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Statement by Mr. Sadun and Mr. Cipollone on
Central African Economic and Monetary Community
(Preliminary)
Executive Board Meeting 07/56
June 29, 2007

We thank the staff for the well-written set of reports and Mr. Rutayisire for his interesting BUFF statement. The growth performance of the region has deteriorated mainly because of the lack of progress in diversifying the economy and the divergence between the countries has remained substantial. We will focus our comments on three main areas: sources of growth, policy mix, and the regional integration.

Sources of growth: *the output base has remained limited*

In the last couple of years, the economy has grown at a much lower pace than the rest of the whole region. The growth acceleration in the non-oil sector was able to offset only partially the sharp contraction in the oil production. From 2007 onwards, growth is expected to accelerate thanks to a sharp increase in the contribution of the non-oil sector. This should contribute to closing the gap with the rest of the regional growth rates. However, we are skeptical about the projected large contribution of the non-oil sector considering the slow progress in broadening its output base and in strengthening competitiveness. Expanding the output base will be even more difficult in the current environment with high oil prices and the strengthening of the Euro.

Fiscal policy: *the pro-cyclical stance should be reversed*

The surge in oil revenues has improved the compliance with the fiscal criteria. We agree with staff that, in the current economic environment characterized by high oil revenues, the current fiscal criteria are not adequate to prevent a pro-cyclical stance. As stressed in previous occasions, we believe that the adoption of an "unsophisticated cyclically-adjusted balance" framework would be a better tool to assess the budgetary stance and prevent an expansionary stance. The deterioration of non-oil balances indicates the current pro-cyclical fiscal stance, which, if not reversed, might undermine the macroeconomic framework through a further acceleration of inflation.

Given the high volatility of oil revenues and the need to upgrade the physical infrastructure, a better use of the oil stabilization funds is the best strategy to spread the current large oil revenues out over time in accordance with a multi-year budget framework. We, thus, encourage the authorities to modernize the current framework of the oil funds in order to make them more financially attractive. This would help contain public expenditure in the short-term and consolidate the medium-term sustainability.

Monetary policy: *absorbing liquidity through market instruments*

The pro-cyclical fiscal policy has made it more difficult to contain inflationary pressures. The current use of only reserve requirements to absorb liquidity is ineffective. We concur with staff that a more proactive monetary policy is necessary in order to achieve a tighter policy mix. The use of market instruments will allow raising the interest rate and bringing it in line with the Euro interest rate. This would contribute to contain credit expansion. The whole region is at a critical stage to make the best use of the unexpected increase in oil revenues. It is crucial to seize this opportunity to maintain a stable macroeconomic environment. The objective is to find the right balance between absorption and spending of oil revenues in each member state, taking into account their key differences and stages of economic development. *Staff comments would be helpful.*

Real exchange rate: *upward trend and significant differences among countries*

The real exchange rate has remained broadly in line though with an ongoing upward trend. In the current environment of a fixed exchange rate regime, the only way to respond to the inflationary pressures from the capital inflows is to strengthen the competitiveness of the non-oil sector. While translating structural reforms in higher growth of the non-oil sector takes time, some Dutch disease effects have already been emerging in some member states. Following the 1994 nominal depreciation, the REER has steadily appreciated with substantial differences among members. While the REER has remained close to the equilibrium rate, we are concerned about the continuing appreciation and the widening of differences among members. *Could staff elaborate more on this issue and the possible policy response to prevent a continuous deterioration of competitiveness which might undermine the regional integration process?*

Regional integration: *still a slow progress*

The recent renewed commitment of the Heads of State to strengthen regional institutions provides the political backing to move forward and more expeditiously on the integration process. The agreement to reduce the maximum intra-union tariff is an important step. However, more is needed to eliminate all tariff and non-tariff barriers. Establishing a well-functioning single market is the best way to strengthen and expand the output base and increase the potential of these economies.