.2	27.1	12.8	2.4	6.8	8.6
Share of individual countries (in percent) [5]									
In GNP	9.8	12.7	32.3	1.3	12.9	8.0	19.0	4.2	100.0
In exports	4.2	7.4	56.3	0.6	10.2	5.3	11.4	4.6	100.0
In imports	6.9	8.5	36.8	0.9	11.1	8.8	20.4	6.5	100.0
In net domestic assets	6.0	6.6	30.4	0.3	6.2	3.1	17.0	5.0	74.6
In net foreign assets	13.5	12.0	25.7	1.7	13.4	5.4	18.3	4.8	94.8

Sources: World Bank, *World Development Report*; IMF, *Direction of Trade Statistics*; and staff estimates.

[1] Unless otherwise indicated.

[2] Data shown for Benin is 2005, Burkina Faso is 2006, Mali is 2007, Niger is 2003, Togo is 2005.

[3] Data shown for Benin is 2005, Burkina Faso is 2006, Mali is 2006, Niger is 2003, Togo is 2005.

[4] Exports to and imports from WAEMU countries in percent of total exports and imports.

[5] Totals may not add up to 100 because of statistical discrepancy.

APPENDIX I: Exploring Risks to the WAEMU from a Weaker Global Environment

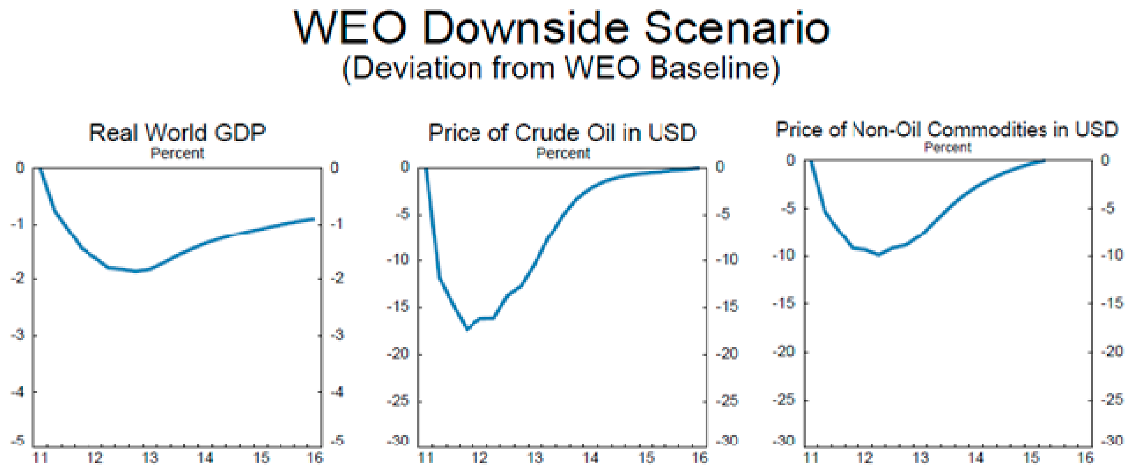
This note was prepared by Christina Kolerus with excellent support from Dirk Muir (RES) and Doug Shapiro (AFR).

The baseline scenario for 2012 described in the staff report assumes a slowdown of the world economy. The main risk to this scenario is that the external environment weakens further, particularly in the euro area if the debt crisis is not resolved quickly. This note explores how the WAEMU would be affected if the downside scenario of the January 2012 WEO update materialized. In this scenario, global real GDP growth is about 2 percentage points lower than in the baseline (4 percentage points in Europe). Trade, worker remittances, foreign direct investment, and the terms of trade would be the main channels of transmission to the WAEMU. Aid might also be significantly reduced. The financial sector, however, is mostly domestically funded and therefore has only limited direct exposure to Europe. Overall, the impact on growth in the WAEMU would be substantial (about 1.5 percentage point)..

A. Assumptions of the Adverse Scenario

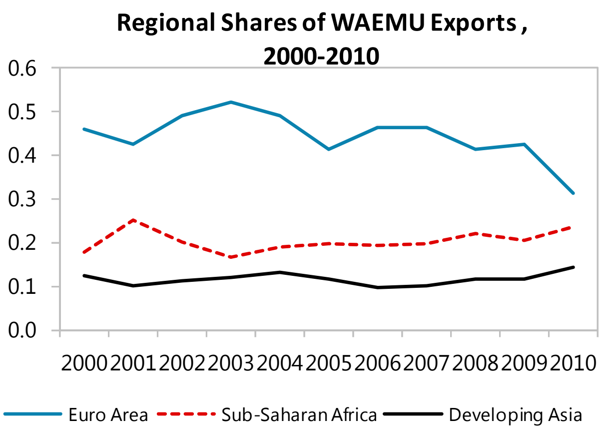
The adverse scenario is based on the January 2012 WEO downside scenario. In the latter, the adverse feedback loops between sovereign and bank funding pressures in the euro area intensify, resulting in much larger and more protracted bank deleveraging and sizable contractions in credit and output. Euro area countries, in particular those in Southern Europe, are under pressure to frontload fiscal consolidation which, together with higher interest rate spreads and bank deleveraging, adversely affects euro area investment and growth.

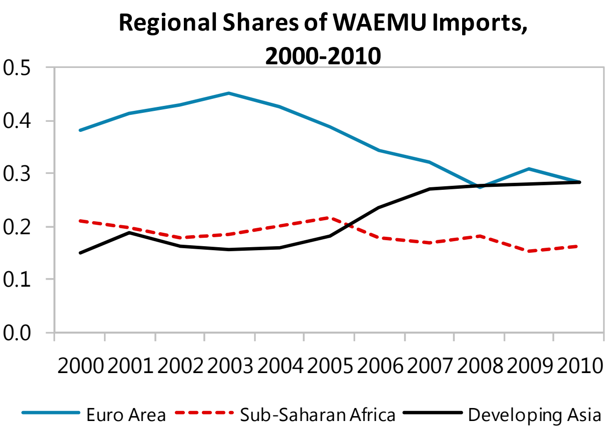
In this scenario global real GDP growth is about 2 percentage points lower than in the baseline. The recession is significantly larger in the euro zone with a reduction in output by 4 percentage points. Commodity prices fall accordingly: oil prices and non-oil commodities prices are 10-20 percent below their baseline levels. The euro is expected to depreciate during the first year of the crisis and consumption, in particular of those households without access to credit, drops significantly while inflation decreases.



B. Likely Channels of Transmission to the WAEMU

Trade would remain an important transmission channel even though the share of the euro area in total trade has declined. The euro zone remains the largest trade partner of the WAEMU region, particularly on

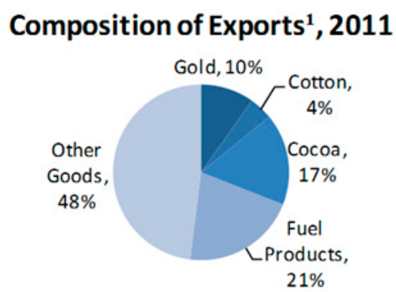




the export side, although the shares of sub-Saharan Africa and Asia have been on the rise. With a decline in demand from the euro area, and to a lesser extent from the rest of the world, WAEMU exports are likely to be significantly affected.

Commodity price changes could have a major impact on the WAEMU external accounts and incomes. The composition of exports shows a large share of commodities, leaving the region exposed to world market price volatility (and individual member countries exposed to asymmetric shocks). In 2011, half of the region's exports were commodities, such as fuel products, gold, cotton, and cocoa. This share is expected to continue increasing owing to new mines and oil production facilities in certain WAEMU countries.

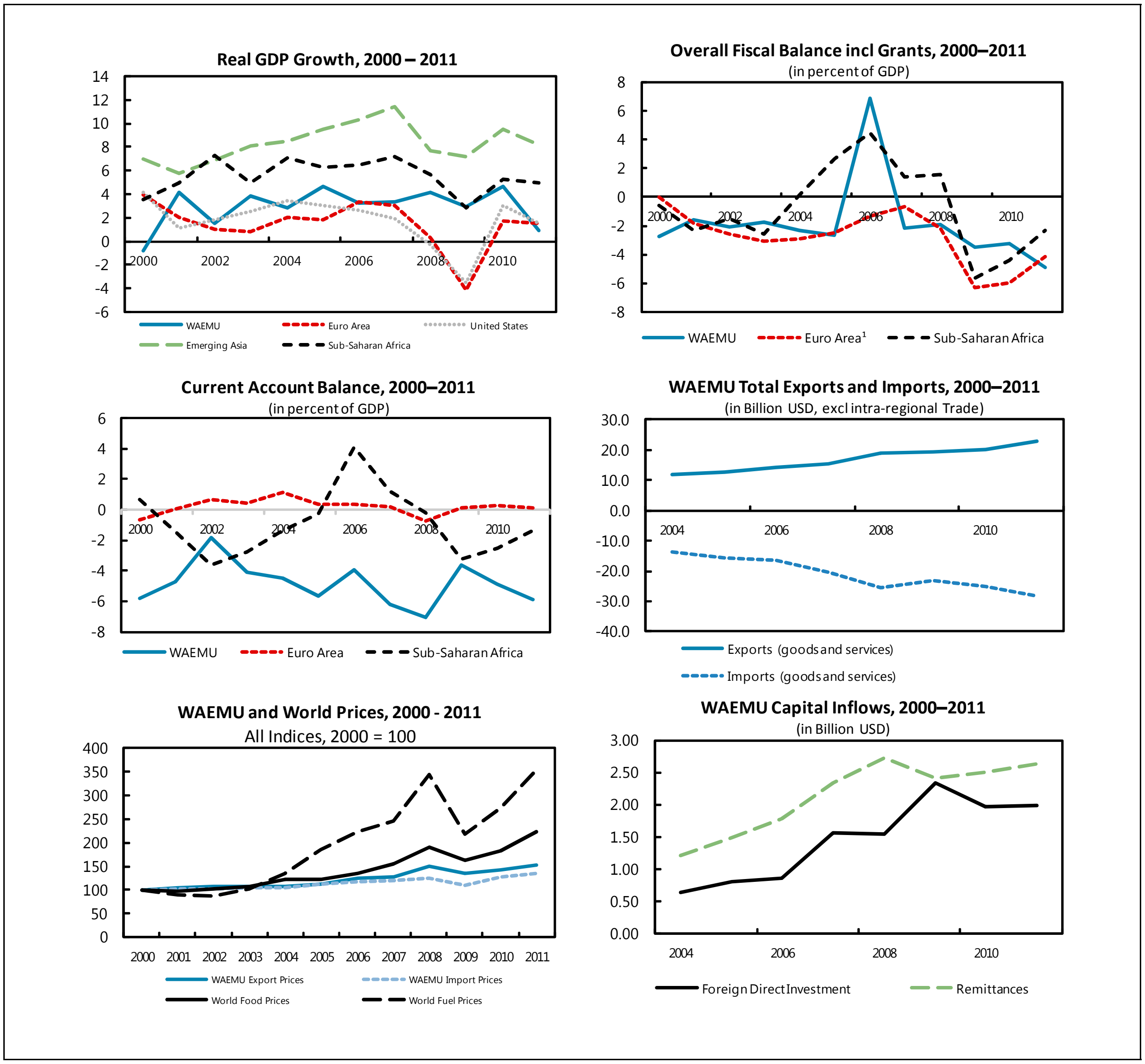
Remittances, aid and foreign direct investment (FDI) could also be transmission channels. Remittances are estimated to average 4 percent of WAEMU GDP, with three



quarters stemming from the euro area. A substantial decline in demand for labor owing to the recession in the euro area is likely to lead to worker layoffs and reduced wage payments, in particular for lower skilled workers. This would affect remittances negatively, although in the short term transfers could increase, particularly if migrant workers return to their countries. Aid could be affected by further fiscal consolidation efforts in donor countries, and FDI by lower growth in advanced and emerging economies.

