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The International Financial Crisis and Global Recession: Impact on the CEMAC Region and Policy Considerations

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Contents Page

Executive Summary

The global financial crisis has had little direct impact on the CEMAC region, as the banks in the region have limited connections to the global market. The resulting global recession is having significant direct and indirect impacts on the region, however, creating important challenges for the region's economic policymakers.

The most important impact of the ongoing crisis on the CEMAC region stems from the decline in world oil prices. By spring 2009, crude oil prices had declined by around US$100 since their peak in 2008. Consistent with this decline in prices, overall fiscal revenues from oil for the CEMAC region in 2009 were projected, at the time of this study, to be more than 67 percent lower than they were last July. Combined with the fall in export volumes and prices for timber and other commodities, total export values are now projected to be less than half of what was previously projected. The non-oil growth rate in the region is expected to fall by half, to 2.5 percent. This note assesses planned policy responses to these developments, and makes recommendations for policies going forward.

Medium-term fiscal policy must be guided by considerations of fiscal and external stability. While external stability does not appear to be in jeopardy—in particular, the region's pool of foreign exchange reserves appears more than adequate—all CEMAC countries are projected to have fiscal deficits that will be unsustainable, calling for medium-term fiscal tightening. Short-term fiscal policy, however, must be geared toward cushioning the impact of the global recession on the domestic economy and protecting the most vulnerable. As there appears to be sufficient financing available, governments may wish to engage in temporary fiscal stimulus, if they can reconcile that with the needed medium-term fiscal adjustment.

With the CFA franc pegged to the euro, there is little scope for independent monetary policy. However, the de facto limited capital controls leave some room for monetary policy to influence markets through interest rate movements. In addition, the rapid development of the planned regional bond market would enhance government financing options. At the same time, the weak global outlook and financial markets give greater urgency to the need to strengthen banking supervision.

I. Introduction

1. **The international financial crisis and resulting global recession are having a profound impact on Sub-Saharan Africa (SSA).** This note focuses on the CEMAC countries[2] and lays out some policy considerations.

2. **There are several reasons for looking separately at the CEMAC region.** The countries share a common monetary and exchange rate framework, so any monetary policy response to the crisis must have a regional rather than country specific focus, while any fiscal policy response cannot ignore regional implications. The parity of the CFA franc to the euro separates the region from the rest of SSA in terms of policies to address competitiveness issues. And the pooling of reserves implies that external sustainability can only be addressed from a regional perspective. In addition, the economies of the CEMAC countries are dominated by commodity exports (notably oil) and are thus affected—to varying degrees—by the collapse in commodity prices.

3. **The objectives of this note are twofold.** First, we attempt to assess the response of CEMAC governments to the global financial crisis and recession, with particular focus on the impact of current policies on each country's fiscal sustainability, as well as the region's external sustainability and reserve coverage. In light of this assessment, the note then provides general policy advice to CEMAC governments, as they refine their response to global developments.

II. The Impact of Recent Global Developments on CEMAC Countries

4. **The global financial crisis has had little direct impact on the CEMAC region**, as the banks in the region have in general not invested in subprime mortgages or other toxic assets, with foreign exchange assets largely used for trade transaction. However, the same cannot be said of the resulting global recession—the most severe since World War II—which is having direct and indirect impacts on the region irrespective of member countries domestic policies.

[2] The Central African Economic and Monetary Community (Communauté Économique et Monétaire de l'Afrique Centrale, CEMAC) is a customs and monetary union among Cameroon, the Central African Republic, Chad, the Republic of Congo, Equatorial Guinea, and Gabon. CEMAC objectives are the creation of a common market based on free movement of goods, services, capital, and persons, as well as harmonization of business laws and coordination of economic policies. CEMAC members have adopted a common currency (the CFA franc), which is issued by the Central Bank of Central African States (Banque des États de l'Afrique Centrale, BEAC).

5. **The most important impact of the ongoing crisis on the CEMAC region stems in large part from the fiscal and external balance implications of the decline in world oil prices.** By spring 2009, crude oil prices had declined by around one hundred dollars since their peak last summer. The WEO forecast for the average oil price in April was US$52 for 2009, significantly lower than the forecast from mid-July (US$125). Consistent with this decline in prices, overall fiscal revenues from oil for the CEMAC region in 2009 are projected to be more than 67 percent lower than they were last July (Table 1).[3] [4] The overall impact on expected export revenues for 2009 is aggravated by the ongoing contraction in export volumes for timber and other commodities (Table 2).

Table 1. CEMAC: Fiscal Oil Revenues

	2008	2009 (proj)
Fiscal oil revenues (% of GDP)		
- July'08 WEO projections	22.7	25.9
- Apr'09 WEO projections	23.0	11.4
Fiscal oil revenues (CFAF billion)		
- July'08 WEO projections	8207	10484
- Apr'09 WEO projections	7948	3235

Source: IMF staff.

