

OVERVIEW

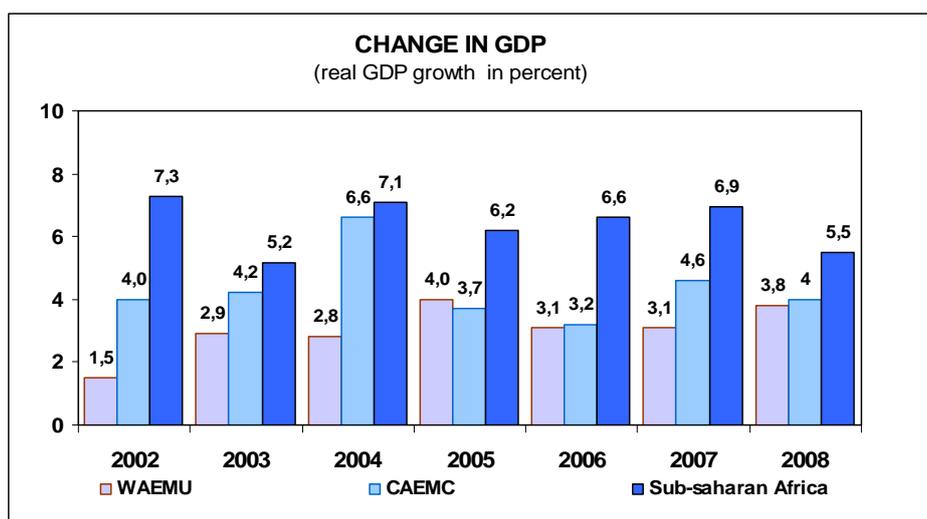
In 2008, against a backdrop marked by the international financial crisis and a sharp slowdown in global economic growth from 5.1% to 3.1%, the growth rate of African franc zone countries as a whole stabilised at 3.9%. This overall result can be attributed to the deceleration in GDP growth in Central Africa and a slight recovery in West Africa.

Key economic indicators						
	GDP growth (%)		Inflation (%) *		Fiscal position (% of PIB) **	
	2007	2008 ^(a)	2007	2008 ^(a)	2007	2008 ^(a)
WAEMU	3.1	3.8	2.4	7.4	-2.4	-2.0
CAEMC	4.6	4.0	1.8	5.9	8.8	12.0
Sub-Saharan Africa	6.9	5.5	7.2	11.7	1.0	2.1

* Change in consumer prices, as a yearly average
 ** On an accrual basis, incl. grants
 (a) estimations
 Sources: IMF: Regional Economic Outlook April 2009, World Economic Outlook, updated July 2009, BCEAO, BEAC

ECONOMIC ACTIVITY

Like in the previous year, the two main sub-regions of the franc zone¹ put in a weaker performance than that of Sub-Saharan Africa. However, unlike in Sub-Saharan Africa, overall franc zone growth did not decline. This resilience to the crisis can be ascribed to the low international exposure of local financial systems, the strong improvement in terms of trade and good food crop harvests.



Sources: central banks, IMF Regional Economic Outlook April 2009 updated July 2009

¹ These sub-regions are the Central African Economic and Monetary Community countries (CAEMC) and the West African Economic and Monetary Union countries (WAEMU).

In 2008, against the background of a smaller decline in oil production (-1.2%, after -4.4 % in 2007), GDP growth in the CAEMC slowed but remained relatively sustained (4%, after 4.6% in 2007). However, the CAEMC's reliance on the oil industry remained strong, with the latter accounting for 73% of tax revenues in 2008 and 67% in 2007, due to the 24.4% rise in average export prices (in CFA francs) in the hydrocarbons sector.

On the demand side, economic activity was essentially driven by investment and consumption. On the supply side, real economic growth was underpinned by the non-oil sector. In the primary sector, the contribution of mining and quarrying to growth was zero overall while that of forestry was negative, due to the drop in wood sector production on the back of the steep decline in world demand. Conversely, the services sector particularly benefited from buoyant domestic consumption and, above all, from strong performances from the commercial activities, transport and telecommunications sectors. Lastly, the manufacturing sector and the construction and public works sector also contributed positively to growth.

The CAEMC's investment rate remained relatively high (28.8% of GDP, after 29.5% in 2007) thanks chiefly to the strength of private investment, in particular in the oil (exploration and development), telecommunications and agri-food sectors. Investment activity remains very largely determined by its oil component, which has, until now, had limited spillover effects on local economic development.

