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**Statement by Mr. El-Khouri and Ms. El-Ganainy on WAEMU**
**(Preliminary)**
**Executive Board Meeting 08/45**
**May 23, 2008**

1. We thank staff for a well-written report and Mr. Rutayisire for his helpful Buff statement. Economic performance in the West African Economic and Monetary Union (WAEMU) region has been, in a number of aspects, satisfactory in 2007. Regional growth accelerated, although it remained below the level needed to make a meaningful progress on poverty reduction. At the same time, inflation decelerated—supported by the exchange rate peg to the euro, and reserves strengthened further. However, progress on economic convergence, regional integration, and structural reforms was slow. These latter developments, together with the new challenges facing the region, including the current environment of high international food and fuel prices render the economies of the WAEMU susceptible to shocks and social unrest. Against this backdrop, the main challenge in the period ahead is to sustain macroeconomic stability, particularly in the face of rising international prices, while enhancing the region's growth prospects to reduce poverty and achieve the MDGs. Addressing these challenges would require sustaining a sound fiscal policy that is consistent with long-term fiscal and debt sustainability, while progressing with the implementation of structural reforms aimed at enhancing the region's competitiveness, strengthening the resilience of the financial sector, and creating an enabling environment for private sector-led growth.

2. On the growth outlook, staff project regional growth to rebound from 3.2 percent in 2007 to 4.1 percent in 2008. While continued improvement in the security situation in the region's largest economy (Cote d'Ivoire) should contribute positively to the region's growth performance, the expected slowdown in the world economy, in general, and in the Euro area (the region's main trading partner), in particular, could have a negative effect on growth. In this connection, we believe that growth projections might be somewhat optimistic, and *would appreciate further clarification from staff on the assumption underlying their projections.*

3. Fiscal policy assumes the leading role in macroeconomic management, given the limited role of monetary and exchange rate policies. In this respect, we are encouraged that the overall regional fiscal deficit (excluding grants) remained stable in 2007, in spite of the continued scaling up of much-needed MDGs-related expenditures. Indeed, the expenditure

rise, estimated at about 1 percent of GDP, was financed by higher domestic revenues. Going forward, continued fiscal consolidation, through both revenue-enhancing and expenditure-reducing measures, is necessary to ensure long-term fiscal and debt sustainability, while supporting the robustness of the pegged exchange rate regime. It would also help foster externally financed investment by improving the credibility of the authorities' policies and investors' confidence. In this respect, we regret that all countries, except Benin, continue to miss the convergence criterion of the non-negative basic fiscal balance. In fact, this raises the question about the design of this criterion and/or the presence of institutional mechanisms to enforce it. *Staff may wish to comment on this issue, including their views on the macroeconomic convergence framework, and the potential adverse effects, if any, on the region from the continued non-compliance with the convergence criteria.*

4. We agree with staff on the importance of coordinating national fiscal policy responses to higher food and fuel prices at the regional level to avoid undermining regional integration and/or creating incentives for smuggling. However, we are not clear about the mechanism through which such coordination could be achieved given the differences in member countries' fiscal positions. We are also uncertain about the expected "proactive role" of the WAEMU Commission in this regard. *Could staff comment on these two issues?* Moreover, *could staff provide an update on the reaction to the background note on "Food and Fuel Price Increases in Sub-Saharan Africa", which was prepared for the WAEMU meeting held last April in Abidjan?*

5. The primary objectives of the regional Central Bank for West African States (BCEAO) remains appropriately focused on containing inflation, while maintaining an appropriate level of reserves to support the pegged exchange rate regime. We commend the authorities for their prudent conduct of monetary policy, which has helped contain inflation as monetary developments have not added to inflationary pressures stemming from higher food and fuel prices. We also welcome the BCEAO efforts to enhance its monetary policy implementation capacity through strengthening liquidity management capacity and further developing the regional inter-bank market, as such measures would enhance monetary policy transmission mechanism, going forward.

6. The exchange regime of the CFA franc, which is pegged to the euro, has served the WAEMU region well. We note that there is some indication of a possible moderate overvaluation of the WAEMU real exchange rate at end-2007, although the evidence is inconclusive. We believe that competitiveness issues in the region could be best addressed through a cautious fiscal policy, along with bold structural reforms aimed at strengthening the business environment. The authorities' commitment to accelerate such reforms, as indicated in Mr. Rutayisire's Buff statement, bodes well in this regard.

7. We welcome the Financial System Stability Assessment (FSSA) for the WAEMU region, which shows that the creation of a regional government securities market and the modernization of the payments system have been instrumental in facilitating financial integration within the WAEMU. Nevertheless, continued weaknesses in the banking sector, which remains undercapitalized and highly vulnerable to macroeconomic shocks, is a source of concern. In this respect, we welcome the recent approval of important institutional reforms

of the BCEAO—with the aim of enhancing its independence and modernizing its monetary policy framework. The timely and comprehensive implementation of such reforms should contribute to strengthening banking supervision and regulation, while reducing vulnerabilities in the financial sector as a whole.

8. We note the recent decision to increase the minimum regulatory risk-weighted capital adequacy ratio (CAR) requirement. Staff recommend a further increase in the CAR requirement, given the risky environment in which banks operate. Nevertheless, the authorities prefer to maintain the current standard, which is in compliance with Basel I. In this respect, we believe that if banks cannot raise capital flexibly and some firms are dependent on bank loans, an increase in CAR requirement might lead to a credit crunch, and hence a reduction investment and output. Indeed, for banks to raise their CAR, they would have to either raise more capital, curtail their lending, and/or shift their portfolio towards assets with lower risk-weights. If the cost of raising capital is too high, banks are likely to reduce their lending, which could contribute to a reduction in aggregate loan supply, with particularly adverse consequences for credit access by small firms. *In this respect, staff may wish to comment on the likelihood that such a scenario might materialize, and the possible safeguards that could limit its potential adverse impact.* With that said, it would be important to balance such risks against threats to the stability of the financial system when deciding on the appropriate CAR requirement.

9. We welcome the pick up in the implementation of the Regional Economic Program (REP) in 2007, which should facilitate regional integration. We also note that, under current economic conditions, the rapid move to a monetary union at the Economic Community of West African States (ECOWAS) level without adequate preparation is unlikely to provide net economic benefits. Given that a monetary union would have to be carefully designed to be able to manage asymmetric shocks, we believe that the end-2009 deadline for the establishment of such union might be somewhat ambitious. In this respect, and while we are of the view not to rush the process to ensure its success, we encourage the authorities to progress towards meeting some of the minimum conditions, as the process of preparing for a currency union can be highly beneficial in itself.

With these remarks, we wish the authorities success in meeting the challenges lying ahead.