

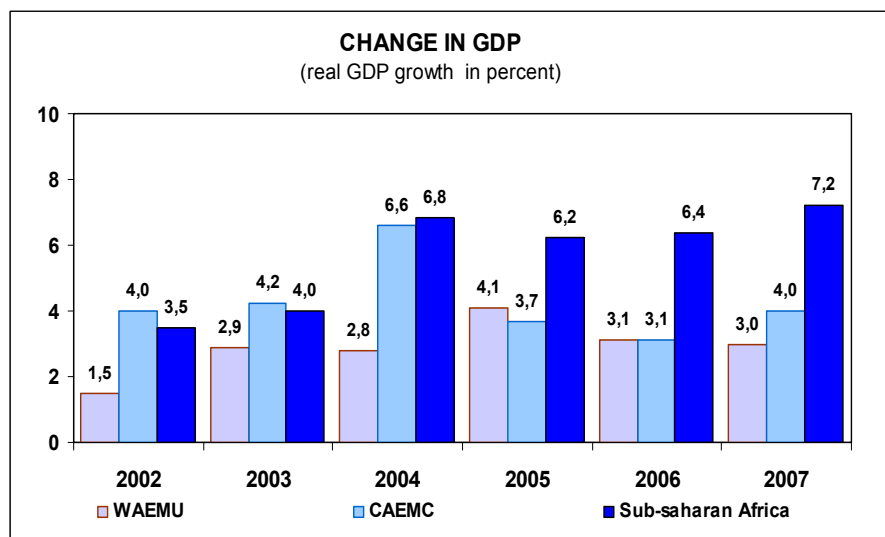
## OVERVIEW

In 2007, in the context of once again robust global economic growth, African franc zone countries as a whole posted a slight increase in their growth rate, which rose from 3.1% in 2006 to 3.5% in 2007. This is due to the stabilisation of GDP growth in West Africa and a slight recovery in Central Africa. Like in 2006, the two main sub-regions of the franc zone put in a weaker performance than that of Sub-Saharan Africa. However, inflation remained significantly lower in the franc zone than in Sub-Saharan Africa.

Key economic indicators						
(%)						
	GDP growth (%)		Inflation (%) *		Fiscal position (% of GDP) **	
	2006	2007 <sup>(a)</sup>	2006	2007 <sup>(a)</sup>	2006	2007 <sup>(a)</sup>
WAEMU	3.1	3.0	2.3	2.4	-2.9	-2.0
CAEMC	3.1	4.0	5.2	1.6	11.7	9.0
Sub-Saharan Africa	6.4	7.2	7.3	7.2	5.1	0.8

\* Change in consumer prices, as a yearly average  
 \*\* On an accrual basis, incl. grants (excluding MDRI)  
<sup>(a)</sup> estimations  
 Sources: IMF Regional Economic Outlook April 2008, World Economic Outlook, updated July 2008, BCEAO, BEAC

The terms of trade of the Central African Economic and Monetary Community (CAEMC) remained relatively stable while those of the West African Economic and Monetary Union (WAEMU) improved slightly (they were up by 0.4% and 1.6% respectively).



Sources: central banks, IMF Regional Economic Outlook April 2008 updated July 2008

GDP growth in CAEMC countries picked up, rising to 4.0% from 3.1% in 2006, despite the further decline in oil production, which was down by 4.4% compared with 3.9% in 2006.

Equatorial Guinea remained the largest oil-producing country of the sub-region, with an annual production of 17.5 million tonnes, ahead of Gabon (12.1), Congo (11.0), Chad (7.3) and Cameroon (4.3).

These five countries account for roughly 11% of Africa's total oil output. In 2007, the CAEMC's reliance on the oil industry was still strong, with the latter accounting for 42% of GDP, 79% of exports and 67% of tax revenues.

Economic growth in CAEMC countries was mainly underpinned by the non-oil sector which contributed 3.5 percentage points to GDP growth. Industries, commercial activities, transport and telecommunications were particularly dynamic. Local crops and log and wood productions also yielded good results. By contrast, the contribution of export crops to growth was very small as a result of the decline in cotton and cocoa harvests.

