LAPSE OF TIME

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March 17, 2020

To:	Members of the Executive Board
From:	The Secretary
Subject:	**Union of the Comoros—Staff Report for the 2019 Article IV Consultation—Draft Press Release**

Board Action:	Executive Directors' **consideration** on a lapse of time basis
Deadline to request Board meeting:	**Wednesday, March 18, 2020** **12:00 (noon)**
Publication:	Yes*
Questions:	Mr. Weisfeld, AFR (ext. 37482) Mr. Melhado Orellana, AFR (ext. 29090)

***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the press release will be published.**

PRESS RELEASE

PR[20/XX]

IMF Executive Board Concludes 2019 Article IV Consultation with the Union of the Comoros

FOR IMMEDIATE RELEASE

WASHINGTON, DC – **March xx, 2020.** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Union of the Comoros on March 18, 2020 and considered and endorsed the staff appraisal without a meeting.[2]

In a challenging environment, the Comoros authorities have made progress with several policy reforms in recent years. Among other things, they strengthened electricity provision, opened the telecommunications sector, and created a Treasury Single Account. Building on these successes, the authorities hope to transform Comoros into a dynamic emerging market over the next decade by strengthening human capital, infrastructure, and governance, and reducing the scope for corruption.

Pronounced fragility arising from the presence of two interlocking vicious circles puts realization of these hopes at risk, however. Institutional fragility manifests in inter-islands tensions and weak governance, including a weak civil service and weak judicial system. Economic fragility manifests in severe constraints on domestic resources and pronounced vulnerability to shocks, including natural disasters associated with climate change.

In line with this, economic developments over the past two years have been challenging. Driven mainly by political uncertainty and cyclone Kenneth, which hit Comoros in 2019, growth slowed to 3.6 percent in 2018 and 1.9 percent in 2019. At the same time, the external accounts weakened, and fiscal challenges intensified amid difficulties at state-owned enterprises and in tax revenue mobilization. Growth of credit to the economy has remained weak as the banking sector has suffered from an unfavorable operating environment.

Under the assumption of only slow improvements in economic policies, and absent major shocks, growth is expected to recover somewhat but remain moderate over the medium and longer terms. The outlook comprises several substantial downside risks, however. The ongoing COVID-19 pandemic is likely to bring large economic dislocation in the near term, which is not reflected in the baseline projections as these were prepared before the global spread of the virus. Medium to longer terms risks include risk of external debt distress (this risk is assessed as “moderate” for now, but buffers are shrinking).

Executive Board Assessment

In concluding the 2019 Article IV Consultation with the Union of the Comoros, Executive Directors endorsed staff’s appraisal as follows:

The authorities have had several policy successes in recent years, and Comoros benefits from two important structural advantages: large remittances and low crime and violence.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

Building on these successes and advantages, the authorities hope to transform Comoros into a dynamic emerging market but pronounced fragility from the presence of two interlocking vicious circles puts realization of these hopes at risk. The institutional dimension manifests in tensions between the islands and weak governance resulting in a weak civil service and a weak judicial system, among other things. The economic dimension manifests in severe constraints on domestic resources and pronounced vulnerability to shocks.

Fragility has weighed on economic performance, and per-capita GDP has grown only slowly. Economic developments over the past two years have been particularly challenging, due to political uncertainty and cyclone Kenneth, which a weak administration with very limited fiscal buffers has struggled to offset. Growth has slowed, fiscal challenges have intensified amid difficulties at SOEs and weaknesses in taxation.

Under baseline projections, growth is expected to rebound in 2020 but remain moderate over the medium term. The outlook comprises several downside risks. Near-term risks include risk of a growth decline (from inter-island tensions, weaker global growth, or natural disasters); fiscal stress (from volatility in revenue in combination with credit constraints); and financial sector stress. Medium to longer terms risks include a risk of external debt distress (assessed as “moderate” for now but buffers are shrinking). The external position is assessed to be broadly in line with fundamentals and desirable policy settings, but longer-term risks exist nevertheless (e.g., from volatility in some inflows and a narrow export base).

