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WEST AFRICAN MONETARY AGENCY (WAMA)

GUIDE FOR DRAFTING REPORTS ON MULTILATERAL SURVEILLANCE

Freetown, August 2008

INTRODUCTION

Following a seminar organized for officials of National Coordinating Committees (NCC) as part of the preparation of quarterly reports on macroeconomic convergence, a format for drafting these reports was adopted.

The aim of this guide is to further facilitate NCCs' work and achieve a better harmonization of reports that will be submitted to the ECOWAS Commission and the West African Monetary Agency. It has no pretensions of being exhaustive and therefore it is not very rigid. It was prepared just to assist NCC officials in their daily work.

The quality of the report will be determined based on the writing style, knowledge of issues addressed, sense of synthesis as well as the mass of qualitative and quantitative information that supports arguments and the relevance of recommendations provided.

"INTRODUCTION"

- **Developments in the world economic environment**

The interest in providing an overview of the international environment is to assess opportunities opened to the country as well as constraints that had adverse effect on the national economy.

At this level, an analysis on the following aspects is expected:

i. An analysis of trends in world demand through world economic growth with special emphasis on major economies. The effect of world demand on the country's growth could be highlighted.
ii. Inflationary trend across the world especially in major partner economies in order assess inflation differentials;
iii. A presentation of trends in prices of major commodities exported by the country ;
iv. An analysis of developments in the international financial situation based on trends in interest rates and exchange rates of currencies of major partners.
v. All other shocks and how they affect your country's economy

It is also worth noting at this point that the international environment is addressed comprehensively in the first part of the on ECOWAS Monetary Cooperation Programme (EMCP) Report. At the country level it is not necessary to dilate on generalities. It is advisable to present major economic and financial trends which directly affect the national economy. That is why the point on the country's export commodity prices is of particular interest.

- **Major economic policy targets**

A recall of the government's main targets helps to highlight whether concerns in terms of macroeconomic convergence are taken into account in the formulation of the country's economic policy, among others. At this stage, it is important to indicate government objectives in terms:

- Real GDP growth rate
- End of period inflation rate
- Budget deficit excluding grant /GDP
- Current account deficit in relation to GDP

With these four indicators, it is possible to have an idea about the government's ambitions on one hand, and its commitment to achieve convergence on the other.

❖ **Major achievements or results achieved**

At this level, the report must indicate whether the achievements are commensurate with the targets or not. Reasons for performance or counter performance should be provided in detailed in the first part.

1. ANALYSIS OF THE FINANCIAL AND ECONOMIC SITUATION

The analysis of the economic and financial situation must be addressed under the four key sectors of the economy:

1.1 REAL SECTOR

The analysis of the real sector must be addressed through trends in the supply and demand of goods and services and must be based on national accounts and macroeconomic framework as well as price statistics.

1.1.1 Trends in overall supply

With regard to supply, the report must lay emphasis on value added formation through the contribution of various sectors (primary, secondary and tertiary). For each sector, the analysis must indicate the factors driving trends in production. These factors may be linked with the international economic situation, (trends in demand) weather conditions and an increase in production capacities or policy or sector reforms. After this, the report should indicate the importation of goods and services.

1.1.2 Trends in overall demand

On the demand side, the report must analyse trends in the various components of world demand with particular emphasis on consumption and investments. This involves, in actual fact, measuring the impact of GDP variation on the composition of demand.

In the analysis of consumption and investments, it is useful to break them down into public and private components in order to measure the State's share in overall demand

At this point, it is also appropriate to compare savings and investment levels in order to assess the share of domestic savings in the financing of investments.

Besides, it is important to give an indication of the impact of exports on economic growth. However, the details must be provided under the external sector.

1.1.3 Prices and inflation

It is expected that the report will provide a detailed analysis on consumer prices while stressing underlying causes of variations. These causes may be linked to demand or supply factors.

After determining the level and type of inflation, it is important to analyse price increases through various sources, indicating products or groups of products that are the most affected by the hike in prices.

Inflationary trends must be assessed in terms of average and end of period inflation.

1.2 PUBLIC FINANCES AND PUBLIC DEBT

1.2.1 Public finances

Given that fiscal operations is at the centre of macroeconomic convergence in ECOWAS (six out of 10 convergence criteria are directly linked to fiscal operations), the analysis of budget indicators is of utmost importance.

