INFORMAL SESSION TO ENGAGE

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CONFIDENTIAL

April 25, 2017

To: Members of the Executive Board

From: The Secretary

Subject: **Cameroon—Statement by the Staff Representative on a Preliminary Evaluation of High Access Under the Poverty Reduction and Growth Trust**

Board Action:	**Informal session to engage** Executive Directors
Tentative Board Date:	**Monday, May 1, 2017**
Questions:	Ms. Delechat, AFR (ext. 36981)

Statement by the Staff Representative on High Poverty Reduction and Growth Trust Access for Cameroon
Informal Board Meeting
May 1, 2017

Staff and the authorities are discussing a three-year program to be supported by high access under an Extended Credit Facility (ECF) arrangement. In line with the procedural safeguard on high access requests for the Poverty Reduction and Growth Trust (PRGT) resources, this note provides the background for the program request and explains the rationale for the high access.

I. Background and Regional Context

1. **Like other CEMAC countries, Cameroon has been severely affected by the oil price shock as well as security threats since end-2014.** After showing initial resilience owing to its greater economic diversification, Cameroon's macroeconomic performance deteriorated markedly in 2016. Growth has decelerated, public debt is rising fast, government deposits have dwindled, and its persistent current account deficit is contributing to the rapid fall in the region's pooled external reserves. With other CEMAC members also reeling from the oil price shock, the pooled reserves of the region fell from a total of US$ 15.3 billion at end-2014 to 4.1 billion or 2 months of imports by end-2016.

2. **Against the background of a looming regional crisis, President Biya convened a summit of CEMAC heads of state in Yaoundé on December 23.** At the summit, all CEMAC heads of state called on the need to implement expeditiously a package of coordinated measures to prevent a crisis, supported by financial assistance from the Fund and other partners with the ultimate objective of gradually rebuilding external reserves to an adequate level.

II. Balance of Payments Need

3. **In the absence of policy adjustment, the combined oil price and security shocks have generated a large and protracted balance of payments deficit for Cameroon, of about US$1.4 billion (4.7 percent of GDP) in 2016.**

- Since 2014, the oil price shock has led to a drop of 2 percent of GDP in oil revenue, and the medium-term oil price forecast remains subdued. At the same time, non-oil exports are underperforming in 2016–17 in line with weaker demand from emerging markets including China.
- Cameroon's fight against Boko Haram and the support of approximately 600,000 refugees and internally displaced persons have pushed security and related humanitarian spending to about 1 percent of GDP annually in 2014–16. The United Nations has recently noted the insufficient international support for the crisis, and credits the effectiveness of national government responses for averting famine and maintaining regional stability. Nonetheless, these unanticipated expenditures have displaced regular budgeted spending.
- At the same time, infrastructure projects launched in the context of Cameroon's strategy to become an emerging economy by 2035 continued.

4. These shocks have resulted in growing fiscal and external imbalances, rapidly declining foreign reserves, and a worsened growth outturn in 2016.

- *The 2016 fiscal deficit reached 7 percent of GDP*, higher than anticipated in the budget (4½ percent of GDP). Lower oil revenue and an end-year surge in expenditure commitments, including for priority infrastructure projects under the government's emergency plan, explain this outturn. Total public debt has more than doubled in three years to 33.2 percent of GDP in 2016, from 15.6 percent of GDP in 2013.
- *Reserves declined sharply*. The current account deficit improved from 4.1 percent of GDP in 2015 to 3.6 percent in 2016, reflecting import compression which more than offset the decline in oil exports, but reserve coverage fell from 6.0 to 3.7 months of imports.
- *Private sector credit growth shrank by half, to 6.4 percent at end-December*. Credit to the economy contracted because of a surge in bank financing of the government, through the use of the remaining Eurobond proceeds, bond and T-bill issuances, and BEAC statutory advances.
- *Growth is estimated to have declined from 5.8 percent in 2015 to about 4.4 percent in 2016* owing to weaker oil output and a mixed performance of non-oil production. Average inflation declined to 0.9 percent due to lower import prices.