Table 2. CEMAC: Export Statistics

	2008	2009 (proj)
Exports (% of GDP)		
- July'08 WEO projections	60.2	61.2
- Apr'09 WEO projections	59.7	46.2
Exports (US$ billions)		
- July'08 WEO projections	48.1	55.6
- Apr'09 WEO projections	46.2	26.3

Source: IMF staff.

6. **While the expected worsening of the 2009 fiscal balance is common to all oil producers, some countries are relatively more exposed to fluctuations in oil prices.** Republic of Congo and Equatorial Guinea have the highest level of government revenues from oil, in percent of GDP, followed by Gabon and Chad. Cameroon's exposure is comparatively limited, while the Central African Republic (CAR) is the only oil importer in the region (Table 3). Equatorial Guinea, Gabon and Chad will see the largest reversal in their fiscal position, while Cameroon and Republic of Congo will see only a relatively modest deterioration in their overall fiscal balance and CAR expects an unchanged deficit (Table 4). At April's WEO price forecast, all CEMAC countries except Equatorial Guinea would have fiscal deficits in 2009, with the region seeing a swing of almost 14 percent of non-oil GDP in its overall fiscal balance.

Table 3. CEMAC: Oil Revenues by Country, 2008

	Cameroon	CAR	Chad	Congo	Equatorial Guinea	Gabon
Oil revenues (in percent of GDF	7.8	0.0	21.6	44.1	34.4	20.9

Source: IMF staff.

Table 4. CEMAC: Overall Fiscal Balance by Country, 2008-2011
(in percent on non-oil GDP)

	2008	2009	2010	2011
CEMAC	11.3	-2.2	6.1	8.1
Cameroon	2.1	-0.8	-2.1	-0.6
Central African Republic	-2.2	-2.2	-3.8	-3.7
Chad	9.7	-9.9	2.0	5.2
Congo	-10.7	-11.2	45.6	44.2
Equatorial Guinea	60.5	5.3	16.7	21.1
Gabon	21.3	-0.6	6.5	8.3

Source: IMF staff.
Note: Overall balance on cash basis. In the case of Chad, the WEO medium-term framework incorporates a significant fiscal consolidation in 2009.

[3] April 2009 projections are based on the latest WEO submission by CEMAC member countries, while July 2008 projections are those based on data used at the time of the 2008 CEMAC Article IV consultations.

[4] The contemporaneous relation between oil exports and public revenues from oil is highly non-linear and depends on the taxation regime, the arrangement on royalties, and the timing of payments, among other factors.

7. **Some countries have greater oil-related savings than others**. Republic of Congo and Equatorial Guinea have sizable domestic deposits, while Gabon, Chad, and Cameroon have relatively modest savings (Table 5).[5] However, to the extent that the problem is access to foreign exchange, and not to CFAF, all countries will need to turn to the same pool: the foreign exchange reserves of the regional central bank (Banque des États de l'Afrique Centrale, BEAC). Thus, while the main challenge for the CEMAC region is to adjust to this decline in external revenue in a way that is least disruptive to their domestic economies, it will be essential to coordinate the regional response, being aware of the impact on regional reserve levels while taking into consideration that the impact will be greater in some countries than in others.[6]

Table 5. CEMAC: Government Deposits with BEAC and CEMAC Commercial Banks, 2008

	CEMAC	Cameroon	CAR	Chad	Congo	Equatorial Guinea	Gabon
Government deposits with BEAC and CEMAC commercial banks (CFAF billion)	4344.9	594.1	8.0	333.8	1102.1	2009.9	297.0
in percent of GDP	12.5	5.7	0.9	8.9	23.0	24.2	4.6

Source: IMF staff.

8. **The balance-of-payment needs resulting from the lost exports could exert significant pressure on BEAC reserves**. Table 6 shows the change in the region's current account balance, which is projected to swing from a more then CFAF 1.1 trillion surplus in 2008, to almost a CFAF 2 trillion deficit in 2009. The region was a net creditor to the rest of the world during much of the last four years, and its reserves have been steadily increasing, both in US dollars and in months of imports. However, meeting projected balance of payments needs for all CEMAC countries could lead to a large decline in reserves. The Appendix

Table 6. CEMAC: Balance of Payments, 2007–09
(In billions of CFA francs)

	2007	2008	2009
Balance on current account	-140	1,141	-1,980
Balance on goods and services	5,086	7,178	1,526
Exports of goods	15,457	19,184	11,955
Exports of services	1,364	1,501	1,206
Imports of goods	-6,127	-7,568	-6,674
Imports of services	-5,608	-5,940	-4,962
Income, net	-5,410	-6,157	-3,699
Current transfers, net	183	120	194
Balance on capital and financial account	-70	-1,424	1,919
Balance on capital account	-18	16	-147
Balance on financial account (incl. Reserve	-51	-1,440	2,067
Direct investment, net	2,670	1,817	2,433
Portfolio investment, net	602	28	-12
Other investment, net	-2,528	-1,490	-974
Reserve assets	-796	-1,795	620
Errors and omissions, net	210	284	60

Source: BEAC and Fund staff estimates.

