OVERVIEW

Against the backdrop of a slow, fragile and patchwork recovery in global economic growth, Franc Zone countries performed reasonably well in 2014, even compared to the rest of Sub-Saharan Africa (SSA), which grew by 5% over the year. Growth therefore remained strong in the WAEMU (6.5% in 2014) and rebounded in the CEMAC (4.7% in 2014). However, it slowed down to 2.1% in the Comoros. This relatively robust economic activity can largely be attributed to the strength of domestic demand. Overall, the improvement in fundamentals, and in particular in the management of public finances, made it possible to dampen the shock resulting from the deterioration in the terms of trade.

Subdued by food and energy price developments, inflation remained generally low and contained, albeit at different levels across areas: it was slightly negative in the WAEMU, and stood at 3.2% in the CEMAC and 1.4% in the Comoros. In this context, and given the fact that external coverage ratios continued to be comfortable, monetary policy remained accommodative. Excess liquidity in the banking sector declined and the amounts of refinancing granted to banks increased.

In the WAEMU, the overall fiscal balances generally continued to worsen in 2014, in particular due to ongoing public investment programmes as well as increased current expenditure. For instance, the aggregate fiscal deficit widened from 3.1% of GDP in 2013 to 3.4% in 2014. Moreover, in the CEMAC, the five oil-producing countries were affected by the decline in oil revenues as of the second half of 2014, but a significant reduction in investment spending made it possible to bring down the total deficit from 1.4% of GDP in 2013 to 1.0% in 2014.

As regards foreign trade, current account deficits continued to worsen. In the WAEMU, the rise in imports of capital goods required for infrastructure projects was the main factor that caused the deficit to widen to 7.2% of GDP, while falling oil prices had a sizeable negative impact on the CEMAC's current account balance, which therefore deteriorated significantly, from 2.8% of GDP in 2013 to 7.0% in 2014.

Growth prospects for 2015 remain mixed. In West Africa, growth should remain robust, with the Central Bank of West African States (BCEAO) forecasting an annual growth rate of 6.7%. However, the collapse in oil prices in 2014-2015 will continue to depress fiscal revenues and the current account of CEMAC countries, whose growth is expected to fall to 2.8%, according to the Bank of Central African States (BEAC). Conversely, in the Comoros, growth should firm to stand at 3.2%.

However, there are many downside risks at the international level: in particular, the faster-than-expected slowdown of some large emerging countries could result in a further decline in commodity prices – or delay their rebound – and heightened volatility on financial markets could lead to a tightening of credit conditions and a rise in risk premia that would be detrimental to the central scenario.

It should be noted that Franc Zone countries have limited leeway to implement countercyclical policies, especially fiscal, while they have to cope with a major and probably persistent terms-of-trade shock. In this context, an improvement in the business environment and a stepping-up of structural reforms, based on the better use of tax revenue and an optimisation of budgetary expenditures (notably by taking advantage of the lower oil prices to reduce or even abolish energy price subsidies) are prerequisites for the growth dynamics seen in recent years to be able to survive a turnaround in the cycle of commodity price rises that had contributed to generating them.

Activity

Against the backdrop of slow, fragile and patchwork recovery in global economic growth, economic activity in the Franc Zone strengthened in 2014. The West African Economic and Monetary Union (WAEMU) recorded growth of 6.5%, up significantly on the previous year (5.9% in 2013), while Central African Economic and Monetary Community (CAEMC) countries saw a marked rebound in growth in 2014 (4.7%, after 1.7% in 2013). Overall, growth remained more buoyant in the Franc Zone than in Sub-Saharan Africa (SSA), thanks, in West Africa, to huge infrastructure investment projects, which were highly beneficial to regional integration (railways, roads, etc.) and, in Central Africa, to strong private consumption growth.

