

**WEST AFRICAN MONETARY AGENCY  
(WAMA)**



**ECOWAS MONETARY COOPERATION PROGRAMME**

**MACROECONOMIC CONVERGENCE REPORT  
2007 LIBERIA**

**FREETOWN, JUNE 2008**

In addition to efforts aimed at consolidating peace and security, the 2007 economic policy thrust of Liberia was intended to revitalize the real sector, alleviate the level of poverty and large scale unemployment; and achieve price and exchange rate stability. In this regard, the authorities outlined the following targets in their 2007 macroeconomic programme: real GDP growth rate of 8.5 percent, end-of-period inflation of 5.0 percent, overall fiscal balance of 0.0 percent of GDP and gross external reserves of 1.0 month of imports.

Driven by donor activities and removal of sanctions on diamond and timber exports, the economy continued to recover significantly. The macroeconomic indicators showed signs of improvement. Inflation increased moderately from 8.9 percent at end-2006 to 11.7 percent whilst the exchange rate stabilized, depreciating about 4.8 percent against the US dollar during 2007. There were no significant changes in interest rates during the year under review.

## **1 Sector Analyses**

### **1.1 Real Sector**

Gross Domestic Product (GDP) was estimated to grow 9.4 percent in real terms from US \$ 433.2 million in 2006 to US \$ 473.9 million, driven by the agriculture and services sectors. The growth in Agriculture Sector was primarily influenced by investment in the rubber sector, a favourable weather condition, donor assistance to subsistence farmers and improved security environment, while the expansion of the services sector was propelled mainly by Construction, Trade, Hotels and Restaurants activities and Transportation and Communications.

Financial institutions contributed significantly to the growth of the Liberian economy. Total credit of commercial banks increased from L\$ 2690.0 million in 2006 to L\$ 4, 342.04 million in 2007, largely benefiting activities in Trade, Hotels & Restaurants, Construction, Agriculture, Transportation and Communications.

The reactivation of the mining sector continued during the year; regulatory policies were put in place which made Liberia Kimberly compliant; an iron ore concession agreement was signed between the Government of Liberia and Acelor Mittal Steel; there was tendering of the Western Cluster Iron and the Bong Range Iron Ore Projects and renewed Mineral Development Agreements (MDAs) were signed between the Government and various mining establishments. A total of 21, 700 carats of diamonds valued at about US \$2.7 million were mined during the year, while gold production valued at about US \$ 5.5 million increased from 304 ounces in 2006 to 10, 014 ounces in 2007.

During the year, the manufacturing sector grew from US \$ 55.5 million in 2006 to 60.7 million (see table), while maintaining its share of 12.8% of total GDP in 2007. It should be mentioned that the potential of the sector is being underutilised, primarily due to the inadequacy of public-electric generating capacity, the low level of investment, high cost of imported raw materials, and shortage of skilled labour.

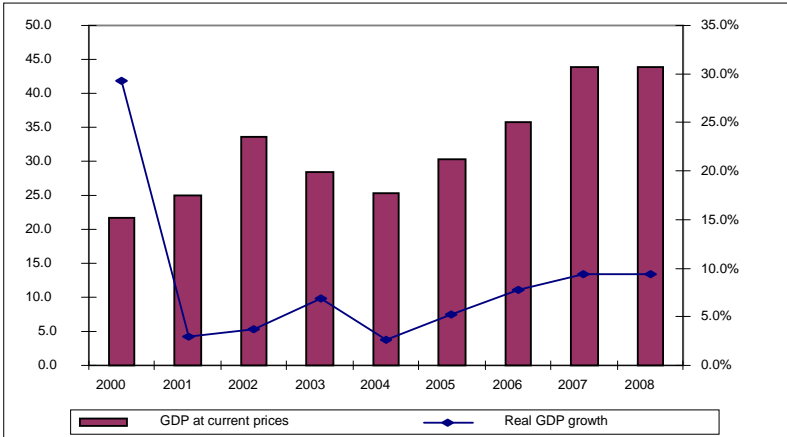
Rubber production increased by 41,667 metric tonnes (44.4%), from an estimated 93, 533 metric tonnes in 2006 to 135, 200 metric tonnes in 2007. This was attributed, in part, to seasonal rainfall, termination of illegal occupation of rubber plantations by former combatants and the resumption of full production of rehabilitated rubber farms.

The production of cocoa during the year increased to 21, 126 metric tons in 2007, from 1,107 metric tonnes in 2006. The gradual resettlement of displaced cocoa farmers to their original villages mainly accounted for the rise in the production.