5. Large external financing needs are emerging. Based on a macroeconomic framework with policy adjustment under a Fund-supported program,[1] staff project a financing gap of 6.7 percent of GDP remaining in 2017–20 (CFAF 1.3 trillion, of which CFAF 514 billion or 2.8 percent of GDP in 2017). Given the already tightening domestic liquidity conditions and rising interest expenditure, additional external financing, preferably on concessional terms, will be needed to allow the government to fill the financing gap, and gradually rebuild fiscal and external buffers.

6. Fund financing will be critical to mobilize additional IFI and donor financing. Staff is proposing access under the PRGT of 175 percent of quota, or SDR 483 million, which would cover around 30 percent of the estimated financing gap for 2017–20. Fund support would help catalyze substantial additional budget support from Cameroon's other development partners, including the World Bank, the African Development Bank, the European Union and France, who have already indicated that they could fully cover the remaining financing need of CFAF 887 billion (US$1.4 billion) over the next three years.

III. POLICY MEASURES AND MACROECONOMIC FRAMEWORK

7. At the authorities' request, staff has initiated discussions on a Fund program to support the authorities' adjustment efforts. Cameroon is PRGT eligible, and staff and the authorities are currently discussing a three-year ECF arrangement, which is the appropriate instrument given the protracted nature of the BOP need and the importance of accompanying structural reforms to boost non-oil sector growth. The program would rest on three pillars: (i) frontloaded fiscal adjustment; (ii) structural fiscal reforms; and (iii) measures to accelerate private-sector led economic diversification and boost financial sector's resilience. Policies at the regional level, in particular monetary tightening through higher interest rates and including

[1] The 2015 Article IV mission projected a financing gap of 11.6 percent of GDP for 2017–19 based on a no policy change scenario.

a freeze on BEAC's statutory advances at their current level would support the fiscal adjustment.[2] Close cooperation with development partners who would be initiating budget support operations will ensure traction and focus on a critical mass of reforms in key sectors to unlock sustainable growth (e.g. transport, electricity transmission, information and communication technology, agriculture).

8. **Frontloaded fiscal consolidation is key to return to fiscal and external sustainability**. Given lower oil receipts and fast rising non-concessional borrowing for large public investments with very high import contents, the program will propose measures focusing on non-oil revenue mobilization and capital expenditure rationalization, while protecting social spending in priority areas such as health and education and supporting a scaling up of social safety nets with a floor on social expenditures. Staff will also propose consolidation of recurrent expenditures in line with the budget, focused on a reduction of the government's overhead costs, such as spending on travel, vehicles, and equipment purchases. Proposed adjustment in 2017 is anchored in the authorities' budget deficit target, with most of the adjustment coming from expenditure reduction, while starting in 2018 measures to expand the non-oil revenue base drive the fiscal consolidation.

9. **Structural fiscal measures would aim at enhancing the transparency and credibility of the budget, while containing fiscal risks**. Significant weaknesses in budget preparation, execution and monitoring have led to arbitrary reallocations of expenditures across budget lines and arrears accumulation. Improving procedures to prepare, plan and execute high-quality investment projects is also critical. Contingent liabilities and other fiscal risks appear contained as gross debt from state-owned companies has significantly declined in recent years. Nonetheless, some large commercial public enterprises still represent a drag on public finances, and the authorities are committed to lower fiscal risks while restarting privatizations.

10. **The program would outline a strategy to resolve insolvent banks and address high levels of NPLs, consistent with the strategy being developed at the regional level**. The Cameroonian financial system has so far remained resilient to the regional crisis, but persistently high NPLs weigh on banks' ability to extend new loans (Text Table 1). Accelerating the preparation of a strategy to resolve four longstanding insolvent (but non-systemic) banks, in cooperation with the regional supervisor, would also be important.