In the WAEMU, regional growth continued to be largely driven by that of the Union's main engine, Côte d'Ivoire. The latter accounts for over 35% of the area's total GDP and boasted the region's highest annual growth rate for the second consecutive year (8.5% in 2014). Growth also improved in most of the other countries of the Union, underpinned notably by huge public infrastructure investment projects that continue to boost domestic demand. Thanks to the fact that there were no major climatic events in 2014, the agricultural sector performed particularly well and accounted for almost a third of the region's growth. However, the services sector was the main driver, accounting for over half the growth in 2014, buoyed by the strength of the market services sector. The secondary sector, driven by ongoing infrastructure projects, also made a positive contribution to growth, despite the relatively sluggish extractive sector, although this sector is one of the new sources of potential growth of the sub-region as a whole.

Key economic indicators

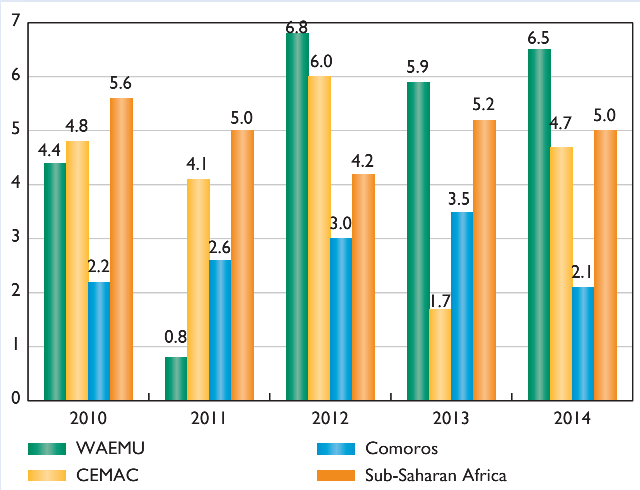
(%)

	Real GDP growth		Inflation[a)]		Fiscal position (% of GDP)[b)]	
	2013	2014[c)]	2013	2014[c)]	2013	2014[c)]
WAEMU	5.9	6.5	1.5	-0.1	-3.1	-3.4
CEMAC	1.7	4.7	2.0	3.2	-1.4	-1.0
Comoros	3.5	2.1	1.6	1.4	-0.9	-0.6
Sub-Saharan Africa	5.2	5.0	6.5	6.3	-3.0	-3.3

a) Change in consumer prices, on a yearly average basis.
b) Including grants.
c) Provisional data.
*Sources: BCEAO, BEAC, BCC, IMF (*Regional Economic Outlook*, April 2015,* World Economic Outlook*, updated July 2015) for Sub-Saharan Africa.*

GDP growth

(real growth rate – %)



*Sources: Central banks; IMF (*Regional Economic Outlook*, April 2015,* World Economic Outlook*, updated July 2015) for Sub-Saharan Africa.*

In the CEMAC too, economic activity was also driven by robust domestic demand, and especially by investment and private consumption. Due to the fall in oil prices in the second half of the year, the non-oil sector accounted for the bulk of growth in the sub-region. Cameroon and Chad were the main motors for economic activity. These two economies proved particularly resilient despite the growing insecurity at their borders with Nigeria and the Central African Republic (CAR). The CAR and Equatorial Guinea, hit in 2013 by serious external shocks (security crisis and severe slump in oil production respectively) returned in 2014 to slightly positive growth.

In the Comoros, a slowdown in economic growth was observed, with real GDP growth falling from 3.5% in 2013 to 2.1% in 2014. In recent years, the Comoros has been experiencing an energy crisis. GPD growth nevertheless remained positive, underpinned by public investment, mainly channelled into improving the country's transport infrastructures, and by private consumption, fuelled by migrant workers' remittances.

MONETARY POLICY

Since the adjustments made in 2009 to address the crisis, the **monetary policies of Franc Zone central banks remained accommodative,** against the backdrop of comfortable external coverage ratios and moderate inflation.

At end-2014, the ratio of money in circulation to foreign exchange reserves, which constitutes an intermediate target for monetary policy in the Franc Zone, stood at 84% in the WAEMU, 89%

in the CEMAC and 92% in the Comoros. Despite falling sharply over the past few years, these levels nevertheless remained largely above the minimum threshold (20%) established in the framework of the Franc Zone agreements and testify to the external stability of the CFA and Comorian francs.

