Office Memorandum

To: Members of the Executive Board July 14, 2014

From: The Secretary

Subject: **Union of the Comoros—Assessment Letter for the African Development Bank**

Attached for the **information** of Executive Directors is the Fund's assessment letter on the macroeconomic conditions in the Union of the Comoros which was requested by the African Development Bank (AfDB).

If the authorities of the Union of the Comoros consent to the publication of this assessment, it may be published by the AfDB.

Questions may be referred to Mr. Trines (ext. 35639), Mr. Arnason (ext. 38867), and Mr. Jidoud (ext. 37356) in AFR.

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Union of the Comoros—Assessment Letter for the African Development Bank
July 9, 2014

This letter provides the IMF staff's assessment of the Union of Comoros' (Comoros') recent macroeconomic performance and outlook, based on information available through end-March, 2014. The sixth and final review under the three-year Extended Credit Facility (ECF) arrangement with the IMF was completed in December 2013. (*See* IMF Country Report 13/371). An IMF team visited Comoros during February 25 -March 11, 2014 to review developments in the last quarter of 2013 and assess short and medium-term prospects.

Recent Economic Developments

Growth remained strong, with inflation contained. Following 3 percent real growth in 2012, available data point to an acceleration of growth to 3.5 percent in 2013, with strong agricultural performance helped by favorable rains, a pickup in construction, as well as a continued expansion in aggregate demand supported by resilient remittances and an increase in private sector credit. Year-on-year inflation in December 2013 was 3.2 percent but dropped to 0.6 percent in May 2014.

The fiscal primary balance deteriorated in 2013. Comoros recorded a primary deficit of 1.4 percent of GDP compared to a surplus of 3 percent of GDP in 2012, slightly worse than expected. Tax revenues increased moderately due to better tax collection efforts but this was more than offset by lower non-tax revenues due to the temporary suspension of the Economic Citizenship Program. While current expenditures were contained, an unexpected increase in domestically financed capital spending impacted the fiscal position. Overall capital expenditures grew by about 3 percent of GDP, with a substantial part of these continuing to be financed by grants from Comoros' partners. Capital spending focused on infrastructure such as roads, schools, and hospitals. Overall grant financing jumped in 2013, reflecting the effect of the debt relief that Comoros received following the achievement of the completion point under the HIPC Initiative in December 2012.

Credit to the economy continued to expand, although at a slower pace than in the previous year. Credit to the private sector expanded by 12.6 percent, while overall credit expanded by about 21 percent. The bulk of credit to the private sector is in the form of import financing. The banking system remained broadly sound, but some vulnerability exists with respect to one undercapitalized institution. Non-performing loans remained steady at about 17 percent.

The current account deficit widened and international reserves declined in 2013. Exports grew by nearly 25 percent in volume terms, albeit from a very small base, which was not sufficient to offset a reduction in remittances of 2 percent of GDP (to around 23 percent of GDP) and a drop in external receipts under the Economic Citizenship Program. The current account deficit widened to 5.7 percent of GDP in 2013, compared to 3.8 percent of GDP in 2012. Reflecting these developments, international reserves dropped to a coverage of just under 6 months of imports.

Outlook for 2014 and Challenges Ahead

The outlook for 2014 generally remains positive. Barring unforeseen developments, economic growth is expected to further strengthen to around 4 percent and inflation to remain moderate at around 3 percent. The approved 2014 budget targets a further small increase in tax revenues (based on continuing administrative improvements) and an increase in capital spending, while containing the primary deficit at around 1.7 percent of GDP. The external current account deficit is projected to increase to about 8.2 percent of GDP, reflecting continued strong capital spending but somewhat lower budget financing from external sources than in the past.

