

**WEST AFRICAN MONETARY AGENCY
(WAMA)**



ECOWAS MONETARY COOPERATION PROGRAMME

**MACROECONOMIC CONVERGENCE REPORT
2007 TOGO**

FREETOWN, JUNE 2008

After the period of great uncertainties that followed the 2005 presidential elections, there seems to be good prospects for the socio-political situation in Togo. Indeed, the country is now in a period of national reconciliation and political reforms, which recently paved the way for legislative elections in November 2007. These elections were very much expected as a precondition for effective resumption of cooperation with the international financial and technical community. It was in a bid to ease social tension and renew the confidence of local economic operators and development partners that the government set quantitative objectives for 2007. In view of the state of deterioration of the economic fabric, marked by fifteen years of almost no external financing, comprehensive reforms are required before resumption of any real economic activity. In view of such limitations, the following objectives were reasonably set:

- a 2.3% real GDP growth;
- improvement of overall budget balances, thanks to relaxation of external financial constraints;
- improvement of overall level of convergence, thanks to expected favourable budget trends.

At the end of 2007, the results achieved may be considered to be in tune with expectations. Growth rate was 2.1% compared to 4.1% in 2006. Likewise, the overall budget situation was consolidated following improvement in the major typical balances. However, these achievements were realized in a context of slight resurgence of inflationary pressures. On the whole, these trends led to stagnation in terms of convergence, with the achievement of five criteria.

1. Sector Analysis

1.1 Real Sector

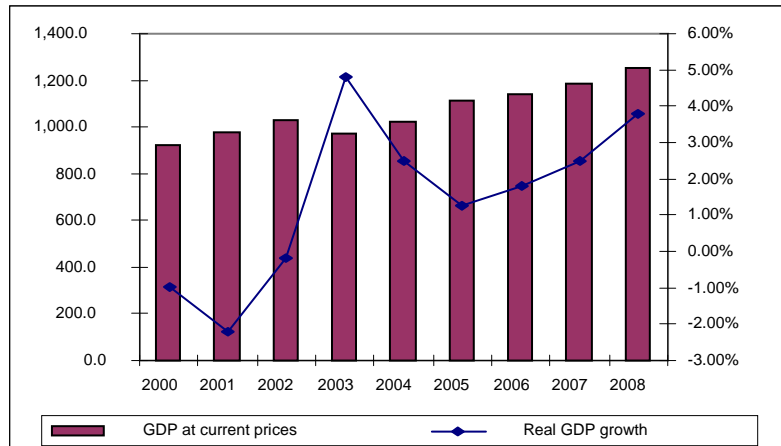
The upturn in economic activity which started in 2006 with an annual growth rate of 4.1% slowed down in 2007. Indeed, the rate of increase in real GDP was 2.1% and this was attributed to the persistent energy crisis that affected all areas of activity. The main reason of this moderate growth was the overall favourable weather conditions and recovery measures put in place in the cotton sector.

The primary sector, which was the main source of this growth, went up by 5.8% compared to 4.9% in 2006, thanks to food crop and cash crops farming, particularly cotton. Cotton seed production increased by 54.8%, from 42,000 tonnes in 2006 to 65,000 tonnes in 2007 compared to a 75,000-tonne forecast. This trend in production is due to farmers regaining confidence after the government paid outstanding amounts owed by the Togo Cotton Company (SOTOCO). However, these achievements fall well below initial forecasts, thwarted by the effects of floods that occurred in the cotton seed producing areas.

Activities in the secondary sector suffered as a result of the energy crisis, thus slowing down value added in the sector which was only 3.5% compared to 6.8% in 2006. Poor performance was more pronounced in the “phosphate” and “clinker” sub sectors. Indeed, phosphate production dropped by 25.0% due to persistent problems associated with obsolete equipment and dilapidated transport rolling stock. Clinker production has continued to decline since 2006; this is attributed to floods in the extraction quarries during the second quarter of 2007. Production in 2007 declined by 8.2%.