Although the United Nations sanction on log exports was lifted, actual logging on a large scale was yet to begin, reflecting the extended time taken for the Government to prepare policy guidelines to regulate logging and logging-related activities.

Output of cement increased to 157, 200 metric tonnes during the year, from 135, 486 metric tonnes in 2006. The 16.0 percent rise in output was as a result of heightened domestic demand, influenced by the reconstruction activities taking place in the country. Beverage production recorded a 15.0 percent increase, from 17.3 million litres in 2006 to 19.9 million litres in 2007.

**Graph 3.57: Trends in Nominal GDP and Real Growth Rate**



The rate of inflation for 2007 averaged 11.4 percent. At end-December 2007, it was 11.7 percent. Excluding food and non-alcoholic beverages, the rate was 6 percent. The inflationary pressure was pronounced mainly in domestic food, clothing, water, rent and transportation. Domestic food prices recorded an average rate of 25.8 percent, during the year. It contributed over 4.2 percent to the overall average rate of inflation. The rise in the prices of food commodities was due to the escalation in the price of petroleum products on the world market, which contributed to the rise in transportation cost.

The inflationary situation in Liberia was mainly driven by structural factors, including poor condition of infrastructure, dilapidated state of farm- to-market roads, inadequate farm inputs, concentration of some subsistence farmers on gold mining rather than on farming, and the general shortage of some domestically-produced food items. Although exchange rate movements do have direct impact on inflation, the data for 2007 showed that while the quarterly rate of change in the exchange rate was moderately increasing, the quarterly rate of change in inflation was declining. The quarterly average rate of depreciation of the domestic currency was 6.6 percent, while the quarterly average rate of change in inflation showed a decline of 6.2 percent for the same period. This development demonstrates the importance of foreign exchange auction conducted by regularly by the CBL in order to help stabilize the exchange rate.

The influx of people, mainly returning from neighbouring countries also exerted enormous pressures on the demand for housing, thereby increasing the cost of rent. The growing cost of building materials, such as cement, paint, timber etc also contributed to the increases in rent.

Health and communications registered declines of 0.64 percent and 4.81 percent, respectively. The decline in the health category was attributable to the free medical services rendered patients and donations of medications by health-related International Non-Governmental Organisations (INGO).

Competition in the communication industry, particularly in the cellular phone sector, drastically pushed down the cost of communication.

## **1.2 Public Finances**

The Government of Liberia took appropriate steps to enhance fiscal policy by strengthening revenue collection, with the objective of raising the ratio of total revenue to GDP above a minimum target of 15.0 percent. To achieve this objective, the authorities requested for technical assistance from the IMF on tax policy reforms. The policy measures on the revenue side included the broadening of the country's revenue base, institution of audit and control mechanisms, elimination of overdue tax obligations and rationalization of the list of tax exemptions. On the expenditure side, the authorities introduced measures aimed at strengthening the cash management/budgeting procedures, ensuring financial discipline and establishing transparency. The authorities also endeavoured to clear the civil service salary arrears.

The commitment of the authorities to the above policy measures resulted in a significant improvement of the fiscal situation. The overall balance improved from a deficit of 0.7 percent of GDP to a surplus of 2.5 percent, compared to the balanced cash budget target programmed for the year.

The relative enhancement in fiscal policy was due to an improvement in the operational efficiency of the revenue collection institutions. Tax revenue, comprising mainly of income tax and excise duties, increased considerably by 70.1 percent in 2007 compared to the negligible enhancement of 0.4 percent recorded in the preceding year. Total expenditure rose by 22.6 percent compared to 11.7 percent in 2006. Recurrent expenditure, which constituted 96.0 percent of total outlays, also increased by 23.9 percent in 2007. However, the level of capital expenditure dwindled over the period 2006-2007 from US\$ 617.8 million to US\$ 203.6 million.

The wage burden that shot up significantly in 2004 following the resumption of salary payments to civil servants eased during the year under review. In effect, wages and salaries decreased moderately by 8.6 percent from 46.5 percent of recurrent expenditure to 35.8 percent. This development impacted favourably on outlays on goods and services (including education and health) which increased accordingly by 60.6 percent to 36.1 percent of recurrent expenditure. Interest payments also increased marginally by 2.3 percent.