Transmission through other financial flows, including those of the financial sector, is unlikely to play a major role. Financial integration of the WAEMU with the rest of the world is limited. The exposure to European banks is low despite the large presence of French bank subsidiaries. Banks in the region fund themselves domestically and liquidity is abundant. However, local banks could be affected through a decline in real GDP growth in the WAEMU, which could increase nonperforming loans and reduce bank profitability. In this case, borrowing costs could increase for the local corporate sector. Large exchange rate fluctuations owing to the euro-CFAF peg could be a source of instability, but so far they have not materialized.

An analysis of the impact of the 2008 global financial crisis on the WAEMU provides useful lessons, broadly confirming the channels identified above. The overall impact of the crisis on the WAEMU was relatively moderate compared to other regions (see charts). Trade flows (and tourism) were substantially affected, with exports stagnating and imports declining by 10 percent. Import prices declined by about 10 percent, in line with world food prices. With imports much larger than exports, these developments produced a large improvement in the current account. Remittances declined substantially after the 2008 crisis. FDI held up quite well, possibly reflecting increasing investment from emerging economies. Fiscal deterioration was less pronounced than elsewhere, reflecting the lesser growth slowdown, smaller automatic stabilizers and limited discretionary stimulus spending.


Real GDP Growth, 2000 – 2011
14
12
10
8
6
4
2
0
-2
-4
-6
2000
2002
2004
2006
2008
2010
WAEMU
Euro Area
United States
Emerging Asia
Sub-Saharan Africa
Overall Fiscal Balance incl Grants, 2000–2011
(in percent of GDP)
8
6
4
2
0
-2
-4
-6
-8
2000
2002
2004
2006
2008
2010
WAEMU
Euro Area[1]
Sub-Saharan Africa
Current Account Balance, 2000–2011
(in percent of GDP)
6
4
2
0
-2
-4
-6
-8
2000
2002
2004
2006
2008
2010
WAEMU
Euro Area
Sub-Saharan Africa
WAEMU Total Exports and Imports, 2000–2011
(in Billion USD, excl intra-regional Trade)
30.0
20.0
10.0
0.0
-10.0
-20.0
-30.0
-40.0
2004
2006
2008
2010
Exports (goods and services)
Imports (goods and services)
WAEMU and World Prices, 2000 - 2011
All Indices, 2000 = 100
400
350
300
250
200
150
100
50
0
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
WAEMU Export Prices
WAEMU Import Prices
World Food Prices
World Fuel Prices
WAEMU Capital Inflows, 2000–2011
(in Billion USD)
3.00
2.50
2.00
1.50
1.00
0.50
0.00
2004
2006
2008
2010
Foreign Direct Investment
Remittances

C. Assessing the Impact of the Adverse Scenario on the WAEMU

The Global Integrated Monetary and Fiscal (GIMF) model is a Dynamic Stochastic General Equilibrium (DSGE) model that is well suited to analyze the impact of the envisaged shock, because it is multi regional and includes a number of channels relevant to our case. Its structure is detailed in Box 1. The version of the GIMF model used in this note covers three regions: the euro zone, the WAEMU and the rest of the world. The regions are interlinked as bilateral trade flows and relative prices, including exchange rates and interest rates, are explicitly modeled. Moreover, this version of the model contains remittances and foreign aid flows.

Box 1. Sectors and Policy Channels in the GIMF

Household Sector

There are two types of households: those with access to financial markets (overlapping generations, OLG) which make borrowing and savings decisions over a finite planning horizon; and those that are liquidity constrained and consume their income out-of-pocket. Both types of household supply labor, whose cost is determined by means of unions, and pay direct–distortionary–taxes on labor income, indirect taxes on consumption spending, and a lump-sum tax. All households can benefit from government transfers.

Financial Sector

The financial sector in the current version contains a limited set of financial assets. OLG households can acquire domestic government bonds, international euro dominated bonds and fixed term deposits. Other than euro government debt, however, is denominated in domestic currency and financial assets, as well as ownership of firms, are not tradable across borders. For a spillover in borrowing costs we therefore generate an exogenous shock to all regions with different magnitude of impact. The corporate balance sheet channel (endogenous borrowing premium) and the bank balance sheet channel (endogenous lending spread) provide the basis for macro linkages (Bernanke, Gertler and Gilchrist, 1999).

Monetary Policy

Because the WAEMU is pegged to the euro, the monetary rule follows the maintenance of the peg. Monetary policy in the euro area and in the rest of the world follows a Taylor rule.

Firm Sector

Firms are owned by households, use capital and labor and produce tradable and nontradable intermediate goods. They also have a finite planning horizon which gives rise to a substantial equity premium. Firms pay capital income taxes to the government and wages and dividends to households. Monopolistic competition allows for a markup over marginal costs. Firms use public investment as input, in combination with tradable and nontradable intermediate goods.

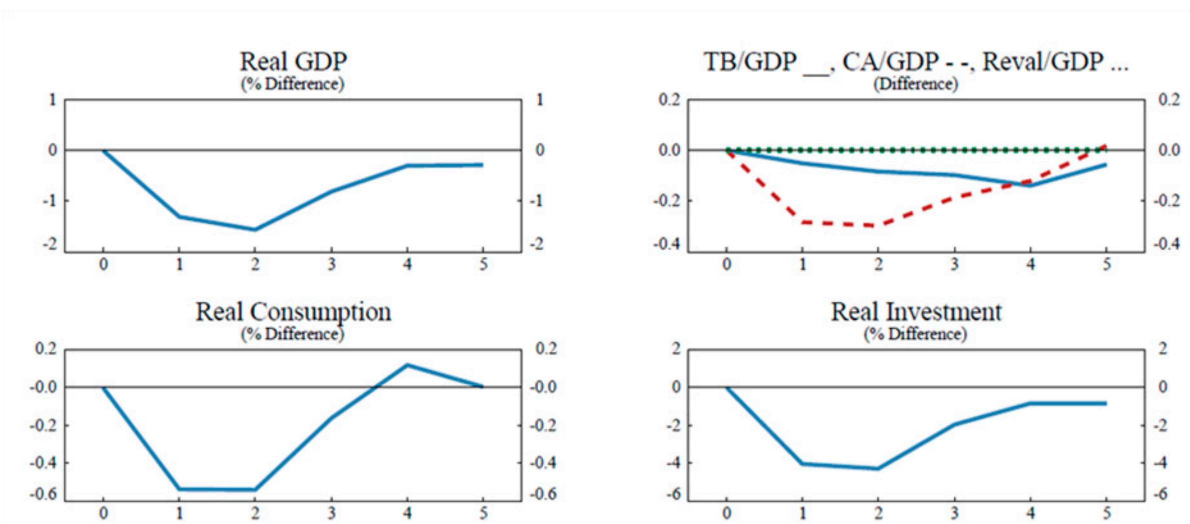
Fiscal Policy

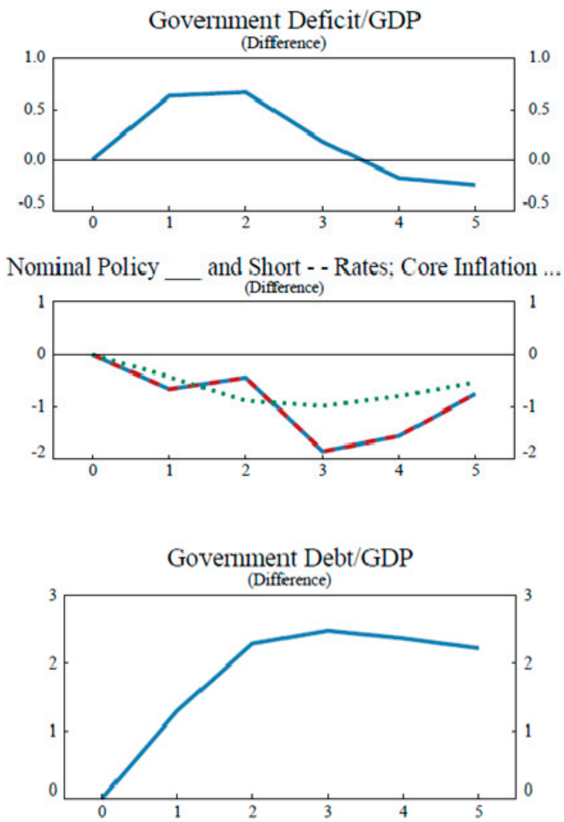
The GIMF model comprises a variety of fiscal instruments, such as government consumption or investment expenditure, lump sum transfers, taxes on labor, corporate profits and consumption, and tariffs. Non-Ricardian features allow for a sizable impact of spending- and revenue-based fiscal measures: stimulation of economic activity in the short run and crowding-out of private investment and net foreign assets in the long run. Sustained fiscal deficits in large economies can also lead to a higher world real interest rate. For instance, a tax cut has a short run positive effect on output owing to the finite planning horizon of households. And the larger the proportion of liquidity-constrained households, the larger the fiscal multiplier from temporary changes to taxes and transfers. The fiscal rule in place maintains a structural surplus and ensures that the long-run ratio of government debt to GDP remains stable. In the current version, all three regions target a balanced budget.

(cf. Kumhof et al, 2010)

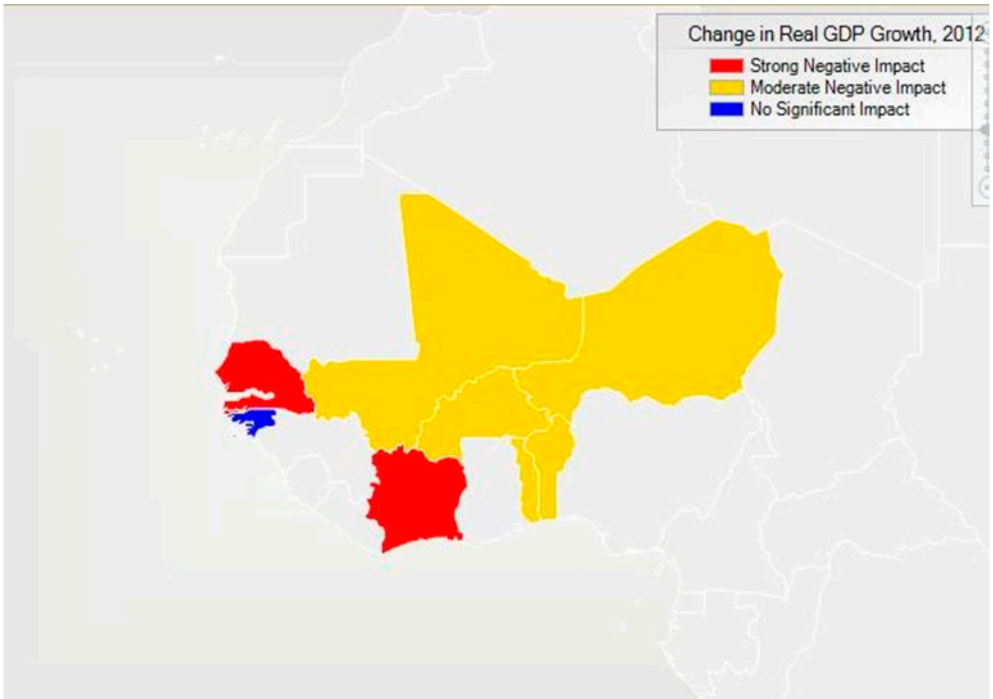
The model's parameters have been calibrated based on available data for the WAEMU. The share of households without access to credit is estimated at 70 percent, as roughly 30 percent of the households are assumed to have access to a bank account or some form of microcredit. Exports and imports between the WAEMU and the Euro zone as well the rest of the world are taken from the directions of trade (DOS) databases. Remittances and official development aid are from World Bank sources, and fiscal data are taken from IMF country desks. Several parameters for the WAEMU have been derived from the application of the model to Asia, to better capture patterns of developing economies, such as a lower share of labor in national income, higher investment levels and a larger share of consumption in GDP from liquidity constrained households. Parameters for the euro zone and the rest of the world are taken from previous studies using the GIMF (Kumhof et al, 2010).