While key interest rates remained unchanged in 2014, one of the salient features of the year, in both the WAEMU and the CEMAC, was a sharp increase in refinancing volumes. In the WAEMU, this can be explained by the steady decline in autonomous bank liquidity since 2011, which can mainly be ascribed to the worsening of external and fiscal imbalances and to the carry trades of certain banks. In 2014, the IMF expressed concerns about the medium-term risks of the increase in bank refinancing. However, this situation also reflects an interbank market in its infancy in an environment where the reforms to foster its development are underway (launching of electronic platforms to facilitate interbank lending, activation of the secondary market for government securities, etc.).

In the CEMAC, despite the fact that liquidity in the banking system remains ample, banks' use of central bank refinancing also increased sharply. This can be explained, notably, by the almost 30% rise in bank lending to CEMAC countries against the backdrop of falling oil prices and fiscal revenues.

While central bank refinancing operations allowed the banking system to maintain adequate levels of liquidity despite the inefficiency of the interbank market, they nevertheless only have a limited impact on the financing of the real economy. In general, concerns relating to borrowers' solvency and the often questionable legal environment fostered investment in relatively safe assets. Moreover, in 2014, although growth in lending to the economy remained highly positive, it slowed down significantly. In the WAEMU, it stood at 14% in 2014, compared with 16% the previous year, whereas in the CEMAC, it fell from 23% in 2013 to 8% in 2014.

Lastly, it should be noted that Franc Zone countries, and in particular the WAEMU, are continuing their transition to market financing, especially via the regional banking systems. This shift constitutes a real opportunity for the regional integration and development of the financial sector, as well as the modernisation of the operational framework of monetary policies. The development of the regional financial markets combined with the enhanced regional integration of banking systems, and in particular the holding of government securities by non-resident institutions, nevertheless increases the risks of the transmission of financial shocks within monetary unions, which must be closely monitored.

Inflation

Thanks to the CFA franc's euro peg, combined with the discipline imposed by Franc Zone mechanisms, inflation in the area has been relatively stable. Inflation has always been significantly lower than that of the rest of SSA, in particular over the long term. In the 1990s, the inflation rate observed in the Franc Zone stood at around 6%, against almost 30% in the rest of SSA. This differential declined in the 2000s, with SSA displayed an average inflation rate of 8.3%, against 2.3% in the Franc Zone. Today, this differential persists and, in 2014, while the average rate in SSA as a whole remained stable at 6.3%, inflation in the Franc Zone continued to be very moderate.

With the slowdown in international food and fuel prices, **inflation in the WAEMU even fell slightly,**

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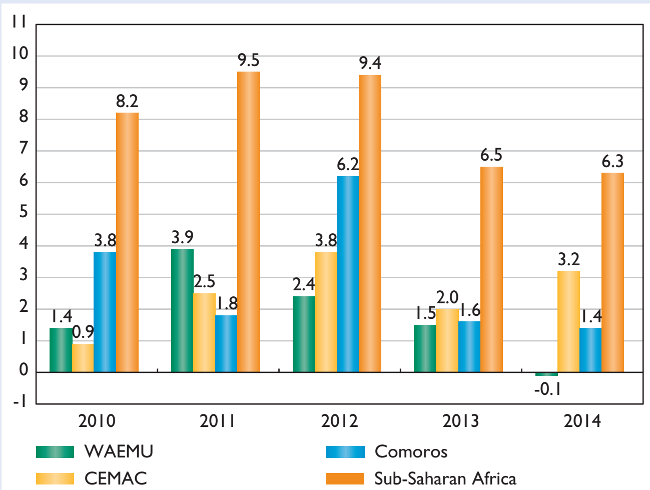
Consumer prices
(yearly average – %)



Sources: Central banks, IMF (World Economic Outlook, updated April 2015).

to stand at -0.1% in 2014. Stripping out the most volatile components of inflation (food and energy prices), underlying inflation dynamics nonetheless remained slightly positive in the sub-region as a whole.

