WEST AFRICAN MONETARY AGENCY
(WAMA)

ECOWAS MONETARY COOPERATION PROGRAMME

MACROECONOMIC CONVERGENCE REPORT
2007 GUINEA

FREETOWN, JUNE 2008

In Guinea, the year 2007 was marked by a popular revolt which paralyzed economic activity in the first quarter. The Government that emerged from the tripartite agreement drew up an emergency programme with the aim of reviving activity and improving the living conditions of people. The emergency programme focused, among others, on streamlining economic and financial management as well as restoring macroeconomic fundamentals. The implementation was expected to lead to infrastructure improvement as well as the provision of basic social services, particularly, water and electricity.

In view of serious disruptions in economic activity in the first quarter, the authorities set as targets an economic a growth rate of 1.5% and an annual inflation rate of 15%.

With regard to prices, the Guinea Government set more ambitious targets. The annual inflation rate was to be brought down from 39.1% in 2006 to 15% in 2007 by pursuing a rigorous monetary policy that would ensure greater stability in exchange rate. Consequently, the economic growth rate settled slightly above projections. Inflationary pressures were contained and the budget situation improved significantly. However, electricity supply was very low. Besides, the country's exchange reserves continued to dwindle as a result of the debt burden and a worsening current account balance.

1 Sector Analyses

1.1 Real Sector

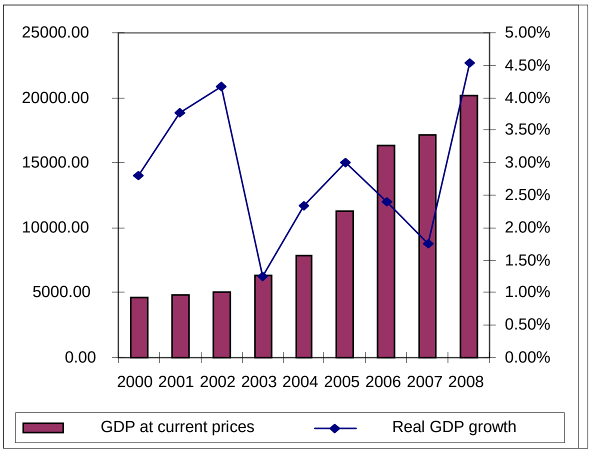
In 2007, the Guinean economy recorded a real economic rate of 1.8% against 2.4 % in 2006. This marginal growth is largely due to the impact of trade union strikes which paralysed the country during the first quarter of the year and led a total halt in activity in some sectors. These developments affected the primary and tertiary sectors especially. Compared to other sectors, the primary sector recorded a better performance in 2007; however, it was affected by unfavourable climatic conditions across the country.

During 2007, the primary sector grew at an estimated rate of 2.8% against 3.9% the previous year. Besides the livestock sector, all the other sub sectors were affected by the slow down in the expansion of value added. With regard to agriculture, the 2007 farming season was marked by a shortfall in rainfall in some areas while other regions experienced floods that adversely affected yields.

In the secondary sector, the growth rate fell from 2.3% in 2006 to 1.7% in 2007. This decline is largely attributed to the mining sub sector which recorded a slow down in activity, especially at the level of ACG/Friguia as a result of serious technical breakdowns and a rail accident. The sector also experienced social unrest which led to a halt in activities.

With regard to the tertiary sector, its value added grew in real terms by o.6% compared to 1.2% in 2006. With the exception of the transport sub sector, the slow down in activity affected all other sub sectors. The impact of the strike was strongl**y** felt in the area of trading and other activities of the sector.

Graph. 3.41 : Trends in Nominal GDP and Real Growth Rate



The structure of the Guinean economy did not undergo any fundamental changes in 2007. With the expansion in trading activities, the tertiary sector continued to dominate GDP. This sector accounted for about 47% of value added, driven mainly by mining activities which represented 32.1% of overall value added. On the other hand, the primary sector, which provides employment for the bulk of the population, accounted only for 21.1% of GDP in 2007.

With regard to prices, the inflationary pressures recorded in recent years are being contained. As a result the annual inflation was 12.8% in 2007 against 39.1%. In terms of annual average, inflation rate fell from 34.7% in 2006 to 22.9% in 2007.

The reduction in inflation is largely due to the implementation of a strict monetary policy combined with a rigorous budget policy.