The simulation results indicate that in the adverse scenario the WAEMU real GDP is about 1.5 percentage points below its baseline level in the first two years (see charts). The fall in external demand leads to lower exports (about 3 percent). Domestic consumption is moderately lower (about 0.5 percent), but that of liquidity constrained households is more severely affected partly owing to lower remittances. Real investment is lower by about 4 percent. The current account deficit widens by about 0.3 percentage points of GDP, reflecting a modest deterioration of the trade balance and lower remittances. Inflation would be lower, and the exchange rate would initially depreciate like the euro. The fiscal balance deteriorates by 2/3 percentage point of GDP leading to a 2.5 percentage point higher accumulation of government debt.





The impact would likely differ substantially across individual WAEMU countries. These countries are heterogeneous and differ significantly in terms of their exposure to a recession in the euro zone. This is particularly true of the destination of exports, which in some WAEMU commodity exporters (e.g., Burkina Faso, Guinea-Bissau, and Mali) has shifted substantially away from Europe. As a result, these countries would be less affected than those more exposed to Europe, such as Senegal and Côte d'Ivoire. The Figure below, which is based on the methodology of the IMF's vulnerability exercise for low-income countries, suggests how the strength of the impact might vary across WAEMU countries.



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Kumhof, M., D. Laxton, D. Muir and S. Mursula, 2010, "The Global Integrated Monetary Fiscal Model (GIMF)---Theoretical Structure", IMF Working Paper 10/34 (February 2010)

Appendix II: Lessons From the Euro Area Crisis for the WAEMU

This note was prepared by Hervé Joly. Some sections draw extensively on existing publications, which are referenced.

The euro-area crisis provides important lessons for the governance and stability of currency areas. Although the crisis is still ongoing and there is a wide range of views on how it should be addressed, there is more agreement on the factors that led to the crisis. This note summarizes these factors and the general lessons that can be learned from the euro area experience in the past few years. It then explores which lessons are relevant for the WAEMU. Indeed, although the euro area and the WAEMU share a number of characteristics—they are both currency areas and single markets with similar regional institutions—they also exhibit important differences. The main ones are that the WAEMU's exchange rate is pegged to the euro with guaranteed access to foreign exchange; the WAEMU is much less integrated, both commercially and financially, than the euro area; the WAEMU is also less integrated to international financial markets; and finally, the WAEMU already has regional regulation of most of the financial sector. In light of these similarities and differences, the main lessons for the WAEMU are that: Market flexibility and regional integration facilitate adjustment to asymmetric shocks; fiscal discipline is essential; more attention to competitiveness and external imbalances is desirable; a crisis management system should be established, and regional surveillance (including over the financial system) should be strengthened.

A. What Went Wrong in the Euro Area?

The low interest–rate environment in the 2000s and lax financial sector regulation led to a number of developments, particularly in periphery countries, which in hindsight appear to have increased vulnerabilities.[1] Although not all these developments can be found in each periphery country, one or several of them were often at play. They include:

- ***Excessive borrowing, financing consumption or investment in real estate*** (fueling, in some cases, large real estate bubbles). This borrowing was generally from other euro area countries and allowed by a massive development of financial integration in the area.
- ***Excessive leverage in the financial sector.*** Banks' balance sheets grew very rapidly, with a sharp rise in the size of systemically important financial institutions, and heavy reliance on volatile wholesale funding.
- ***Procyclical fiscal policy in certain countries*** (e.g., Greece, and to a lesser extent Ireland and Portugal). This also contributed to higher domestic demand and overheating. In other cases, fiscal policy was just insufficiently countercyclical and failed to build sufficient buffers to be used in less favorable periods, because temporary increases in output and tax revenues were mistakenly interpreted as permanent.
- ***A loss of competitiveness***. Debt-financed demand contributed to excessive wage and price increases, while the main country at the core of the euro area (Germany) was

[1] This section draws heavily on Florence Jaumotte (2011), "Fixing the flaws in EMU", Finance and Development, December 2011.

making significant efforts to contain its production costs and improve its competitiveness. This was compounded by weaknesses in the functioning of product and labor markets, such as limited competition in the service sector, wage bargaining at the industry or regional level that often failed to factor in employment and competitiveness considerations, and wage indexation that made inflation more persistent.

Existing safeguards for the stability of the euro area did not work as expected or proved insufficient:

- ***Fiscal integration remained incomplete.*** The euro area lacked institutions of fiscal risk sharing and coordination. The Stability and Growth Pact (SGP) was not adequately monitored and enforced, letting some governments incur large deficits and accumulate substantial debts. Other countries did not create sufficient fiscal space in good times and thus reduced their margin for maneuver in bad times.

- ***At the same time, generalized risk mispricing failed to impose discipline*** until mid-2007, despite rising signs of imbalances (e.g., large and increasing external debt of periphery countries, large current account deficits). This reflected partly the laxity of financial sector regulation (below) but perhaps more importantly a rising "search-for-yield" behavior in a low-interest environment, a belief that current account imbalances mattered less in a monetary union, and perhaps confidence that the SGP would prevent crises.

- ***Lack of a European-wide crisis management framework***. The euro area did not have enough formal coordination mechanisms between the regional and national authorities to address crises of regional importance affecting either a sovereign or a financial institution. Mandates for financial stability, both at the EU and national level, were sometimes conflicting.

- ***Regulatory and supervisory policies for the financial sector were insufficiently coordinated***, at a time when cross-border capital flows increased dramatically and the financial system in the region became highly interconnected. This made it difficult to detect early excessive exposure or borrowing.

- ***Insufficient capital buffers***. In the run-up to the crisis, with the implementation of Basel II, banks were able to reduce their capital buffers by relying on internal risk models that failed to account for significant negative interdependence and spillover effects during times of stress.

B. General Lessons from the Euro Area Crisis for the Stability of Currency Unions

The optimal currency area (OCA) theory remains a useful framework to think of factors affecting the stability of currency unions. In the euro area, the loss of competitiveness and excessive debt levels require painful adjustment in the periphery countries. In the absence of a national monetary policy and exchange rate, this adjustment means engineering simultaneously large fiscal consolidation and "internal" devaluation, that is, an adjustment of relative prices and wages. This illustrates some of the main conclusions of the OCA theory which suggests that price and wage flexibility and labor mobility play a critical role in adjusting to possible asymmetric shocks in a currency union. Fiscal transfers can also facilitate adjustment.

Strong fiscal discipline is critical to the stability of a currency union. While fiscal discipline is desirable in all countries, it is even more important in currency unions for a number of reasons. First, fiscal policy remains the main macroeconomic policy tool at the disposal of national authorities to address asymmetric shocks. It is therefore essential that countries run counter-cyclical fiscal policies in good times too, so that they indeed have space for an accommodative fiscal policy stance in the event of an asymmetric shock. Second, imprudent fiscal policy in a member of a currency area can have negative spillovers on the others. An extreme case is when unsustainable debt in a member country jeopardizes the financial stability of others. A more common problem is reckless fiscal policy in a member country increasing borrowing costs in all the others if markets believe in the possibility, even remote, of a bailout if things really go wrong in that country.

A currency union needs to move toward greater fiscal integration. To complement strong fiscal governance, a common currency area needs some form of fiscal risk-sharing, which would allow for common support before economic dislocation in one country develops into a costly fiscal and financial crisis for all.

In addition, effective and comprehensive crisis-fighting tools must be available. The euro area experience shows that designing and implementing such tools in the middle of a crisis is particularly challenging, while quick, comprehensive, and forceful action is generally required to address a crisis. This applies both to tools to address a crisis in the financial sector, but also a crisis affecting the sovereign itself.

Strong supervision of the financial system and a crisis management framework are also required at the regional level. [2] Banks in a financially integrated currency area can no longer be treated as purely national institutions. Regional supervision is needed to detect early excessive exposure or expansion of banking systems. A currency area–wide approach to crisis management and resolution is also required.

Country external imbalances and competitiveness still matter in a currency union. Large current account deficits, possibly reflecting insufficient competitiveness, can lead to a heavy external debt burden.[3] Even if the debt is held for a large part within the currency union, sustainability issues can arise and eventually lead to an external payment crisis. It is therefore critical to maintain competitiveness and prevent excessive accumulation of external debt in each member of a currency union. This may require, among other things, reforming labor and product markets to make them more flexible.

Finally, a strong regional surveillance framework is needed to monitor and ensure adherence to these principles. It should focus on fiscal developments (particularly in the absence of fiscal federalism and binding national rules), but also on other possible sources of imbalances and members' ability to address asymmetric shocks. It should also promote data availability, timeliness, and integrity.

[2] Regional means currency area-wide in this note.

[3] External here is defined on a residency basis. It includes debt owed to residents of other countries of the currency area.

C. How do These Lessons Apply to the WAEMU?

As mentioned earlier, the WAEMU differs in key respects from the euro area. This section therefore explores to what extent the general lessons discussed above are relevant for the WAEMU.

OCA issues

Improving the OCA characteristics of the WAEMU should remain a medium-term goal. Countries benefit all the more from sharing the same currency (or having a pegged exchange rate) that trade among them is intensive. Even if its share has decreased in the past 15 years from more than half to about a third, the euro area remains the WAEMU's main trading partner. Intra-WAEMU trade represents in addition about 10 percent of total trade by WAEMU countries.

From this perspective, strengthening economic integration is highly desirable for reaping greater benefits from the common currency. Greater economic integration is also often thought to promote "real convergence", that is, convergence of economic structures that reduces members' susceptibility to asymmetric shocks. This has been observed in the euro area, where business cycles have become more synchronized in the past decades. There are a number of ways economic integration could improve. First, obstacles to genuinely free trade of goods and services inside the region should be removed. A number of nontariff barriers have been identified, which should be addressed .[4] Second, regional infrastructures, particularly in the transport area, should be developed to facilitate the movement of goods and people.[5] Third, some form of fiscal integration may need to be considered in the medium term.

Other key OCA features—price and wage flexibility, labor mobility—should also be promoted. Little is known about labor market flexibility in WAEMU countries because of insufficient coverage of labor markets by statistical systems, and also because of the large size of the informal sector, which is not well documented. This is a gap which should be addressed. Labor mobility is in principle guaranteed in the region, but there are still impediments that could be addressed.

Fiscal discipline[6]

The need for fiscal discipline in the WAEMU will increase with regional integration. All WAEMU countries accumulated unsustainable debts and experienced debt crises in past decades. Three critical elements explain why these crises did not destabilize the currency

[4] See Goretti and Weisfeld (2008), "Trade in WAEMU: Developments and Reform Opportunities", in Gulde and Tsangarides (ed.), *The CFA Franc Zone: Common Currency, Uncommon Challenges*, IMF.

[5] See IMF, Regional Economic Outlook, Sub-Saharan Africa, October 2010 (Box 3.4 on Overcoming Infrastructure Bottlenecks in the WAEMU).