Activities in the service sector rose modestly by 1.1% in line with poor performance in the “banking and insurance” branch, which declined by 18.7%.

Graph 3.29 : Trends in Nominal GDP and Real Growth Rate



With regard to demand, growth in economic activity was mainly cushioned by final consumption, which went up by 6.4%. This trend in total consumption was due to its private component, which increased by 7.8%, thanks to renewed confidence of the national private sector, particularly of farmers who received full payment for arrears owed by SOTOCO. On the other hand, investment dropped by 16.8%, both in its private and public components. This drop is attributed to uncertainties in the business environment due to legislative elections held in October 2007, and the energy crisis.

With regard to external trade, goods and services imports shot up at a slower pace than in 2006, i.e. by 3.6% compared to 20.6% in 2005. Likewise, exports grew by 1.1% compared to 19.4% in 2006.

There were general price hikes in 2007. However, these increases fell below the community's standard of 5.0%. Indeed, the rate of inflation at the end of the period was 3.4% at the end of September 2007, compared to 1.5% for the same period in 2006. This upward trend in inflation is attributed to hikes in prices of food products and alcoholic beverages, partly cushioned off by a drop in prices of clothing, footwear and communication.

1.2 Fiscal Sector

In public finances, total fiscal revenues went up slightly by 2.1%. This slight increase, coupled with a disproportionate rise in nominal GDP resulted in a drop in its ratio from 17.2% of GDP in 2006 to 16.8% in 2007. Increase in budget revenues is mainly attributed to the trend in the recovery of tax revenues which rose by 3.4%. This achievement in tax revenue recovery is the outcome of the effective implementation of structural reforms in the financial sectors, particularly computerization of the Customs Department, with the application of the SYNDONIA ++ software, and changes in governance at the management levels.

Total expenditures and net loans rose by 4.1% to 21.4% of nominal GDP, the same ratio recorded in 2006. This relative control is due to the slight variation in its current component (+2.7%) in spite of a higher increase in capital expenditures. These expenditures went up by 9.7% under its internally funded component. Externally funded capital expenditures recorded a relatively high drop of 21.3%.

Graph 3.30: Trends in Current Revenue and Expenditure



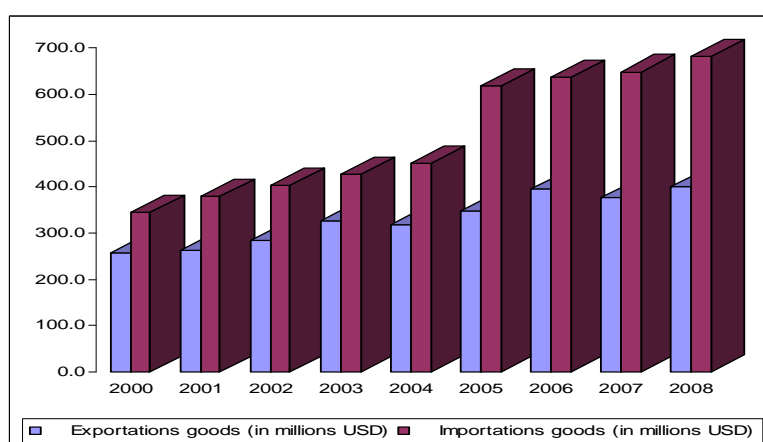
Financial operations of the State recorded an overall improvement in the major budget balances. The overall budget deficit reduced from a 2.8% ratio of GDP in 2006 to 2.5% in 2007. This same balance excluding grants dropped from -4.2% of nominal GDP in 2006 to -4.6% of the same GDP in 2007.

Total outstanding debt in relation to nominal GDP was 92.1% in 2007 compared to 94.3% in 2006. This ratio should improve further in the future, in line with the expected resumption of cooperation with the European Union and the speeding up of the attainment of decision point in 2008. Togo could therefore enjoy the HIPC Initiative, which would bring in considerable concessionary resources.