1.2 Public finances

The execution of the 2007 budget in Guinea resulted in a deficit on commitment basis excluding grants of GNF 164. 05 billion, representing 0.9% of GDP. This ratio has remained almost stable for the past two years.

In spite of a slight decline, State financial operation continued to record a substantial primary surplus. In fact, the primary balance recorded a surplus of GNF 652.86 billion in 2007 compared to GNF 622.81 billion in 2006. As a percentage of GDP, the primary balance declined from 4.2% in 2006 to 3.8% in 2007.

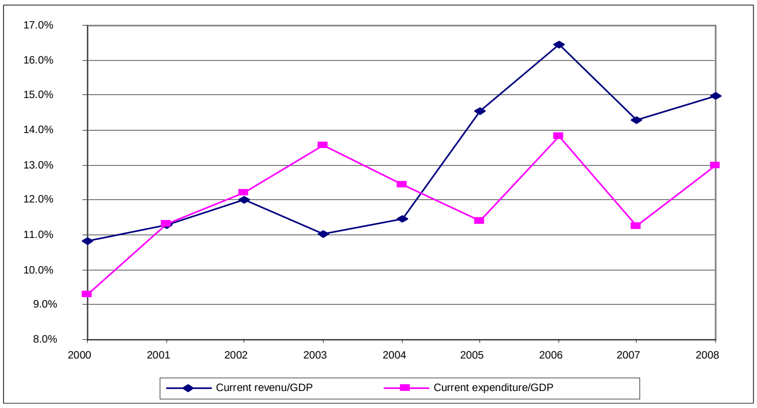
The positive trend of typical budget balances stems from the good performance in terms of public expenditure controls within a context of a near stagnation in internal revenue.

Internal revenue mobilized during the 2007 financial year stood at GNF 2477.28 billion that is an increase of GNF 63.87 billion compared to the previous financial year. In view of the strong appreciation of the Guinean franc, revenue from mining fell considerably in 2007 (GNF 102.55 billion). Similarly, customs duties fell by GNF 121.60 billion following a downturn in trading activities and the appreciation of the Guinean franc which led to a reduction in the taxable base (CIF value of imported goods).

On the other hand, the tax authority deployed significant efforts to mobilize revenues accruing from direct contributions as well as trade in goods and service In fact, tax payments in respect of direct contributions rose by 52% in 2007 to settle at GNF 427.01 billion. Taxes on consumption of goods and services reached GNF 875.27 in 2007 against GNF 750.30 billion in 2006, representing an increase of 16.7%.

In spite of efforts made to mobilize tax revenues, the tax pressure fell from 14.6% in 2006 to 13.5% in 2007.

Graph 3.42 : Trends in Current Expenditures



With regard to expenditure execution, current expenditures decreased by GNF 72.59 billion in 2007. The decline in expenditures stems from savings made on the procurement of goods and services and interest payments. The reduction of interest payment on external debt is largely due to the appreciation of the Guinean franc. Concerning domestic debt, the downward trend in interest payments is linked to a reduction of the Treasury debt owed to BCRG.

On the other hand, emoluments and salaries increased considerably in 2007. Personnel cost rose from GNF 444.42 billion in 2006 to GNF 607.21 billion in 2007, representing an increase of 36.6%. This upward trend is largely due to the engagement of contract workers, provisions on the special status of teachers, the implementation of some points in the protocol agreement signed in January 2007 and recruitment of new civil servants.

On the whole the ratio current expenditure/GDP settled at 11.3% in 2007 against 13.8% in 2006.

Capital expenditures grew by GNF 10.10 billion. This marginal growth is attributed to externally funded capital expenditures. However, the ratio public expenditure/GDP fell from 4.6% in 2006 to 3.9% n 2007.

In all, the execution of the 2007 budget led to a cash basis surplus of GNF 138.25 billion. This surplus helped to reduce public debt owed to the banking system by GNF 130.61 billion and to settle other categories of domestic debt to the tune of GNF 62.56 billion.

Despite these budgetary performances, foreign exchange difficulties prevented the State from meeting its total external commitments. There was accumulation of external arrears to the tune of US$ 34.3 million during the budget year.