[6] There are also lessons to be learned from debt management, including: (i) developing and having in place a solid risk management framework;
(ii) developing the countries' capacity to formulate debt strategies and in making more systematic use of the debt structure to mitigate shocks; (iii) preserving access to a liquidity cushion; (iv) making progress in adopting a framework for integrated management of assets and liabilities in order to monitor and minimize the risks to the sovereign balance sheets; and
(v) stepping up the monitoring of public debt management by the BCEAO.

union.[7] The first is the convertibility guarantee provided by the French treasury, which gave credibility to the currency even in these dire circumstances. The second reason is that the region's integration, both economic and financial, was relatively limited. As a result, adverse developments in a country had a limited impact on the rest of the zone. The third factor is the limited financial integration with the rest of the world. However, financial integration has increased recently in the WAEMU, with in particular a rise in cross-country holding of sovereign paper. As the recent debt restructuring in Côte d'Ivoire showed, the debt situation of a sovereign may substantially affect agents in other WAEMU countries. This strengthens the case for fiscal discipline in the region.

From this perspective, it may be worth reconsidering whether the current regional framework for fiscal surveillance remains adequate. The latter consists mainly of two convergence criteria: (i) the basic fiscal balance (i.e., a fiscal balance which excludes external debt-financed investment), which should be positive; (ii) the debt-to-GDP ratio which should be below 70 percent. Following HIPC and MDRI debt relief, debt-to-GDP ratios are indeed well below the WAEMU ceiling in all WAEMU countries except Côte d'Ivoire—the only country in the region not yet to have benefited from full HIPC and MDRI relief—which begs the question of whether the current ceiling is too high. Conversely, many countries do not meet the fiscal balance criterion. Changes to the debt criterion are currently under consideration, with a review initiated in 2011.

A comprehensive approach to fiscal sustainability seems desirable for convergence criteria. The current 70 percent of GDP benchmark is probably on the high side for a sustainability threshold. Recent empirical work done by Fund staff in the context of reviewing the Fund-Bank debt sustainability framework (DSF) suggests lower thresholds on average, ranging from about 50 to 75 percent depending on the quality of policies and institutions.[8] These empirical thresholds should be seen as ceilings beyond which the probability of debt distress becomes significant, rather than optimal levels to target. They could usefully inform the authorities' ongoing review of the debt criterion. Lowering the threshold, however, would not be sufficient to ensure reasonable debt accumulation in the short and medium term, because many countries would still have debt ratios far below even a lower debt threshold. This task should fall on the fiscal balance criterion. An issue here is that the indicator currently used excludes a significant source of debt accumulation.[9] Consideration could therefore

[7] These factors also explain why fiscal integration is a less pressing issue in the WAEMU than in other currency areas.

[8] See. Revisiting the Debt Sustainability Framework for Low-Income Countries, January 12, 2012. More specifically, the estimates are a threshold of 49 percent for countries with weak policies and institutions (i.e., with a CPIA lower than 3.25), 62 percent for countries with medium policies and institutions (i.e., with a CPIA between 3.25 and 3.75), and 75 percent for countries with strong policies and institutions (i.e., with a CPIA greater than 3.75). These thresholds were estimated for total public debt in nominal terms, i.e., the same variable as the one used for the convergence criterion. Present values could also be considered, although they are more challenging to measure and perhaps communicate to a wide audience.

[9] The current definition likely reflects three considerations: (i) a desire not to constrain investment financed with external assistance; (ii) a focus on

(continued)

be given to moving to a more comprehensive definition of the fiscal balance. Another relevant consideration is the need to disentangle cyclical from structural factors when assessing the fiscal stance.

Another issue is whether sanctions for breaching fiscal convergence criteria should be considered. Presently, only a breach of the fiscal balance criterion in the "stability phase" can trigger a sanction. Breaching fiscal criteria in the current "convergence phase" has limited consequences, which limits the incentive for members to meet the WAEMU targets.

Monitoring external imbalances and competitiveness

Regional surveillance will cover a new set of real convergence and regional integration indicators. It was recently decided that the following areas would be monitored from 2012: (i) standard of living (changes in per capita GDP relative to average in the zone); (ii) trade integration (change in intra-regional trade as a share of the total); (iii) labor mobility within the WAEMU (visa and/or passport requirements); (iv) implementation of the Regional Economic Plan (number of projects underway and completed relative to plan and disbursements relative to commitments); (v) changes in the business climate (based on data from the *Doing Business* survey) and (vi) financial integration (share of cross-border bank-to-bank transactions, in value and volume). Responsibility for monitoring country progress is vested mainly in the WAEMU Commission, except for the financial integration indicator, which is the responsibility of the BCEAO, and trade integration, which relies on the provision of information from the BCEAO to the WAEMU Commission.

While this is a much welcome development, some additional indicators could be considered. It would be useful to complement the monitoring of current account balances and the business climate by measures of real effective exchange rate (REER) developments (which could be based on a range or price indices). This would improve the early detection of diverging competitiveness trends among member countries. Total external indebtedness, on a country basis, would also be useful to monitor, because it would allow capture of external debt accumulation by the private sector (including vis-à-vis other WAEMU countries). This indicator would be particularly relevant if financial integration were to increase substantially in the region in the coming years.

Supervision of, and crisis management framework for, the financial system

In terms of supervision of the financial system and crisis management framework, the WAEMU is in a better position than the euro area was before the crisis. Firstly, financial integration in the WAEMU is much more limited than in the euro area. Secondly, the WAEMU's financial integration with the rest of the world is also limited. Thirdly, the WAEMU already has regional regulation for the main parts of the financial system, in particular banking, and a regional banking supervision and crisis resolution framework, with the Banking Commission at its center.

demand management, under the assumption that externally financed investment had little impact on domestic demand (because of its high import content), unlike other government expenditure; and (iii) a desire to have a target on a variable fully within the control of the authorities (which is not entirely the case with aid disbursements).

However, there is room to strengthen the current framework.

The regulatory framework for banks could be tightened in a number of areas. This would allow detecting problems earlier. A broad area for improvement is the assessment of risks borne by banks, and in particular credit risk. This applies both to private and sovereign risk. Regarding the latter, the current practice is to assign a zero weight to paper issued by any of the sovereigns in the WAEMU when calculating capital requirements. This is clearly inadequate, as the recent crises in the euro area and in Côte d'Ivoire show it. Adoption of certain provisions of the Basel II framework could be considered, as well as the experience in the CEMAC.[10] A tightening of rules on risk division, asset write down, and internal controls could also be considered.[11]

Banking supervision could also be strengthened, including of regional and international groups. Some of these groups have developed quickly in the WAEMU but are not supervised on a consolidated basis. As a result, no supervisors may have an overview of their activities and the risks that they raise. Collaboration with supervisors outside the region should therefore be deepened and ultimately lead to consolidated supervision of these groups. More generally, the Banking Commission's resources should be increased, and these resources should be leveraged by moving to risk-based supervision, and macroprudential supervision should be further developed by the Financial Stability Committee.

There is also scope to improve the crisis management framework. The new banking law requires banks to participate in a deposit insurance scheme, which should be put in place in due course. It also has provisions giving the BCEAO and the Banking Commission a significant role in the process leading up to the liquidation of a bank and in granting a degree to priority to the net claims of depositors. Notwithstanding these provisions, the liquidation of the banks is left to the judicial system. There is no explicit framework or provisions indicating the process of unwinding a troubled financial institution, beyond the strengthening of the role of the Banking Commission in the appointment of conservators or liquidators. The authorities could consider developing understandings on their role and coordination in such circumstances. A last issue to consider is whether the BCEAO should be given formal authority to be the lender of last resort (LOLR). The BCEAO does not have such formal authority presently. In practice, it can use monetary tools for LOLR purposes, but its ability to do so is limited.

Instruments to address sovereign debt problems

The need for instruments to address sovereign debt problems has been limited so far. The only country in the region with an

[10] In the CEMAC, government risk rating is based on compliance with CEMAC convergence criteria.

[11] As mentioned in the staff report, and flagged in the 2008 FSAP, a number of prudential rules are not in line with international standards. This is in particular the case for: The ceiling on maximum liabilities with a given counterpart (which at 75 percent of capital and reserves is about three times as high as the international norm); the classification of loans as non-performing (after being past due for 6 months, against 3); the transformation ratio and the portfolio structure ratio, which are probably too restrictive. Also, the financial statements produced and published by banks are based on the chart of accounts implemented in 1996, which has not been updated to reflect recent changes in the international accounting standards.

unsustainable public debt is Côte d'Ivoire. Its debt burden will be substantially relieved when it reaches the HIPC completion point, which is expected in 2012. Beyond this, the issue is whether there is a need for a regional facility to lend to solvent but illiquid sovereigns. The case for such a facility has been limited so far. First, countries facing liquidity problems could relatively easily access concessional external resources for such purposes from donors (e.g., the World Bank, the European Commission) and the Fund. Second, the share of debt held by private creditors has been limited on average, and as a result most WAEMU countries did not face large rollover needs and risks. From this perspective, their situation has been quite different from that of countries in the euro area, whose debt is mostly in the form of bonds, and financing requirements are very high.

A number of issues could be considered in the medium term. Beyond a regional financing facility, which could become more relevant as the share of debt held by private creditors increases, the authorities could consider introducing collective action clauses (CACs) in the longer-term paper they issue on the regional market. CACs would facilitate the restructuring of public debt, should it become necessary in the future.

Improving the provision and quality of information

Good and timely information is critical. Most of the recommendations made above to improve the regional surveillance and supervision framework assume adequate data availability, timeliness, and integrity. Inadequate data leads to wrong diagnostics and late recognition of problems, leaving little time for preventive action. This point is well illustrated by the problems created in the euro area by the late discovery that Greek fiscal data had been inaccurate, and that Greece's fiscal situation was much worse than believed. Addressing statistical gaps and strengthening statistical agencies should therefore be a priority for WAEMU countries. Financial data should also be available more quickly including allowing for regular stress-testing of the banking sector.

APPENDIX III: What is the impact of a recovery in Côte d'Ivoire on the WAEMU region?

This paper was prepared by Alexei Kireyev.

Côte d'Ivoire experienced political instability in the past 15 years. With the political crisis overcome, the economic outlook for Côte d'Ivoire is strong. There are two main channels through which the recovery in Côte d'Ivoire can affect other WAEMU countries: the real economy channel and the financial channel. Overall, resumption of trade, remittances and investment from Côte d'Ivoire to other countries would have a positive impact on the region, whereas large borrowing needs may generate negative spillovers. In the medium term, the recovery also offers opportunities to accelerate regional integration.

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A. Côte d'Ivoire: A Strong Outlook After a Crisis

Côte d'Ivoire experienced political instability in the past 15 years. The death of President Houphouët-Boigny in 1993 was followed by civil strife in the following years and by a brief civil war in 2002-3. Although the conflict was short and physical destruction relatively limited, the country experienced a prolonged crisis. Agriculture was disrupted in many parts of the country, investment dropped and some enterprises relocated outside the country. The crisis had a major negative impact on growth, and therefore living standards. Real GDP barely grew in the 2000s, and real per capita income actually fell significantly. As a result, poverty recorded a substantial increase. Intraregional trade through Côte d'Ivoire came to a halt, and without the leadership of the largest country the process of regional integration slowed and important institutional reforms were delayed.

Côte d'Ivoire experienced a second armed conflict for a few months after the presidential election held in November 2010. The crisis ended in April 2011 when President Ouattara took control of the country, but it had a severe impact on the economy. Banks were closed for a few weeks and activity came to a standstill. Despite the subsequent rapid recovery, GDP is expected to have decreased by about 6 percent in 2011. The crisis also further disrupted the regional transportation network, and led to more trade diversion and higher transportation costs for landlocked WAEMU countries.

