

EBS/86/60

CONFIDENTIAL

March 13, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Liberia - Real Effective Exchange Rate - Information Notice

Attached for the information of the Executive Directors is an information notice on the real effective exchange rate of the Liberian dollar.

Mr. Belanger (ext. 8671) is available to answer technical or factual questions relating to this paper.

Att: (1)

U.S. dollar, which amounted to more than 40 percent from 1980 through early 1985. Partly as a result of the loss of competitiveness due to the appreciation of its currency, the volume of Liberia's exports has declined steadily since 1980 and no new export products have been developed in recent years.

Following several years in which modest progress was achieved in correcting domestic and external imbalances, financial conditions deteriorated sharply in 1984/85, reflecting in particular a substantial widening of the overall fiscal deficit, on a commitment basis, to the equivalent of 13 percent of GDP from 7 percent in 1983/84. As a result, the balance of payments deficit, which had been reduced somewhat in 1983/84, increased again to 5 percent of GDP and entailed a major accumulation of arrears, including arrears to the Fund, as gross official reserves of the National Bank of Liberia were depleted. Arrears to the Fund at the end of June 1985 amounted to US\$28 million. 1/

Budgetary performance in the first six months of 1985/86 has also been disappointing. The overall fiscal deficit, on a commitment basis, amounted to about \$78 million, or 13 percent of GDP at an annual rate. The deficit was again largely financed by the accumulation of domestic and external arrears, as well as by borrowing from the domestic banking system, including the further issuing of Liberian coins. The proforma budget which is being considered by the authorities for the second half of the fiscal year (January-June 1986), and which has partially been implemented, projects a deficit of less than one percent of GDP on an annual basis. The budgetary targets could, however, prove difficult to achieve, given the optimistic assumptions on which the revenue and expenditure projections are based; furthermore, the budget fails to provide adequate resources to cover all scheduled debt service payments.

Liberia's external position continued to deteriorate during the first six months of 1985/86. At end-December 1985 gross official reserves of the National Bank of Liberia declined to \$2 million, from \$4 million at end-June 1985, while total external arrears rose to \$142 million from \$110 million during the same period. Of this total, arrears to the Fund amounted to \$45 million at end-December 1985. As the Liberian authorities were unable to settle the arrears to the Fund, on January 24, 1986, Liberia was declared ineligible to use the Fund's resources.

1/ Apart from the projections for 1985/86 shown in the staff report for the 1985 Article IV consultation (SM/85/188; 6/28/85), no meaningful medium-term scenarios could be produced because of uncertainties concerning domestic policies.

Staff Appraisal

At the conclusion of the 1985 Article IV consultation on July 24, 1985, Executive Directors noted with considerable concern the sharp deterioration in government budgetary operations during the past year which had resulted in the rapid accumulation of domestic and external payment arrears. Since the fiscal area must be the focus of adjustment in Liberia, Directors urged the authorities to take immediate steps to restore fiscal discipline and to take the necessary measures to meet current debt service obligations falling due so as to prevent a further accumulation of external arrears. Directors also took note of the significant erosion in Liberia's external competitiveness, and some Directors questioned the ability of the authorities to maintain the existing monetary arrangement in which the Liberian dollar is pegged at par with the U.S. dollar. These Directors thought that consideration should be given to *complementing the urgently needed fiscal adjustment* with supporting monetary and exchange rate policies, but stressed that any shift away from the dollar peg system would only make sense if the resulting greater monetary autonomy was used to restore the competitiveness of the economy and not to finance uncontrolled fiscal deficits.

Developments so far in 1985/86 indicate that no progress has been achieved in this direction. Accordingly, a comprehensive package of adjustment policies continues to be urgently required to correct the existing structural problems and cost-distortions. As regards exchange rate policy, developments in the effective exchange rate of the Liberian dollar since March 1985, while in the appropriate direction, are insufficient to restore the competitiveness of the Liberian economy and to stem the demand for foreign exchange. These issues will be discussed with the authorities in the context of the 1986 Article IV consultation discussions which are tentatively planned for April 1986.

Table 1. Liberia: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

	Real Effective Exchange Rate <u>1/</u> <u>2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars <u>1/</u>	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1981						
I	106.4	108.5	98.0	100.0	104.3	104.8
II	114.1	116.3	98.2	100.0	107.0	107.1
III	119.2	122.5	97.3	100.0	108.8	108.8
IV	113.9	118.1	96.4	100.0	110.2	109.7
1982						
I	117.1	122.4	95.7	100.0	111.2	111.5
II	120.4	125.6	95.9	100.0	113.5	113.6
III	125.0	130.6	95.7	100.0	115.4	115.4
IV	126.0	132.8	94.9	100.0	116.0	115.7
1983						
I	123.5	131.2	94.1	100.0	116.3	116.4
II	126.2	135.3	93.3	100.0	116.9	117.0
III	130.0	141.1	92.1	100.0	117.2	117.4
IV	130.6	143.1	91.3	100.0	118.0	117.9
1984						
I	130.1	144.6	90.0	100.0	118.1	118.1
II	129.6	145.4	89.2	100.0	118.4	118.5
III	136.0	153.3	88.7	100.0	119.1	119.3
IV	138.4	158.5	87.3	100.0	118.8	118.7
1985						
I	143.2	166.3	86.1	100.0	118.8	118.7
II	135.4	160.6	84.3	100.0	117.9	117.9
III	126.3	152.8	82.7	100.0	116.4	116.5
IV	117.6	143.7	81.8	100.0	116.5	116.4
Monthly						
1985						
July <u>3/</u>	128.6	154.6	83.2	100.0	116.9	116.9
Aug.	124.9	151.0	82.7	100.0	116.4	116.7
Sep.	125.4	152.7	82.1	100.0	115.9	116.0
Oct.	119.9	145.8	82.2	100.0	116.5	116.5
Nov.	117.6	143.8	81.8	100.0	116.5	116.4
Dec.	115.2	141.5	81.4	100.0	116.4	116.2
Percentage change						
July 1985- Dec. 1985	-10.4	-8.4	-2.2	0.0	-0.4	