The structure of the analysis must be as follows:

- Total revenues: This involves explaining trends in revenues while making a distinction between tax and non tax revenues. Concerning tax revenues, the report must state the share of customs duties and that of internal revenue;
- Grants: indicate its share in total revenue
- Current expenditures: structure and trends
- Capital expenditure: share of internally funded capital investments and that of externally funded capital expenditure
- Overall balance and financing: indicate trends in typical budget balances (basic primary balance, overall balance on commitment basis, balance on cash basis and how financing needs were met (internal and external financing).

The analysis of public finances must bring out the effects of decisions taken by government on public finances. With regard to revenues, this could involve measures concerning the expansion of the tax base, introduction of new taxes and levies, strengthening rigour in revenue mobilization and modernization of tax administration. In terms of expenditure, measures could include reduction in the wage bill, increase in capital expenditure and a downward trend in subsidies, etc. They could also be political decisions that would lead to public expenditure, for example, increase in salaries taxes, establishment of new governmental structures, etc.

1.2.2 Public debt

Domestic debt and external debt must be analyzed separately.

1.2.2.1 Domestic debt

While addressing domestic public debt, the report must stress on trends in outstanding debt as well as debt servicing. With regard to outstanding debt, the report must make distinction between debt owed to the banking sector and those outside the banking sector. The analysis of payments must also take into account accumulated arrears.

1.2.2.2 External debt

The analysis of external debt must focus on the outstanding sum and its various components (multilateral or bilateral, private or commercial debt) in order to come up with possible relief measures. There must be comments on trends in debt servicing.

On the whole, the debt analysis must be based on the following typical ratios:

- Total Debt / GDP;
- External Debt/GDP;
- Domestic debt servicing/ tax revenue;
- External debt servicing/export of good and services

1.3 MONETARY SECTOR

In analyzing the monetary sector, the report must present important policy decisions as well as their effects on trends in monetary aggregates.

1.3.1 Decisions on monetary policy

The report should mention decisions taken by monetary authorities during the period under review. The report should highlight important decisions relating to interest rates, mandatory reserve rate, etc or the organization of the money market such as the introduction of a new instrument or a decision to limit advances to the Government.

1.3.2 Trends in monetary aggregates

The descriptive analysis of trends in monetary aggregates is of little interest if it does not take into account the explanatory factors. Thus, the report should indicate whether external assets are influenced by the nature of prevailing monetary and budget policies, balance of payments orientation or the country's capacity to mobilize external resources. Regarding internal credit, it should assess the financial needs of companies which depends on the nature of fiscal policy

The report must decompose M2 aggregate into cash in circulation and demand deposits order to have an idea about economic operators' preference for cash or not. It must also be interested in long term deposits that help to determine the capacity to finance investments. The share of foreign exchange deposits is also important as it will help assess the preference between the local currency and foreign currency.

The report must review liquidity ratios in the economy (m2/GDP) or the velocity of money circulation in order to assess the stability of money demand.

1.4 EXTERNAL SECTOR

In a globalized economy, the analysis of economic and financial relations between a country and the rest of the world is of particular importance.

In this section, the report must analyse the various components of the balance of payments, especially external trade.

1.4.1 External Trade

With regard to external trade, the analyst must tackle the merchandise trade through trends in exports and imports.

The analysis of imports and exports must take into account the volume and value as well as related prices and structure for each product as well as the direction of trade. The report must touch on the level of balance of trade and its trends. Basic data meant for the analyses must be derived from EUROTRACE statistics.

1.4.2 Analysis of other components of the balance of payments

The analyses of other balances must begin with non factor services which depend to a large extent on trends in external trade and infrastructure available in the country in terms of insurance and transportation.

Concerning the net income, it will deal with trends in factor services especially interest on debt, and net transfers of revenue.

As far as transfers are concerned, they will be addressed on the basis of the beneficiary entity (public or private). Under private transfers, it is important to indicate the magnitude of remittances.

To conclude on current operations, the analysis must review trends in the current balance excluding or including public transfers.

In the analysis of the capital account and financial operations, the report must dwell particularly on trends in foreign direct investments. Trends in FDI could be explained by developments in the business environment (legal and regulatory framework, business opportunities, privatisation programmes, internal monetary conditions, macroeconomic framework viability and good political and economic governance). The balance of payment analysis must be concluded with an indication of trends in the overall balance and how it is financed.