With the political crisis overcome, the economic outlook for Côte d'Ivoire is strong (Table 1). Real growth is expected to reach 8–9 percent in 2012 and to remain at about 5–6 percent in the medium term, with improved confidence, political normalization, and expected HIPC/MDRI debt relief leading to higher investment. After a spike driven by

Table 1. Côte d'Ivoire: Medium-term projections

	2010 Act.	2011 Est.	2012	2013	2014	2015	2016	2017
					Proj.			
			(Annual percentage changes)					
GDP at constant prices	2.4	-5.8	8.5	6.0	6.0	5.5	5.2	5.2
Consumer price index (average)	1.4	5.1	2.8	2.5	2.5	2.5	2.5	2.5
			(Percent of GDP)					
Overall fiscal balance	-2.3	-8.1	-4.4	-3.5	-2.9	-2.7	-2.6	-2.6
Primary basic balance	-0.2	-4.8	-2.0	-0.5	0.2	0.5	0.7	0.7
Central government investment	3.1	2.9	5.0	5.6	6.0	6.2	6.4	6.4
Nongovernment sector investement	5.9	5.2	6.6	8.5	10.0	10.9	11.5	11.5
Current account balance	1.1	1.1	-1.7	-4.3	-4.8	-5.3	-5.5	-5.5
Overall balance	-0.9	-0.2	-3.1	-3.3	-2.7	-3.4	-3.4	-3.4
Nominal GDP (CFAF billions)	11,352	11,150	12,400	13,400	14,500	15,959	16,782	17,456
Nominal GDP per capita (US$)	1,043	1,044	1,083	1,128	1,175	1,227	1,282	1282
Real GDP per capita growth (percent)	-0.6	-8.8	5.5	3.0	3.0	2.5	2.2	2.2

crisis-induced food shortages, inflation is expected to moderate to 3 percent in the medium term. The postconflict recovery program supported by the IMF assumes an increase in public and private investment from some 9 percent of GDP during 2009–11 to 14 percent of GDP in 2012–14, which would boost construction and transport activities. The current account deficit is projected to gradually increase to 6 percent of GDP by 2016 and would be financed by foreign direct investment and new borrowing. Côte d'Ivoire's fiscal strategy aims at achieving fiscal sustainability, while ensuring higher investment in priority sectors and reprioritizing other expenditure. The overall fiscal deficit is expected to gradually decrease to 2.5 percent of GDP, while the basic primary balance should recover from its deficit to a small surplus over the medium term.

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B. What is the Impact of Recovery in Côte d'Ivoire on the WAEMU Region in the Short Term?

Côte d'Ivoire's macroeconomic conditions and policies will continue to have an important impact on the aggregate performance of the WAEMU. Côte d'Ivoire is the largest economy in the WAEMU, although its share of regional GDP declined from almost 45 percent during the 1980s to about 30 percent now. As a result, an improvement in Côte d'Ivoire's real growth, inflation, fiscal position and current account has a significant positive impact on the consolidated performance indicators of the zone. This can be illustrated by a simple accounting exercise. A 1 percentage point higher real growth in Côte d'Ivoire, everything else equal, raises regional growth by 0.3 percentage point. Similarly, a decline of inflation in Côte d'Ivoire by 1 percentage point lowers regional inflation by 0.4 percentage point. An improvement in the Ivorian fiscal deficit by the same magnitude improves the area-wide fiscal deficit by also about 0.3 percentage point. Finally, a similar improvement in its current account improves the WAEMU's current account by 0.2 percentage point.

Côte d'Ivoire's growth has historically been correlated with the growth rate of some, but not all, WAEMU countries. Correlation between growth in Côte d'Ivoire and hinterland WAEMU countries (Burkina Faso, Mali and Niger) was positive and relatively high in the 1980s–90s (Table 2). This correlation broke in the 2000s, with the crisis in Côte d'Ivoire and the extreme volatility of its growth. While this correlation by itself does not imply causality (e.g., the correlation with Guinea Bissau was high in the 2000s, despite limited links), it should be noted that the hinterland countries are those in the WAEMU trading most with Côte d'Ivoire (with imports from the latter amounting to 6 percent of their GDP on average).

Table 2. Côte d'Ivoire: growth correlations with WAEMU countries

	1980-2010	1980-1993	1995-2001	2002-2010
Benin	0.27	0.38	-0.15	-0.36
Burkina Faso	0.38	0.37	0.79	-0.38
Côte d'Ivoire	1.00	1.00	1.00	1.00
Guinea-Bissau	-0.04	0.10	-0.20	0.67
Mali	0.21	0.18	0.40	-0.39
Niger	0.23	0.43	0.14	-0.36
Senegal	0.05	0.08	-0.11	-0.09
Togo	-0.23	-0.52	0.70	-0.04

Source: IMF staff estimates.

Real economy channels

Resumption of trade with Côte d'Ivoire will help improve resource allocation and growth. The crisis diverted transit trade through Côte d'Ivoire for the three hinterland WAEMU countries to more costly routes, including through Ghana, Togo, or Senegal. Although the ports of Dakar and Lomé have benefitted from this additional trade, resumption of normal transit trade routes will improve supply of imported construction materials and industrial inputs for the three hinterland countries. Restoration of disrupted oil product exports to all WAEMU countries from the most technologically advanced refinery in the region located in Abidjan, and of electricity to Burkina Faso and Mali, will help reduce production costs. Growth in regional trade, including exports of cattle, poultry, onions and other agricultural products to Côte d'Ivoire and imports of construction materials, processed foods, cooking oils, and soap from Côte d'Ivoire will reinvigorate residential construction, and help dampen food price inflation. Countries sharing a common border with Côte d'Ivoire can expect an increase in border trade.

Higher remittances from Côte d'Ivoire to neighboring countries will stimulate consumption and private investment. Côte d'Ivoire is a significant source of remittances for Burkina Faso and to a lesser extent for other countries in the region. In sub-Saharan Africa, Burkina Faso ranks second in the total number of emigrants and their principal destination is Côte d'Ivoire, where 50 percent of the immigrants are Burkinabe. In 2011, the total estimated size of inward private transfers to Burkina Faso through formal channels amounted to 2.7 percent of GDP, including private remittances of 1.1 percent of GDP, two thirds of them from Côte d'Ivoire. There has been some slowing of remittances from Côte d'Ivoire in the recent past that, if reversed, can help improve households' consumption and investment expenditure in Burkina Faso.

Risks of inflationary pressures from Côte d'Ivoire seem limited. Although growth is expected to be high in this country, it reflects only a rebound of activity after the crisis, in a context of large spare capacity. However, price developments in Côte d'Ivoire should continue to be monitored closely.

Financial channels

Although there is no clear evidence of this yet, the cost of credit in WAEMU countries could increase in the event of high demand for credit from Côte d'Ivoire. So far, key interest rates have remained stable (Table 3). While lending to the private sector in the region increased in 2011, possibly driven by high demand for credit from Côte d'Ivoire, the average lending rate (both in Côte d'Ivoire and the region as a whole) has remained broadly unchanged. However, high demand for credit in Côte d'Ivoire could in the future lead to higher interest rates there; spillover to other WAEMU countries cannot be ruled out, although low financial integration in the region is likely to limit this phenomenon. This is illustrated by the fact that the temporary closure of banks in Côte d'Ivoire in 2011 had a limited impact on the financial system in the rest of the WAEMU.

Table 3. WAEMU: Key Interest Rates (percent, averages)

	2010	2011			
	Q4	Q1	Q2	Q3	Q4 (Nov)
T bills	5.38	5.53	5.78	5.54	5.25
Lending rate	8.39	8.44	8.31	8.68	8.11
Deposit rate	5.40	5.14	5.12	5.14	5.12

Source: BCEAO, Rapport sur la Politique Monétaire dans l'UEMOA, Décembre 2011.

While lending to the private sector in the region increased in 2011, possibly driven by high demand for credit from Côte d'Ivoire, the average lending rate (both in Côte d'Ivoire and the region as a whole) has remained broadly unchanged. However, high demand for credit in Côte d'Ivoire could in the future lead to higher interest rates there; spillover to other WAEMU countries cannot be ruled out, although low financial integration in the region is likely to limit this phenomenon. This is illustrated by the fact that the temporary closure of banks in Côte d'Ivoire in 2011 had a limited impact on the financial system in the rest of the WAEMU.

Côte d'Ivoire rolled over its short-term government securities before restructuring them into long-term bonds in late 2011. The total domestic debt at end-June 2011 was estimated at about 14.5 percent of GDP. The bulk is owed to investors in the regional securities market (60 percent; mostly banks in Senegal, Benin, Burkina Faso, and to a lesser extent Mali) and the BCEAO (25 percent). With the onset of the crisis in December 2010, regular auctions of Treasury securities were discontinued and holders of Côte d'Ivoire's T-bills were not paid at maturity. To limit the impact on the regional banking system, the authorities of Côte d'Ivoire in close cooperation with the BCEAO (acting as an execution agency) decided to roll over the maturing T-bills on the same terms. The rollover procedures were in place until November/December 2011 when the government restructured the stock of short-term paper (CFAF 600 billion at interest rates ranging from 5.1 to 6.4 percent) into 2-year T-bills, and 3- and 5-year bonds at 4.75-5.25 percent interest rates (i.e., below market rates for corresponding instruments) and paid the accrued interest in cash. This helped reduce liquidity and solvency risks in the banking sector. At end-2011, participation in the restructuring exceeded 90 percent.

Côte d'Ivoire's borrowing from the regional debt market is expected to be large in 2012. Côte d'Ivoire's net borrowing needs in the domestic and regional markets in 2012 were estimated at CFAF 450 billion in the 2012 budget. This amount is relatively large in absolute terms (3.5 percent of Côte d'Ivoire GDP and 1.1 percent of regional GDP) but also when compared to last year (almost doubling). With Senegal, the other large issuer on the regional market, planning to keep net borrowing at a high level (CFAF 178 billion), total borrowing from the regional market is expected to increase by almost 40 percent (Table 4).

Table 4. Projected net issuances of government securities (CFAF billions, 2011-13)

	2011	2012	2013
	Est.	Proj.	
Benin	47	-3	-9
Burkina Faso	35	-21	-31
Côte d'Ivoire	230	450	360
Guinea-Bissau	0	0	0
Mali	3	50	…
Niger	5	-3	…
Senegal	170	178	141
Togo	-23	14	…
Total	468	664	462

Source: IMF staff estimates.

Such large borrowing could raise a number of challenges. Although bank excess liquidity suggests that banks may continue finding government securities attractive as investments, financing conditions may become tighter for all sovereigns. To avoid the risk of issuance bunching, governments will need to adopt clear medium-term issuance strategies and to stick to announced issuance schedules. In the medium term, it would be desirable to expand the investor base to nonbanks. This will also help the BCEAO to control money supply. Indeed, in the past two years, credit to governments has become an important factor, contributing almost 40 percent to broad money increase in the region

C. What Could the Impact in the Medium Term Be?

In the medium term, a peaceful and growing Côte d'Ivoire will benefit the whole region. If the country were to grow annually at about 6 percent (as in the 1960s-70s) in the next 10 years, the size of its economy would almost double. Some of the positive externalities described earlier (e.g., trade, remittances) would continue to be at play, but may get even larger. In addition, investment in critical infrastructure, including in the energy and transportation sectors, an improved business climate, and ambitious plans for postconflict reconstruction may attract foreign investors to Côte d'Ivoire and create new opportunities for outsourcing to countries in the region.

This also offers opportunities to accelerate regional integration. The following areas could benefit:

- *Strengthening the common regional market*. The national and regional authorities should accelerate their efforts to remove the barriers to trade (including those erected because of the crisis in Côte d'Ivoire) and improve the dispute resolution system for the problems arising in the intrazone trade.

- *A more coherent common external trade policy*. Country-specific exemptions to the application of the common external tariff (CET) should be reduced, in particular in Côte d'Ivoire as the main importer of goods and services into the region. Lessons could be learned from Côte d'Ivoire's interim Economic Partnership Agreement (EPA) with the European union for the negotiation of the EPA for the West Africa region.