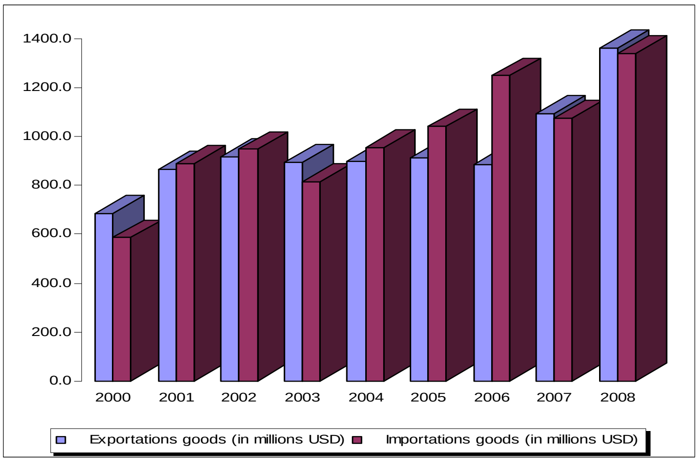
1.3 External Sector

Guinea's balance of payments recorded in 2007 a current deficit of US$ 458.14 million. This deficit worsened by nearly US$ 250 million compared 2006. The deterioration of current payments which occurred in spite of a trade surplus is attributed largely to the significant increase of payments in respect of transfers, incomes and services. These trends reflected in the deterioration of the current account, which in relation to GDP worsened from 7.9% in 2006 to 11.9% in 2007.

In 2007, Guinea's trade balance declined marginally but still maintained a surplus. In fact, the trade surplus stood at $US 50.04 million in 2007 against US$ 76.54 million in 2006. This decline is ascribed to the fall in agricultural exports especially fish, coffee and other food products which were affected by a ban on exports.

With regard to minerals, the volumes sometimes decreased but the upward trend in sale prices ensured an improvement in the value of exports. In 2007, mining exports appreciated by more than 10% compared to 2006.
Trends in other components of the current account were still marked by the worsening of deficits in respect of services (US$ 96.94 million) and transfers (US$ 109.98 million).

Graph 3.43 : Trends in Exports and Imports



Concerning financial operations, 2007 recorded massive inflows of Foreign Direct Investments (FDI). In 2007 the Guinean economy attracted FDIs to the tune of US$ 400 million, which is equivalent to the total amount obtained during the past four years. The bulk of these investments went to the mining and telecommunication sectors.

Outstanding external debt stabilized around US$ 3.1 billion as at 31st December 2007. However, this outstanding debt in terms of GDP reduced significantly in 2007 as a result of a strong appreciation of the Guinean currency. The external debt/GDP ratio fell from 112.8% in 2006 to 74.7% in 2007.

During the year, Guinea's debt servicing was to the tune of US$ 202.5 million against US$ 208.7 million in 2006. Debt servicing accounted for 18.1% of goods and services exports in 2007 against 19% in 2006.

On the whole debt burden continued to weigh down on Guinea's public finances and reserves.

As regards exchange rate, the Guinean franc experienced a net reverse in trends. In fact, the Guinean currency which depreciated significantly in recent years recovered sharply in 2007. The Guinean franc appreciated on the average by 25.8% against the US dollar and by 15.1% against the euro.

In relation to the end of period value, the Guinean franc recovered by 35.1% against the US dollar and by 21.1% against the European currency.

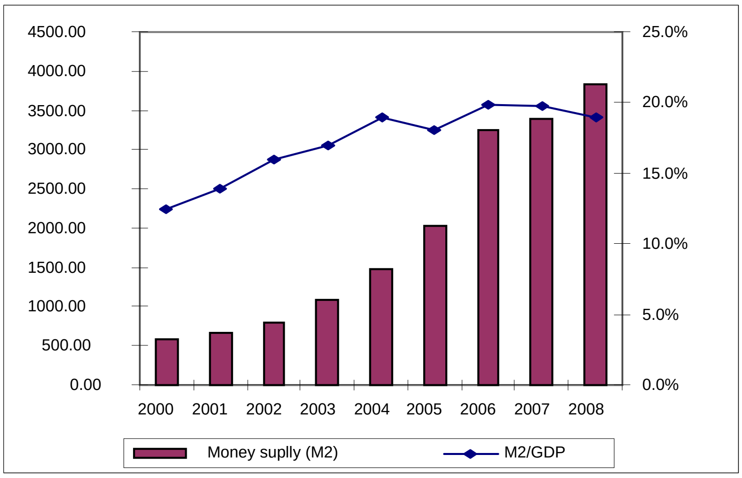
With regard to the exchange rate variation, the trend towards a narrowing of the gap observed since the total liberalisation of the exchange market in 2005 was consolidated in 2007. At the end of 2007, the gap was 0.98% for the US dollar and 1.83% for the Euro against 8.41% and 6.82% respectively in 2006.