However, this outlook is subject to significant uncertainty and challenges. Continued fiscal and structural reforms will be needed to create an environment conducive to sustained and accelerated growth. It is expected that a comprehensive plan for reforms will be developed in the context of a second poverty reduction strategy that is under preparation and is expected to be completed by September 2014. Priority areas should include measures to improve the business climate and increase exports, deepening of reforms in public financial management, improvements in infrastructure, particularly the energy sector, and further strengthening of the financial sector.

Particular efforts are needed on the fiscal front. Preliminary data for the first quarter of 2014 show a substantial shortfall in tax revenues. While the situation may have improved in April and May, strong efforts will be needed to reach the revenue targets established in the budget. This needs to go hand-in-hand with further improvements in public financial management and revenue administration, which are key to achieving a sustainable fiscal position over the longer-term. In both areas, reform programs have been developed and have started to be implemented, but much remains to be done. Additional fiscal efforts will also be needed to accommodate within the existing budgetary ceilings the recent wage increase for teachers, approved after demonstrations and effective in April, and the introduction of an explicit subsidy on purchases of fuel by the electricity company, MAMWE. Furthermore, expenditures to prepare for parliamentary elections later in the year could be higher than estimated in the originally approved budget. Clarity will also be needed with respect to the timing and size of receipts from the Economic Citizenship Program, an important past source of government revenue.

Reforms started in the energy sector and supported by the African Development Bank need to be pursued vigorously and deepened to achieve a sustainable energy supply and to alleviate pressure on scarce government resources, which are currently partly channeled to subsidize directly the electricity company (see above). Improving competition in the communications sector will be needed to reduce the currently high costs for these services.

An IMF mission is scheduled to visit Comoros in September to conduct the 2014 Article IV consultation discussions and to assess how the IMF can continue to assist the authorities in their adjustment efforts.