Equatorial Guinea and Gabon recorded sustained growth on account of the rise in crude oil production. Conversely, Congo, whose oil production decreased, posted negative growth. The macroeconomic performances of Cameroon (35% of the GDP of CAEMC) remained stable, while the Central African Republic recorded a slowdown. Faced with a security crisis, the Chadian economy continued to post slow growth.

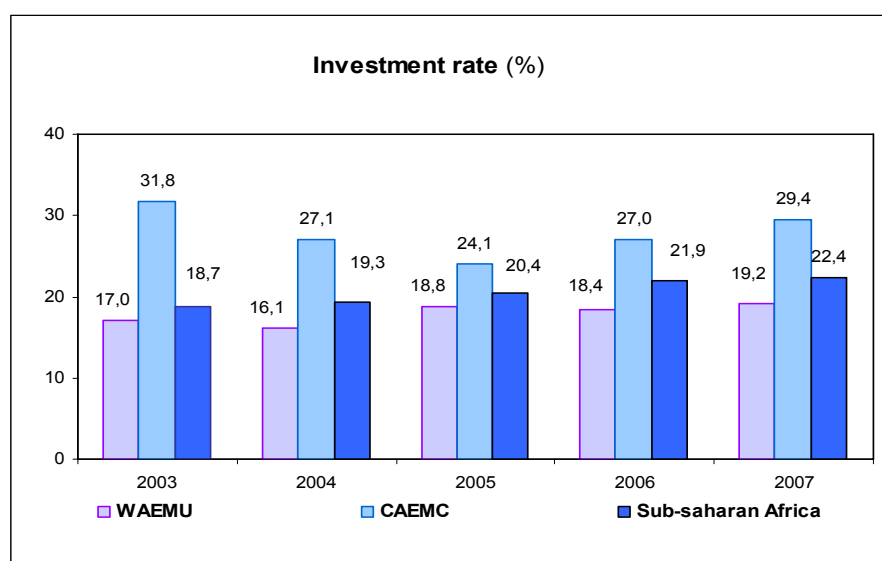
The CAEMC's investment rate (29.4% of GDP) is higher than that of Sub-Saharan Africa (22.4%). However, investment activity is very largely determined by its oil component, which has, until now, had limited spillover effects on local economic development.

In 2007, economic growth in WAEMU countries stabilised at 3% (3.1% in 2006), close to the area's population growth rate. In the primary sector, agricultural production in 2007-2008 was badly affected by adverse weather conditions in some countries. A 2.6% decline in cereal production and a 2.7% increase in local crop and cereal production were recorded. Conversely, export crops – with the exception of cashew nuts – remained unchanged, and even declined in some countries. There was no increase in cocoa and coffee crops; groundnut crops dipped slightly, while cotton production showed a further marked decrease due to late payments to producers and disruptions in certain sectors. The cotton sector in franc zone countries is adversely affected by the asymmetrical competition from a number of industrialised countries that heavily subsidise their own producers.

The secondary sector continued to be disrupted by problems in the supply of electricity and was also impacted by the decline in mining and quarrying activities. Mining activities (gold in Mali, uranium in Niger and oil in Côte d'Ivoire) registered a fall; the phosphates industry started to pick up in Senegal, but posted a sharp decrease in Togo. Growth was mainly underpinned by the buoyancy of market services.

In addition to cyclical factors, the socio-political environment continued to weigh down on companies' development decisions and affect investment, which remained relatively low. Thanks to the progress made towards the settlement of their socio-political crises, Côte d'Ivoire, Togo and Guinea Bissau were able to re-establish ties with the Bretton Woods institutions, but have not yet recorded a significant increase in activity. For the past seven years, the economic potential of WAEMU has been hampered by the situation in Côte d'Ivoire, which accounts for roughly 35% of the sub-region's GDP: the latter's growth rate rose slightly in 2007, but only reached an average of 0.4% over the period. Economic activity in Togo slowed sharply, while economic growth in Guinea Bissau increased yet remained weak.