[5] Table 5 underestimates some countries' savings, while overestimating the available savings for other countries. First, while all CEMAC countries are obligated to repatriate all oil proceeds, this is not the case in practice. In particular, Equatorial Guinea has significant foreign exchange savings held outside BEAC. In addition, for some countries (particularly Gabon) a portion of their savings is in the Funds for Future Generations, which are not liquid. However, from an economic perspective, withdrawing savings is no different from leaving the savings and borrowing from BEAC, which some countries may choose to do.

[6] The decline in global food and metal prices, as well as prices of advanced countries' manufacturing exports, should attenuate the external stability implications of lower oil prices, as countries in the region rely heavily on imports. For oil producers however, the impact of the crisis will be dominated by the decline in oil revenues.

provides an estimate of the impact of the loss of reserves, and remaining reserve coverage, based on current government expenditure plans and a range of oil price assumptions. Barring a dramatic further decline in oil prices, reserve coverage in the CEMAC region is estimated to remain more than adequate under existing expenditure plans.

9. **Other channels of transmission of the global crisis pose somewhat less of a risk for CEMAC countries than for other African countries:**

- A decline in foreign direct investment (FDI) and other private capital inflows could affect external sustainability somewhat, as the region has averaged over 6 percent of GDP in FDI over the last four years, and was expected to reach 9 percent in 2009. However, most FDI in the region has a very heavy import component, limiting the impact on external sustainability of any decline in such investment. De facto limited capital mobility in the region manifests itself in small net (and gross) portfolio flows, which have averaged around 1 percent of GDP since 2003. Foreign capital inflows, which are mostly focused on Republic of Congo and Equatorial Guinea, are estimated to have declined more than 20 percent in 2008, but are currently forecast to increase by almost 10 percent in 2009 (Table 7).

Table 7. CEMAC: Foreign Capital Inflows, 2007-09
(USD million)

	2007	2008	2009
CEMAC	4280.0	3321.6	3624.1
Cameroon	601.4	161.4	433.6
Central African Republic	56.8	69.2	75.4
Chad	67.1	68.6	0.0
Congo	1178.6	2486.5	764.8
Equatorial Guinea	1715.6	-570.1	1303.9
Gabon	660.4	1106.1	1046.3

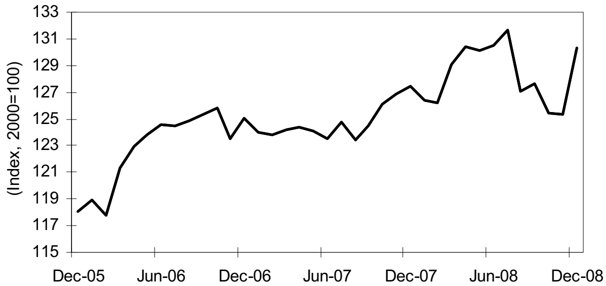
Source: Fund staff estimates.
Note: Includes foreign direct investment in reporting country (net), portfolio investment liabilities (net) and other investment, liabilities (net).

- With the exception of Gabon in 2007, governments in the region have had limited recourse to private external debt financing over the last few years.

10. **Despite its insulation from the direct effects of the sub-prime crisis, the banking sector is potentially exposed to the global financial turmoil.** According to the 2006 FSAP, foreign banks—mostly French—account for 60 percent of bank assets. As such, the banking system is potentially exposed to capital repatriation by foreign banks, if they were to deleverage or close their local operations. On the asset side, CEMAC banks were holding significant gross and net foreign exchange positions (over 150 percent of their equity) as of 2006, most likely on assets issued by their parent banks, which also leaves them exposed to their parent banks' default and repayment risk. Overall, the banking system suffers from poor compliance with prudential norms, especially those based on capital, and large single exposures are pervasive. The latest available data indicated an increase in non-performing loans through March 2008. While little information is available since then, it is likely that problems in the forestry and other key sectors will lead to increases in non-performing loans. The system is abundantly liquid, however, and could withstand a large and sudden increase in deposit withdrawals.

