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The Global Financial Crisis: Impact on WAEMU Member Countries and Policy Options

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The Global Financial Crisis: Impact on WAEMU Member Countries and Policy Options[1, 2]

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[1] West African Economic and Monetary Union.

[2] The views expressed herein are those of the authors and should not be attributed to the IMF, its Executive Board, or its management. This project was overseen by Benedicte Vibe Christensen and Roger Nord. All eight WAEMU country teams have contributed to the paper, and while every effort was made to reflect the latest country team projections, this may not have been possible in all cases due to the teams' different mission cycles. The authors appreciate the comments received from the Central Bank of West African States (BCEAO) and the WAEMU Commission on an earlier draft of the paper, which have largely been incorporated. Finally, they are also grateful to Gustavo Ramirez for his excellent research contribution and to Silvia Perez and Monica Snyder for their able assistance.

EXECUTIVE SUMMARY

Most WAEMU countries are likely to see economic growth deteriorate over the next two years as a result of the global economic crisis, and some WAEMU countries will be more severely affected by the crisis than others. This could have a detrimental effect on efforts to reduce poverty. Deteriorating remittances and commodity export prices are projected to negatively affect the WAEMU countries' external current account deficit and reserves, although the impact should be cushioned by positive terms-of-trade shocks, such as declining import prices for food and fuel products. These developments should also help lower inflation pressures, bringing WAEMU inflation closer to its historical level of about 2 percent by 2010.

The analysis points to some room for fiscal and monetary easing and the need for stepped-up vigilance on financial sector developments. All WAEMU countries are now in Fund-supported programs, and the design of these programs is being adjusted to help the countries cope with the impact of the crisis. The specific policy recommendations are as follows:

- *A fiscal expansion could be considered for countries at low or moderate risk of debt distress if the resulting higher fiscal deficits can be financed.*[1]

- *Any fiscal expansion should preferably result from holding expenditures at or close to planned levels in the face of falling revenues to help protect priority social spending and investment outlays. Additional support from development partners could be essential in this regard.*

- *Targeted and effective discretionary fiscal stimulus measures are less advisable, as they are difficult to design at short notice and may ultimately be procyclical.*

- *Exchange rate developments, reserve levels, and the easing of monetary policy in the euro area could allow the BCEAO to inject more liquidity to support banking sector soundness, credit to the private sector, and government tapping of the regional financial market.*

- *The BCEAO should consider reinforcing its liquidity forecasting and refining its set of monetary policy instruments to give the financial sector faster access to liquidity if that should become necessary.*

- *Bank balance sheets should be more closely monitored to ensure early detection of rising credit risks or solvency and liquidity problems, and prompt remedial actions.*

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[1] The terminology in this paper on the role of fiscal policy is consistent with the terminology used in recent Fund analysis. The term "fiscal expansion" is used as a general description and can result from (i) automatic stabilizers; (ii) other nondiscretionary effects (including changes in commodity-related revenues); and (iii) a fiscal stimulus, which is comprised of discretionary policy measures.

I. TRANSMISSION OF THE GLOBAL CRISIS ON WAEMU COUNTRIES

1. **As for sub-Saharan Africa (SSA) in general, the global crisis could affect the WAEMU through several related channels:** (i) reduced commodity prices and volumes, along with corresponding changes in the terms of trade and pressures on the trade balance; (ii) falling remittances and net capital inflows—possibly even net outflows—related to foreign direct investment (FDI), portfolio investment, and development assistance; (iii) a direct impact on the financial system through investments in toxic assets, losses in deposits in foreign correspondent banks, and capital repatriations by foreign parent banks; and (iv) weaker financial intermediation due to higher credit risk and solvency and liquidity problems.