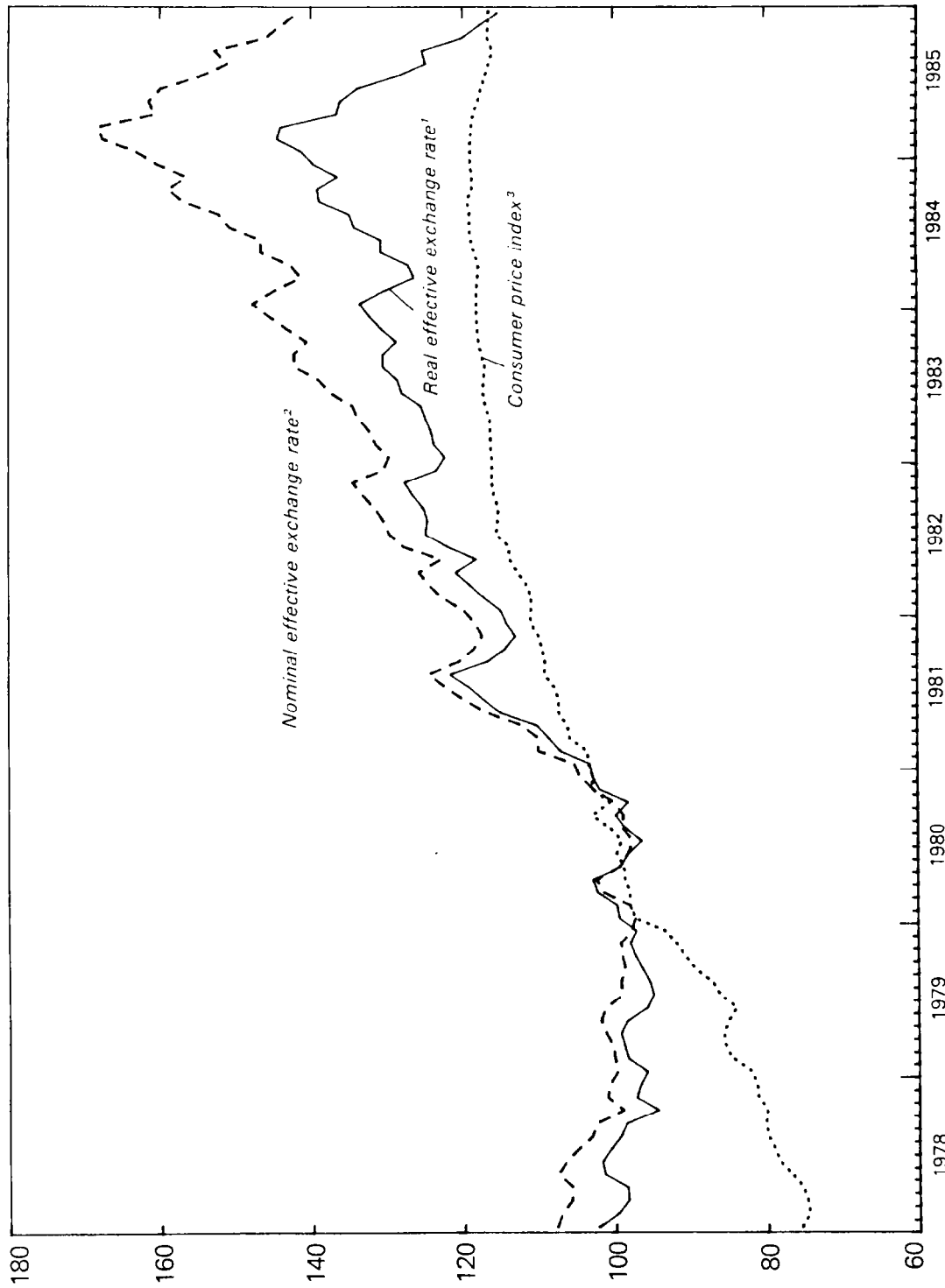
Source: Information Notice System.

1/ Increases mean appreciation.

2/ Using seasonally adjusted price indices.

3/ Date of latest consideration by Executive Board.

CHART 1
LIBERIA
INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE
(1980 = 100)



¹ Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices; increases mean appreciation.

² Trade-weighted index of nominal exchange rates.

³ Seasonally adjusted.