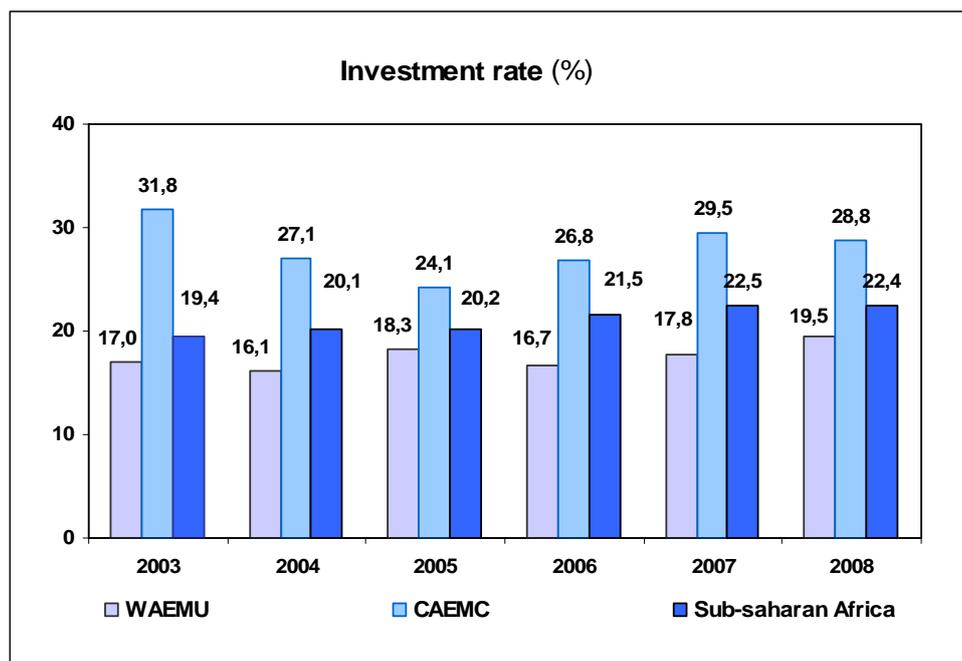
In 2008, owing to the firmness of subsistence crop production, the WAEMU recorded growth of 3.8%, after 3.1% in 2007. Crop yields in 2008-2009 were aided by generally favourable climatic conditions as well as government measures² aimed at enhancing agricultural supply in the sub-region in the wake of spiralling food prices.

A sharp rise in cereal and tuber production was observed. Nevertheless, given the reduction in planted areas and the difficulties experienced by certain industries, export crops showed diverging trends. While coffee, groundnut and cashew nut production increased, cocoa harvests plummeted and cotton harvests stagnated after falling sharply in 2007. Aside from internal difficulties, the zone franc cotton industry is suffering from asymmetrical competition from a number of industrialised countries, in particular the United States, which largely subsidises its producers.

Growth was also underpinned by the robust performance of market services, especially the telecommunications and the construction and public works sectors thanks to basic infrastructure projects. Conversely, the secondary sector continued to be disrupted by problems in the supply of electricity, but it was also impacted by the decline in the activity of cotton processing and textile transformation and of mining and quarrying. On the demand side, consumption and fixed investment gross fixed capital formation (GFCF) grew at a strong pace. The investment ratio improved while remaining relatively low.

For the past seven years, the WAEMU's economic potential has been constrained by the situation in Côte d'Ivoire, which accounts for almost 35% of the sub-regions GDP. In 2008, while remaining low, this country recorded its highest growth rate (2.3%) since 2001.

² In particular, via distributions of pesticides and seeds.



Sources: Central banks, IMF World Economic Outlook April 2009

In 2008, economic growth in the Comoros slowed further, with real GDP inching up by just 0.2% (compared with 0.8% in 2007). This can be ascribed, in particular, to the chronic energy shortages that affect all economic sectors and a socio-political climate that has remained tense over the past months.

(NB: Part 4 of the 2008 annual report contains the summary, drafted by the BCEAO, of the report entitled “Impact de la crise financière sur les pays du groupe Afrique francophone au FMI et à la Banque mondiale”)

INFLATION

The inflation rate increased in zone franc countries, thus reflecting their great vulnerability to the food price shock that occurred in the first half of 2008. This rise in inflation was mitigated by the exchange rate system and the euro peg, which explains why inflation was much lower in the franc zone than in Sub-Saharan Africa. The inflation differential between the two latter remains above 5%. Conversely, this differential widened with the euro area, causing the real exchange rate to appreciate.