2. **Current indications suggest that the global crisis will impact growth prospects in WAEMU countries in 2009–10.** Growth projections for the region have been revised significantly downward, but the deceleration in WAEMU-wide economic growth is projected to be cushioned by a pickup of economic activity in the two largest economies (Côte d'Ivoire and Senegal) and in Togo. In the other WAEMU countries, economic growth will slow noticeably, especially during 2009, largely because of a decline in export demand. In Benin, Burkina Faso, Mali, and Niger, lower cotton prices and exports are behind this development, which in the case of Benin will be amplified by the spillover of the crisis from Nigeria. In Guinea-Bissau, lower cashew prices and exports and lower remittances are expected to trigger slower growth in 2009, although it is hoped that a more stable political environment will improve growth prospects in 2010. By contrast, Côte d'Ivoire, Senegal, and Togo could see a rise in economic activity during this period. This reflects, in the case of Côte d'Ivoire, the effects of the more stable political and economic environment; in Senegal, the government's settling of its unpaid bills and the resumption of full production of the main phosphate company (ICS); and in Togo, the stepped-up donor support and rebound of food production following flood damage.

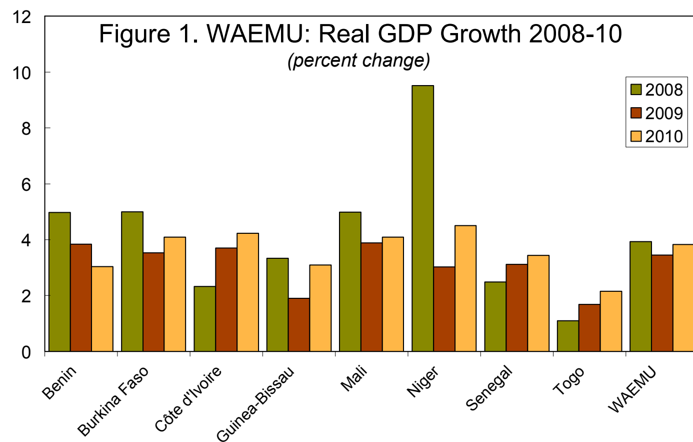
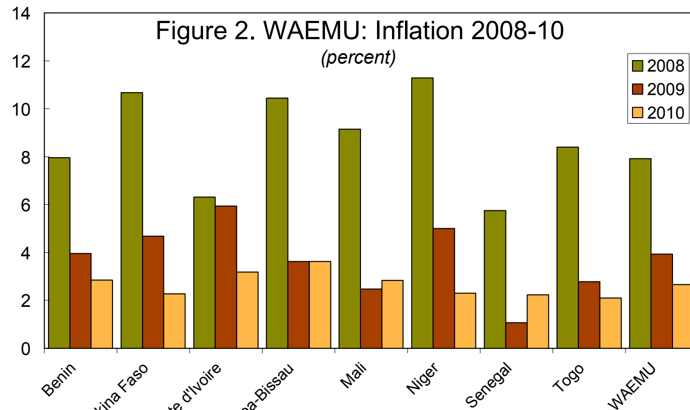


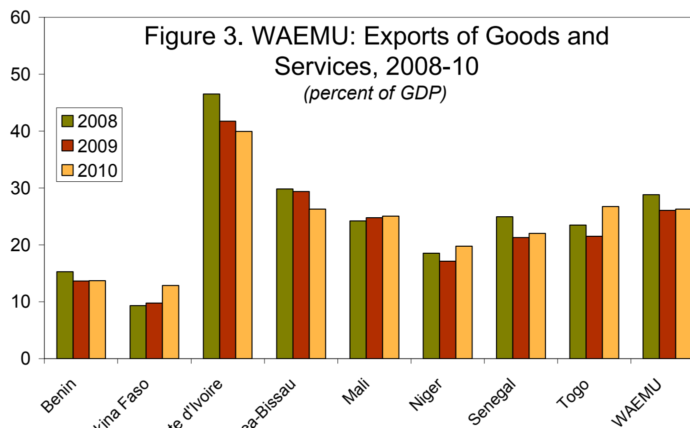
Figure 1. WAEMU: Real GDP Growth 2008-10
(percent change)
Source: IMF, African Department database.