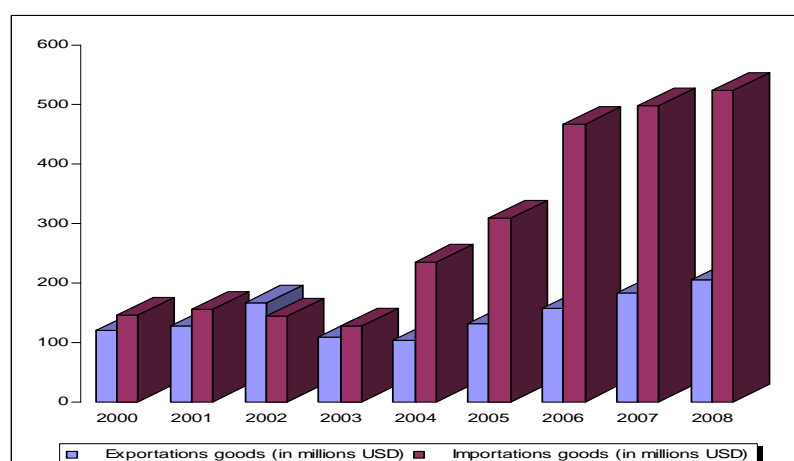
The fiscal operations in 2007 resulted in a borrowing requirement of L\$ 933.6 million, which was financed mainly from domestic sources outside the banking system and non-bank private sector, particularly, from domestic revenues accruing during the year. It was noted that the Central Bank of Liberia has not as yet introduced treasury bills to facilitate borrowing on behalf of government.

## **1.3 External Sector**

The constraints in the balance of payments continued to worsen in 2007 as the overall deficit balance increased by 3.8 percent to US\$133.0 million, representing 18.8 percent of GDP compared to 21.7 percent in 2006. The downward pressure in the external account was driven by an increasing demand for imports.

The deficit balance on the current account decreased from 37.29 percent of GDP to 34.83 percent. This was attributed to developments on the trade balance, whose deficit decreased from 49 percent of GDP in 2006 to 46.7 during the period under review. Exports increased from US\$ 158 in 2006 to US \$ 227 million, an increase of 43.7 percent due to the lifting of the ban on timber exports. On the other hand, imports increased by 21.4 percent due to massive increases in the bills for oil and non-oil commodities.

**Graph 3.58 : Trends in Exports and Imports**



The balance on the capital and financial account enhanced moderately in spite of massive outflows in respect of private financing of trade credits. Capital and financial account increased from US\$96.0 million in 2006 to US \$117 million, an increase of 21.87 percent. Foreign direct investments jumped from US \$6 million in 2006 to US \$120 million in 2007. In addition, the country received concessionary loans from its development partners. Consequently, the foreign exchange position of the Central Bank of Liberia, comprising mainly of foreign notes and deposit balances with correspondent banks, boosted from 1.0 month of imports cover to 1.5 months by end-2007. However, the net foreign assets and liabilities of the banking system remained in deficit. Despite the constraints in the external account, the domestic currency remained relatively stable against the US dollar as it depreciated by 3.5 percent and 4.8 percent in 2006 and 2007 respectively.

The country's external debt stock decreased from US\$ 5032 million in 2006 to US\$ 4725 million by end-2007, and represented 645 percent of GDP. This development could be explained by the debt relief enjoyed by Liberia. The external debt position relative to exports also eased, reflecting the relative enhancement in the exports base during the year under review. These indicators clearly show that the external debt position of Liberia is highly unsustainable. It should be noted that a country's external debt position is generally considered sustainable if the scheduled debt service payment is below 25% of exports of goods and services and if the net ratio of debt to exports is below 250%.

**LIBERIA: EXTERNAL DEBT SUSTAINABILITY**

	2002	2003	2004	2005	2006	2007
External debt/GDP	479.7	665.3	571.6	543.9	507.7	645
External debt/export of goods and services	1522.9	2657.4	2899.9	2379.8	2030.0	2030
External debt service /export of goods and services	47.9	6.9	81.0	76.6	74.9	27.4
External debt service/GDP	15.1	16.8	16.0	17.5	18.7	12.8

Source: CBL, IMF

## 1.4 Monetary Sector

Monetary policy in 2007 aimed at containing inflation by maintaining a stable exchange rate. The Central Bank took a number of measures to strengthen the monetary policy framework, including the establishment of a Money Management and Policy Review Committee with primary responsibility for guiding policy decisions and overseeing regular bi-weekly foreign exchange auctions.

In contrast to the objective for macroeconomic stability, the Central Bank of Liberia continued its recent expansionary monetary policy aimed at supporting the infrastructural development needs of the country. Reserve money, the intermediate target of the central bank, expanded by 26.7 percent, compared to 30.9 percent growth recorded in 2006. Broad money supply also grew by 40.1 percent compared with 34.4 percent in the preceding year. All the components of money supply registered significant increases, with currency in circulation and demand deposits growing by 27.7 percent and 39.5 percent respectively. The significant expansion in demand deposits signified the growing confidence of the private sector in the banking system following the restoration of peace and security.