11. **The recent decline in the nominal value of the euro should help the region withstand the fall in oil revenues.** Following a sustained nominal and real appreciation which peaked in mid-2008, the euro subsequently declined in value by around 14 percent, before appreciating again recently, with the real exchange rate of the CFAF now close to its recent peak (Figure 1). Forecasts for 2009 and beyond, however, are lower than before the crisis. This could help the region deal with the external sustainability implications of lower oil prices, mainly by causing a real depreciation of the CFA franc and cushioning the impact of lower oil prices on fiscal revenue (measured in local currency).[7]

Figure 1. CEMAC: Real Effective Exchange Rate



Source: IMF International Financial Statistics

12. **The crisis will have a large direct impact on the non-oil private sector.** While the impact on external public sector revenues seems to be the main channel of transmission, the private sector is also likely to be directly affected. A decline in foreign direct investment, a sharp fall in domestic credit, or a contraction in the production of commodities that are labor intensive, such as timber—due to the overall decline in global demand—could all contribute to an increase in unemployment and a contraction in growth.

13. **While the impact of the crisis on region-wide inflation will depend on a number of factors, there could be disinflationary pressures in 2009, stemming largely from easing food and fuel price pressures.** Recent work has highlighted the role of CEMAC non-oil fiscal deficits on inflation, and changes in the fiscal stance in the short run (see discussion below) will have a considerable impact. A potential decline in private sector growth would also contribute to lower inflation. In countries where the pass-through of past oil price increases to prices at the pump has been high—such as in CAR and Gabon—the subsequent decline should also exert an important disinflationary pressure. On the other hand, the moderate depreciation of the euro may have some inflationary impact on domestic prices.

III. Policy Options

14. **CEMAC finance ministers have met on a number of occasions, to seek to coordinate their responses to the global financial crisis and economic recession.** The need for continued close cooperation between CEMAC member states is underscored by the projected regional balance-of-payment deficits (caused by the global recession) in the context of the regional pooling of countries' foreign reserves. In the CEMAC region, since the major

[7] However, to the extent that external debts are denominated in dollars, this will partially offset the beneficial impact of depreciation.

direct impact would come from a decline in fiscal revenues from oil, the fiscal policy response in the short and medium term is of first order importance to help cushion domestic economies from the crisis. However, monetary policy could also in principle contribute to a smooth adjustment. This section analyses fiscal, monetary, financial and structural policy options.

15. **The extent to which the authorities may wish to consider policy adjustments depends in part on the impact of the global developments on domestic growth.** April projections were that the non-oil growth rate in the CEMAC region will fall by half, to around one-third of the growth rate of 7.5 percent estimated to be needed to meet the Millennium Development Goals (Table 8), indicating that policy adjustment to support growth may be desirable.

Table 8. CEMAC: Real Non-oil GDP Growth, 2008-10
(percent)

	2008	2009	2010
CEMAC			
- Apr'09 WEO projections	5.0	2.4	3.7
- July'08 WEO projections	6.2	6.1	6.1
Cameroon			
- Apr'09 WEO projections	4.1	3.2	3.3
- July'08 WEO projections	4.6	4.8	5.2
Central African Republic			
- Apr'09 WEO projections	3.5	4.5	5.0
- July'08 WEO projections	4.9	5.0	5.0
Chad			
- Apr'09 WEO projections	3.2	4.0	3.5
- July'08 WEO projections	2.0	5.0	4.5
Congo			
- Apr'09 WEO projections	5.4	3.5	6.0
- July'08 WEO projections	6.9	7.3	7.5
Equatorial Guinea			
- Apr'09 WEO projections	17.6	-0.5	4.6
- July'08 WEO projections	31.3	16.1	12.7
Gabon			
- Apr'09 WEO projections	3.0	-0.5	2.8
- July'08 WEO projections	4.4	5.0	5.3

Source: Fund staff estimates.

A. Fiscal Policy

Medium term fiscal and external sustainability

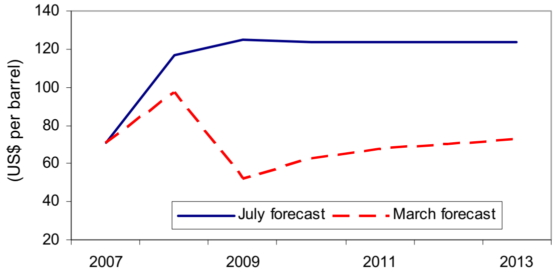
16. **The fiscal policy response must be guided by both medium-term and short-term considerations.** When considering the medium term, policymakers need to take into account the implications of fiscal policy actions on both fiscal and external sustainability.