1.3 External sector

The overall balance of payments position recorded a surplus of CFA F 20.0 billion at the end of December 2007, compared to 70.0 billion in 2006. This trend is due to the combined effects of the worsening deficit balance of current operations and the fall in capital account and financial operations.

Graph 3.31: Trends in Imports and Exports



Indeed, current deficit recorded a drop of 4.2%, mainly due to decline in trade balance in line with depression in export activities. The latter reduced by 4.7% compared to 1.8% in imports. On the other

hand, balances in the services sector, revenues and transfers without counterparts were on the right path.

With regard to capital and financial operations account, the surplus dropped by 35.0 billion compared to 2006, to settle at 205.5 billion, due to the decrease in portfolio investments and other private investments, following the issuing of Treasury bonds to the tune of 30 billion in 2006.

1.4 Monetary sector

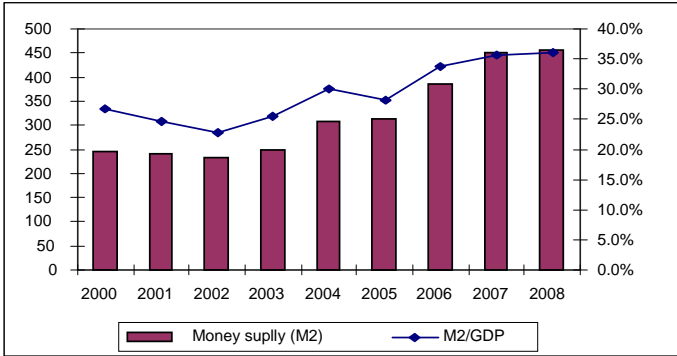
In 2007, the common monetary policy of UEMOA was implemented in a context of relative price stability. In this regard, the Central Bank maintained its key rates unchanged in 2007. The pension rate therefore remained at 4.25% and discount rate at 4.75%. Likewise, reserve coefficients imposed on banks and financial institutions remained unchanged. In Togo, this coefficient is maintained at 3.0%. This situation led to various changes in the main monetary aggregates.

The net foreign assets of monetary institutions was therefore 199.0 billion, i.e. a decrease of 2.5% compared to achievements in the same period of the previous year, due primarily to the drop in the net external assets of banks, whose impact was mitigated by the firming of those of the Central Bank.

The outstanding domestic credit increased to 263.2 billion i.e. a rise of 32.2% compared to what pertained at the end of December 2006. This trend is the result of the worsening of the net debtor position of the government by 5.5 billion, which is mainly absorbed by a considerable increase in the volume of credits in favour of the economy. Worsening of the net debit position of the government is due to increase in State commitments towards the banking system, whose impact was reduced through a slight increase in State debts. Credits to the economy increased by 28.9% to settle at 255.1 billion at the end of December 2007. Outstanding debts standing in the name of companies operating in the petroleum products distribution sector partly explain this trend.

As a result of trends in its counterparts, money supply increased by 16.8% to reach 449.5 billion at the end of December 2007. This increase in domestic liquidity was realized through bank deposits which increased by 4.3% and especially through cash circulation which increased considerably by 21.9% during the period under review.

Graph. 3.32 : Trends in Money Supply



In 2007, the appreciation of the euro against dollar mechanically drew along the value of the CFA to the dollar. The negative effect of this rise in value on the external competitiveness of the Togolese economy was however mitigated by improvement in the terms of trade brought about by a high increase in world prices of phosphate.

2 Performance in terms of macro-economic convergence

With regard to convergence, the overall situation in Togo has not changed significantly. At the end of December 2007, five (05) targets were achieved, i.e. the same number recorded in 2006.