The acceleration in inflation in the CAEMC (5.9%, after 1.8% in 2007) and the WAEMU (7.4%, against 2.4% in 2007) reflects the sharp rise in food prices and their weight in the index as well as the gradual pass-through of world oil price increases to domestic prices. In 2008, annual inflation trends in both sub-regions inflation were characterised by a strong acceleration in the first months of the year: in year-on-year terms inflation peaked at 10.8% at end-August in the WAEMU and 7.1% at end-September in the CAEMC.

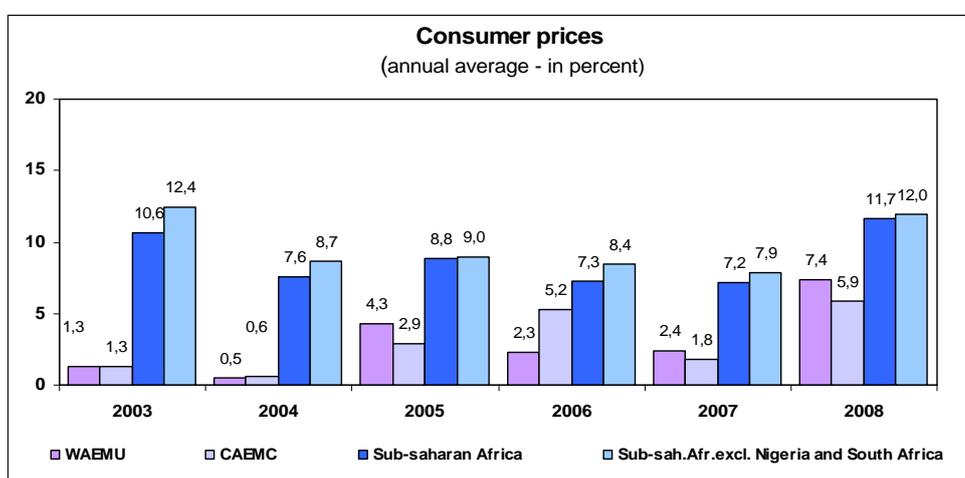
In the WAEMU, a decrease in price inflation was observed in the last four months of the year. This can be attributed to the good harvests in 2008-2009 and the reversal of the trend of rising imported food prices and international oil and gas prices.

In the CAEMC, however, inflation did not slow at the end of the year for reasons that varied across countries: security problems, transport and supply difficulties, etc. The monetary and fiscal environment

(abundant bank liquidity and large oil surpluses fuelling domestic demand via government expenditure) remains conducive to the development of inflationary pressures. In this context, the BEAC pursued its policy of reducing excess bank liquidity by keeping in place its open window mechanism.

In the Comoros, inflationary pressures increased, with consumer price inflation reaching a six-year high of 6.5% in 2008, compared with 4.6% in 2007. This deterioration stems mainly from spiralling world prices of some imported commodities (oil, cement, etc.) and foods (oil, rice, flour, etc.).

In 2008, the franc zone continued to achieve better results in terms of fighting inflation than Sub-Saharan Africa³ (11.6%). The franc zone countries have an excellent long-term record of keeping inflation under control: in the period 1997–2008, the average annual inflation rate was below 3% in the CAEMC and the WAEMU, compared with 11% for Sub-Saharan Africa as a whole. This lower inflation can be attributed to the nominal pegging of the CFA and Comorian francs to the euro. The stability of the African franc zone currency helps to contain the cost of imports from the rest of the world. Notably, in the year under review, the anchoring to the euro clearly contributed to dampening the inflationary impact of the sharp rise in oil and food prices.



Sources: Central banks, IMF World Economic Outlook, April 2009

Irrespective of the exchange rate regime, the quality of macroeconomic policies remains the key determinant of economic performance. In this respect, while the soundness and the credibility of the euro peg are contingent on the vigilant monetary policies conducted by the franc zone central banks, sound and balanced fiscal policies are also crucial.

MONETARY POLICY

In 2008, monetary policy was tight in both regions before being eased in response to the crisis in the first half of 2009.

In August 2008, the persistence of inflationary pressures in a context characterised by a strong rise in lending and money supply led the BCEAO to hike the repo rate by 50 basis points and the discount rate by 200 basis points. In June 2009, in view of the second round effects from the international crisis and a balance of risks pointing more to weaker growth than further upward pressure on prices, the BCEAO

³ Excluding Zimbabwe that is facing hyperinflation.

lowered its key rates by 50 basis points and, for the first time in four years, revised down minimum reserve ratios.