17. **In oil producing countries, fiscal sustainability depends on how oil price forecasts affect the sustainable non-oil fiscal deficit, that is, the medium- to long-term fiscal position that can be financed with oil revenues and savings**:

- To the extent the decline in commodity prices is temporary, the sustainable non-oil deficit would not change significantly and fiscal sustainability would be less of a concern. If the decline in oil prices is permanent or very persistent, then the sustainable non-oil fiscal deficit is permanently lower and fiscal policy must eventually adjust spending toward the new sustainable level.[8]

- In a context of great uncertainty regarding medium term projections, the recent WEO projections indicate that, while some of the recent decline is expected to be temporary, prices are not projected to return to their previous trend in the medium term (Figure 2). Moreover, the gap between the previous trend and the new one is large. Fiscal sustainability is therefore a key concern for oil producing CEMAC countries, and adjusting to lower oil prices will require reducing non-oil fiscal deficits in the medium term.

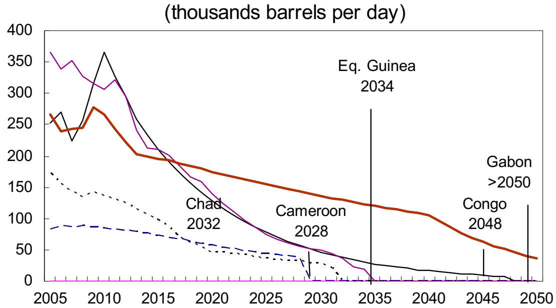
Figure 2. WEO Oil Price Forecasts



Source: IMF World Economic Outlook

- The assessment of sustainable fiscal positions is complicated by the relatively short oil production horizon for most CEMAC countries (Figure 3). With a shorter production horizon, even temporary declines in oil prices can have a considerable impact on sustainable non-oil deficits. This factor tilts the fiscal policy recommendation toward greater adjustment of the fiscal stance in the medium term.

Figure 3. CEMAC: Oil Production Horizons (thousands barrels per day)



Source: CEMAC country teams.

- The need for a medium-term fiscal adjustment should also depend on current fiscal conditions. In all oil-exporting CEMAC countries, the fiscal deficit was already above its sustainable level *before* the fall in oil prices, in most cases far above the sustainable level (Table 9).[9] The global shock has led to rising non-oil deficits in the majority of the CEMAC countries and declining sustainable non-oil deficits, pushing

[8] In addition, for countries like Equatorial Guinea, who have significant assets held abroad, declining returns on those investments may also reduce the sustainable non-oil deficit.

[9] The sustainable non-oil deficits indicated in Table 9 may not fully reflect the impact of recent developments on that sustainable level.

those countries further from fiscal sustainability. Thus, the authorities will need to adjust regardless of whether the revenue decline is permanent or temporary. The required medium term adjustment is also likely to be stronger in countries that have higher oil revenues (in percent of GDP)—such as Equatorial Guinea—as the sustainable long run fiscal position is more sensitive to oil-price fluctuations in those countries.

Table 9. CEMAC: Central Government Non-Oil Primary Balance on Payment Orders Basis, 2008-09
(percent of non-oil GDP)

	2008	2009	Long-run sustainable non-oil primary balance
CEMAC			
- Apr'09 WEO projections	-20.9	-16.2	…
- July'08 WEO projections	-15.5	-16.7	…
Cameroon			
- Apr'09 WEO projections	-6.8	-4.1	-1.4
- July'08 WEO projections	-4.3	-4.5	-3.1
Central African Republic			
- Apr'09 WEO projections	0.6	0.3	1.0
- July'08 WEO projections	1.3	1.3	1.0
Chad			
- Apr'09 WEO projections	-27.4	-17.9	b/n 1 and -3
- July'08 WEO projections	-22.0	-39.6	…
Congo			
- Apr'09 WEO projections	-46.6	-42.3	b/n 0 and -2
- July'08 WEO projections	-43.2	-39.3	-10.0
Equatorial Guinea			
- Apr'09 WEO projections	-75.6	-60.9	-18.5
- July'08 WEO projections	-58.7	-52.1	-25.0
Gabon			
- Apr'09 WEO projections	-15.3	-13.4	-3.6
- July'08 WEO projections	-11.2	-9.5	-5.6

Source: Fund staff estimates.
Notes: Including grants.
In the case of Chad, the WEO medium-term framework incorporates a significant fiscal consolidation in 2009.

- Converging toward a new sustainable non-oil deficit may require adjusting the fiscal stance as early as 2010, or even earlier in some cases. The authorities should begin adjusting their medium-term spending frameworks sooner rather than later, otherwise they may end up facing large financing gaps—and potentially larger adjustments—in the medium term.

18. **The impact of the crisis on fiscal sustainability for the only non-oil producer in the region (CAR) is obviously different from the other CEMAC countries.** The sustainable long run fiscal position in CAR is not affected by the decline in oil prices, although it may be affected by declines in other commodity prices such as timber and diamonds. However, CAR's ongoing revenue mobilization efforts, in the context of its PRGF program, should help compensate for any permanent decrease in non-oil resource-based revenue.