TOGO : POSITION	CONVERGENCE	Target	2003	2004	2005	2006	2007	2008. (*)
Primary criteria								
Budget deficit/GDP		≤4%	-1.2	0.6	4.0	4.2	4.6	5.3
Rate of inflation		≤5%	-1.7	3.9	5.5	1.5	3.4	3.3
Monetary financing of budget deficit /Previous year tax revenue		≤10%	0.0	0.0	0.0	0.0	0.0	0.0
Gross external reserves in months of imports		≥ 6	6.0	3.9	1.8	3.1	3.1	2.9
Secondary criteria								
Tax revenues/GDP		≥ 20%	15.3	15.7	14.6	15.7	15.6	16.1
Wage bill/Tax revenues		≤ 35%	34.7	32.0	30.4	33.1	34.5	34.9
Private invest./tax revenues		≥ 20%	7.6	7.4	8.4	3.6	10.6	11.5
Real interest rates		≥ 0	5.2	-0.4	-2.0	20	0.1	0.2
Real exchange rate stability		± 5%	3.5	1.3	2.4	-1.3	-0.5	0.5
Total No. of criteria met			7	5	4	5	5	5

Source: AMAO, BCEAO.

(*): Annual estimates

If stagnation of the general performance at the end of 2007 constitutes in itself a source for concern, the almost generalised deterioration of the criteria profile is another reason for concern. This situation is mainly attributed to the low increase in budget resource mobilization. Also, the upward trend in budget deficit resulted in a trade-off unfavourable to the structure of expenditure. All ratios relating to expenditure structure show signs of deterioration in the profile.

3 Prospects for 2008

Prospects for 2008 are relatively promising for economic activity in Togo. Indeed, the pace of economic growth would pick up, together with resumption of financial assistance from donors and restoration of confidence in the business community. Real GDP growth would reach 3.0%, in line with the reform scenario explained during consultations on Article IV in November 2007. The upturn would initially be fuelled by public investment expenditures financed by donors, greater confidence of the business community, regional trade growth and rise in cotton and phosphate production. In the medium term, growth would be sustained through increase in foreign direct investment (FDI), a more improved financial intermediation and modernization of public infrastructures, particularly electricity that will help to remove obstacles that had previously hampered private sector development.

Inflation would be controlled, together with firm stronghold in the monetary union and support for UEMOA's prudent fiscal policies. Nevertheless, it could go up, should there be unfavourable weather conditions or a continuous rise in world food and energy prices.

In 2008, a boost in investments in road infrastructure, which had considerably deteriorated, would result in a downturn in major budget balances. Overall budget deficit excluding grants in relation to nominal GDP would be 5.3%.

Togo is eligible for the HIPC Initiative. Resumption of cooperation with the European Union and implementation of an EPRF programme, with resource support from the Bretton Woods Institutions could help the country to benefit from considerable concessional resources in 2008. These resources would complement domestic financial mobilization and improve public finances position, following a proper management of external debt.

4 Conclusions and recommendations

The promising favourable prospects, together with the change brought about by the resolution of the social difficulties that caused a break in cooperation with technical and financial partners, should provide the opportunity for the government to address the numerous challenges, particularly institutional and economic challenges facing the country. The rather modest growth objectives, which are among the lowest in the sub-region, would be achieved. These objectives could be reviewed upwards if the series of effective measures included priority concerns relating to:

- bad governance and poor administrative capacities, resulting from a long period of intense socio-political conflicts, poor management of State resources and lack of external aid;
- excessive public debt, together with external debt higher than the threshold fixed for the HIPC Initiative, very high external and domestic arrears;
- fragile banks, that show the highest aggregated ratio of unproductive loans within the UEMOA zone (a reflection of past loans), many of which are under-capitalized, scarcities of regional magnitude have caused neighbouring countries to cut off power exports to Togo ; this has led to frequent power cuts;
- Unproductive State-owned enterprises (cotton and phosphates): decades of poor management have led to considerable budget deficits, growing indebtedness and near collapse of these important export sectors;
- Unfavourable business climate, compared to regional standards, resulting from several decades of under-investment in transport and energy infrastructures;
- Deterioration of social conditions resulting from poor management of State resources and suspension of aid from donors to the health, education and infrastructure sectors.