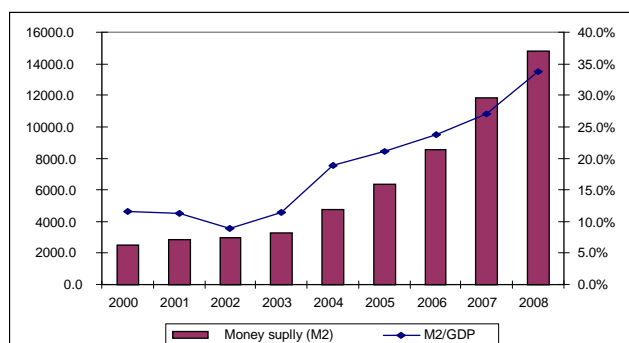
### Liberia: Growth in Monetary Aggregates (2003-2008)

Aggregate	2003	2004	2005	2006	2007	2008
Reserve Money	8.9	62.3	27.1	30.9	26.7	20.6
Broad Money (M2+)	8.3	49.3	35.7	34.4	40.1	23.2
Narrow Money (M1)	14.0	38.3	30.7	35.9	33.6	21.7
Currency in Circulation	24.8	34.6	23.6	22.1	27.7	20.2
Demand Deposits	5.5	41.8	37.0	47.0	39.5	23.2
Quasi-Money	-17.0	116.2	55.3	29.3	61.7	26.23

SOURCE: CBL, IMF

The growth in money supply was fuelled mainly by activities of the deposit money banks, resulting in a 45.7 percent enhancement in their claims on the private sector compared with an increase of 18.3 percent in 2006. The net claims on government and public institutions, although representing 95.5 percent of net domestic assets of the banking system, increased marginally by 0.5 percent compared to 10.3 percent in 2006. The credits were channelled to agriculture, mining and quarrying, construction, transportation, and communication. On the other hand, the net foreign liability position of the banking system improved by 8.8 percent to US\$44.9 billion.

**Graph 3.59 : Trends in Money Supply**



The average savings rate declined by 45 basis points to 3.6 percent whilst the average lending rate also dipped by 60 basis points to 15.3 percent. However the spread between the savings and lending rates remained high.

## 2 Performance under Macroeconomic Convergence

The performance of Liberia under macroeconomic convergence remained the same in 2007 compared to 2006. The country sustained the two targets on budget deficit and central bank budget deficit financing and realized the secondary criteria on salary mass and real exchange rate stability.

LIBERIA: STATUS OF MACROECONOMIC CONVERGENCE							
	2002	2003	2004	2005	2006	2007	2008
<b>Primary Criteria:</b>							
i) Budget Deficit/GDP	-1.1	-0.5	-0.7	-0.7	2.5	3.4	1.8
ii) Inflation Rate	11.1	5.0	16.1	7.0	8.9	11.7	9.5
iii) Budget Deficit Financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0
iv) Gross External Reserves	0.2	0.5	0.7	1.0	1.0	1.5	1.0
<b>Secondary Criteria:</b>							
i) Tax Revenue/GDP	8.5	8.0	11.9	10.5	13.24	19.13	18.28
ii) Salary Mass/Tax Revenue	28.0	32.0	43.5	52.0	40.12	29.0	45.15
iii) P. Invest/Tax Receipts	113.2	58.9	15.7	15.7	7.8	11.9	14.11
iv) Real Interest Rate	-5.4	-0.6	-11.4	-2.6	-5.3	-2.9	-7.4
v) Real Exchange Rate Stability	-4.4	-4.3	-5.5	-5.4	-3.1	-4.6	-4.8
<b>No. of criteria met</b>	4	5	3	3	4	4	3

Sources: CBL, IMF, AfDB and WAMA Calculations

With the sustenance of the two criteria mentioned above and the relative improvement in the fiscal position and gross external reserves, the country's performance on the primary criteria was generally satisfactory. The budget deficit in 2007 was 3.4 percent, thus within the required target, compared to surplus of 2.5 percent during the preceding year. The adoption of cash budgeting policy has nibbled the necessity for fiscal accommodation by the central bank, as a result of which this target has been realized consistently. However, inflation increased moderately, fairly above the maximum requirement for 5.0 percent. Gross external reserves remained low during 2007 at 1.5 months of imports cover, compared to 1.0 in 2006.