At the same time, in order to ensure that it could better steer money market interest rate in the context of reduced bank liquidity, the BCEAO maintained an active open market policy, where it conducted, in February 2009, tenders with a maturity of one month alongside those of one week.

While the BEAC had left interest rates unchanged since its March 2006 cut, the Monetary Policy Committee, given the persistence of inflationary pressures, decided to raise them by 25 basis points in July 2008. Subsequently, the moderation of inflation expectations, together with the economic slowdown in the last quarter, prompted the BEAC to lower its interest rates in three stages (December 2008, March and July 2009) by a total of 125 basis points.

In 2008, essentially as a result of the strong increase in net external assets, banks' total reserves increased by 16.4% in the CAEMC. Nevertheless, banks' free reserves declined from 73% to 68% following the decision in July 2008 to raise minimum reserve ratios in order to reduce excess bank liquidity. Moreover, as part of an active excess liquidity management policy, the BEAC confirmed its decision of June 2007 to accept all amounts offered by banks in these liquidity absorbing operations.

In the Comoros, money supply rose by 11.5% in 2008, mainly due to the strong growth in domestic credit that was driven by credit to the government and credit to the economy. Key interest rates linked to the EONIA declined sharply. Furthermore, the Central Bank of the Comoros revised down on 1 January 2009 the interest rate on banks' minimum reserves from EONIA -0.25 to EONIA -1.25.

PUBLIC FINANCES

Despite the deterioration in the economic environment at the end of the year, public finances improved overall in 2008. In general, African franc zone countries pursued efforts to consolidate their budget.

Thanks to the sharp rise in oil revenues, and despite the substantial increase in current expenditure and capital expenditure, CAEMC countries generated a budget surplus (on an accrual basis, excluding grants) of 11.5% of GDP, compared with 8.2% in 2007.

In the WAEMU, thanks mainly to enhanced tax recovery and a broadening of the tax base, the budget deficit (on an accrual basis, excluding grants) decreased slightly from 5.2% in 2007 to 4.7%. However, the fiscal position of several countries remains fragile and some countries continued to experience cash flow pressures, which led to the accumulation of further external payment arrears.

In the Comoros, against a backdrop of political crisis and economic slowdown that depressed revenues while expenditure grew rapidly, the fiscal position deteriorated. The budget deficit (on an accrual basis, excluding grants) stood at 13.1% of GDP, compared with 10.1% in 2007.

The public finances of many franc zone countries were most generally adversely affected in 2007 and 2008 by temporary measures taken to offset the rise in oil and food prices (subsidies, VAT exemptions, lowering of customs duties, etc.).

The monetary authorities of the WAEMU and the CAEMC decided on the principle of the gradual phasing out the direct advances made by central banks to the government. In the WAEMU, this reform was accompanied by the rapid development of a regional public debt market. In the CAEMC, the plan to issue government securities as of 2009 no longer includes the phasing out of advances to the government.

In June 2009, the MPC of the BEAC nevertheless adopted the principle of capping long-term advances, as of the launch of the securities issuance programme, then reducing them by one-fifth each year.

EXTERNAL ACCOUNTS

Current account balance				
	Current account balance (% of GDP)		Change in the terms of trade (%)	
	2007	2008 (a)	2007	2008 (a)
WAEMU	- 6.4	- 5.9	- 20.0	+ 13.8 (*)
CAEMC	- 0.7	+3.1	- 7.9	+ 15.9

(a) : estimation
 Change in the terms of trade: (+) = improvement
 Sources: Central banks, IMF

In 2008, the terms of trade of the CAEMC and WAEMU countries improved, thanks to the average rise in export product prices (agricultural products and commodities, in particular oil). Moreover, the real effective exchange rate of the two sub-regions appreciated continuously to reach a peak in the middle of the year before depreciating in the second half of 2008.

In 2008, their trade balances moved in opposite directions with an increase in the surplus in Central Africa and a second successive deficit in West Africa.

The CAEMC recorded a current account surplus of 3.1% of GDP, compared with a deficit of 0.7% in 2007. This primarily reflects the improvement in the trade surplus on the back of the significant rise in oil exports, while the services and income balances continued to deteriorate.

The WAEMU showed a trade deficit for the third time since 1993 (followed by 2005 and 2007). The rise in exports (cocoa, gold and oil) was lower than the increase in imports (capital goods purchases, increase in the oil bill and food prices). Conversely, the current account deficit saw a slight improvement from -6.4% of GDP to -5.9%.