1.4.3 Trends in exchange rates

Besides the balance of payments, the external sector analysis must cover exchange rates as well. Variations in exchange rates of the local currency in relation to major international currencies (US Dollar, Euro, Pound Sterling) must be explained. Beyond these variations, the analyst must find the cause of depreciation or appreciation of the national currency. In addition to the official market rate, the report must also deal with rates on the parallel market. Within West Africa, the parallel market plays an important role in the development of trade.

It is worth noting that the analysis must cover both average exchange rates and end of period rate.

2. PERFORMANCE IN TERMS OF MACROECONOMIC CONVERGENCE

It is important to recall that the two categories of convergence criteria adopted at the 22nd session of the Assembly of Heads of State and Government held in December 1999 in Lome are as follows:

Primary criteria:

i) Budget deficit (excluding grants)/GDP(on commitment basis) ratio ≤ 4 %;
ii) End of period inflation rate ≤ 5 % ;
iii) Budget deficit financing by the Central Bank ≤ 10 % of previous year's revenue ;
iv) Gross external reserve ≥ six months import cover ;

Secondary criteria:

i) Prohibition of the accumulation of new arrears and settlement of all outstanding arrears ;
ii) Tax revenue/GDP ratio ≥ 20 % ;
iii) Wage bill/total tax revenue ≤ 35 % ;
iv) Internally funded public investment/tax revenue ≥ 20 % ;
v) Positive real interest rate ; and
vi) Real exchange rate stability.

The methodology for the calculation of indicators is attached to this guide.

The analyst must assess the country's performance in relation to the various criteria while indicating the main factors that led to the results. The performance must be assessed in terms of trends and at end of period.

3. HARMONIZATION OF POLICIES AND INSTITUTIONAL ARRANGEMENTS

This section must focus on progress made in the implementation of harmonization policies and institutional arrangements defined in various ECOWAS agreements and protocols. The various protocols will be transmitted to the NCCs.

4. PROSPECTS

- The report will make room for the analysis of prospects opened to the country's economy. Based on these prospects, the compiler must outline the implications in terms of convergence criteria.

It is also at this point that the compiler must mention strategies and measures planned by the Government and indicate how these measures would improve convergence.

5. CONCLUSION AND RECOMMENDATIONS

The conclusion must highlight major lessons drawn from macroeconomic convergence trends.

Based on these trends, the compiler must identify measures and actions that can sustain or strengthen performances. The recommendations, at most ten, must be clear and specific.

APPENDIX:

All tables of the questionnaire must be attached to the report.

ECOWAS CONVERGENCE CRITERIA

The indicators presented below are convergence criteria as defined in Decision A/DEC.7/12/99 by the Assembly of Heads of States and Government. The table provides, for each criterion, the method of calculation and interpretation

	CRITERION	FORMULA FOR CALCULATION	SOME USEFUL TIPS	OBSERVATIONS
1	Overall budget balance excluding grant/nominal GDP ratio **(OBBEG/GDP)**	**OBBEGR** = $\frac{TREG - TE - NB}{NGDP}$	The overall budget balance excluding grant is the difference between total revenue excluding grants (**TREG**) on one hand, and total expenditure **(TE)** and net borrowings **(NB)** on the other. Total revenue excluding grants, total expenditure and net borrowings are defined in accordance with Directive 06/99/CM/UEMOA on TOFE Nominal GDP is equal to the total value added (at prevailing market prices) achieved by local production units.	The overall budget balance excluding grants in relation to GDP measures the sustainability of pubic finances in terms of wealth created. This ratio facilitates the comparison of countries. The overall balance excluding grants shows the scope of real budgetary efforts required to balance the State's financial position without resorting to grants which are unpredictable. Given that public finances account for the most of the structural imbalances, this indicator was retained as the basic criterion under the ECOWAS macroeconomic convergence pact.
2	End of period inflation **(IR)**	$IR = 1\text{-}\ \frac{CPI_{n}}{CPI_{n-1}}$	For a given month, it is the variation between the index for the month and that of the same month in the previous year. Thus, if in September 2004, the index was 110.9 then for September 2003, it was 108.5 The variation in the index is therefore 110.9/ 108.5 = 1.022 or + 2.2 %. The annual inflation rate as at September 2004 was therefore 2.2 %.	Inflation is the generalized increase in prices. It affects the average purchasing power. Annual inflation was retained because it gives a clearer picture of trends in prices.

