

**FOR  
INFORMATION**

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To: Members of the Executive Board

From: The Secretary

Subject: **Gabon—Assessment Letter for the African Development Bank**

Board Action:	Executive Directors' <b>information</b>
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Questions:	Mr. Segura-Ubiergo, AFR (ext. 34829)



**Gabon—Assessment Letter for the African Development Bank**  
**November 16, 2016**

*The sharp decline in oil prices has continued to worsen Gabon's growth outlook, fiscal performance, and the external position. There is a need for urgent action to address the pronounced fiscal and current account deficits and stop international reserve losses. Gabon is the second largest economy in the CEMAC region and its policy stance is crucial to the stability and viability of the union. This letter updates the assessment contained in the 2015 Article IV Consultation staff report from February 2016 (Country Report No. 16/86). A staff visit is scheduled for November 15–23, 2016.<sup>1</sup>*

**1. Macroeconomic conditions have deteriorated further in 2016, increasing near-term vulnerabilities.**

- **Gabon has been severely affected by the decline in oil prices since mid-2014.** Recent data indicate that the prolonged oil price shock is weighing down heavily on investment in the oil sector. Some non-oil related activities have also slowed down considerably, particularly in the construction, trade, and service sectors. However, gold production and agriculture-related industries have been relatively resilient. As a result, the authorities have revised down the projection for real GDP growth from 3.2 to 2.9 percent in 2016, but there are considerable downside risks. Consumer price inflation eased to 0.1 percent (y/y) at end-December 2015, largely driven by the decline in oil prices, but has edged up slightly to 1.6 percent in July 2016.
- **The negative terms-of-trade shock has led to a sharp decline in resource revenue collections and this is placing budget execution under substantial stress.** The overall fiscal deficit (cash basis) increased from 1.1 percent of GDP in 2014 to 4.1 percent of GDP in 2015 and is likely to deteriorate further in 2016, while the non-oil primary deficit (in percent of non-oil GDP) remains high (about 10 percent of GDP). As a result, fiscal buffers have been depleted. Public debt increased from 29 percent of GDP in 2013 to an estimated 44 percent of GDP in 2015 (well above the 35 percent indicative ceiling of the Government). In addition, government deposits at the central bank (BEAC) have declined sharply, BEAC's credit to the government has reached its maximum limit allowed by law (reaching about 5 percent of GDP), and there are signs of increasing arrears to domestic suppliers. Foreign financing has become increasingly costly, as rating agencies have downgraded the sovereign debt of oil exporters, including Gabon, contributing to a significant increase in spreads in recent months.

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<sup>1</sup> At the request of the African Development Bank and the Gabonese authorities, this letter is being prepared prior to the staff visit and is based on limited information and substantial uncertainty around the macroeconomic environment. Should the findings of the mission deviate greatly from what is currently expected, a follow-up assessment letter with more updated policy recommendations could be envisaged.

- **The elimination of oil price subsidies at the beginning of 2016, coupled with some of the efforts to improve non-oil revenue administration, have helped mitigate fiscal pressures.** However, implementation of the government's plans to contain expenditures, including through greater control of current spending (wage bill, staff travel and transfers) was complicated by the difficult political environment in an election year.
- **A widening external current account deficit, combined with declining capital inflows, has led to an unsustainable loss of international reserves.** Exports had declined by about 25 percent (y/y) at end-June 2016, but import growth remained positive (+2.1 percent). While reserves are pooled at the BEAC level to support the monetary union, those attributed to Gabon have declined from \$3bn in 2013 to \$1.1bn at end-August 2016. In addition, the pace of reserve losses has picked up in recent months.<sup>2</sup>
- **There has been limited progress toward the resolution of distressed public banks.** The government, in consultation with CEMAC regional bank supervisor (COBAC), has appointed temporary administrators for three banks (Banque Gabonaise de Développement (BGD), Banque de l'Habitat du Gabon (BHG), and the Poste Bank. For the BGD, the current Managing Director has been tasked with reforming the bank. The government has decided to restructure the bank and to find a new business partner. Measures have already been taken to make BGD's operations viable, including reductions in personnel and collection of outstanding government debt. Regarding the BHG and Post Bank, no concrete decision to either liquidate or restructure them has been taken. For the Post Bank, the priority is to separate the postal operations from the banking operations, while looking for a partner for the latter.

**2. The macroeconomic outlook for 2017 is very challenging, barring decisive policy action, with still elevated fiscal and external current account deficits.**

- **Some positive momentum is expected in 2017 and the medium term, as agriculture projects ramp up.** But this pick-up will depend on actions to address large macroeconomic imbalances and policy uncertainty. A growth rebound is likely to require a much more sustained adjustment effort to increase policy credibility and private sector confidence.
- **Much stronger measures are needed to address macroeconomic imbalances.** Given medium-term projections of oil prices at less than half of their pre-2015 levels, the overall fiscal deficit is likely to remain close to 6 percent of GDP in 2017 and over the medium term. Strong and prompt fiscal consolidation is needed in the short-term to reduce the current account deficit, and over the medium-term to prevent excessive accumulation of public debt. In this context, the government needs to contain public spending, while stepping up efforts to increase non-oil revenues and protecting social spending. With less fiscal space for public investment, greater emphasis on public investment management and project prioritization seems essential. In addition, the authorities should consider anchoring fiscal policy on a

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<sup>2</sup> Reserve losses by August 2016 amounted to \$685 million, compared with \$615 million in 2015 as a whole.

credible medium-term fiscal framework that takes into account the exhaustibility and volatility of natural resource revenues, drawing lessons from the recent experience. Rebuilding buffers and precautionary savings over the medium-term would increase resilience to future shocks.

- **Fiscal adjustment should also take into account the need to foster Gabon’s economic diversification and reduce its vulnerability to oil price fluctuations.** In the present tight budgetary environment, the authorities would benefit from improvements in public spending efficiency. This can be achieved through a focus on infrastructure, productivity-boosting structural reforms, notably in the areas of education, road networks, labor flexibility, simplification of bureaucratic procedures, and deeper intraregional integration. Such productivity enhancing measures are also needed to address current real exchange rate overvaluation.
- **Ongoing public financial management reforms would contribute to fiscal adjustment and the quality of public spending.** The ongoing implementation of program budgeting is an important step to address the major public finance management weaknesses that were identified in the 2013 Public Expenditure and Financial Accountability (PEFA) performance assessment. Results have already started to materialize, but recent recommendations by IMF technical assistance emphasizing measures to improve treasury management and avoid further accumulation of arrears (especially to the Paris Club) need to be taken into account.
- **The magnitude of the terms-of-trade shock requires careful monitoring of the likely negative impact on the financial sector.** The regional and national authorities need to aggressively address currently troubled public banks. In addition, and considering the dominance of oil and government activities to bank creditors, the entire banking system needs to be closely monitored, focusing on the likely increase in NPLs.
- **At the regional level, Gabon should advocate tighter fiscal and monetary policies to ensure continued viability of the monetary union.** As a key member of the CEMAC currency and economic union, Gabon’s economic policies have significant regional implications and spillovers. Coordination efforts with other CEMAC members are particularly important given similar adverse developments in other countries in the region.

**3. The main risk to the outlook remains insufficient fiscal adjustment to the weak oil prices that could further deplete fiscal buffers and weaken the external position.** Ancillary risks concern a stronger-than-expected spillover of the oil price shock to non-oil economic activity, and persistent fragility at three small distressed state-owned banks.

**4. Gabon remains on the standard 12-month Article IV Consultation cycle.** Staff continue to actively engage with the authorities, including through the provision of technical assistance.