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Statement by Mr. Fayolle on CEMAC
(Preliminary)
Executive Board Meeting 08/74
August 8, 2008

We welcome this discussion on CEMAC, as an integral part of the Article IV consultation with member countries and stress the usefulness of this regional surveillance framework. We thank staff for their insightful set of reports. We would also like to thank Mr. Rutayisire for his comprehensive and informative buff statement. We broadly concur with the staff and would like to make the following points for emphasis.

1/ **Macroeconomic performances in 2007 were broadly satisfactory in the CEMAC region, even if they were unequal across countries.** GDP rose by 4 percent on average, driven by the non-oil sector which has experienced an overall growth of 10.3 percent in 2007 for the CEMAC countries. However, we are aware that the short-term outlook is mixed, with the fuel and food price crisis and related driven inflation representing downside risks. In this regard, we encourage the CEMAC authorities to enhance their role by coordinating fiscal answers to price increases as well as by tracking poverty. In the medium term, we concur with staff's recommendation to diversify the economy away from the oil sector in order to mitigate macroeconomic volatility. As stressed by the staff, the appropriate management of oil windfalls will be crucial in order in achieve this goal. Member countries will have to find the right balance between productive investment and safeguarding oil resources, in line with absorptive capacity and sustainability of resources. In some countries, the potential risk of the so-called "Dutch disease" poses some important challenges to competitiveness, and requires careful macroeconomic management. We welcome the willingness of the CEMAC authorities to enhance coordination of fiscal and monetary policy to reduce macroeconomic volatility.

Staff estimates that the non-oil sector's growth is sustainable, averaging 6% over the 2008-2012 period. It is driven by an expansionary fiscal policy made possible by high oil revenues. However, even under such favorable conditions, the growth rate is expected to slow down to 2.8% by 2012. In that context, we regret that staff did not elaborate more, beyond the necessary structural reforms and the business climate upgrading, on what should be the best diversification strategy and the best sharing of oil revenues between financial saving and public investments. Public policies aimed at supporting private sector development should be more precisely described.

2/ **Concerning fiscal policy, the level of the non-oil fiscal deficit is worrisome.** We concur with staff's analysis in terms of long-run public expenditure stabilization in a context of the oil revenue drying up. However, staff should sharpen this model by taking into account the long-term public investment profitability. This analysis should be systematically applied to all the oil-producing countries of the CEMAC. We stress the importance of compensating for the use of non-renewable natural resources by increasing physical and financial capital accumulation. We suggest that staff sensitize the authorities on that issue by organizing an International Seminar with the purpose of tackling this topic.

3/ **It is encouraging to note that all but one country complied with the fiscal convergence criteria of a non-negative basic fiscal balance.** However, we concur with staff that this convergence criterion is somewhat misleading in an environment of oil-related surpluses. The recent economic context shows that there is a contagion effect of too expansionary fiscal policies, especially through food product exchanges. We welcome the recent commitment made by the CEMAC ministers of finance to strengthen regional surveillance. That reflects progress in convergence matters that the ministers of finance of the Franc zone countries committed themselves, at the Lome meeting in 2007, to reinforce the means of regional surveillance. We hope that a rapid implementation of this commitment will occur. In that context, we welcome the institutional reform of the CEMAC and particularly that of the Commission.

Moreover, the credibility of the convergence indicators should be enhanced. In this regard, we would like to stress the importance of harmonizing regional statistics and having a prompt publication. Strengthened and timely data will ensure a better assessment by the CEMAC authorities of the process of convergence. Complementary indicators have already been introduced to help better assess the effectiveness of this convergence, among them a corrected basis for fiscal balance, using a three-year moving average of revenue to smooth the impact of fluctuations in oil revenue. We understand the argument that surveillance should be more focused on the sustainable non-oil primary deficit. However, we would like to underscore the difficulties of measuring such an indicator and the necessity to preserve a uniform treatment of fiscal measures throughout all Franc zone member countries, both oil and non-oil countries.