3. **The fall in commodity, fuel, and food prices, accelerated by the drop in global demand for African exports, has allowed inflation pressures to abate within the WAEMU.** Average inflation is expected to approach 4 percent in 2009, a drop of 4 percentage points, although food price inflation persists in some countries (e.g., Burkina Faso and Benin). A similarly declining inflation trend is observable in most SSA countries. All WAEMU countries are expected to return to single-digit inflation in 2009, and zone-wide inflation should approach the BCEAO's long-run target of 2 percent over the medium term.



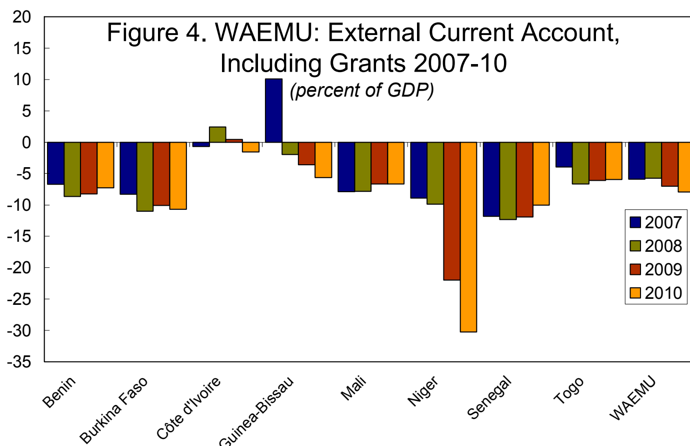
Source: IMF, African Department database.

4. **A widening of WAEMU's external current account deficit is projected for 2009–10.** Losses from export earnings and remittances are the driving forces behind this deterioration. Exports are expected to decline relative to GDP in 2009 in all countries except Burkina Faso and Mali, but to recover in several countries in 2010. In Niger, a massive increase in imports related to uranium, oil, and dam projects will more than double the projected current account deficit by 2010.



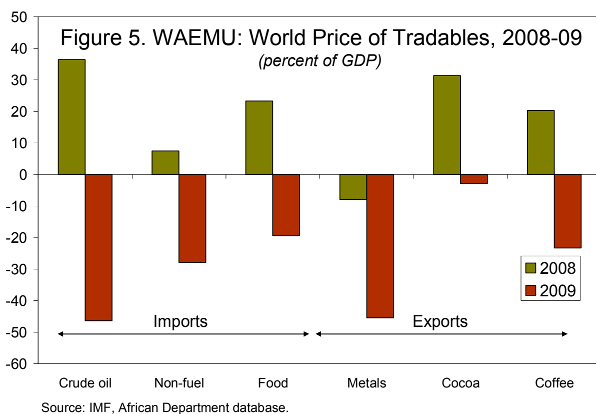
Source: IMF, African Department database.

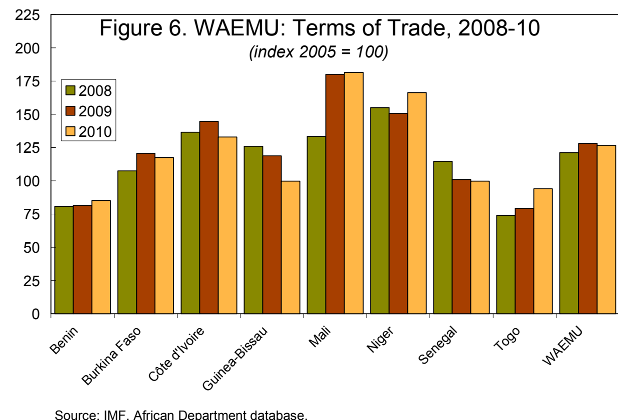
5. **The regional terms of trade are expected to improve during 2009–10, which should mitigate the effect of the global crisis on WAEMU's external position.** In most WAEMU countries, the decline in export prices will be more than offset by lower prices for imported food and fuel products. The terms of trade for the zone are thus