Concerning exchange reserves, the BCRG was holding as at end of December 2007 US$42.8 million against US$71.9 million as at 31st December 2006. Import coverage fell from eight (8) months in 2006 to four (4) months in 2007.
The implementation of a formal agreement with Bretton Woods institutions should lead to a substantial reduction in the debt burden. The foreign exchange savings that would accrue from this programme would help shore up the country's foreign exchange reserves.

1.4 Monetary Sector

Following an accelerated growth of 60% in 2006, money supply grew moderately in 2007. In fact, as at 31 December 2007, the M2 aggregate stood at GNF 3401.70 billion against GNF 3222.06 billion at the end of 2006. As a proportion of GDP, money supply dropped from 22.1% in 2006 to 19.6% in 2007. This growth in money supply in 2007 was fuelled by both internal and external factors.

Graph 3.44: Trends in Money Supply



As at 31st December 2007, net external assets improved by 6.44% to reach GNF381.06 billion. This improvement is attributed solely to foreign exchange assets of commercial banks which grew by nearly 7% to settle at GNF 529.72 billion as of 31st December 2007. On the contrary, external assets of BCRG dwindled by 8% in 2007. Since 2006, net external assets of BCRG have shown a negative trend.

In dollar terms, the decline in net assets of BCRC was very significant. In fact, the assets dropped from US$ -24.34 million to US$ -35.55 million. On the other hand, those of banks strengthened by 44.3% to reach US$ 126.67 million.

Domestic debt grew by 2.6% in 2007 exclusively due public sector debt owed to commercial banks which increased by 75.4% to settle at GNF 253.98 billion. However, credits to the private sector shrunk by 1.4% to stand at GNF 947.99 million. In spite of the public debt reduction process at the level of the Central Bank, the public sector continued to absorb the bulk of financial resources available.

Concerning the M2 components, the share of currency in circulation remained predominant (42%).

2 Performances in terms of macroeconomic convergence

In 2007, Guinea met in all five criteria, including two primary criteria namely the budget deficit/GDP ratio and deficit financing by the Central Bank criterion. Compared to previous years, Guinea's performance was impressive. In fact, since the launch of the ECOWAS convergence programme, it was only in 2001 that Guinea achieved a similar success.

Though budget performance remained appreciable, the fact still remains there is the need to improve efficiency of the Revenue Service. In fact, with a tax pressure rate of 13.5% (one of the lowest in the region), Guinea need to deploy additional efforts. Besides, the breakdown of expenditures raises some concerns especially with regard the share allocated to investment. With internally funded investments representing only 12% of tax revenue, Guinea is still far from the community standard of 20%. On the other hand, as far as the control of the wage bill is concerned, achievements were satisfactory with a ratio of 25.9% compared to a community standard of 35%.

Even tough inflationary pressures were strongly contained in 2007, price increases were still in double digits. However, the significant drop in inflation helped achieved positive interest rates.

Foreign exchange reserves of the Central Bank remained a source of concern. Since 2001, the foreign exchange reserves have continued to dwindle. With only four months imports coverage, Guinea is far from achieving the ECOWAS standard of 6 months of imports.

GUINEE : CONVERGENCE POSITION	2000	2001	2002	2003	2004	2005	2006	2007	2008
Primary criteria	**0**	**2**	**0**	**0**	**0**	**2**	**1**	**2**	**2**
Budget deficit/GDP (≤ 4%)	5.2	5.4	6.2	7.9	6.9	1.6	2.0	0.9	3.7
Inflation Rate (≤ 5%)	7.2	1.1	6.1	14.8	27.6	29.7	39.1	12.8	15.0
Budget deficit financing (≤ 10% of previous year's tax revenue)	24.0	0.7	24.5	14.6	20.0	-1.5	49	0.0	0.0
Gross external reserves (≥ 6 months of imports)	2.2	2.9	2.2	1.7	1.4	1.2	0.8	0.4	1.1
Secondary criteria	**1**	**2**	**3**	**1**	**1**	**2**	**1**	**3**	**2**
Tax revenue/GDP (≥20%)	10.8	11.3	12.0	10.5	10.4	12.2	14.8	13.5	14.0
Wage bill./tax revenue (≤ 35% of tax revenues)	38.2	32.0	31.0	36.7	31.5	23.2	18.4	25.9	29.2
P.invest. p/tax revenues (≥ 20% tax revenues	7.7	5.5	10.2	12.9	17.3	12.6	12.0	11.9	12.1
Real interest rate (positive)	0.7	2.8	1.3	-8.3	-9.1	-23.0	-20.0	1.8	-0.3
Real Exchange rate stability	n.d	-3.2	-2.3	-4.3	-5.8	-3.9	-8.3	4.2	-1.6
Total number of criteria met	1	5	3	1	1	4	2	5	4