Finally, we concur with the staff's recommendation to strengthen the dialogue between CEMAC members and BEAC for establishing a monetary programming framework. The latter should be conceived as a country member's assistance tool for designing its budget law's financial and macroeconomic framework. We welcome the progress made in this regard by CEMAC authorities.

4- **We share staff's diagnostic on the efforts made by BEAC to improve the monetary policy framework**. We welcome the progress accomplished over the last 18 months:

- on the institutional level: reform of its statutes aimed at strengthening its independence and creating a Monetary Policy Committee, paving the way for a clear-cut line of sharing between monetary policy and the central bank management;
- on the source of inflation analysis and the necessity to manage overliquidity. This active liquidity management policy allowed for a decrease in the bank's intermediation margin and therefore in the credit rates (as shown in the biennial COBAC's study on banks' conditions);
- on the monetary policy activation level: under the framework in place since mid-2007, the BEAC accepts most deposit bids by banks during its weekly auctions and therefore absorbs excess liquidity through negative auction bids;
- on monetary policy tightening: through an increase in refinancing and negative auctioned rates, combined with an increase in reserve requirements. We concur with the Staff's analysis on the need to raise further auctioned deposit rates that are below ECB deposit rates and negative in real terms. However, the priority remains to increase medium-term deposit interest rates in the member countries. In counterpart, reserve requirements should be raised further.
- on improving the general monetary policy framework: we welcome the measures adopted by the Monetary policy committee consisting in abolishing the maximum lending rate and lowering the minimum deposit rate by one percentage point, to 3.25 percent. These measures were key recommendations of the staff. Given the difficulties to anticipate the amount of liquidities and the risks involved in returning to a discretionary system, we have doubts on the suggestion that staff made to the BEAC to shift to a mechanism fixing the amount of liquidity and letting the interest rate be determined by market force.

5- **We associate ourselves with staff to welcome BEAC's effort in improving deposit rates of the member countries.** However, as said before, the rates of remuneration are still too weak in comparison with the rates in the euro area. We encourage the CEMAC authorities to work in two ways: to carry out efforts to increase medium and long-run deposit rates and to enlarge the range of financial instruments than what is currently available. The rapid implementation of such a policy is all the more crucial that, as estimated by Staff, CEMAC countries' incentives to repatriate their foreign exchange holdings is decreasing. However, our recollection is that the tripartite convention between Gabon, BEAC and the World Bank is consistent with the Franc zone rules and that in the case of Equatorial Guinea, a large part of its foreign holdings has been rapatriated recently.

Concerning fiscal savings management, we wonder whether the staff's recommendation consisting in determining, first, the optimal reserve level for the whole zone and, second, what the level of the contribution of each country member will be to this pool of reserves is not overly complex and would pose a number of operational and legal problems.

6- **We broadly concur with the staff's analysis of CEMAC's competitiveness.** The REER remains in line with its fundamental determinants and consistent with medium-term stability. The exceptionally low inflation rate in 2007 limited the REER appreciation to only 2 percent that year and this appreciation has been lower than that of the terms of trade. However, long-term competitiveness hinges on successeful reforms. As underlined by staff, rationalizing and lowering trade barriers are crucial to enhance international and sub-regional integration and we concur with staff that further efforts are needed to harmonize trade policies to be applied across the CEMAC membership. This will in turn promote incentives to improve competitiveness. We welcome the CEMAC authorities' intention to promptly implement the 2007 reforms of the regional institutions.

The Staff's analysis concerning the long-run sustainable level of saving brings us back to the fiscal stance debate more than to the exchange rate policy.

7- **On financial sector development, the regional FSAP provides a very useful assessment of the challenges and weaknesses of the regional financial system**, and we encourage the national authorities and regional institutions to fully take on board its recommendations, in order to guide their financial reform agenda. Strengthening the supervisory capacity and institutional independence of the COBAC is particularly key to reduce vulnerabilities in the banking system and heighten its efficiency to finance SMEs. We welcome the action plan adopted by COBAC to address this issues.