Strengthened policies under an “active policy scenario” could gradually lift Comoros out of fragility, spur inclusive growth, and limit risks. For this, the authorities would need to tackle both vicious circles of fragility. To address institutional fragility, they would strengthen governance, including by enhancing civil service implementation capacity and the rule of law. To address economic fragility, they would relax resource constraints by raising fiscal revenue, enhancing PFM, strengthening SOE oversight, strengthening the financial sector, and implementing a targeted growth strategy. The authorities would also enhance resilience by implementing prudent fiscal and monetary policies and strengthening resilience to natural disasters. As a result, growth would likely rise to around 4½ percent per year and risks would recede, thanks for example to enhanced debt sustainability.

Improving policies as described under the active policy scenario will strain the authorities’ limited implementation capacity, and prioritization will be key:

- Strengthening the civil service is likely the single most important reform. Success in this endeavor will enable better performance in all areas of government activity. As reform efforts will take time to show impacts, efforts should start right away. Efforts should focus on hiring and promoting based on merit, enhancing training of officials, and setting realistic expectations and holding public servants to them.

- Strengthening the judicial system to ensure enforcement of property rights and contracts likely comes next. Success in this area will go a long way towards transforming the business environment and enabling private-sector led growth. As with broader civil service reform, efforts will take time to show impact and should start immediately. They should include efforts to enhance funding of the judicial system, strengthening staffing in a low-cost manner by complementing the corps of professional judges with laymen judges, and strengthening arbitration. Refraining from exerting political interference will be key.

- Enhancing fiscal revenue is the third key priority, which also holds substantial opportunities for quick wins. Higher revenue is critical for enabling a much-needed increase in investment in physical and human capital while preserving debt sustainability. Opportunities for quick wins exist in this area, for example by broadening the tax-base to include a larger share of already known companies in the taxpayer rolls and following up more determinedly with delinquent taxpayers. Other actions to expand fiscal space, including notably the elimination of unproductive fiscal spending such as on keeping the postal bank afloat, will also be important.

The Fund will need to support the authorities with sustained policy advice and capacity building efforts, in collaboration with the World Bank and other development partners.