19. **External sustainability depends both on fiscal sustainability and the maintenance of a cushion against external shocks.** The key cushion is CEMAC's pool of external reserves, which, as noted above and detailed in the Appendix, appears adequate to cover existing fiscal plans. This is true whether those plans are financed by drawing down savings at BEAC, borrowing from BEAC, or borrowing on the regional bond market being developed.[10] Indeed, the substantial reserves could support some additional fiscal stimulus in the short term, should policymakers decide that is appropriate, as discussed below.

Short term fiscal policy response

20. **In principle, adjusting to ensure medium-term fiscal sustainability does not necessarily imply that the fiscal stance should contract in the short run.** The objectives of fiscal policy in the short run should be to help cushion the domestic economy from the financial crisis and allow for a smooth adjustment to new external conditions, subject to the financing constraints faced by the government and the need to ensure fiscal and external sustainability in the medium term, while simultaneously protecting the most vulnerable in society from the impact of the crisis. As it appears there is sufficient financing available for the region, there is no need for fiscal tightening for the region as a whole, although country specific factors may lead to a different conclusion for individual countries (see Appendix I). Indeed, for countries with substantial savings and fiscal positions in line with, or close to, the sustainable level, the appropriate policy response could conceivably entail a temporary fiscal stimulus package.

21. **The desirability and feasibility of such a fiscal stimulus hinges on several key conditions.** It has already been determined that adequate financing exists for this region as a whole, without risking reserve adequacy or the sustainability of the exchange rate regime. In some cases—Chad, and to a lesser extent Gabon—current plans would entail using most or all of the country's existing savings to finance expenditures in 2009, leaving the country with fewer options for 2010 and beyond. In addition, the authorities need to evaluate the current state of the economy, to ensure stimulus is warranted. Finally, governments contemplating such an expansion must judge their own ability to implement a timely and temporary fiscal expansion, and to reverse that expansion in the coming years, before embarking on additional spending projects. While in one sense a stimulus program targeted at the most vulnerable would seem appropriate, it could be difficult to design such a program that is truly temporary.

22. **Finally, governments need to consider their initial fiscal stance:** How far were they from a fiscally sustainable non-oil deficit prior to this shock? How does the collapse in

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[10] However, significantly increasing BEAC's net claims on CEMAC governments could sharply reduce the ratio of BEAC's foreign exchange to the regional money supply. As adequate currency coverage is important for the long-term sustainability of the region's fixed exchange rate, governments should consider the impact of their actions on this coverage.

oil prices impact their sustainable deficit? And how will a larger non-oil deficit in 2009 impact their prospects for achieving sustainability in the near future?

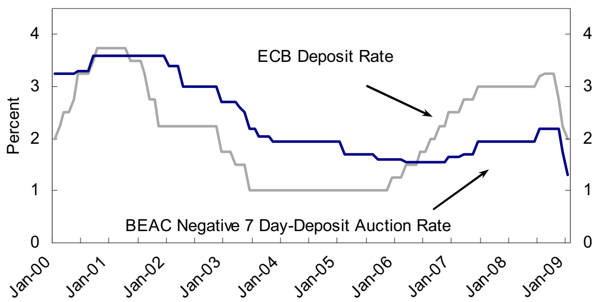
23. **Some short-term adjustment in fiscal spending may be inevitable for other reasons.** Improving fiscal sustainability may require scrapping or postponing long term projects scheduled to begin in the near future. This is especially the case in countries where capital spending has been deemed excessive (Equatorial Guinea before the recent decision to cut these spending plans, and Chad), although countries should in general avoid disrupting large scale projects with high returns or with a potentially large impact on long run growth. In cases where a reduction in capital spending is inevitable, the impact on short term growth will depend on its import component: all else equal, postponing projects with a large import component should have a smaller impact on aggregate demand. In any short-term fiscal adjustment, efforts should be made to safeguard key social spending.

24. **Finally, regardless of the short term response, countries should not lose sight of the ongoing reform agenda.** Improving non-oil revenue collection through several channels, such as broadening the tax base and improving the efficiency of taxation, and strengthening public financial management systems, will contribute to fiscal sustainability and improve the efficiency of spending in the short, medium and long run. It is particularly important to strengthen efforts aimed at enhancing the targeting and effectiveness of social safety net programs.

B. Monetary Policy

25. **While the CFA franc is pegged to the euro, there is still some room for an independent monetary policy due to the de facto limited capital mobility.** The relevant CEMAC policy rate (the interest rate on 7-day negative auctions) has been considerably below the ECB deposit rate for more than two years, although the spread has declined in a context of interest rate cuts by both central banks (Figure 4).