Performance under the secondary criteria was also encouraging. Tax revenue increased by 5.9 percentage points to 19.13 percent, reflecting the successful outcome of the extensive structural reforms began since 2006. The wage burden, which shot up in 2004 following the resumption of payment of wages and salaries, eased significantly thereafter, moving from 40.12 percent in 2006 to 29.0 percent of tax revenue, thus, meeting the required maximum target of 35.0 percent. However, the level of public investments financed from domestic sources, even though increased from 7.8 in 2006 to 11.5 in 2007, the indicator largely fell short of the required target. The relatively high inflation contributed to the prevalence of negative real interest rates. Using the year 2000 as the base year and a fluctuation band of  $\pm 5.0$  percent, the real effective exchange rate was stable during 2007.

## 3 Prospects for 2008

The new government that took office in January 2006 put in place a policy framework under four strategic pillars (security, economic revitalization, infrastructure and basic services, prudent macroeconomic policies) aimed at meeting the daunting economic challenges. The key element of this framework was to rebuild the key government institutions and revenue generating agencies, establish a functioning budgetary process and revitalize exports. Pursuance of these policies has started yielding positive results, particularly, in the secondary and tertiary sectors and prudent macroeconomic policy implementation.

Commitment to the relevant policies would help sustain the level of economic activity as the authorities consolidate the peace and security environment. The projections indicate that the economy would grow by 9.6 percent in 2008, to be driven by increased donor activities and the reconstruction of manufacturing and services sectors.

Given the need for higher growth and accelerated development, the authorities should take necessary precautions to avoid a possible escalation of inflationary pressures. The expansionary monetary policy adopted in recent years to facilitate the economic resuscitation programme and accelerated developmental objectives would call for mopping up of excess liquidity in due course as aggregate demand and level of employment increase. The absence of treasury bills to conduct open market operations and lack of adequate monetary policy tools would constrain effective liquidity management in 2008 and subsequent years.

The above precautions notwithstanding, the projections show that inflationary pressures would improve to 9.5 percent by end-2008, from a double digit position by end 2007. However, the increasing level of economic activity may thwart the achievement of this objective if the rate of development is not properly programmed. Increased donor inflows and foreign direct investments would also help to alleviate the stress in the balance of payments. Interest rates would be expected to decline further in the absence of open market operations and government borrowing from the private sector as attempts to re-invigorate investment activities are made. However, with the declining interest rates and still high inflation, real interest rates would remain negative, a problem that would as well provide a downside risk to the potential growth in output.

Ceteris paribus, performance under macroeconomic convergence will deteriorate as the country is expected to realise three targets in 2008. The improving fiscal position will support the realization of the primary criteria on budget deficit and deficit financing targets as well as the secondary benchmarks on tax revenue and salary mass. Even though inflation is expected to decrease in 2008, the required 5.0 percent target may not be attained. Negative real interest rates may persist during 2008, while there will be real exchange rate stability. Gross external reserves will decline to 1.0 month of imports.

#### **4 Conclusion and Recommendations**

Liberia faces a myriad of economic problems ranging from weak physical infrastructure, inadequate but increasing revenue, high demand for expenditure, unsustainable external debt position, weak financial system with inadequate monetary policy tools, balance of payments constraints, a weak foreign exchange earning capacity. Notwithstanding these limitations, the government of Liberia will have to strengthen the effectiveness of its restructuring programme in order to accelerate the rate of economic recovery. Depending on the availability of adequate technical and financial assistance, the Government of Liberia may take the following issues into consideration in its reconstruction and development programmes:

1. restructure the financial sector, in order to strengthen the effectiveness of its intermediation role in accelerating the rate of development;
2. introduce appropriate monetary policy instruments and mechanism to monitor and mop-up excess liquidity;
3. create jobs by developing cottage industries to reintegrate the displaced population who should contribute their quota to economic development;
4. reconstruct economic infrastructure on priority basis to support revitalization of economic activities;

5. strengthen the revenue collection apparatus to sustain their mobilization capacity; and inculcate the convergence targets into the pluri-annual budgets as the macroeconomic fundamentals improve.
7. There is need to strengthen national development strategies, improve the alignment of donor support to domestic priorities, increase the credibility of the budget as a tool for governing and allocating resources, and increase the degree of accuracy in budget estimates of aid flows;
8. The country and donors should use performance assessment frameworks and • more cost-effective, results-oriented reporting. In this regard, there is need for donors to contribute to capacity building and make more use of country reporting systems; and more credible monitoring systems need to be developed to ensure mutual accountability.