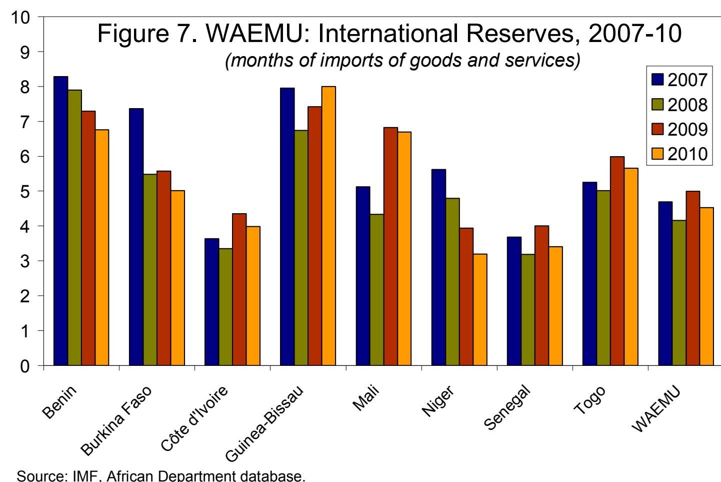
Source: IMF, African Department database.

projected to improve by nearly 6 percent on average in 2009, with a slight drop of about 1 percent projected for 2010. As a result, WAEMU's external current account deficit is expected to deteriorate less than the average for countries in SSA, for which a widening by about 6 percent of GDP is forecast for 2009. However, there are significant differences by country within the WAEMU. In particular, for Mali and Burkina Faso, the changing world prices for gold should substantially improve the terms of trade, but they are likely to deteriorate in Guinea-Bissau and Senegal because of falling prices for cashews and phosphate exports, respectively. Although the European Union remains WAEMU's main trading partner, trade with Asia and Africa now accounts for one-third of trade in the WAEMU region. This growing diversification of trading partners may help explain why the region is relatively resilient to the current shock.





6. **Lower capital and remittance inflows could negatively affect economic growth and complicate the financing of the balance of payments and fiscal deficits** (Box 1)**.** Abstracting from some one-off factors in 2009 (such as privatization receipts from abroad), WAEMU's international reserves are projected to decline during 2008–10. Although reserve levels are projected to remain above 4 months of imports, the contribution of some countries to the zone's reserves should fall noticeably. This needs to be carefully monitored.



- *Remittances* have been rising steadily and accounted for 0.7 to 8.5 percent of GDP in WAEMU countries in 2006–08. Projections for 2009 suggest remittances will fall on average for the WAEMU region, although they would remain well above the 2003–07 average, despite the slowdown in global growth. Remittances are important

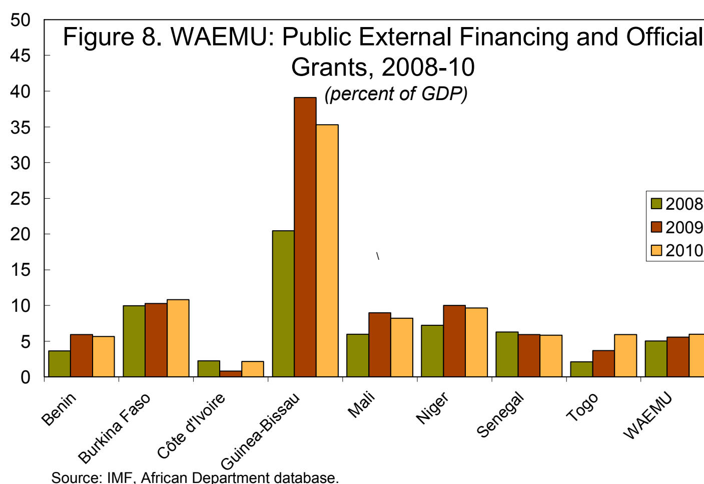
determinants of growth in WAEMU countries, especially in construction and real estate, and are a major source of household income and financing.