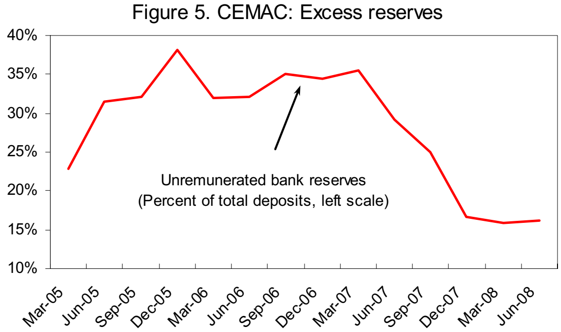
Figure 4. CEMAC: ECB and BEAC Policy Rates



Source: BEAC and ECB.

26. **Despite recent changes to BEAC's monetary policy framework, monetary policy's ability to help cushion a potential economic downturn is limited.** Since May 2007, the BEAC has accepted most bids for deposits at the central bank at the policy-determined interest rate, which has led to an exponential increase in negative auctions and

Figure 5. CEMAC: Excess reserves



Source: IMF staff

has greatly reduced the level of excess reserves in the banking system (Figure 5). By exerting greater control on liquidity conditions in the banking system, via changes in the policy rate, the BEAC has improved its capacity to influence credit. In principle, a decrease in the policy rate could encourage banks to increase lending at the margin. However, credit growth remains hampered by the high cost of intermediation[11] and lack of competition among banks in many CEMAC countries that keep the cost of lending high and demand low. The experience prior to May 2007, when excess reserves increased to 35 percent of total deposits, is revealing: banks preferred to hold assets with a net nominal return of zero (excess reserves) rather than increase lending. Interestingly, credit growth accelerated significantly in 2008, despite BEAC's efforts to withdraw liquidity (Table 10); current forecasts are for a significant slowdown in credit growth in 2009.

Table 10. CEMAC: 12-Month Growth Rate of Bank Credit to Private Sector, 2007-09
(percent)

	Dec-07	Dec-08	Dec-09 [1]
CEMAC	10.9	28.0	7.9
Cameroon	7.0	20.8	8.1
Central African Republic	4.7	8.6	6.7
Chad	-10.9	46.1	7.3
Congo	7.6	87.7	15.6
Equatorial Guinea	41.9	109.2	8.1
Gabon	17.8	1.1	5.5

Source: BEAC and Fund staff estimates.
[1] Projections are based on credit to non-government of both the central bank and deposit money banks.

27. **While monetary policy options are limited, there are other policy measures available to the BEAC.** Accelerating plans to put in place the regional debt market could cushion the impact of the crisis by improving national governments' ability to finance their operations in the short to medium term, and it could also improve the allocation of savings across countries in the region. This is especially important given the uneven distribution of oil-related savings across the region.

C. Financial Sector Policies

28. **The worsening global and domestic economic outlooks necessitate a more proactive and preemptive monitoring of the banking system and readiness to act swiftly.** Safeguarding the stability of the financial sector requires ensuring that the regional bank supervisor—the Central African Banking Commission (Commission Bancaire de

[11] The main impediments to improving access to financial services and increasing financial intermediation are (1) legal and judicial weaknesses in enforceability of claims and property rights, which make provision of financial services to a broader segment of the population costly; (2) deficiencies in corporate accounting and financial data; (3) weak payment systems; (4) the high percentage of the population engaged in informal activities that cannot meet the documentation requirements of financial institutions; and (5) low income and population density outside urban centers that make it costly to operate branches.

l'Afrique Centrale, COBAC)—can fulfill its supervisory role. This is particularly true in light of the high probability of rising non-performing loans, following the sharp declines in non-oil exports. As highlighted during the last Article IV consultation, there remains a gap between COBAC's missions and its resources, and staffing levels are below the minimum target that was proposed by the 2006 FSAP mission. To enable financial supervision to be carried out effectively, countries should ensure COBAC's power and resources are increased. The efficiency of supervision also suffers from the limited institutional independence of COBAC, which has contributed to poor enforcement of prudential norms. Finally, COBAC should strengthen enforcement of capital adequacy requirements, and consider raising those requirements and bringing other prudential norms in line with international standards.

29. **Bank balance sheets should be carefully monitored to detect credit risks, as well as solvency and liquidity problems**. In particular, the focus should be on identifying and monitoring the growth of nonperforming loans, providing adequate provisioning, avoiding excessive risk concentration (including off-balance sheet risks) and asset-liability mismatches, and anticipating spillovers from problems in parent companies abroad. The authorities should be prepared to act swiftly to resolve problem banks once vulnerabilities have been identified.

30. **Trade financing developments need to be followed.** Although there has been no reported significant increase in the cost of trade financing, the authorities should be alert for any decline in the availability of trade credits, such as regarding pre-paid letters of credit.