The foreign exchange reserves of the central banks of African franc zone countries represent over four months of imports of goods and services in the WAEMU, over seven months in the CAEMC and over five months in the Comoros. The ratio of money in circulation to external assets largely exceeds the mandatory franc zone threshold of 20%: 107.7% in the WAEMU, 102.2% in the CAEMC and 111.6% in the Comoros.

Overall, the regional convergence process is insufficient in the franc zone: no country had met the four primary convergence criteria⁴ at end-2008. Yet, strict economic discipline goes hand in hand with sound monetary policy. This discipline must attempt, in particular, to ensure that national budgets are left with sufficient room for manoeuvre since they are the only stabilisation instrument capable of countering the asymmetric shocks with which the franc zone is often faced.

Moreover, in both sub-regions it is essential to continue to strengthen the macroeconomic framework in order to generate sufficient fiscal resources to address the under-investment in infrastructure, in particular in the electricity and transport sectors. However, the ways to achieve this differ for oil producing countries and non-oil producing countries. For the former, an enhanced macroeconomic framework could

⁴ Fiscal position, inflation rate, debt outstanding as a percentage of GDP, change in payment arrears.

be achieved through better management of oil revenues, while, for the latter, it is mainly a question of efficiently channelling their own fiscal resources, foreign aid and transfers. This growing difference constitutes a challenge for the franc zone in terms of increasing cross-border financial flows.

Structural reforms (privatisations, transparency of public funds, restructuring of the banking system, sustainable management of natural resources, etc.) are also a key instrument for improving the growth potential of the economies. Although some countries have made progress in terms of privatisation and restructuring of state-owned enterprises, as well as governance and fiscal transparency, these reforms were still too slow in 2008 despite the general consensus on the need to improve the business environment in order to attract local and foreign investors and to enhance the franc zone's position in the global arena

(NB: the 2008 annual report contains three boxes on the measures taken to deal with the financial crisis drafted by the BCEAO, the BEAC and the BCC respectively).

OUTLOOK

In an environment still characterised by a large number of regional geopolitical uncertainties and exposed to major exogenous shocks, the franc zone mechanisms continued to act as an essential stabilising force for the area. First, solidarity between member countries, in each of the monetary unions, is contingent on the implementation of multilateral surveillance, which greatly encourages a rigorous management of public finances. Second, the euro peg, implemented via the monetary cooperation arrangements with France, ensures that monetary policy is always conducted with due vigilance with regard to the risk of inflationary pressures. All in all, franc zone institutions provide a framework conducive to regional integration and economic development.

As regards 2009, franc zone countries will be faced with an international environment deeply affected by the economic and financial crisis. The IMF⁵ expects, in 2009, global economic activity to contract by 1.4% and international trade by 12.2%. Real GDP is expected to shrink by 3.8% in industrialised countries and growth is likely to stand at 1.5% in emerging and developing regions such as Sub-Saharan Africa.

In this context, franc zone countries should see a slowdown in growth that could be mitigated by a sustained rise in export commodity prices.

According to the BEAC, the CAEMC's economic activity is likely to be greatly impacted, with a growth rate of around just 2.1% in 2009. As regards price developments, inflationary pressures are expected to persist with a 4.0% increase in the consumer price index, compared with 5.9% in 2008. Owing to a decline in oil revenues and a rise in investment and current expenditure, in particular wages, public finances should show a deficit (on an accrual basis excl. grants) of -0.6% of GDP, after a surplus of 11.5% in 2008. The current account balance is expected to record a deficit of 12.3% of GDP reflecting, in particular, a steep fall in the trade surplus due to the sharp deterioration in terms of trade. Nevertheless, the rise in oil prices as of the end of the first half of the year could result in an upward revision of these forecasts.

⁵ See the July 2009 update of the *World economic outlook*. These forecasts are expected to be revised upwards with the estimates slated for September.

In the WAEMU, the spread of the crisis in member countries is also likely to affect the macroeconomic performance of the sub-region, which is expected to grow at around 3.0%. While the implementation, in all countries, of programmes supported by IMF is a positive factor, the outlook remains clouded by uncertainty. Given that price pressures have eased since September 2008, inflation could come out below 2.5% both as an average and in year-on-year terms. Domestic fiscal revenues, for their part, are likely to be affected by the slowdown in economic activity and the budget deficit (on an accrual basis, excluding grants), is expected to stand at almost 6% of GDP, compared with 4.7% in 2008. Lastly, like in 2008, the external accounts should show a current account deficit (excluding grants) of around 7.0% of GDP.