Text Table 1. Cameroon: Financial Sector Indicators, 2014–16 (percent)

	2014	2015	2016
Capital adequacy			
Capital/risk-weighted assets	10.6	10.1	9.0
Base Capital/ risk-weighted assets	9.1	9.3	7.6
Asset quality			
Loans in arrears/total loans	12.4	12.6	14.2
Non-performing loans/total loans	9.7	10.5	9.6
Large exposures/equity	258.4	181.1	226.6
Liquidity			
Reserves/total deposits	27.7	24.3	18.0
Liquid assets/ST liabilities	139.5	147.5	148.7
Total deposits /Total loans (non interbank)	112.2	113.4	104.7

Sources: BEAC; COBAC; and IMF Financial Soundness Indicators.

11. **Robust reforms to boost diversified private sector-led growth will be essential.** In close coordination with other development partners, in particular the World Bank, the program

[2] On March 22, the BEAC monetary policy committee increased by 50 basis points its main policy interest rate, to 2.95 percent. Cameroon is the only CEMAC country that has not yet reached the ceiling (frozen at the 2014 level) on the use of BEAC statutory advances, having drawn CFAF 266 billion out of a ceiling of 576.9 billion.

will propose specific measures to improve business climate and boost investor confidence to unlock more sustained private-sector led growth. These include measures to simplify tax payments, enhance the management of VAT refunds, and reduce delays in processing government payments to private service providers. At the regional level, staff will discuss a financial sector reform strategy and attendant country-specific measures aiming at addressing high non-performing loans and resolving insolvent banks, while supporting national and regional measures to broaden financial inclusion.

IV. Expected Strength of the Program and Capacity to Repay

12. Successful implementation of the program is expected to fully unwind fiscal and external imbalances while boosting the conditions for medium-term growth. The program envisages a fiscal adjustment of about 5 percent of GDP over the program, of which about 3.6 percent in the first year, on a commitment basis. The program would also provide for the full repayment of the stock of domestic arrears (2.7 percent of GDP) by 2020. This effort would allow Cameroon to rebuild adequate cash buffers and form an integral part of the CEMAC region's effort to return to fiscal and external sustainability. Usable government deposits at the BEAC would increase from 0.5 months of expenditure in 2016 to 2.3 months by the end of the program, and imputed reserves would increase from 3.7 months of imports in 2016 to 4.2 months by 2020. Growth would temporarily decline to 3.7 percent in 2017, driven by negative growth in the oil sector and the contractionary impact of fiscal adjustment proposed by the program. However, growth would return to its potential rate of about 5 percent in the medium term, supported by strong non-oil exports and private investment. The current account and the fiscal deficits would narrow to sustainable levels of about 2 and 1½ percent of GDP by 2020, respectively.

13. Cameroon's capacity to repay the Fund remains strong. Cameroon has implemented three programs financed by the PRGT and four using GRA resources. The last fully-implemented PRGF-supported program culminated in Cameroon reaching the completion point of the HIPC and MDRI initiative in 2006, following which an RAC-ESF was approved in 2009 to help the country weather the impact of the global crisis. Cameroon's track record of repaying the Fund has been good, with 49.08 million SDR outstanding as of March 31, 2017. Repayments to the Fund stemming from the proposed ECF-supported program would peak at 4.3 percent of imputed reserves in 2023–26 and decline to 2 percent in 2027.

14. A preliminary debt sustainability analysis (DSA) suggests that Cameroon's risk of external debt distress remains high, albeit a borderline case. Public debt has been increasing rapidly. The breach of the policy-dependent threshold under the baseline scenario is nonetheless less pronounced than in the 2015 Article IV DSA, reflecting fiscal consolidation envisaged under the program combined with a greater recourse to concessional financing. However, public external debt remains highly vulnerable to exogenous shocks, notably a shock to export revenues. Beyond fiscal tightening and the use of concessional loans, mitigating risks to the public debt requires a strengthening in public debt management, accelerating growth and exports in the non-oil sector and bolstering the quality of policies to improve the CPIA rating.