Box 1. Vulnerability of WAEMU Countries to Falling Inflows

An illustrative scenario emphasizes how vulnerable WAEMU members are to a drying up of remittances and capital flows. In this scenario, aid inflows decline by 10 percent, FDI and remittances by 20 percent, and net portfolio inflows by 20 percent. The following first-round effects could then be expected:

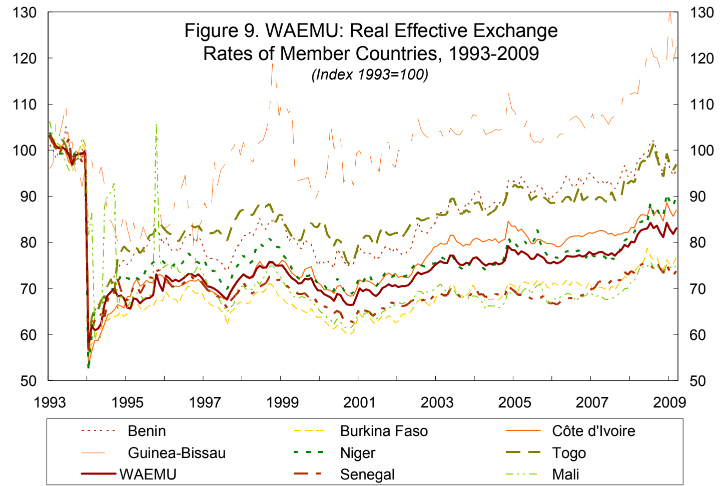
- **WAEMU reserves would fall to 1½ months of imports, below the 3-month benchmark level.** Correcting for the fact that all such inflows generally lead to a rise in imports, import coverage of reserves would hover at around 2.9 months of imports, on the assumption that imports would fall by a factor of 0.6 for every CFA franc lost in inflows.
- **Even a modest shortfall in aid would lead to an average increase in the financing gap by 0.6 percent of GDP for WAEMU countries' fiscal deficits.** This may further complicate the scope for any countercyclical fiscal expansion that member governments may be considering, because the regional financial market may not be sufficiently liquid to offset a possible shortfall in donor support. This in turn might delay progress in raising WAEMU countries' growth potential, reducing poverty levels, and achieving the Millennium Development Goals (MDGs).
- **Lower remittances would tend to reduce private consumption.** Assuming that remittances go fully into it, private consumption could fall by 0.6 percent of GDP.

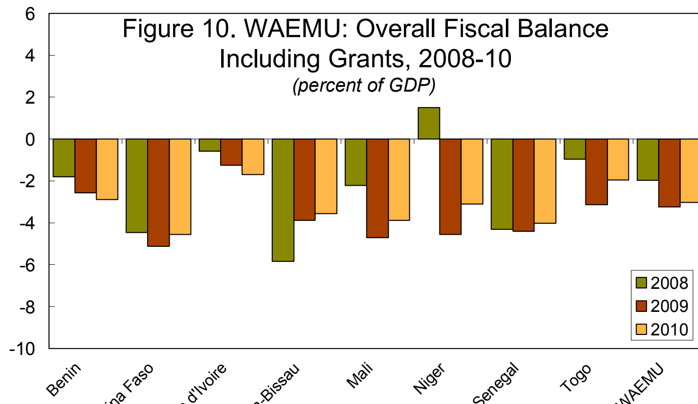
- *Aid flows* have become instrumental in financing the external and fiscal accounts. Official support (comprising program and project loans and grants) ranges between 2 and 39 percent of GDP. Zone-wide, official grants and loans are projected to increase to nearly 6 percent of GDP in 2010, up from 5 percent in 2008.



- *FDI* has become an important source of financing for external current account deficits, for example, reaching 3½ percent of GDP in Senegal over the last three years. Projections suggest that FDI will diminish over the next few years, although it remains an important factor in countries like Senegal and Niger.

