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**Statement by Mr. Sadun and Mr. Spadafora on WAEMU  
(Preliminary)  
Executive Board Meeting 08/45  
May 23, 2008**

We thank staff for the well-written set of papers and Mr. Rutayisire for his informative Buff statement.

While we very much welcome the improvement in the macroeconomic performance of the West African Economic and Monetary Union (WAEMU), we regret to know that per-capita growth in the region is still insufficient to alleviate poverty in a meaningful way. Unfortunately, the acceleration in growth expected in 2008 will be accompanied by a surge in inflation, following the recent increases in food and energy prices.

Controlling inflationary pressures and their socio-economic consequences are thus the key challenges for the authorities in the short term. We concur with staff that these challenges require a coordinated, targeted and fiscally responsible response at the regional level and we believe that the IMF could offer an important advisory contribution in this regard.

However, as well evidenced in the FSAP paper, macroeconomic management is complicated by the segmentation of the regional money market and a persistent situation of excess liquidity. These characteristics weaken the monetary transmission mechanism and cast doubts on the operational capacity of the regional central bank (BCEAO) to tighten monetary policy, should this be warranted in the new, more inflationary environment (inflation in 2008 is forecast at over twice as much as the target value of 2 percent). *Staff comments are welcome.*

Over the longer term, the fight against poverty calls for a substantial effort to intensify the reform process in order to address several structural deficiencies in infrastructure, the financial sector, and the business environment, and to advance regional integration. An acceleration of the reform process will also be beneficial towards improving competitiveness, fostering export growth, and countering the appreciation of the real effective exchange rate.

As we broadly agree with the thrust of the reports, we focus our comments on the financial sector, which, as correctly pointed out by staff, is crucial in order to promote regional integration and, ultimately, growth.

## **Financial sector**

The financial sector consists mostly of banks (holding 90 percent of total assets), which are concentrated in the two largest countries and controlled by local and foreign groups. Although the number of bank branches and accounts increased by 70 and 60 percent, respectively, in 2002-2006, financial intermediation in the WAEMU is among the lowest in the world.

Progresses toward regional financial integration have included the creation of a regional securities exchange in 1998 and, more recently, the modernization of the payment system and the creation of a clearing system. This notwithstanding, the activity of banks is still largely confined to the country of establishment, although we note that four local groups operate in almost all of the countries.

The allocation of credit on a regional basis is hampered by structural deficiencies and constraints at the national level. Furthermore, serious shortcomings in the legal system prevent the development of banks' activities. The fact that the responsibilities for the legal framework are shared between national and regional authorities does not bode well for a prompt adoption of corrective measures.

Insufficient capitalization as well as weak and uneven compliance with prudential requirements make the banking system particularly vulnerable, on account of the large exposure to the public sectors (which absorb one-third of bank credit), a difficult business environment, lack of diversification in the member economies, and volatile terms of trade.

Particularly alarming is the noncompliance with the limits on large exposures, which is adding a financial stability dimension to the recent increases in energy prices. In fact, by undermining the profitability of the national electric companies, to which banks are heavily exposed, the above increases turn out to have a direct bearing on bank riskiness. In light of the above vulnerabilities, the inadequacy of the Banking Law and of the framework for crises resolution is another source of concern.

Against this background, we commend the authorities for the adoption, in January 2007, of the Institutional Reform of the WAEMU and the central bank (BCEAO), which is now being ratified by national parliaments. The measures strengthen the legal framework and autonomy of the BCEAO, by making price stability the primary objective of monetary policy, creating a Monetary Policy Council and prohibiting monetary financing to member states. They also enhance the autonomy and enforcing power of the regional banking commission (BC-WAEMU) and the regional aspect of the financial supervision.

We welcome the positive impact of the FSAP mission in fostering the implementation of the reforms of the financial system, including an increase in banks' minimum statutory capital. In this regard, given that close to a third of the banks do not comply with the current low minimum statutory capital, the enforcement of the recent significant increase of such a minimum (from 1 to 5 CFA franc billions and subsequently to 10 CFA franc billions) appears

challenging, although the transfer of regulatory powers from finance ministries to the regional banking commission, envisaged under the institutional reform, will help and might be an opportunity to boost the credibility of supervision. *Staff comments are welcome, particularly on whether the BCEAO has formulated contingency plans to deal with those banks unable to meet the new minimum statutory capital.*

With these remarks, we wish the authorities well on their future endeavors.