15. Financial implications and risks associated with the high-access program requested by Cameroon will be manageable. As explained in the recent Update on the Financing of the Fund's Concessional Assistance (SM/17/64), based on a staff survey as of end-March 2017, PRGT demand in 2017 could exceed peak levels of SDR 2.5 billion, last seen around the time of the global financial crisis in 2009. Simulations suggest that, should annual PRGT demand remain elevated in 2018 (two standard deviations over historical averages), the estimated self-sustained lending capacity would remain above the targeted capacity of SDR 1¼ billion. These calculations include the high-access request for Cameroon and suggest that the proposed access of 175 percent of quota can be accommodated without jeopardizing the self-sustainability of the PRGT. However, if combined with other high-access requests from countries in the CEMAC region, total PRGT exposure to CEMAC could amount to one-fifth of PRGT outstanding credit as of end-March 2017 or one-third of the end-February 2017 balance in the PRGT Reserve Account. This suggests that performance under the Cameroon program and other high-access programs for CEMAC members will need to be carefully monitored.

V. NEXT STEPS

16. Staff has initiated discussions with the Cameroonian authorities on a three-year ECF-supported program. A mission took place in Yaoundé in late February, and discussions continued on April 3–7 in Washington. These discussions are expected to be finalized in the coming weeks, and the program request could be submitted for Board approval by end-May. The authorities have expressed their readiness to play a leadership role in the prevention of a regional crisis and indicated their interest in promptly concluding discussions on a Fund-supported program.

17. The Cameroon program is part of a regionally-coordinated effort. Since reserves are pooled, cooperation across the union members and avoiding free-riding on these pooled reserves is critical to achieve an adequate reserves level and safeguard resources. Staff's judgement that sufficient progress is being made on the discussions currently under way with the other CEMAC countries not yet under Fund-supported programs, together with policy assurances sought from regional institutions to closely monitor and support individual countries' adjustment efforts, are critical elements of the strategy to support the region's external stability.