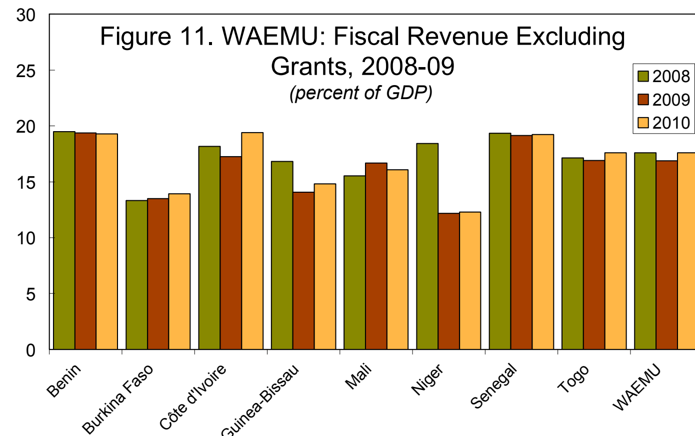
7. **The CFA franc's real depreciation in recent months could temporarily mitigate the negative growth impact of lower commodity prices and falling export demand.** Driven mainly by changes in the euro-dollar exchange rate and a narrowing of the inflation differential with trade partners, the CFA franc has recently seen a real depreciation of about 2½ percent, following a period of gradual real appreciation through most of 2006–08. This could provide some relief for economic growth and the region's external balance. Since the recent real depreciation is only moderate, it can be expected to have a limited effect on inflation. It also does not fundamentally change the need for sustained structural reforms to promote the region's external competitiveness. Given the volatility in currency markets, exchange rate developments must be carefully monitored.





Source: IMF, African Department database.

8. **The global crisis has begun to affect fiscal positions.** All WAEMU countries except Guinea-Bissau are expecting their fiscal deficits to deteriorate in 2009 compared to 2008. The zone-wide fiscal deficit is projected to increase to 3.2 percent of GDP in 2009, from 2 percent in 2008. The deterioration is partly driven by a decline in tax and non-tax revenues; this is particularly pronounced in Niger, Guinea-Bissau, and Côte d'Ivoire.[1] Some countries (e.g., Senegal) saw a



Source: IMF, African Department database.

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[1] In Côte d'Ivoire, the rise in the deficit also reflects new interest payments to the Paris Club.

drop in tax receipts in late 2008, which, if sustained, may require a further downward revision of revenues in 2009. Other countries may be affected by a larger-than-currently-envisaged drop in trade taxes if trade volumes continue to decline.

9. **Finally, deteriorating economic conditions and a slowing or reversal of capital inflows could weaken banking systems and financial intermediation.** Banking systems were vulnerable before the onset of the global financial crisis. In several countries, bank capital adequacy ratios have been below the required norm, large single exposures are pervasive, nonperforming loans are on the rise, and the liquidity situation has been volatile. As a result, a deterioration of credit quality in the wake of a growth slowdown—possibly concentrated in certain sectors (e.g., cotton)—could have repercussions for the solvency of parts of the banking system.

10. **However, direct exposure of the WAEMU financial sector to the global crisis appears modest due to limited integration.** According to the BCEAO, WAEMU banks do not hold any toxic international assets. However, many banks in the region are subsidiaries of foreign banks, and these could possibly be facing difficulties at home that may lead them to try to repatriate capital from the WAEMU region or make them unwilling or unable to inject additional capital into their WAEMU subsidiaries.