- *The implementation of the regional economic program could be accelerated by active Côte d'Ivoire participation.* Although financing of the program will remain challenging, projects aimed at improving governance, economic infrastructure, and human resource development would help remove the bottlenecks to growth in the region.

APPENDIX IV: Financial Development in the West African Economic and Monetary Union

This note was prepared by Rodrigo Garcia-Verdu, with input from Alexei Kireyev.

Economic growth in WAEMU countries during the past decade has lagged behind that of fast-growing countries in sub-Saharan Africa (SSA). One possible reason is the low level of financial penetration that characterizes their financial systems. This note discusses the contribution of the financial sector to economic development, including the relationships between financial deepening and growth and financial deepening and poverty reduction. It also analyzes the evolution of various measures of financial sector development in the WAEMU since the last Financial Sector Stability Assessment (FSSA) was performed in 2008. Despite improvements during 2006-2011, the financial system in WAEMU member countries continues to be characterized by low levels of financial intermediation.

A. The Role of the Financial Sector in Economic Development

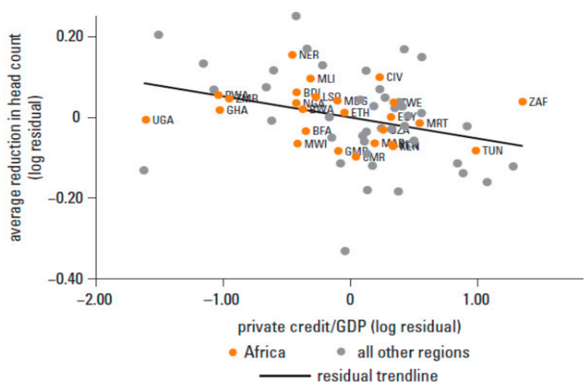
It is generally agreed that a well-functioning financial system performs an essential role in the growth process by pooling resources from savers, transforming their maturity from short-term deposits to medium- and long-term financing, and intermediating these resources by screening investment projects, allocating them to those projects with the highest (risk-adjusted) expected rates of return, and monitoring their performance. This intermediation function is in addition to the payment and transaction services and the insurance and risk management services that financial systems also provide. At its most basic level, an efficient financial system (as measured, for example, by the level of the net interest margin) leads to higher growth by increasing both savings and investment. Higher interest rates paid on deposits will attract more savings, while lower interest rate charged on loans will encourage higher investment. In addition the financial system contributes to economic growth by improving resource allocation.

There is a large body of empirical evidence showing the relationship between financial sector development and growth and poverty reduction in a cross-section of countries. Financial deepening is typically measured by the ratio of private credit to GDP. There is a positive (and statistically significant) relation between growth of GDP and this measure of financial deepening. There is also evidence of a positive (and statistically significant) relationship between financial development and poverty reduction. Although these relationships cannot be interpreted as evidence of causality, because higher growth rates of GDP and lower incidence of poverty are also likely to lead to higher financial deepening, they are suggestive of the importance of the financial system in promoting economic development.

Relationship between financial development and growth in a cross section of countries, 1970-2007

Source: Figure 1.1 in Beck, Munzele Maimbo, Faye, and Triki (2011).

Relationship between financial development and poverty reduction in a cross section of countries, 1980-2003



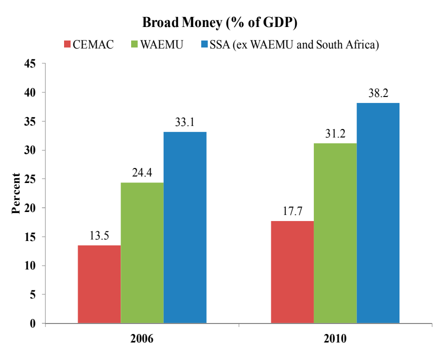
Source: Figure 1.2 in Beck, Munzele Maimbo, Faye, and Triki (2011), based on Beck, Demirgüç-Kunt, and Levine (2007).

The mechanisms through which poverty reduction can be accelerated through financial development are diverse. They include direct channels such as the increased provision of credit, so more socially profitable projects will be undertaken. They also include indirect channels, such as an improved allocation of risk sharing and the consequent reduction in the vulnerability to shocks and greater ability to smooth consumption. Furthermore, a more developed financial system allows the most talented or skilled individuals in the population to become entrepreneurs instead of wage earners. If access to the financial system is expanded, more highly-skilled but credit-constrained individuals will become entrepreneurs instead of wage earners, while subsistence workers will benefit too since some will become wage earners and will be employed by the new entrepreneurs. In the absence of a well-developed financial system, the decision of which activity or occupation to engage in (entrepreneur, wage earner, or subsistence worker) is determined by each person's endowment or initial wealth, and the resulting allocation of talent is typically suboptimal.

B. Evolution of Financial Deepening in WAEMU Between 2006 and 2010

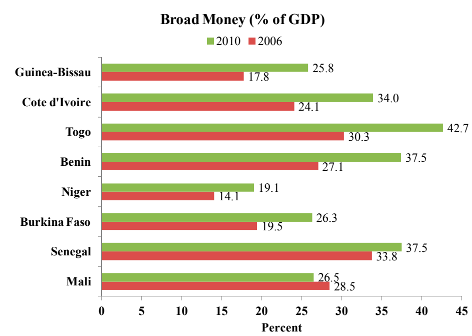
The period 2006–2010 was dominated by the global financial crisis of 2008–2009 and the resulting Great Recession, which had only a limited impact on the financial system in the WAEMU. At the onset of the crisis the financial systems of most countries in SSA, including those of the WAEMU, were on average well capitalized and highly liquid, and had little or no exposure to toxic assets such as sub-prime mortgages, asset-backed securities, and collateralized debt obligations. As a result, the financial systems in the SSA region weathered the crisis reasonably well, avoiding contagion from the financial systems in developed countries and preventing a repetition of the banking crises that afflicted the region during the 1980s and 1990s (see Allen and Giovannetti (2011) and Beck et alii (2011)).

Financial deepening in the region in 2006–2010 increased. We begin by analyzing the evolution of the ratio of broad money to GDP, one of the most common mmeasures of financial deepening. This is a broader measure of the extent of financial intermediation than the ratio of domestic credit to the private sector to GDP. The ratio of broad money to GDP among WAEMU member countries increased from an average of 24.4 percent in 2006 to 31.2 percent in 2010. Despite this significant increase, one can also see that WAEMU started from a relatively low level, even compared with other countries in SSA.[1]



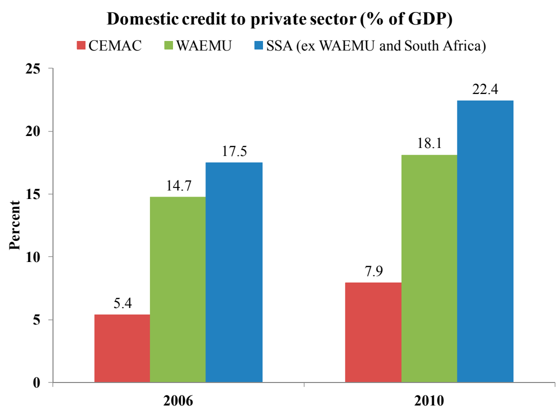
Source: World Development Indicators 2011. World Bank.

All WAEMU member countries except Mali experienced an increase, albeit at different rates. Guinea-Bissau experienced the fastest growth (annual average of about 10 percent), followed by Cote d'Ivoire, Togo, Benin, Burkina Faso, Niger, and Senegal. The ratio of domestic credit to the private sector to GDP, another important indicator of financial deepening, provides a broadly similar picture.

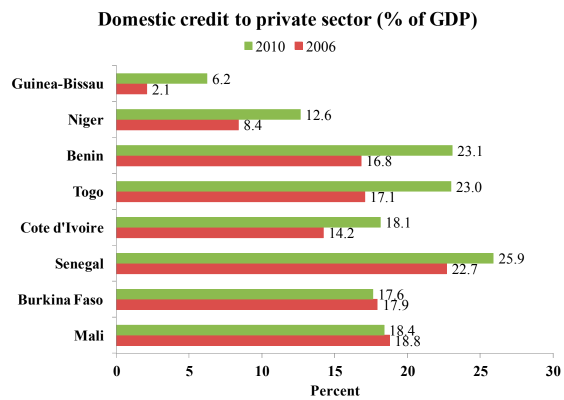


Development Indicators 2011. World Bank.

[1] It is higher, however, than among six other members of the franc zone (CEMAC).



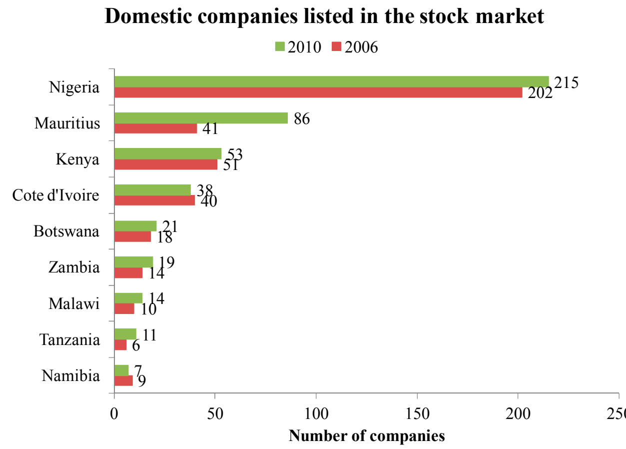
Source: World Development Indicators 2011. World Bank.



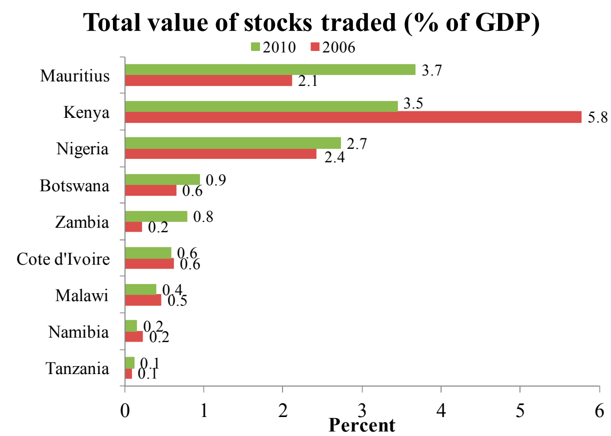
Source: World Development Indicators 2011. World Bank.

These developments are encouraging, but financial depth remains low relative to the average for SSA. In addition, the ratio of domestic credit to the private sector to GDP increased at a lower rate than for the average of SSA although it started from a lower level. Another development worth further exploring is why Burkina Faso and Mali have experienced less favorable developments, despite a common financial regulatory framework and strong growth.

The regional stock market registered modest growth in 2006–2010 and it remains a small market with limited



Source: World Development Indicators 2011. World Bank.



Source: World Development Indicatrors 2011. World Bank.

liquidity. While market capitalization as a share of GDP increased, the number of listed firms declined from 40 to 38 and the level of liquidity in terms of the value of stocks traded as a share of GDP remained very low compared to other exchanges in the SSA region and decreased marginally.

A very dynamic segment of the financial sector in recent years has been the government securities market. The amount of annual securities issuances increased almost 60 times in nominal value since its establishment in 2001and 30 times as a share of the WAEMU GDP and government revenue. By end-2011 annual issuances of government securities represented almost 10 percent of GDP and 70 percent of its tax revenue. The fastest growth was observed in 2009–11, when the issuances of government securities increased six-fold, both in nominal terms and as a share of GDP and tax revenue.