Table 1. Cameroon: Selected Economic and Financial Indicators, 2014–21

	2014	2015	2016	2017	2018	2019	2020	2021
		Est.	Est.	Proj.	proj.	proj.	proj.	proj.
	(Annual percentage change, unless otherwise indicated)							
National account and prices								
GDP at constant prices	5.9	5.8	4.4	3.7	4.3	4.9	5.0	5.4
Oil GDP at constant prices	13.8	28.1	-3.6	-2.3	0.9	-2.7	-3.5	6.4
Non-Oil GDP at constant prices	5.6	4.9	4.8	3.9	4.4	5.2	5.3	5.4
GDP deflator	2.6	0.3	-1.0	1.2	1.4	1.5	1.9	1.9
Nominal GDP (at market prices, CFAF billions)	15,846	16,807	17,387	18,243	19,284	20,518	21,946	23,584
Oil	977	876	700	917	913	867	831	886
Non-Oil	14,869	15,931	16,687	17,326	18,371	19,650	21,116	22,698
Oil output (thousands of barrels per day)	75.4	95.8	92.8	90.4	89.5	86.4	83.1	86.9
Consumer prices (average)	1.9	2.7	0.9	1.0	1.4	1.7	2.0	2.0
Consumer prices (eop)	2.6	1.5	0.3	1.5	1.4	1.7	2.0	2.0
External trade								
Export volume	17.6	17.8	1.0	2.0	5.4	6.8	8.5	10.0
Oil sector[5]	20.6	27.9	-3.1	-2.3	0.9	-2.7	-3.5	4.4
Non-oil sector	16.9	15.2	2.2	3.2	6.5	9.0	11.0	11.0
Import volume	15.0	1.9	-19.1	3.9	5.3	4.8	4.6	4.7
Average oil export price[1] (US$ per barrel)	88.5	51.9	34.6	44.7	44.5	43.8	43.6	44.0
Nominal effective exchange rate (depreciation -)	1.6	-3.7	…	…	…	…	…	…
Real effective exchange rate (depreciation -)	1.3	-3.0	…	…	…	…	…	…
Terms of trade	-7.3	-13.8	-20.4	3.3	-0.8	-3.4	-3.0	-1.7
Export price index	-8.1	-19.2	-13.1	10.9	-0.1	-2.8	-2.6	-0.7
Non-oil export price index	-2.6	-12.4	-0.7	3.6	0.6	-1.8	-1.7	-0.2
Import price index	-0.8	-6.3	9.2	7.3	0.8	0.6	0.3	1.1
Money and credit								
Broad money (M2)	10.8	9.1	5.4	3.5	5.7	5.9	7.8	7.5
Net foreign assets[2]	3.4	13.9	-18.3	-0.3	1.3	0.7	1.7	2.8
Net domestic assets[2]	7.3	-4.8	23.7	3.8	4.4	5.2	6.0	4.7
Domestic credit to the private sector	14.4	12.8	6.4	5.9	9.3	10.9	12.1	13.3
	(Percent of GDP, unless otherwise indicated)							
Gross national savings	18.6	17.2	16.5	16.7	17.7	18.6	19.5	20.1
Gross domestic investment	22.9	21.3	20.1	19.7	20.6	21.2	21.5	21.6
Public investment	7.7	6.7	8.8	7.1	6.9	6.7	6.5	6.5
Private investment	15.2	14.6	11.4	12.6	13.7	14.5	15.0	15.1
Central government operations								
Total revenue (including grants)	18.1	17.9	16.3	16.7	17.3	17.6	17.7	17.8
Oil revenue	4.6	3.4	2.4	2.4	2.4	2.3	2.2	2.1
Non-oil revenue	13.5	14.6	13.6	13.9	14.5	15.1	15.3	15.4
Non-oil revenue (percent of non-oil GDP)	14.4	15.4	14.1	14.6	15.2	15.7	15.9	16.0
Total expenditure	22.2	20.6	23.3	20.2	19.9	19.6	19.2	19.0
Overall fiscal balance								
Excluding grants	-4.8	-2.8	-7.3	-3.7	-2.8	-2.2	-1.8	-1.5
Including grants	-4.5	-2.8	-7.0	-3.4	-2.5	-1.9	-1.6	-1.2
Non-oil primary balance (percent of non-oil GDP)	-9.0	-5.9	-6.5	-5.2	-4.4	-3.6	-3.1	-2.7
External sector								
Current account balance								
Including official grants	-4.3	-4.1	-3.6	-3.0	-2.9	-2.6	-2.1	-1.5
Excluding official grants	-4.7	-4.5	-4.0	-3.4	-3.3	-2.9	-2.4	-1.8
Public debt								
Stock of public debt[3,4]	26.2	33.2	33.2	35.0	35.9	36.5	35.6	34.6
Of which: external debt	17.5	21.3	22.7	26.7	29.4	31.4	31.5	31.4