Table 1. Comoros: Selected Economic and Financial Indicators, 2011-18

	2011	2012	2013	2014	2015	2016	2017	2018
	Act.		Est.	Projections				
	(Annual percentage change, unless otherwise indicated)							
National income and prices								
Real GDP	11.1	3.0	3.5	3.9	3.9	3.9	4.0	4.0
GDP deflator	4.7	2.6	3.1	3.0	2.9	2.9	2.9	2.9
Consumer price index (annual averages)	6.8	6.3	2.3	3.0	2.9	2.9	2.9	2.9
Consumer price index (end period)	7.0	1.0	3.2	2.9	2.9	2.9	2.9	2.9
Money and credit								
Net foreign assets	17.2	16.5	-9.8	0.7	2.8	4.4	6.8	7.2
Domestic credit	4.9	7.6	21.0	15.6	11.6	10.1	8.3	8.0
Credit to the private sector	8.9	22.4	12.6	8.7	11.5	12.8	11.5	12.2
Broad money	9.6	16.0	2.8	7.2	7.5	7.5	7.6	7.5
Velocity (GDP/end-year broad money)	2.9	2.6	2.7	2.7	2.7	2.7	2.7	2.7
External sector								
Exports, f.o.b.	16.4	-19.0	-3.1	6.9	7.2	7.1	7.1	7.1
Imports, f.o.b.	7.2	18.1	2.8	13.7	0.7	2.7	4.6	4.3
Export volume	-24.7	-27.9	24.7	3.5	4.0	4.1	4.1	4.1
Import volume	-10.4	12.2	7.4	19.5	3.3	4.6	6.0	5.0
Terms of trade	2.1	3.0	-0.8	2.3	3.7	3.2	2.9	2.5
	(In percent of GDP, unless otherwise indicated)							
Investment and savings								
Investment	14.9	16.8	20.4	21.3	22.2	23.1	24.0	25.0
Public	5.4	6.8	9.8	15.2	13.5	12.9	13.0	12.7
Private	9.5	10.1	10.5	6.1	8.7	10.2	11.0	12.4
Gross national savings	-19.0	12.6	12.2	10.0	9.7	12.8	12.7	14.7
Public	2.2	5.5	2.0	1.8	2.1	2.7	3.3	3.6
Private	-21.3	7.1	10.2	8.2	7.6	10.1	9.4	11.1
Government budget								
Total revenue and grants	23.6	28.9	43.8	24.8	23.7	23.9	24.3	24.4
Tax Revenue	10.9	11.8	12.1	12.5	12.5	12.7	13.1	13.2
Total grants [1]	7.5	9.6	28.3	9.7	8.7	8.7	8.7	8.7
Total expenditure	22.0	25.1	24.6	30.0	26.8	26.8	26.8	26.8
Current expenditure	16.6	18.4	14.8	14.8	14.3	14.0	13.8	13.7
Domestic primary balance	1.6	3.0	-1.4	-1.7	-1.3	-1.1	-0.7	-0.6
Change in arrears	-3.4	-0.7	-0.9	-0.8	-0.8	-0.8	-0.8	-0.8
External (Interest)	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	-2.6	-0.6	-0.9	-0.8	-0.8	-0.8	-0.8	-0.8
Overall balance (cash basis)	-1.9	2.9	17.8	-6.0	-3.9	-3.7	-3.3	-3.2
Excluding grants	-9.4	-6.7	-10.5	-15.8	-12.6	-12.4	-12.0	-11.9
Financing	0.3	-2.8	-17.7	6.0	2.7	1.3	1.0	0.3
Foreign (net)	-0.2	-1.1	-19.3	4.1	2.2	1.2	1.1	0.7
Domestic (net)	0.5	-1.7	1.6	1.9	0.5	0.1	-0.1	-0.4
Errors and omissions	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	1.2	2.4	2.3	2.9
External sector								
Exports of goods and services	16.2	14.9	15.0	15.3	15.6	15.7	15.7	15.7
Imports of goods and services	50.2	53.9	52.2	55.7	52.4	50.3	49.0	47.7
Current account balance	-9.0	-3.8	-5.7	-8.2	-8.9	-8.7	-9.9	-9.8
Excl. official and private transfers	-34.1	-39.6	-37.2	-40.4	-37.0	-34.7	-33.5	-32.2
Remittances	18.7	25.3	23.2	21.5	20.8	20.1	19.6	19.2
External debt, in percent of GDP [2]	44.7	40.5	18.0	16.6	14.8	13.4	12.2	10.8
External debt, in percent of exports of goods and services [2]	275.5	271.8	119.5	106.1	95.0	85.4	77.9	68.8
External debt service (in percent of exports of goods and services) [2]	10.0	10.3	2.1	2.2	2.1	3.4	3.5	3.9
Overall balance of payments (in millions of U.S. dollars)	-11.0	-5.8	-32.2	-2.3	-16.1	-18.4	-16.2	-21.6
Official grants and loans (percent of GDP)	7.5	9.6	28.3	14.1	11.0	10.1	10.0	9.5
Gross international reserves (end of period)								
In millions of U.S. dollars	170.1	191.1	168.0	170.7	173.8	184.0	196.7	209.7
In months of imports of goods & services	6.7	7.1	5.9	5.1	5.2	5.3	5.3	5.4
Real effective exchange rate (2000=100)	97.9	93.7	...	...	...	...	...	...
Exchange rate CF/US$ (period average)	353.6	382.7	...	...	...	...	...	...
Memorandum items:								
GDP (nominal, in bilions of CF)	216.0	228.2	243.5	261.0	280.7	301.8	324.6	349.1
GDP per capita (nominal, in US Dollars)	899	859	920	976	1,038	1,104	1,172	1,245
Education and health expenditure (in bilions of CF)	14.8	16.8	18.3	...	...	...	...	...

Sources: Comorian authorities; and IMF staff estimates and projections.

[1] Includes interim HIPC assistance (2010-12) and debt relief under HIPC and MDRI.

[2] External debt ratios after full HIPC, MDRI and beyond HIPC relief from end-2012.