In the CEMAC, 2014 was marked by a slight increase in inflation due to higher consumption: annual average inflation stood at 3.2%, against 2.0% the previous year, in line with the objective to contain inflation. This trend, observed in all the countries in the region except for Cameroon and the Congo reflects, overall, the recovery in domestic demand.

Lastly, **in the Comoros,** annual average inflation stood at 1.4% in 2014, after 1.6% in 2013, thanks, like elsewhere, to the easing of pressures on global oil and food prices.

Public finances

The Franc Zone continued to record persistent fiscal deficits in 2014. While in most cases these deficits are not a major cause for concern in terms of the sustainability of public debt, regional fiscal deficits are putting increasing pressure on external balances.

The **public finance profile of the WAEMU** was marked by a widening of the overall budget deficit (on an accrual basis, including grants) in 2014 to 3.4% of GDP, from 3.1% in 2013. This partly reflects ongoing infrastructure investment programmes, in particular in Burkina Faso, Côte d'Ivoire, Mali and Niger, as well as insufficient control over current expenditure. In 2013, this expenditure was well contained, but rose sharply in 2014, growing by 9% in year-on-year terms. This was mainly due to the rise in salaries and related costs, owing to the upward adjustment of wages in certain countries (in particular Burkina Faso, Côte d'Ivoire and Niger), and to the increase in interest payments on debt. Other items of current expenditure, including government subsidies, also continued to grow (by 8% in 2014).

Conversely, the **public finances of CEMAC countries** improved slightly, with the overall budget deficit (on an accrual basis, including grants) falling from 1.4% of GDP in 2013 to 1.0% in 2014. This can primarily be attributed to the decrease in budgetary expenditures, notably public investment, while the decline in total oil revenues, following the collapse in oil prices in the second half of the year, was largely offset by an increase in non-oil revenues. All the countries in the region, except for the Congo (6.2% of GDP) and, to a lesser extent, Gabon (0.1% of GDP) continued to display a budget deficit.

Lastly, **in the Comoros,** the implementation of the budget in 2014 resulted in a further deterioration of the underlying budget balance stemming from an increase in total expenditure (8.4%), in particular in current expenditure, which was only partially offset by the rise in revenues. However, thanks to a rise of almost one-third in grants the overall budget deficit improved slightly, from -0.9% in 2013 to -0.6% of GDP in 2014.

In both the WAEMU and the CEMAC, better economic policies and in particular fiscal policies created sufficient leeway to implement countercyclical policies in order to address the terms of trade shock in the second half of 2014. However, this leeway may be insufficient to deal with the amplification of this shock in 2015. In this context, while the redirecting of budget spending towards investment may contribute to a lasting increase in the potential growth of the Franc Zone, it must go hand in hand with an improvement in the mobilisation of tax revenues, which remains insufficient in many countries, and a greater control or even a review of the least productive current expenditure, in particular energy subsidies. Moreover, the profitability of public investment programmes depends crucially on the quality of the selection and management of the projects as well as the efficient coordination of the national or regional authorities in ensuring their rapid implementation.

The authorities of the WAEMU and, since 2013, of the CEMAC have been gradually phasing out the direct advances made by central banks to the government, which has been accompanied by a steady development of regional government securities markets. In addition to the advantages that this has in terms of conducting monetary policy and of developing the sector and the financial markets, it contributes significantly to fiscal discipline, alongside the role of convergence.

External accounts

Foreign trade developments in 2014 showed a general trend towards a current account balance deterioration that differed in magnitude across sub-regions. This deterioration was worst in oil-producing CEMAC countries, which were hit by the fall in oil prices in the second half of the year.

In the WAEMU, the regional current account deficit widened to 7.2% of GDP in 2014. The trade deficit worsened due, notably, to the increase in capital goods and food imports. These rises were limited by the strength of goods exports, in particular growth in cocoa and cotton sales. The primary income deficit was unchanged, owing to the stability of interest payments on external debt. The secondary income surplus, for its part, improved thanks to the rise in budgetary aid and funds received from NGOs.