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

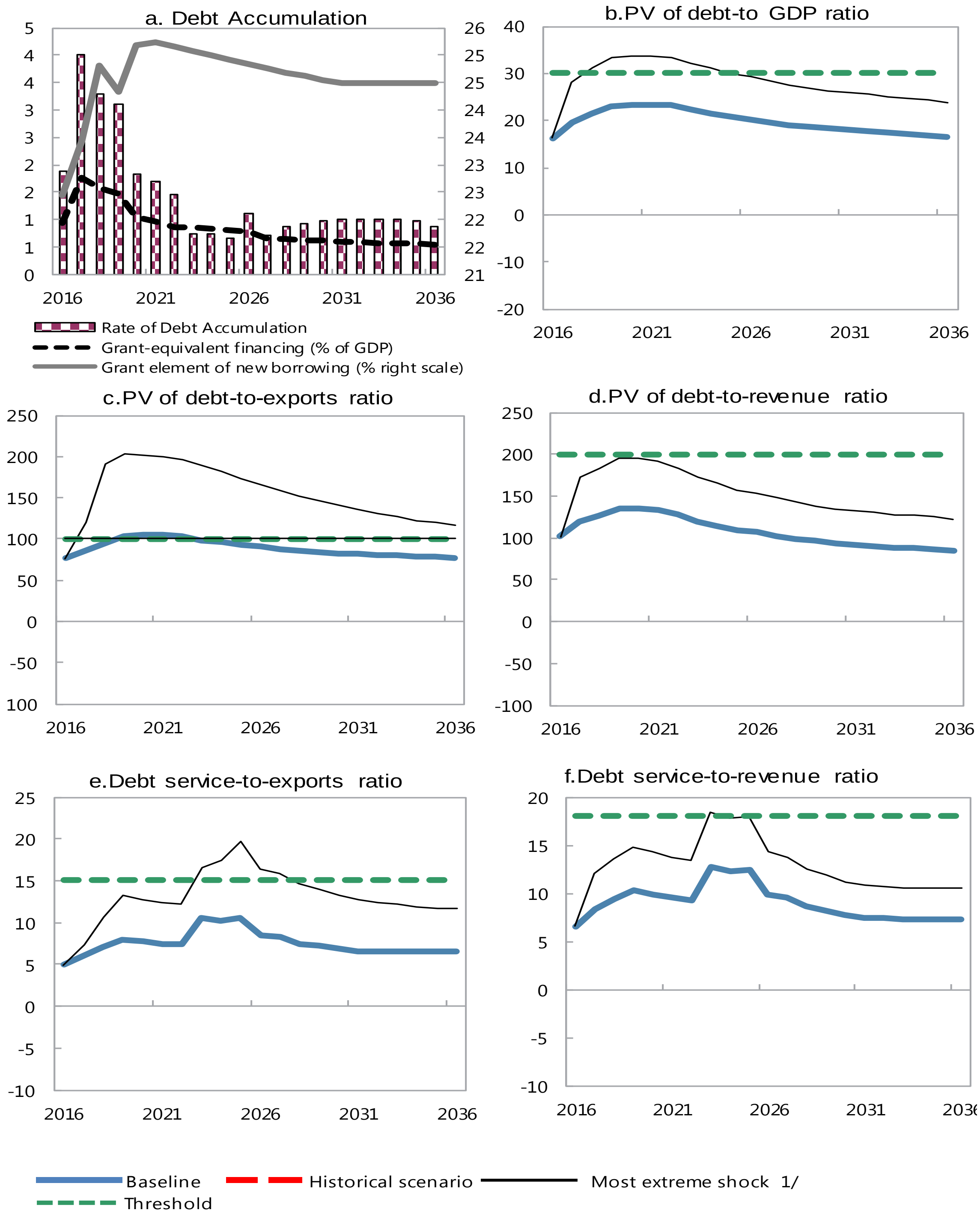
[1] The export price for oil reflects actual prices for past years; for the current and future years, projections reflect movements in the Average Petroleum Spot Price (APSP) of three types of crude oil (Dated Brent, West Texas Intermediate, and the Dubai Fateh), with no discount.

[2] Percent of broad money at the beginning of the period.

[3] Includes the cumulative financing gap.

[4] Projections are taken from an update to the 2015 Debt Sustainability Analysis (DSA), which excludes the stock of debt on which France provided debt relief under the "Contrat de désendettement et de développement" (C2D).