II. Policy Options

A. Overview

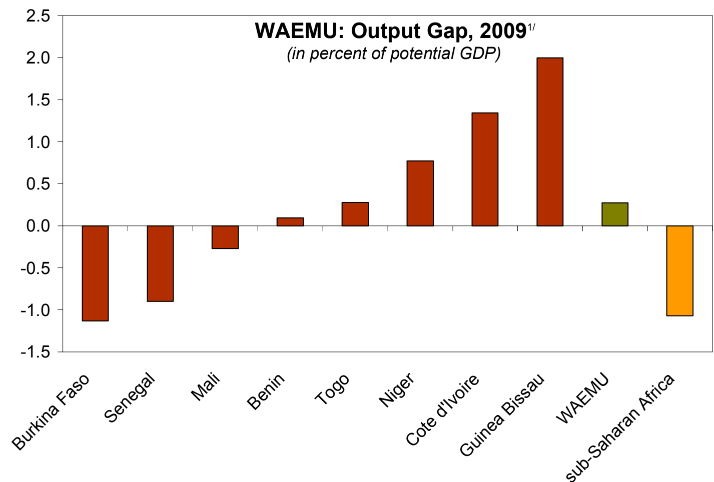
11. **The risks to the WAEMU region stemming from the global crisis warrant consideration of all policy options to shore up zone-wide economic activity.** Although estimating the output gap is challenging (Box 2), it appears that economic activity in most WAEMU countries will be below trend over the next two years and that the slowdown will, in general, be immediate and broad-based. Some countervailing factors may nonetheless help cushion or delay the adverse effects on economic activity for some countries, including the strong 2008/09 agricultural campaigns.[2] Current indications also suggest that the impact of the global crisis is expected to be limited on WAEMU's terms of trade but more noticeable with respect to the external current account deficit and international reserves, although it will vary across countries.

12. **Overall, these developments suggest that there is scope for a countercyclical fiscal expansion by member governments to shore up economic activity.** The BCEAO could complement this by providing more liquidity to support national banking systems and regional financial markets. This in turn would help governments place additional securities

[2] For example, in Niger the main commodity exports (uranium and gold) have been sold forward, remittances are low, and FDI and aid commitments seem firm.

Box 2. Estimating the Output Gap

Traditionally, the scope for countercyclical fiscal policy is assessed in developed countries by estimating the output gap and the role of automatic stabilizers. However, in developing countries, data limitations, structural breaks in time series (exchange rate changes, civil unrest), and exogenous factors that may affect large parts of the economy such as agriculture (weather, insect infestations) make it difficult to precisely estimate the output gap.

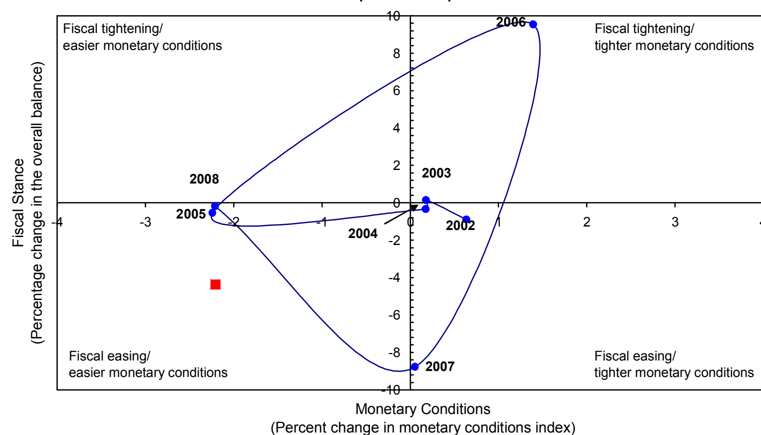


A simple approximation of the output gap for WAEMU countries was produced using a Hodrick-Prescott filter and a time series of log real GDP for the period since the 1994 CFAF devaluation.[1] The analysis suggests that on average the WAEMU region will continue to grow close to potential in 2009, whereas the average output gap in SSA is projected to be 1 percent of potential GDP. However, Guinea-Bissau and Côte d'Ivoire distort the WAEMU average in the estimations because their economies are expected to grow well above potential in 2009. Alternative estimates by the country team suggest, however, that Côte d'Ivoire actually faces an output gap of 10 percent due to depletion of capital and very little investment for eight years during the civil war.

[1] In the estimation, Lambda is set at 100, consistent with the use of an annual data series.

in the regional financial market without crowding out credit to the private sector. At the same time, bank supervisors—the BCEAO and the Regional Banking Commission—should more intensively monitor bank balance sheets to detect credit, solvency, and liquidity risks.

Figure 12. WAEMU: Macroeconomic Policy Environment [1]
(Percent)



[1] The fiscal stance is represented by changes in the overall balance (including grants) as a percent of GDP. Monetary conditions are measured by an index of the average of the real policy interest rate (refinance rate minus inflation) and (the log of the) real effective exchange rate.