Current account balance

	Current account balance (% of GDP)	
	2013	2014 a)
WAEMU	-6.8	-7.2
CEMAC	-2.8	-7.0
Comoros	-9.9	-8.1
Sub-Saharan Africa	-2.5	-3.3

a) Provisional data.
Change in the terms of trade: (+) = improvement.
Sources: Central banks; IMF (for Sub-Saharan Africa).

At the same time, the balance of payments shows an increase in net capital inflows recorded in the financial account. This increase can mainly be attributed to portfolio investment and other investment, while foreign direct investment (FDI) flows declined. Portfolio investment rose by CFA 782 billion, in line notably with issuance of eurobonds by the governments of Côte d'Ivoire and Senegal, in the amounts of USD 750 million and USD 500 million respectively, or the equivalent of around CFA 375 billion and CFA 250 billion respectively. In total, the overall current account surplus of the WAEMU improved, rising from 0.3% of GDP in 2013 to 1% of GDP in 2014.

In the CEMAC, the current account deficit increased from 2.8% of GDP in 2013 to 7.0% of GDP in 2014, due to the combined effect of a fall in the trade surplus and a worsening of the services account deficit. CEMAC's trade was mainly impacted by a deterioration in the terms of trade, estimated at 6% for the region as a whole, due to the lower oil prices in the second half of 2014. The financial account also recorded lower net FDI inflows but saw a rise in "other investment" (excluding portfolio investment), mainly thanks to inflows from emerging markets.

Lastly, **in the Comoros,** trade in goods in 2014 was marked by a 2.3% drop in imports, alongside a 16.7% rise in the value of exports. The other components of the current account balance also improved: like the previous year, the balance of services deficit narrowed, due to the increase in revenues, in particular from tourism and telecommunications. This situation resulted in a slight improvement in the current account deficit, which fell from 9.9% of GDP in 2013 to 8.1% in 2014. Furthermore, the financial transactions account improved significantly, thanks to the reduction in the debt service burden, following a substantial external debt write-off in 2013.

Given the trend towards a deterioration in the external accounts, official foreign reserves also declined. In the WAEMU, they stood at 4.6 months of imports of goods and services at end-2014, far below the 5.5 months observed at end-2013. Indeed they have been falling steadily since 2010, when they stood at 6.6 months of imports. Similarly, in the CEMAC, reserves stood at 4.8 months of imports at end-2014, against 5.5 months at end-2013, and the last few months of the year were characterised by a large contraction stemming from the sharp drop in oil prices that continued in early 2015. Lastly, the reserves of the Central Bank of Comoros remained almost stable, at 5.6 months of imports. Despite a downward trend, the levels of Franc Zone foreign reserves continued to be deemed adequate, in particular by the IMF.

INTEGRATION OF ECONOMIC AND MONETARY UNIONS

Franc Zone countries embarked, in the wake of the 1994 devaluation, on regional processes of economic integration and convergence to strengthen their monetary unions and ensure the consistency and effectiveness of national economic policies, with a view to promoting balanced and sustainable growth.

Indeed, it is expected that the gradual but effective completion of economic and monetary union, and notably of the single market, should, via economy-of-scale effects, result in significant gains in growth, of around 1 to 2%[1] per year. This is why, since 2012, the multidimensional enhancement of the integration of economic and monetary unions has become high on the agenda at the meetings of Franc Zone ministers and governors, in particular in the areas of infrastructure, agricultural policies and trade.

