**FOR AGENDA**

EBS/08/131
Correction 1

December 11, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Benin—Fifth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Request for Waiver of Nonobservance of Performance Criteria**

The attached correction to EBS/08/131 (11/26/08) has been provided by the staff.

**Typographical Error**

**Page 4, text table on Gross Reserve:** the lines for Benin and the WAEMU average in the text table were corrected for 2006-08.

Questions may be referred to Mr. Mongardini (ext. 38569) and Mr. Youm (ext. 38588) in AFR.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

Other Distribution:
Department Heads

## Executive Summary

**Benin's economic growth continues to strengthen, but the global financial crisis represents a significant downside risk**. The main challenge going forward is to limit inflationary pressures from higher food and fuel prices, while sustaining medium-term fiscal consolidation and accelerating structural reforms to increase the sustainable growth rate.

**On current assumptions, the macroeconomic outlook remains favorable.** Real GDP growth is expected to strengthen to 5.1 and 5.7 percent in 2008 and 2009, respectively, following an increase of 4.6 percent in 2007. Inflation soared to 12.0 percent year-on-year in September 2008, after averaging 1.3 percent in 2007, although core inflation remains moderate. The external current account is expected to widen from 7.4 percent of GDP in 2007 to 10.4 percent of GDP in 2008, reflecting the terms of trade shock. However, the external position remains comfortable.

**The authorities have taken actions to address the food and fuel crisis and accelerate structural reforms**. Since July 2008, they have allowed the full pass-through of higher international food and fuel prices and tightened fiscal policy, while putting in place measures to protect the poor. They have also canceled the tax reductions introduced at end-2007 to reduce the impact of higher food and fuel prices. In October 2008, the government privatized a minority stake in its cotton ginning activities and the last state-owned bank, while recruiting consultants for the privatization of Benin telecom and a cement factory.

**Two performance criteria were missed under the program**. The unexpected clearance of large government commitments (1.0 percent of GDP) in the first half of 2008 led to the breaching of the end-June performance criterion on net domestic financing by the same amount. In October 2008, the authorities also contracted a SDR 5.1 million nonconcessional loan from a development partner, which they are in the process of renegotiating. To offset these slippages under the program, the authorities have stopped all expenditure commitments in October 2008, except for urgent priority spending, and are renegotiating the terms of the nonconcessional loan to ensure higher concessionality. On that basis, staff recommends the completion of the fifth review under the PRGF arrangement.

## I. Recent Economic Developments and Program Performance

***Benin continues to be one of the fastest growing economies in the WAEMU***

**Real GDP Growth**

| | 2005 | 2006 | 2007 | 2008[1] |
|---|---|---|---|---|
| **Benin** | **2.9** | **3.8** | **4.6** | **5.1** |
| Burkina Faso | 7.1 | 5.5 | 4.0 | 4.5 |
| Côte d'Ivoire | 1.9 | 0.7 | 1.6 | 2.9 |
| Guinea-Bissau | 3.2 | 1.8 | 2.5 | 3.2 |
| Mali | 6.1 | 5.3 | 2.8 | 5.0 |
| Niger | 7.4 | 5.2 | 3.2 | 4.4 |
| Senegal | 5.6 | 2.3 | 4.8 | 5.3 |
| Togo | 1.3 | 4.1 | 2.1 | 2.5 |
| WAEMU average | 4.4 | 3.6 | 3.2 | 4.1 |

Sources: Country authorities and IMF staff estimates and projections.
[1]Projections.

1. **Benin's economic growth has continued to strengthen** (Figure 1). Despite severe energy shortages and delays in implementing structural reforms, economic growth is expected to increase to 5.1 percent in 2008, up from 4.6 percent in 2007. Growth is driven by buoyant activity in the Port of Cotonou and strong demand from neighboring Nigeria.

***Inflation in 2008 will breach the WAEMU convergence criterion***

**CPI Inflation**

| | 2005 | 2006 | 2007 | 2008[1] |
|---|---|---|---|---|
| **Benin** | **5.4** | **3.8** | **1.3** | **8.8** |
| Burkina Faso | 6.4 | 2.3 | -0.2 | 10.2 |
| Côte d'Ivoire | 3.9 | 2.5 | 1.9 | 5.8 |
| Guinea-Bissau | 1.7 | 3.8 | 4.6 | 6.5 |
| Mali | 6.4 | 1.0 | 0.6 | 8.1 |
| Niger | 7.8 | 0.0 | 0.0 | 7.3 |
| Senegal | 1.7 | 2.1 | 5.9 | 3.7 |
| Togo | 6.8 | 2.2 | 1.0 | 6.9 |
| WAEMU average | 5.0 | 2.2 | 1.9 | 7.2 |

Sources: Country authorities and IMF staff estimates and projections.
[1]Projections.

2. **Food and fuel prices are driving up headline inflation, but core inflation remains moderate** (Figure 2). Following the authorities' decision in July 2008 to apply the full pass-through of international food and fuel prices, inflation soared to 12 percent year-on-year in September 2008. This, combined with the earlier CFA franc appreciation, resulted in the real effective exchange rate (REER) appreciating by 6.6 percent over the same period. This trend has since been reversed, reflecting the recent depreciation of the CFA franc against the dollar. The REER remains broadly in line with its equilibrium level.[1]

***Benin's reserve coverage remains the highest in WAEMU***

**WAEMU: Gross Reserves 1/**

| | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|
| **Benin** | **7.9** | **9.2** | **8.5** | **7.9** |
| Burkina Faso | 3.6 | 4.0 | 5.0 | 5.0 |
| Cote d'Ivoire | 2.2 | 2.7 | 2.5 | 2.4 |
| Guinea-Bissau | 5.4 | 6.4 | 5.2 | 6.1 |
| Mali | 4.6 | 4.6 | 3.8 | 3.9 |
| Niger | 2.8 | 3.4 | 3.5 | 3.9 |
| Senegal | 3.6 | 3.3 | 2.7 | 3.2 |
| Togo | 1.7 | 2.9 | 2.4 | 2.0 |
| WAEMU average | 4.0 | 4.5 | 4.2 | 4.3 |

Sources: Country authorities and IMF staff estimates and projections.
[1] Months of prospective import of goods and non-factor services.
Data for 2008 are Fund staff projections.

3. **Worsening terms of trade and weak cotton exports will likely widen the external current account to 10.4 percent of GDP in 2008 (Figure 3).** Foreign direct investment inflows and additional donor assistance (including from the Fund), are helping limit the decline in gross official reserves, with reserve cover dipping just below 8 months of prospective imports.

[1] See the 2008 Article IV Consultation (IMF Country Report 08/230) for a full analysis of competitiveness in Benin.