31. **In addition, inter-institutional coordination should be enhanced.** In view of the systemic importance of foreign-owned banks, an improved exchange of information and coordination between the BEAC authorities and home supervisors would minimize the risk of contagion from parent banks and clarify responsibilities for lending of last resort.

D. Structural Reforms

32. **Finally, recent global developments increase the importance of strengthening the business environment in the CEMAC region.** Even after the current crisis is over, and investors are once again ready to return to investing in low-income and SSA countries, they are likely to be significantly more risk-averse than before. Thus, if the CEMAC region wishes to position itself to attract investors in the post-global recession environment, aggressive efforts to strengthen the region' business environment are essential now. This will need to include strengthening the judicial and regulatory environment for private business, improving governance, and improving the regional infrastructure, in line with the Regional Economic Plan.

IV. Conclusion

33. **The CEMAC region has been seriously affected by the global financial crisis and resulting global recession**. Exports prices and volumes are down substantially, government revenues—oil and non-oil—have declined sharply, the financial sector is likely to be adversely impacted by rising non-performing loans, and employment is declining. At the

same time, the accumulation of international reserves in recent years provides the countries in the region with a source of financing to help them respond to these global shocks.

34. **While all this would seem to call for some degree of short-term fiscal stimulus, governments in the region must not ignore the concerns of fiscal sustainability.** All five oil exporting countries in the region were running non-oil primary deficits that were above their sustainable levels—in most cases, well above sustainable—prior to the global shocks. With oil prices down substantially, and forecasts of future oil prices also down substantially, the sustainable non-oil deficits have been reduced, at the same time as the global recession has increased the actual non-oil deficits. The tension between the short-term pressure for fiscal stimulus, and the medium-term need for fiscal tightening, will require careful decisions by CEMAC policymakers.

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Appendix 1. Implications of Existing Spending Plans for CEMAC Reserves

The global financial crisis and recession, and related collapse in the prices of oil and other commodities, are dramatically reducing the revenue available to CEMAC governments**.** Despite this, most IMF teams working on CEMAC countries have not called for the governments to reduce expenditures in 2009 in response to the latest developments.[12] The perception is that during the oil price boom the governments (except CAR) accumulated fiscal savings, which they can and should use to finance the resulting overall fiscal deficits, and that reductions in spending would be pro-cyclical and thus aggravate the economic slowdown being felt in all CEMAC countries.

While this makes sense for individual CEMAC countries, the question remains as to whether this advice makes sense, in the aggregate, for the CEMAC region, or whether it would result in a rapid and worrisome reduction in the region's international reserves. To attempt to answer this question, the CEMAC teams undertook the following exercise.

Each team projected the overall fiscal and trade balance, and balance of payments, for

[12] A number of country teams have been calling for their authorities to reduce their deficits, but these calls are unrelated to the recent global developments. Several teams have advised the authorities not to change their spending plans in response to the loss of revenue from the rapidly falling export prices and volumes. The Chad team, however, has been advising a reduction in planned 2009 spending, without which there would be a large financing gap, while the Equatorial Guinea team has long questioned the government's original 2009 investment plans as being excessive.

2009–11, based on the current expenditure plans of their authorities. These estimates were undertaken for two scenarios. First, the projections were done using the April WEO-projected prices of oil. Second, the projections were repeated using the prior WEO oil price projections, which were $8–10 lower than the current forecasts. Appendix Table 1 presents the resulting reserve coverage, given current expenditure plans.

Appendix Table 1. CEMAC: Pooled Foreign Assets

	2008	2009	2010	2011
Apr'09 WEO Prices (2009-52 USD/barrel; 2010-62.5; 2011-67.5)				
In billion of US$	15.7	13.2	16.0	19.3
In months of next year's imports of goods and services	7.6	6.3	7.2	8.5
Feb'09 WEO Prices (2009-44 USD/barrel; 2010-52; 2011-57.5)				
In billion of US$	15.7	12.5	13.8	16.3
In months of next year's imports of goods and services	7.8	6.1	6.5	7.6

Source: IMF staff.

Using either WEO's April or previous price forecasts, the projections seem reasonable. International reserves decline but stay above the minimum of 5 months' import coverage in 2009,[13] before rising again starting in 2010.[14]

[13] Fund staff concluded that 5 months of import coverage is a reasonable minimum for the CEMAC region, as the region's heavy dependence on a few volatile export commodities warrants a larger then normal reserve coverage. This is in line with a separate assessment done by the BEAC staff.

[14] However, under a downside scenario, with oil prices falling to $35 in 2009 and $45 in 2010, reserve coverage falls over 30 percent in 2009, to just above the minimum, and continues to fall thereafter.