Burkina Faso, Mali and Niger posted a slowdown, even though their growth rate was still above 3%. Conversely, economic growth accelerated in Benin on account of the recovery in cotton production, and in Senegal – the second largest economy in the sub-region (20% of GDP) – following the resumption of activity at the ICS (Industries Chimiques du Sénégal).



Sources: Central banks, IMF World Economic Outlook April 2008

In 2007, the Comoros recorded a pronounced slowdown, with real GDP inching up by only 0.8% (compared with 2.6% in 2006). This downturn is the result of the political crisis in Anjouan, which has disrupted the international aid process, and the limitations on domestic loans extended by the only commercial bank in the country, following a litigation.

In terms of prices, 2007 was marked by a narrowing of the gap between the two sub-regions: inflation slowed in the CAEMC (1.6%, after 5.2% in 2006), while in the WAEMU it remained relatively stable (2.4%, after 2.3% in 2006).

In Central Africa, the slowdown in inflation stems mainly from the improved supply of local crops and cereals, and the only partial pass-through of the strong rise in oil prices into domestic prices. However, the monetary and fiscal environment (abundant bank liquidity and large oil surpluses fuelling domestic demand) is conducive to the development of inflationary pressures, in particular in Gabon and Equatorial Guinea. In this context, the BEAC set about reducing the excess liquidity by raising the minimum reserve ratios and carrying out large-scale liquidity-absorbing operations.

In West Africa, following good harvests in 2006-2007, inflation slowed markedly in the first nine months of 2007. However, it picked up in the last quarter due to the increase in several imported food products (milk, oil, wheat and rice). In addition, pressures appeared on the cereal markets at the end of the year, as a result of the harsh weather conditions. Domestic gas prices, and, to a lesser extent, prices of fuel and transport services continued to rise in most countries. Inflation decreased in Benin, Burkina Faso, Côte d'Ivoire and Togo, rose in Senegal and Guinea Bissau and remained stable in Mali and Niger.

In the Comoros, inflationary pressures increased, with consumer price inflation reaching 4.5% in 2007, compared with 3.4% in 2006. This deterioration stems mainly from the serious shortages of some commodities, in particular imported food products (oil, rice, flour, etc.).

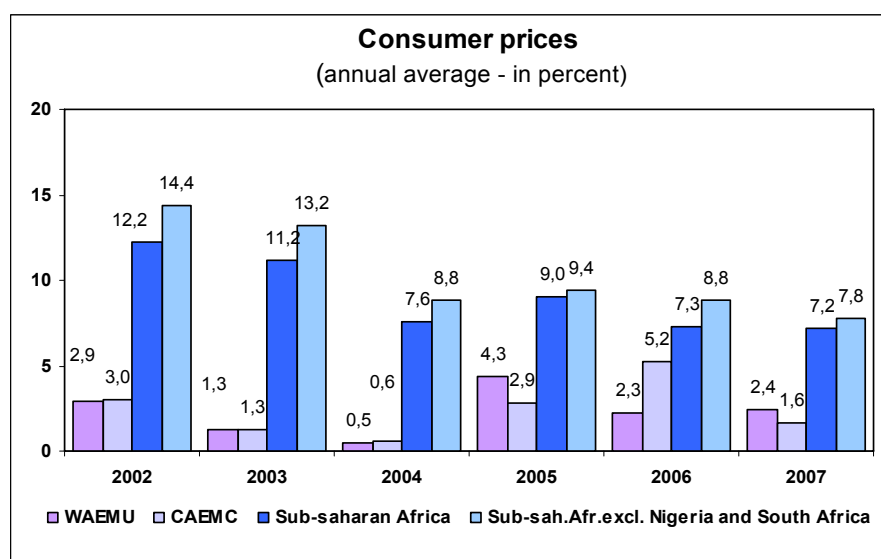
In 2007, the franc zone continued to achieve better results in terms of fighting inflation than Sub-Saharan Africa (7.2%)<sup>1</sup>. The franc zone's performance is well established: between 1997 and 2007, the average

<sup>1</sup> Excluding Zimbabwe, which is experiencing hyperinflation.

annual inflation rate stood at 2.4% in the WAEMU and 2.7% in CAEMC countries, compared with 11% for the whole of Sub-Saharan Africa.