With a view to ensuring the economic convergence of Franc Zone countries, multilateral surveillance arrangements were put in place in the framework of the Convergence, Stability, Growth and Solidarity Pacts implemented in the WAEMU in 1999 and in the CEMAC in 2001. Regional Commissions are largely responsible for implementing multilateral surveillance in the WAEMU and in the CEMAC, using convergence criteria that allow them to assess in particular fiscal consolidation. A distinction is made between "first-level" criteria (budget balance, debt level, inflation, and payment arrears) and "second-level" criteria (wage bill, tax revenues, internally-funded investment, and external coverage ratios). Member countries that do not meet any of these criteria must define a programme of corrective measures in consultation with the Commission. In order to enhance their effectiveness and to adapt them to the changes in macroeconomic conditions in the two areas, projects to reform these arrangements were discussed at the meetings of Franc Zone ministers of 2 and 3 October 2014. For the WAEMU, these discussions led to the drafting of a streamlined and simplified list of convergence criteria that will be applicable as of 2015. In the CEMAC, the reform is nearing completion.

Outlook

Against the backdrop of slow, fragile and patchwork recovery in global economic growth, the mechanisms of the Franc Zone play a key stabilising role and act as a financial safety net for member countries, which is particularly useful in an environment marked by a major, and possibly lasting, terms-of-trade shock. The CFA franc's euro peg, via the monetary cooperation arrangements with France, contributes to the strong price stability record. In this context, compliance with Franc Zone rules, particularly regarding the pooling of foreign exchange reserves at the three Franc Zone issuing banks, remains essential.

Growth forecasts in the WAEMU prepared by the BCEAO nevertheless generally remain favourable, with GDP growth projected at 6.7% in 2015, after 6.5% in 2014, underpinned by robust activity in all sectors and good weather conditions for the 2014-2015 crop season and for the start of that of 2015-2016. Moreover, short-term indicators for early 2015 showed a positive outlook for economic activity and, in particular, for industrial production and retail trade. These growth forecasts nevertheless remain contingent on the ongoing implementation of major public infrastructure programmes and thus on being able to finance high budget and current account deficits.

However, owing to further falls in oil prices, the situation has become more complicated for CEMAC oil exporting countries. The decline in oil revenues, on which a number of CEMAC countries are highly dependent, has a strong dampening effect on fiscal and external balances. According to BEAC forecasts, economic activity is expected to contract significantly in 2015, to 2.8%, after 4.7% in 2014. Moreover, the indirect effects of the deterioration of the terms of trade on the non-oil sector may be underestimated given that CEMAC could be forced to further reduce budget spending, especially investment spending, thus contributing to a slowdown in domestic demand.

Lastly, according to forecasts by the Central Bank of Comoros, its economy should strengthen in 2015, with a rise in real GDP of 3.2%, after 2.1% in 2014, thanks notably to public investment programmes in the energy and road infrastructure sectors. The country nevertheless remains highly dependent on external financing, in particular on ongoing high levels of development assistance and diaspora remittances.

Continued strong, broad-based and sustainable economic growth remains the priority in the Franc Zone as a whole. While the improvement in fundamentals over the past decade has made it possible, thanks to enhanced leeway, to ease the consequences of the 2014 terms-of-trade shock, the protracted nature and increasing magnitude of this shock make it vital to step up the effectiveness of fiscal policies: tax revenue mobilisation, optimising expenditure with a view to fostering long-term growth, in particular prioritising human and physical capital formation, and reducing inefficient spending. In this respect, lower oil prices provide an opportunity to reduce energy price subsidies, which are particularly inefficient.

1 *Report* "Évaluation des gains attendus de l'intégration économique régionale dans les pays africains de la Zone franc", *FERDI, August 2012.*

Against the backdrop of a persistent terms-of-trade shock, it is essential to speed up the diversification of supply in order to underpin the growth dynamics largely generated by the previous cycle of commodity price rises. Yet this diversification remains constrained by ingrained structural weaknesses. It is therefore necessary to step up structural reforms (efficiency and transparency in the management of public finances, a favourable business environment, privatisations, improving the legal system, regulation of the financial system, sustainable management of natural resources, enhancement of health and education systems and social safety nets, etc.) in order to raise potential growth and make the area more attractive to international investors.

Lastly, these reforms must aim to lay the foundations for inclusive growth, i.e. essentially a more job-rich growth, in particular in the formal economy. Such growth should make it possible to reduce unemployment and underemployment, which are particularly high among young adults.