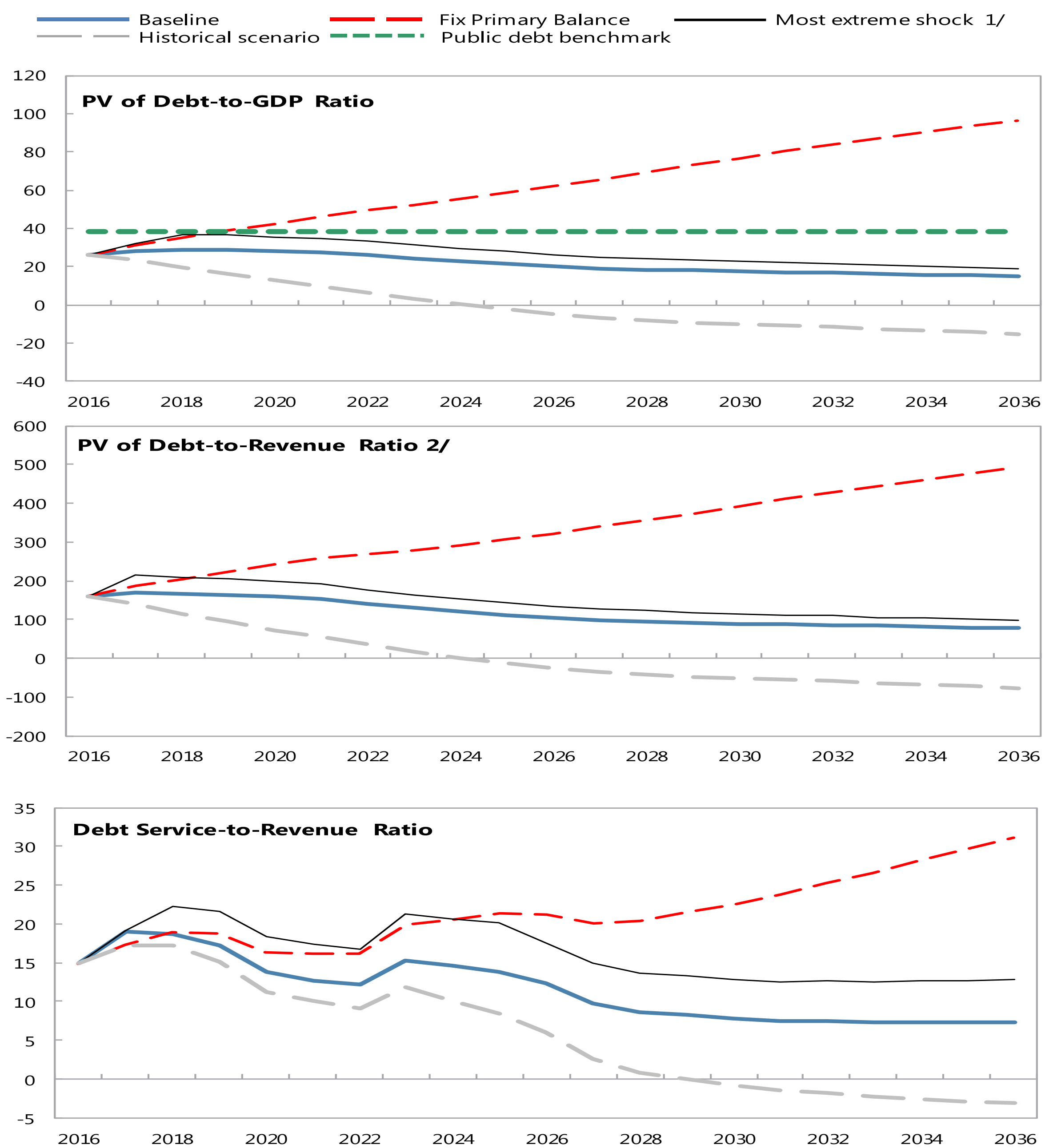
Figure 1. Cameroon: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2016–36 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2026. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Cameroon: Indicators of Public Debt Under Alternative Scenarios, 2016–36[1/]



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2026.
2/ Revenues are defined inclusive of grants.