Despite the growth in this segment, government borrowing in the regional market is mainly short-term. In principle, two types of government securities are used—short-term T-bills and medium-term bonds. Other available types of instruments have marginal importance. Short-term T-bills represent about 90 percent of all government paper issued in the regional market in 2000–11 and their share has been gradually growing, while medium-term bonds, which represented almost half of all issuances until mid-2000s, have become less important in relative terms. The recent Côte d'Ivoire restructuring, however, bucked this trend.

Table 1. WAEMU: Issuances of Government Securities, 2001-11

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011 Est.
						FCFA billions					
T bills	55	50	85	124	271	198	331	343	895	2,084	3,161
Bonds	5	103	99	62	195	167	371	170	259	250	345
Total	60	153	185	186	465	365	701	513	1,154	2,334	3,506
						Percent of GDP					
T bills	0.3	0.2	0.4	0.5	1.1	0.8	1.2	1.1	2.7	6.0	8.7
Bonds	0.0	0.5	0.5	0.3	0.8	0.6	1.3	0.5	0.8	0.7	0.9
Total	0.3	0.7	0.9	0.8	1.9	1.4	2.5	1.6	3.5	6.7	9.6
						Percent of tax revenue					
T bills	2.0	1.7	2.7	3.7	7.6	5.0	7.6	7.3	17.5	37.6	59.9
Bonds	0.2	3.5	3.2	1.9	5.4	4.2	8.5	3.6	5.1	4.5	6.5
Total	2.2	5.1	5.9	5.6	13.0	9.2	16.1	10.9	22.6	42.1	66.4
						Index (2001=1)					
T bills	1.0	0.9	1.6	2.2	4.9	3.6	6.0	6.2	16.3	38.0	57.6
Bonds	1.0	20.7	19.9	12.4	39.0	33.3	74.1	34.1	51.8	50.0	68.9
Total	1.0	2.6	3.1	3.1	7.8	6.1	11.7	8.6	19.3	39.0	58.5

Source: BCEAO, Tableaux de bord du marché des capitaux de l'UMOA, 2002-11.

C. Conclusions

Despite improvements in 2006–2011, the financial system in WAEMU member countries continues to be characterized by low levels of financial intermediation. Financial deepening should be pursued resolutely and will require accelerating reform implementation, starting with developing the interbank market and strengthening the public debt market.

Assessing progress in financial deepening in the WAEMU is made difficult by the near absence of indicators on access. Participation in international surveys like *Financial Access* or *FinScope* could be considered by the authorities.

Selected references

Allen, Franklin, and Giorgia Giovannetti (2011), "The Effects of the Financial Crisis on Sub-Saharan Africa," Review of Development Finance, Vol. 1, Issue 1, January-March 2011, pp. 1-27.

Beck, Thorsten, Samuel Munzele Maimbo, Issa Faye, and Thouraya Triki (2011), Financing Africa: Through the Crisis and Beyond, Washington, DC: The World Bank.

Appendix V: FSAP Follow-up

Recommendations	Status of Implementation
Supervision and Operational Framework of the Banking Sector	
Gradually align prudential norms to international best practice: i.e., CAR, credit exposure, delinquent loan classification threshold.	The institutional reform has provided a basis for aligning prudential norms with international best practice. Current norms will first be rationalized. At a second stage, the regulatory framework will be aligned with Basel II principles.
Enforce the minimum statutory capital requirement to encourage bank mergers and end BCEAO and government participation in the capital structure of banks.	The WAEMU banks compliant with the higher minimum capital requirement at end-December 2010 accounted for 87 percent total assets of the banking system. 10 out of 36 non-compliant banks are from Côte d'Ivoire and are being treated separately in view of the crisis. The remaining 26 have demonstrated their readiness to comply shortly. Supervisory authorities are monitoring closely progress in this regard. While the majority of member states comply with the prudential norm that limits states' participation in financial institutions to 25 percent of equity, some member states do not yet observe this norm. In contrast, although Article 27 of the BCEAO's new statutes allows for its participation in financial institutions, the BCEAO has divested from 7 institutions since late 2008.
Strengthen the WAEMU Banking Commission (BC) and make it accountable for (i) enforcing regulations more strictly; (ii) putting in place early warning procedures for when prudential action is needed in response to distress in a credit institution; and (iii) establishing a procedure resolving banking crises, especially in a systemic case.	The Institutional Reform strengthened the BC's autonomy in enforcing regulations and resolving crises. Critically, it now has the power to propose administrators, and it can be overruled only by the WAEMU Council of Ministers upon a member state's appeal. An early warning procedure has not yet been put in place. The resources of the Banking Commission are expected to be increased substantially in 2012.
Open Market Operations and Public Securities Markets	
Enhance the effectiveness of the operational framework for monetary policy: e.g., collectivize open market operations with prime quality assets, provide daily forecasts through a bank liquidity monitoring committee, and establish active national cash committees.	In progress: the BCEAO is enhancing the operational framework of monetary policy; the BCEAO continues to internally assess the quality of assets and does not currently use external ratings. The BCEAO is in the process of putting in place active national treasury cash flow committees, but national authorities' compliance, which would lead to better liquidity

	forecasts is presently very weak. Providing daily forecasts of liquidity is yet to materialize.
Produce reliable annual schedules of securities issuance.	In progress.
Issue all public debt securities by auction.	Implemented. The BCEAO has clearly favored issuance by auction.
Put in place a network of primary dealers.	In progress: the regulation are being prepared by the BCEAO.
Establish a regional legal framework for repurchase operations.	In progress. Implementation expected in 2012.
Set up a government bond issues coordination committee under the authority of the Council of Ministers.	Adopted in 2010, but is not yet operational because of the national authorities' difficulty complying.
Securities and Exchange Market and Accounting and Audit Framework	
Complete the study of restructuring the market and address the following issues: (i) number of enterprises that can be listed; (ii) potential for venture capital; (iii) possibility of platforms shared by several exchanges (Nigeria, Ghana); (iv) potential afforded by institutional savings; and (v) incentives to attract foreign investment.	Some progress. The principle of creating incentives for the emergence of venture capital is adopted. The regulator has undertaken actions to attract more participants in the market.
Gradually align bank accounting and auditing with international standards (IFRS and ISA) while maintaining financial reporting in accordance with the prudential rules.	In progress. The accounting framework is under review to be aligned with IFRS and IAS standards.
Ease accounting requirements for companies that wish to list their shares on the exchange by reducing the number of audited fiscal years required from five to three.	Not implemented—but under review. A window for SMEs is being established to facilitate listing for these businesses.
Determine under what conditions the guarantee system could be replaced with ratings.	Implemented since 2010—private entities with good ratings do not need any external guarantees before issuing securities. However, private entities with no ratings or bad ratings are still required to use guarantee funds or institutions. Only a few businesses are rated in the region.
Harmonize securities taxation in the WAEMU. Review pricing of services with a view to significantly lowering the cost of transactions.	Implemented—adopted in 2010, review of pricing in progress.

This appendix was prepared by Prosper Youm.

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IMF Executive Board Concludes 2012 Discussion on Common Policies of Member Countries of the West African Economic and Monetary Union

On March 14, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the annual Discussion[1] on Common Policies of Member Countries of the West African Economic and Monetary Union (WAEMU).[2]

Background

2011 was a challenging year for the WAEMU. Côte d'Ivoire experienced a political crisis and armed conflict for a few months after the presidential election held in November 2010. This crisis was the culmination of a decade of political instability in the country, which had a major impact on its development. The crisis ended in April 2011 when President Ouattara (the election

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of these bilateral Article IV consultation discussions, staff hold separate annual discussions with the regional institutions responsible for common policies in four currency unions—the Euro Area, the Eastern Caribbean Currency Union, the Central African Economic and Monetary Union, and the West African Economic and Monetary Union. For each of the currency unions, a staff team visits the regional institutions responsible for common policies in the currency union, collects economic and financial information, and discusses with officials the currency union's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. Both staff's discussions with the regional institutions and the Board discussion of the annual staff report will be considered an integral part of the Article IV consultation with each member. 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 country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

[2] WAEMU's members are Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo.

winner) took control of the country, but it had a severe economic impact. Subsequently, the new government embarked on an ambitious investment-led recovery. The early part of 2011 was also marked by rising food and fuel prices, which have a major economic and social impact on WAEMU countries. The second half of 2011 was marked by a drought affecting severely cereal production in the Sahel countries, but also by the incipient global slowdown.

Regional growth in 2011 (0.9 percent) was affected by the Ivorian crisis and the drought in the Sahel countries. Côte d'Ivoire's economic activity contracted sharply in early 2011 as a result of the crisis, which led to an estimated annual GDP decline of 5.8 percent despite the subsequent recovery. The drought had a large impact on cereal production in Burkina Faso, Mali, Niger, and Senegal with estimated declines ranging from 15 to 27 percent. As a result, growth in these countries was significantly affected. The shortfall in the production of these traditional food crops also exposes millions of persons in the region to food insecurity.

Fuel and food prices had a significant impact on regional inflation. The surge in international fuel and food prices pushed inflation upward to a peak in the spring of 2011. The subsequent easing of these prices was accompanied by a quick drop in year-on-year inflation, which was below 3 percent at year-end. On average, annual consumer price inflation is estimated at 3.6 percent in 2011.

The area-wide overall fiscal deficit (excluding grants) widened in 2011. It is estimated to have increased from 5.5 percent of GDP in 2010 to 7.9 percent of GDP, mainly on account of the impact of the crisis in Côte d'Ivoire. Other factors include higher subsidies to the electricity sector in Senegal, the use of privatization revenue for investment projects in Mali, and lower tax revenue in Benin. Average public debt is estimated to have remained at about 42 percent of GDP in 2011.

The region's current account deficit rose to about 6 percent of GDP in 2011. This increase (from about 5 percent of GDP in 2010) partly reflects less favorable terms of trade, lower worker remittances, and larger imports related to reconstruction in Côte d'Ivoire, to mining in Burkina Faso and Niger, and to higher food and fuel prices. However, thanks to strong capital inflows, the Union's foreign exchange reserves increased and amounted to about six months' imports (excluding intra-WAEMU trade) at end-2011.

Progress in the area of convergence was mixed. Whereas all the countries met the inflation criterion in 2010, only a minority of them still did so in 2011, because of the increase in international food and fuel prices. Most of the countries did not meet the key criterion on the fiscal deficit in 2011. On the other hand, progress was made with respect to the indebtedness criterion, as a result of the debt relief granted to Togo and Guinea-Bissau in the context of the HIPC Initiative and MDRI.

Executive Board Assessment

Executive Directors commended the regional authorities' sound macroeconomic management, which helped contain inflation and maintain financial stability across the region in 2011 despite the political crisis in Côte d'Ivoire in the early part of the year, a sharp increase in international food and fuel prices, and severe drought in the Sahel countries. They noted, however, that progress in complying with convergence criteria has been mixed, and downside risks remain in light of the crisis in Europe and the ongoing drought in the Sahel. Macroeconomic policies will need to respond appropriately if these risks materialize. Over the medium term, it will be critical to improve the macroeconomic policy framework, address underlying structural weaknesses, enhance the stability of the union drawing on the euro area's experience, and strengthen regional surveillance.

Directors underscored the need to reduce the area-wide fiscal deficit over the medium term to maintain fiscal sustainability, with due attention to the region's pressing infrastructure needs. They welcomed the ongoing review of the convergence criterion on debt, and suggested that a broader approach to fiscal sustainability could be considered. They urged prompt implementation by member countries of the directives on public financial management, containment of wages and salaries, broad-based tax reforms, and replacement of petroleum price subsidies with well-targeted social safety nets tailored to the region's circumstances.

Directors considered the monetary stance to be broadly appropriate. However, they highlighted the need to strengthen the liquidity management and forecasting framework and expedite planned inter-bank market reforms. They agreed that foreign exchange reserves are adequate and that the area-wide real exchange rate appears to be broadly aligned with economic fundamentals in the region.