				This indicator is extremely important for countries that are prospective members of a monetary union. In fact, the ultimate goal for any monetary policy is price stability.
3	Budget deficit financing by the Central Bank ≤ 10 % of previous year's revenue **(BDFCB /TRn-1)**	**BDFCB** = $\frac{NCS_n - NCS_{n-1}}{TR_{n-1}}$	Tax revenues are non refundable payments and without counterpart made to the State. These include fees and charges paid to the state which are not commensurate to the cost or scope of services provided to the payer. Financing by the Central Bank on behalf of the State is measured by the variation of nets credits to the state (**NCS)** in the books of the Issuing Institution. .	In view of the negative effects of the monetary financing of public deficits, especially in terms of inflation, the trend is to abandon this practice. Setting a limit to the use of this facility help countries to prepare for a single monetary authority that will be powerful enough to resist pressures from countries.
4	Exchange reserves in months of imports **(ERMI)≥ 6**	ERMI = $\frac{ER}{\text{Im } pBS}$	Exchange reserves are made up of Central Bank assets in gold or SDR, foreign exchange and other credits. Imports are non factor goods and services acquired abroad.	The ability of a Central Bank to sustain the value of its currency depends on the level of its assets in foreign exchange. Besides, the accumulation of these assets reflects the performance of the country's external sector and their prudent management by the central bank. .
5	Non accumulation of internal arrears **(IA)** and settlement of all existing	$IA = (IA_n - IA_{n-1})$	Internal arrears include all commitments of the States to internal suppliers of goods and services. They include previous arrears and all orders for payments that have not led to a	Considering the weight of the State in our economies, the accumulation of arrears on its part affect adversely suppliers and for that matter economic

	arrears		disbursement within a period of three months.	activity as a whole.
6	Tax revenue/GDP≥20% (TPF)	TPF = $\frac{RF}{PIB}$ x 100	Tax revenues are as defined above.	The financial situation of the State is greatly influenced by its performance in tax administration. . This indicator was retained in order to push governments to lay greater emphasis on internal revenue mobilization.
7	Wage bill/Tax revenue Ratio ≤35%	WBTRR = $\frac{WB}{TR}$ x 100	The wage bill includes salaries and other emoluments as well as social security contributions made by the State for its employees.	Personnel costs absorb most of State resources. Given the State meet other obligations (operational costs, investments…), there must be a ceiling to expenditures on account of salaries. The ratio 35% is somehow drawn from the practice in the private sector. .
8	Internally funded public investments/tax revenue ratio ≥20% (IFPITRR)	IFPITRR = $\frac{IFPI}{TR}$ x 100	Internally funded public investments include all investments financed with the country's own resources. Investments financed with HPIC resources must be excluded. Generally, the Table of Financial Operations of the State (TOFE) provides the volume of total investments and the volume of total investments excluding those financed with HPIC resources. In the case where the values of investments financed with the country's own resource excluding HPIC ones is not indicated the	It is important that the State allocate a substantial part of its resources to investments that reflect its commitment to improve services offered to citizens and also guarantee production capacity in subsequent years.

			compiler must contact the department in charge of preparing the TOFE.	
9	Real exchange rate Stability (RERS)	$\frac{\lvert REER_n - REER_{n-1} \rvert}{REER_n}$ x100	Real exchange rate refers to the relative price of goods between two countries. It shows at what rate it is possible to exchange the goods of a country for those of another country. However, the aggregation of bilateral real exchange rates helps to determine the Real Effective Exchange rate. **(REER)**	The REER index is an essential indicator in the assessment of a country's competitiveness. Currently, all the banks are not calculating the REER. WAMA has a project to set up a mechanism for the calculation of REER by Central Banks. WAMA considers an annual REER variation within a band of +/-5% as acceptable.
10	Real Positive Interest Rate (RIR)	$RIR = (MIRS - IR)$	Generally, central banks fix the minimum interest rate on savings (**MIRS**) to protect small savers. The inflation rate to be taken into account is the year-on-year inflation rate.	A negative real interest rate discourages savings mobilisation. In view of the importance of inflation rate in investment and economic activity, it is important to preserve positive real interest rates.