Sources : WAMA, Central Bank of Guinea *(**) Annual Estimates*

3. PROSPECT FOR 2008

At the beginning of 2007, there was a notable upturn in the macroeconomic situation. The will of the new authorities was welcomed by the donor community through the conclusion of a formal programme with the IMF.

The Government's economic policy direction for 2008 is in line with the implementation of this programme

The target set for 2008 is the achievement of an economic growth rate of 4.5%. This economic growth rate would be fuelled largely by a boost in the mining sector, a boom in telecommunications and a recovery in agricultural production.

In the budget sector, an improvement of performance in revenue mobilization is expected. However, the explosion of operational expenditure would worsen the budget deficit. Budget deficit excluding grants would reach 3.7% against 0.9% in 2007. This situation would result from the execution of a series of investment to be funded with external resources.

In spite of the widening deficit, debt reduction measures would be pursued especially with regard to local suppliers.

Monetary authorities, on their part, intend to execute State financial operations on the basis of resources available at the treasury. Consequently, expansion in money supply would be maintained below nominal GDP growth (19.3%). This would enhance the price stabilization process.

With regard to external accounts, a slight reduction in current account deficit is expected. Current deficit would settle at 10.6% of GDP in 2008 against 11.9% in 2007. Similarly, foreign exchange reserves would be strengthened. Gross external reserves would cover 1.1 month imports in 2008.

In terms of macroeconomic convergence, the country seems to be on a path of counter performance in 2008. According to projections made by the authorities, Guinea will meet only four criteria in 2008 after achieving five in 2007 (see table above).

In spite of voluntarist policies, inflationary pressures which were largely contained in 2007 may start off again. An annual inflation rate of 15% is expected. However, this rate may be exceeded to a large extent in view of pressures from world food markets and high crude oil prices. The increases in prices also risk reviving social tensions.

4 Conclusion and recommendations

It seems that Guinea has undertaken major reforms in 2007. However, given the extent of the economic crisis, the country could not regain a really viable macroeconomic framework. There is therefore the need to welcome the conclusion of a formal programme with the IMF. In fact, the effective implementation of this programme would help improve macroeconomic performance.

Currently, the major challenges facing the Guinean economy are restoring growth, stabilizing prices and sustaining gains in terms monetary and budget policy as well as improving the external sector. In this regard, it is imperative to implement the following recommendations. These are to:

1. Pursue the social dialogue in order to renegotiate some points in the agreement especially, the ban on the exportation of foodstuffs which is having an adverse effects on small scale producers and weighing down on the country's capacity to generate foreign exchange ;
2. Implement a monetary policy adapted to an economic situation marked by food crisis and rising oil prices. To be effective, this measure must combined with the identification and implementation of other measures aimed at reducing the impact of the food crisis on inflation rate in the country ;
3. Fight against fraud and tax evasion in order to strengthen the performance of the Tax Authority. The tax pressure rate is far below the ECOWAS average;
4. Improve public finance management by reducing unproductive investments so as to free substantial resources for meaningful investments. The internally funded investment ratio is one the lowest in the sub region;
5. Strengthen efforts aimed at improving water and electricity supply to boost small scale economic activities ;
6. Streamline the business environment so as to attract Foreign Direct Investment inflows;
7. Pursue the revision of mining contracts through consultation to avoid the trap of costly procedures with doubtful outcome;
8. Implement policies that will promote exports and apply regulations on repatriation of export earnings;

9. Strengthen the private sector through the correct application of public procurement procedures and payment of arrears owed to the sector;
10. Pursue negotiations with creditors in order to reduce the debt burden.