Directors were encouraged that stress tests point to a resilient regional financial sector. Nevertheless, prudential regulation and supervision need to be further strengthened and brought into line with international best practices, and a more formal crisis management framework should be introduced. The FSAP recommendations should continue to be vigorously implemented. Directors also called for stepped-up efforts to develop the financial sector to help ease domestic financing constraints and support growth.

Directors urged the authorities to accelerate regional integration. This would require reinvigorating regional policies, ensuring their full implementation, and increasing policy coordination by member countries. Reform priorities include removal of barriers to intra-regional trade and factor mobility, improvement of the business environment to enhance non-price competitiveness, and development of regional infrastructures.

Directors welcomed the authorities' initiatives to further improve transparency and information availability, and urged continued progress in this area. They recommended the regular compilation and timely publication of financial soundness indicators.

The views expressed by Executive Directors today will form part of the Article IV consultation discussions on individual members of the WAEMU that take place until the next Board discussion of WAEMU common policies.

Table 1. WAEMU: Selected Economic and Financial Indicators, 2008—2016

	2008	2009	2010	2011	2012	2013	2014	2015	2016
				Est.	Proj.	Proj.	Proj.	Proj.	Proj.
				(Annual percentage change)					
National income and prices									
GDP at constant prices	4.2	2.9	4.6	0.8	7.0	5.6	5.8	5.7	5.7
excluding Côte d'Ivoire	4.9	2.6	5.5	3.2	6.5	5.5	5.8	5.8	5.9
GDP per capita at constant prices	1.4	0.2	1.8	-1.9	4.1	2.8	3.0	2.9	2.9
excluding Côte d'Ivoire	2.2	0.0	2.8	0.5	3.7	2.8	3.0	3.1	3.1
Broad money to GDP	-3.5	9.5	8.9	6.6	…	…	…	…	…
Consumer prices (average)	7.4	0.4	1.4	3.8	3.6	2.5	2.5	2.4	2.4
Terms of trade	12.0	4.0	-4.5	1.3	2.8	1.8	-0.1	0.9	0.8
Nominal effective exchange rates	3.4	0.9	-4.3	1.7	…	…	…	…	…
Real effective exchange rates	5.8	0.2	-6.4	0.9	…	…	…	…	…
				(Percent of GDP)					
National accounts									
Gross domestic savings	12.8	15.5	13.5	13.5	13.5	13.8	14.6	15.3	15.9
Gross domestic investment	19.8	18.6	19.1	19.3	20.9	21.6	21.7	22.2	22.5
Of which: public investment	5.9	7.1	6.6	7.0	8.2	8.5	8.6	8.6	8.7
Resource gap	-7.0	-3.1	-5.5	-5.7	-7.5	-7.8	-7.1	-6.9	-6.6
				(Annual changes in percent of beginning-of-period broad money)					
Money and credit [1]									
Net foreign assets	0.3	5.8	3.1	5.5	…	…	…	…	…
Net domestic assets	12.4	10.8	14.6	8.9	…	…	…	…	…
Broad money	9.0	14.7	15.7	12.7	…	…	…	…	…
				(Percent of GDP, unless otherwise indicated)					
Government financial operations									
Government total revenue, excl. grants	17.6	17.4	18.0	16.5	18.3	18.7	19.0	19.2	19.4
Government expenditure	22.4	23.9	23.5	24.4	25.3	25.4	25.3	25.2	25.1
Overall fiscal balance, excl. grants	-4.8	-6.5	-5.5	-7.9	-7.0	-6.6	-6.3	-6.0	-5.7
Official grants	2.9	3.0	2.3	3.1	3.0	3.1	3.1	3.1	3.1
Overall fiscal balance, incl. grants	-1.9	-3.5	-3.2	-4.8	-3.9	-3.5	-3.1	-2.8	-2.7
Basic fiscal balance, incl. grants & HIPC	-1.8	-1.3	-0.8	-2.5	-1.9	-1.3	-0.9	-0.7	-0.5
External sector									
Exports of goods and services [2]	22.1	26.6	27.7	29.0	29.0	28.4	27.7	27.1	26.9
Imports of goods and services [2]	35.8	32.0	34.8	36.8	37.9	37.1	35.8	34.9	34.3
Current account, excl. grants[3]	-8.7	-5.7	-6.8	-7.7	-9.2	-9.2	-8.5	-8.3	-7.9
Current account, incl. grants[3]	-7.1	-3.6	-4.9	-5.7	-7.4	-7.7	-7.1	-6.9	-6.6
External public debt	33.8	35.6	32.3	32.2	32.6	32.8	33.3	33.0	32.4
Broad money	29.5	32.3	35.2	37.5	…	…	…	…	…
Memorandum items:									
Nominal GDP (in billions of CFA francs)	31,205	32,551	34,660	35,977	39,800	42,988	46,490	50,162	54,169.7
Nominal GDP per capita (in US dollars)	750	722	713	757	754	791	828	865	905
CFA franc per US dollars, average	448	472	495	471	…	…	…	…	…
Euro per US dollars, average	0.68	0.72	0.76	0.72	…	…	…	…	…
Foreign exchange cover ratio [4]	96.8	98.9	99.9	97.2	…	…	…	…	…
Reserves in months of imports (excl. intra-WAEMU imports)	5.7	6.2	6.3	6.2	6.0	6.1	6.1	6.0	8.0

Sources: IMF, African Department database; World Economic Outlook; IMF staff estimates.

[1] The estimates for 2011 refer to annual change at end-Oct, with the beginning-of-period referring to end-Oct 2010.

[2] Excluding intra-regional trade as estimated by BCEAO up to 2013.

[3] Data up to 2010 are corrected for intra-regional trade discrepancies by BCEAO.

[4] Gross official reserves divided by short term domestic liabilities (IMF definition). For 2011, the estimate refers to end-Oct.

Statement by Assimaidou Kossi
Executive Director for WAEMU
March 14, 2012

My WAEMU authorities would like to thank staff for the thoughtful discussions held in January 2012 during their visit to the regional institutions. The wide range of issues touched upon relate both to area-wide challenges such as the aftermath of the crisis in Cote d'Ivoire, the impact of the drought in Sahel countries and potential shocks which may stem from the euro zone crisis. To date, my authorities have endeavored to address new challenges posed to the stability of the banking system by protracted turmoil in the region. Going forward, they are cognizant of the improvements needed for the institutional framework of the economic and monetary union to sustain shocks and better contribute to macroeconomic stability and high and sustained growth.

Economic Developments in 2011

The recent developments in the WAEMU were marked by the impact of the postelection crisis in Cote d'Ivoire. The **annual GDP** decline of 5.8 percent in this country in 2011, coupled with drought-caused contraction of cereal production in Burkina Faso, Mali, and Niger contributed to curtail the regional growth in 2011 (0.8 percent).
Inflation in the region was in line with targets, after surging in the first half of 2011 as a result of rising food and fuel prices.

The end of the crisis in Cote d'Ivoire and the subsequent resumption of economic activity have had a positive impact on the region. Landlocked countries, which have borne over costs on their imports, are being relieved, and intra-regional trade should further increase accordingly. My regional authorities' decision to roll over maturing Ivorian government paper has helped safeguard the banking system. Going forward, the authorities intend to take stock of this experience to further strengthen the regional institutional framework with the view to better address similar situations in the future.

The **convergence agenda** has also suffered from the Ivorian crisis and the food and fuel price spikes. Overall performance was mixed, with most countries missing the key criterion on fiscal deficit, though debt figures have improved significantly thanks to relief under the HIPC and MDRI initiatives. The return to normalcy in Cote d'Ivoire should help improve convergence criteria within the region.

Outlook and Regional Policies

Recent developments such as the post-crisis recovery in Cote d'Ivoire, high infrastructure investments, and better energy supply, should drive regional growth in 2012, which is expected to stand at 7 percent. Inflation is expected to remain subdued around 3.5 percent. My authorities are committed to implement sound macroeconomic policies to strengthen the stability of the monetary union, taking stock of the area-wide recent experience and the lessons drawn from the euro zone crisis. Furthermore, they intend to speed up the implementation of a broad range of reforms and regional policies regarding infrastructures, energy, industry and trade.

In the fiscal area, deficits are set to narrow, and most of the fiscal measures implemented by WAEMU countries to address the impact of high international food and fuel prices over the past years are coming to an end. Addressing energy shortages has also adversely impacted public finances within the region over the past years, and the improvement on this front should help create some fiscal space. My authorities are committed to appropriately use this fiscal space to increase other public investments, while striking the right balance with medium-term fiscal sustainability concerns.

In the financial sector, my authorities have appropriately addressed the potential systemic risks associated with the closing of the Ivorian banks and the nonpayment of the Ivorian debt vis-à-vis the regional creditors. The effective coordination between BCEAO and the Ivorian authorities has helped insulate the other countries from the crisis. Going forward, my authorities have drawn helpful lessons, which will help devise mechanisms to strengthen the union, notably through improving convergence criteria, enhancing the regional surveillance framework, and reinforcing the financial crisis prevention and resolution system. In this regard, they welcome the staff's analysis which shows that the real effective exchange rate is broadly aligned and reflects fundamentals. Moreover, the BCEAO is working with member countries to better plan the issuance of papers on the regional debt market.

My authorities welcome the stress tests' results that the banking sector is resilient. They will continue to work expeditiously with member countries to enhance compliance with prudential regulation. Furthermore, cognizant of its key role in supporting private activity, my authorities are committed to further deepening the banking sector. Studies undertaken in the region have concluded to the under financing of the private sector, especially SMEs by the banking system. My authorities are determined to turn this situation around. In this regard, the WAEMU commission has launched a number of studies from which important measures should be drawn to address regional aspects of the financial deepening. The BCEAO is also working on a wide range of reforms, including further enhancing the interbank market, and revamping the microfinance sector.

Implementing **growth-enhancing policies** remains a top priority for my WAEMU authorities. Growth rates are still modest within the region, and far away from what is needed to significantly reduce poverty. Closing the infrastructure gap is one of the major tasks my authorities have embarked on. With donors' support, the plan to link the region's capital cities through modern roads is progressing well; so is the project of extending the railway throughout the region. The energy issue is also being addressed. A regional fund has been created and hosted by the West African Development Bank (*BOAD*), with the mission to finance national initiatives to meet energy demand in the short term. Progress on those fronts should help improve nonprice competitiveness of the region.

Beyond measures to reduce factor costs, my authorities are also working on direct measures to enhance the region's enterprises and to further industrialization, especially in the processing of raw materials. Most of these initiatives are part of the Regional Economic

Program, which also includes measures to lift barriers to trade and enhance regional integration.

My authorities are working to revamp the **institutional setting of the Union**, based on lessons learnt from recent crises. The euro zone crisis has underscored the need to complement the governance structure of any monetary union with a mechanism for crisis prevention. Likewise, the Ivorian debt crisis has highlighted the potential risks facing the regional banking sector and the debt market as well. On these issues, my authorities intend to foster analyses and policies, with the assistance of the Fund, in order to identify the appropriate ways to strengthen the institutional apparatus of the WAEMU.

Conclusion

Growth prospects are highly favorable for the WAEMU region for 2012 and the medium term, partly owing the post-crisis recovery in Cote d'Ivoire. In addition to the buoyant public investments programmed in the region's leading economy, the reaching of the HIPC completion point this year should help improve further the outlook for the whole region. The WAEMU authorities are committed to implement a wide array of reforms to fully benefit from these favorable developments and entrench growth momentum.

The new challenges posed by recent crises, both within the region and on the international scene have underscored the need to continuously improve the monetary union's institutions. My authorities will work hand in hand with partners such as the Fund in this endeavor.