This lower inflation can primarily be attributed to the nominal pegging of the CFA and Comorian francs to the euro. Indeed, franc zone countries benefit from the low level of inflation in the euro area, which curbs the rise in the price of imports from this anchor area, and from the stability of their currency, which helps to contain the cost of their imports from the rest of the world. In recent years and given the depreciation of the dollar, this anchoring to the euro has contributed to dampening the inflationary impact of the sharp rise in oil and food prices.

*The 2007 franc zone Annual Report includes a box on the impact of the increase in food prices in the franc zone.*



Sources: Central banks, IMF World Economic Outlook April 2008

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

The Central Bank of West African States (BCEAO) has pursued its policy focused on consolidating external assets and price stability. In 2007, it left its rates unchanged at their August 2006 level. In early 2007, in a context of bank liquidity reduction, it reverted, for the first time since 1998, to an active open market policy, with a view to steering rates on the money market. In addition, on 16 August 2008, the BCEAO decided to raise by 50 basis points its repo rate (its main key rate) to 4.75% from 4.25%. At the same time, it set its discount rate at 6.75%, corresponding to a 200 basis point increase. This decision factors in the persistence of inflationary pressures in a context characterised by a rise in lending and money supply.

The monetary policy of the Bank of Central African States (BEAC) remained focused on curbing inflationary pressures and promoting sustainable growth. In 2007, banks' free reserves were up by 33% in the CAEMC, essentially as a result of the strong increase in net external assets. Consequently, the BEAC took two decisions aimed at reducing excess liquidity: it raised the minimum reserve ratios and conducted liquidity-absorbing operations. In the first half of 2008, the newly-created Monetary Policy Committee

pursued the Bank's active excess liquidity management approach and decided to raise the rate on liquidity withdrawals, the interest rate on minimum reserves and on accounts opened on behalf of governments. It also continued to tighten monetary conditions, by raising the minimum reserve ratios and putting up its key rate (which had been unchanged since March 2006) from 5.25% to 5.50%.

In the Comoros, the money supply rose by 8.1% mainly as a result of the 4.9% increase in net external assets. The key rates of the central bank have been indexed to EONIA since 2000.

Furthermore, the monetary authorities of the WAEMU and CAEMC decided, in 1998 and 2001 respectively, on the principle of phasing out the direct advances made by central banks to the government. In the WAEMU, this reform, which reflects the determination to increase fiscal discipline in the community, was launched in 2003 and has been accompanied by the rapid development of a regional public debt market. In the CAEMC, the plan to issue specific government securities, which should be implemented in 2009, no longer includes the phasing out of direct advances made to the government.

In a context characterised by lower government oil revenues (due to a reduction in the quantities produced not offset by a rise in prices), public finances in the CAEMC were, overall, kept under control. The budget surplus, on an accrual basis (excl. grants), reached 8.5% of GDP, against 9.9% in 2006.

In the WAEMU, despite the pronounced increase in spending, the budget deficit (on an accrual basis excl. grants) dipped from 5.1% of GDP in 2006 to 4.9%, thanks to the exceptional increase in non-tax revenues (payment of operating licenses in telecommunications and mining; collection of exceptional receipts) and enhanced tax recovery. 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 particular in Côte d'Ivoire, Guinea Bissau and Togo).

In 2007, the fiscal position of the Comoros deteriorated, against a backdrop of political crisis and economic slowdown. The budget deficit (on an accrual basis excl. grants) accounted for 9.7% of GDP, after 7.6% in 2006.