Table 1. Selected Economic and Financial Indicators, 2016-25 Baseline Scenario

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
		Est.[1]					Proj.[1]			
	(Annual percentage change, unless otherwise indicated)									
National income and prices										
Real GDP	3.5	4.2	3.6	1.9	4.4	3.5	3.6	3.7	3.8	3.8
GDP deflator	1.6	0.3	1.1	3.2	1.2	2.0	1.9	1.9	1.9	1.9
Consumer price index (annual average)	0.8	0.1	1.7	3.3	1.4	2.1	2.0	2.0	2.0	2.0
Money and credit										
Net foreign assets	-13.1	12.6	4.2	-5.6	1.6	2.9	5.8	8.7	7.6	5.2
Domestic credit	33.5	-0.4	4.9	6.9	0.5	0.7	0.9	-0.3	1.4	4.0
Credit to the private sector	7.2	6.2	1.2	2.0	2.0	2.1	2.5	2.8	3.5	4.3
Broad money	10.3	1.8	8.5	5.1	4.6	4.8	5.5	5.6	5.7	5.8
Velocity (GDP/end-year broad money)	3.6	3.7	3.5	3.6	3.6	3.6	3.6	3.6	3.6	3.6
External sector										
Exports, f.o.b.	82.0	26.2	5.5	1.3	-0.9	5.8	5.8	6.1	6.3	6.3
Imports, f.o.b.	-0.4	12.1	11.1	7.2	12.7	2.4	3.4	4.1	4.2	4.2
Export volume	31.5	-1.0	2.9	5.0	-0.1	6.3	6.3	5.8	5.8	5.7
Import volume	2.0	12.4	11.1	0.1	10.3	5.9	4.9	4.5	4.0	3.9
Terms of trade	14.6	11.8	-0.3	-4.6	-2.8	2.9	1.5	1.1	0.8	0.7
	(In percent of GDP, unless otherwise indicated)									
Investment and savings										
Gross fixed capital formation	13.1	14.2	15.8	16.1	16.0	15.9	15.8	15.7	15.6	15.4
Gross national savings	8.8	12.1	13.2	13.1	13.2	12.9	12.8	12.8	12.8	12.8
Government Budget										
Total revenue and grants	14.2	17.2	13.9	16.1	17.5	16.7	16.7	16.7	16.4	16.3
Total revenue	8.8	10.2	11.3	8.7	9.1	9.2	9.4	9.5	9.6	9.7
Tax Revenue	7.9	9.4	8.3	7.0	7.8	7.9	7.9	8.0	8.1	8.2
Non-tax Revenue	0.9	0.8	3.0	1.7	1.3	1.4	1.5	1.5	1.5	1.6
Total grants	5.4	7.1	2.5	7.5	8.5	7.4	7.3	7.2	6.8	6.6
Total expenditure and net lending	18.7	16.9	14.9	18.4	19.7	19.1	19.1	19.1	18.8	18.6
Current expenditure	11.1	10.3	11.3	10.6	11.1	11.5	11.8	11.8	11.8	11.8
Capital expenditure	6.3	6.3	3.6	7.8	8.7	7.6	7.3	7.3	7.1	6.9
Domestic primary balance[2]	-3.1	-1.1	-1.2	-2.5	-2.7	-2.8	-2.7	-2.7	-2.6	-2.4
Overall balance (cash basis)	-4.9	0.2	-0.4	-2.2	-2.2	-2.5	-2.4	-2.4	-2.4	-2.3
Excluding grants	-10.3	-6.9	-2.9	-9.7	-10.7	-9.9	-9.7	-9.5	-9.2	-8.9
Net Financing	4.2	-0.1	0.7	2.2	2.2	2.5	2.4	2.4	2.4	2.3
Foreign (Including IMF)	1.2	-0.2	0.2	2.1	2.3	2.5	2.4	2.4	2.4	2.3
Domestic	3.0	0.0	0.5	0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Financing gap/errors and omissions	0.7	-0.1	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External sector										
Exports of goods and services	10.7	11.9	12.9	12.3	12.4	12.5	12.6	12.6	12.6	12.6
Imports of goods and services	26.5	28.4	30.0	30.1	31.8	31.1	30.6	30.2	29.9	29.5
Current account balance	-4.3	-2.1	-2.8	-3.8	-5.5	-4.9	-4.4	-4.0	-3.7	-3.5
Excl. official and private transfers	-15.2	-16.0	-16.6	-17.3	-19.0	-18.3	-17.7	-17.3	-16.9	-16.6
Private remittances, net[3]	9.4	10.3	12.3	12.1	12.1	12.0	12.0	12.0	12.0	12.0
External debt	16.4	17.0	19.6	23.8	27.0	29.3	30.0	30.7	31.3	31.7
Official grants and loans	6.8	7.1	3.1	10.5	11.6	10.4	10.2	10.2	9.8	9.5
Gross international reserves (end of period)										
In millions of U.S. dollars	160.0	209.3	198.4	196.4	197.7	201.3	208.2	217.0	227.6	238.2
In months of imports of goods & services	7.2	8.2	6.7	6.6	5.9	5.8	5.8	5.7	5.7	5.7
Exchange rate CF/US$ (period average)	444.6	435.6	416.4	439.4						
Memorandum items:										
Public sector debt (in Percent of GDP)[4]	16.5	17.1	19.6	23.8	27.1	29.4	30.1	30.8	31.3	31.8
GDP (nominal, in billions of CF)	450.2	469.2	491.0	521.1	550.4	581.1	613.3	647.7	684.8	724.3
GDP per capita (nominal, in US Dollars)	1,256	1,301	1,386	1,357	1,397	1,451	1,501	1,553	1,610	1,670

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

[1] From 2017, includes budgeted-for revenues and expenses related to fuel subsidies of SOEs.

[2] Domestic revenues minus current primary expenditures and domestically financed capital expenditures.

[3] From 2015, net private official transfers include estimates made by the Central Bank of Comoros of debit items other than wire transfers.

[4] Coverage of debt: The central government, the central bank and government-guaranteed debt. Definition of external debt is Residency-based.