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

<b>Current account balance</b>				
	Current account balance (% of GDP)		Change in the terms of trade (%)	
	2006	2007 (a)	2006	2007 (a)
WAEMU	- 4.1	- 6.1	+ 5.8	+ 1.6
CAEMC	+ 3.4	- 0.7	+ 18.0	+ 0.4

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

As regards the external accounts, the CAEMC posted a current account deficit of 0.7% of GDP in 2007, after a surplus of 3.4% in 2006. This can be attributed to the fall in the trade surplus and the decline in the services and income balances. Despite the increase in average export prices, sales of crude oil dropped in value terms as a result of the decrease in volumes extracted.

In the WAEMU, external accounts also worsened since the current account deficit increased from 4.1% of GDP to 6.1% in 2006. After having recorded a deficit in 2005 for the first time since 1993, the trade balance once again posted a deficit in 2007 due to the fall in exports (cotton, gold and oil) and the rise in imports (capital goods, food and oil products).

*The 2007 franc zone Annual Report includes two boxes on Foreign Direct Investment in the WAEMU and the CAEMC written respectively by the BCEAO and the BEAC.*

The foreign exchange reserves held by the central banks of African franc zone countries continued to expand. They represent roughly five months of imports of goods and services in the WAEMU and seven months in the CAEMC and the Comoros (similar ratios to those recorded in 2006 for the WAEMU and the Comoros, up on the previous year for the CAEMC). The ratio of money in circulation to external assets largely exceeds the mandatory franc zone threshold of 20%, to stand at 114.5 % in the WAEMU, 96.7 % in the CAEMC and 121.4 % in the Comoros.

Overall, the regional convergence process is insufficient in the franc zone. At end-2007, only two countries, one in the CAEMC (Cameroon) and one in the WAEMU (Benin) met the four first-level criteria<sup>2</sup>. In the Comoros, only one of the four convergence criteria was met.

Yet, strict economic discipline goes hand in hand with sound monetary policy. Indeed, monetary integration is not sufficient to lay the foundations for optimal growth. Fiscal policies also need to be coordinated in order to ensure that national budgets are left with sufficient room for manoeuvre, the only stabilisation instrument capable of countering the asymmetric shocks with which the franc zone is often faced.

Structural reforms (privatisations, transparency of public funds, restructuring of the banking system, sustainable management of natural resources, etc.) are also a means for the authorities of strengthening the growth potential of the domestic 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 2007, 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 ranking on the global stage.

*In this respect, the 2007 franc zone Annual Report contains a special study, written by the BEAC, on the conditions for the diversification of economies.*

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 cohesion of the area. First, solidarity between Member States, via the pooling of foreign exchange reserves in each issuing area, has made it necessary to introduce multilateral surveillance which greatly encourages a rigorous management of public finances. Second, the principle of free-transferability and the unlimited currency convertibility within the franc zone render economic and monetary flows all the more easy and thus act as an incentive for investment. Lastly, the contingency measures accompanying the co-operation agreements with France guarantee that monetary policy shall be conducted with the necessary 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.

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<sup>2</sup> Fiscal position, inflation rate, debt outstanding as a percentage of GDP, change in payment arrears.

According to the BEAC, economic activity in CAEMC countries should strengthen in 2008, with the growth rate coming close to 5.8%. Growth is expected to be underpinned by the further development of the oil sector and the continued robustness of the non-oil sector. Inflationary pressures are expected to increase significantly with consumer price inflation reaching 4.2%, compared with 1.6% in 2007. This development should stem from the rise in food prices on world markets as well as difficulties in the supply of foodstuffs in certain countries, pressures on fuel prices and increased wages in the civil service.

According to the BCEAO, economic activity in the WAEMU should continue to grow in 2008 – assuming weather conditions are favourable – but at a still relatively moderate pace (4.2%). Given the advances made in the normalization of the socio-political situation in WAEMU countries and the renewed co-operation between the international financial community and Côte d'Ivoire, Guinea Bissau and Togo, the outlook for 2008 should be more favourable than in 2007. As regards inflation, the first observations point to continued inflationary pressures in all countries as a result of the persistence of high oil prices and the rise in imported food prices. Inflation is expected to average 5.2% at end-June 2008 (6.3% in year-on-year terms) and could stand at 5.4% for the whole year. It could weigh on household consumption and public finances.