13. **The suggested countercyclical policies for 2009–10 would allow for a macroeconomic policy mix that would be less restrictive than during the last few years.** Fiscal deficits rose early in the decade as aid and debt relief created fiscal space, but the fiscal policy stance of WAEMU countries has

generally remained prudent. The fiscal space has been used mostly to promote investment and for social spending. However, the fiscal positions of several countries widened significantly in 2007–08 as a result of a rise in subsidies and tax suspensions on food and fuel products; these support measures will generally be reversed in 2009–10, to the full extent in countries like Senegal. Monetary conditions began to ease in 2008 as the exchange rate depreciated, although the BCEAO raised its key policy rate in mid-2008.

14. **While there is scope for countercyclical policies, governments should not lose sight of underlying long-term objectives.** These include preserving fiscal and external debt sustainability and implementing structural reforms to help raise the countries' growth potential, reduce poverty, and move toward achievement of the MDGs. In doing so, constraints unique to the WAEMU, such as the exchange rate setup and the limited stage of development of regional financial markets, need to be taken into consideration.

B. Scope for Fiscal Easing

15. **The scope for using fiscal policy to counter the crisis and stimulate aggregate demand will depend primarily on three factors:**

- **The structure of the economy:** Fiscal expansion to increase aggregate demand may work well if consumption represents a higher share of output and if activity in the secondary and tertiary sectors is important. In countries with higher investment and a predominant primary sector, letting automatic stabilizers work or even initiating a discretionary fiscal stimulus may be less effective because of the high import content of investment projects and the effect on primary sector activity of such exogenous factors as weather and insect infestations. In addition, high tax ratios, reflecting a broad tax base and strong tax administration, may make it easier to afford a fiscal stimulus. On the other hand, a heavy reliance on trade taxes may make a country more vulnerable to the external crisis.[3]

- **The availability of domestic and external financing:** This could be a constraint for all WAEMU countries because the regional financial market has limited capacity to absorb additional member-country issuances of securities.[4] This could be compensated for by scaled-up donor resources, but there currently are only limited indications of that possibility. Raising nonconcessional external resources is not likely to be an option, because there is no appetite in international markets for developing country debt. In any case, Fund programs with WAEMU members

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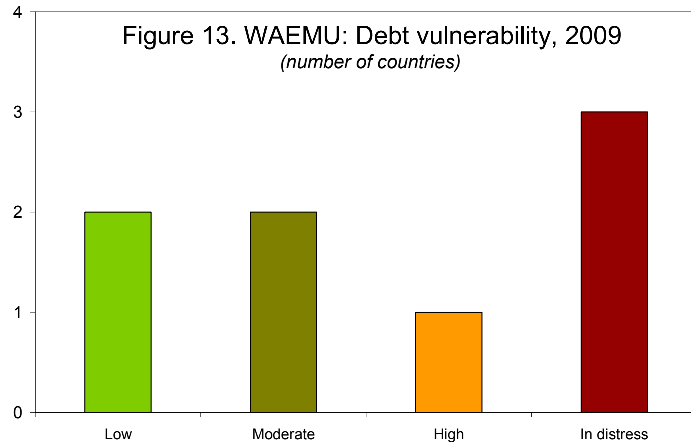
[3] It may be possible in some countries to boost tax revenue temporarily, for example, by capturing the windfall from the decline in petroleum prices through a temporary additional excise on petroleum products.

[4] Several countries have faced difficulties in tapping the regional financial market, as evidenced by delayed and undersubscribed securities issues, and interest rates have risen recently.

generally limit such borrowing. However, some countries, like Senegal, Burkina Faso, and Mali, have been planning to sell government assets, which could provide some welcome room to help finance a temporary rise in the fiscal deficit—although prudence suggests saving some of the proceeds to help finance government deficits in future years. Finally, higher financing needs in some countries may also result from the need to settle domestic payments arrears.

- **Debt sustainability:** Although current debt *s*ustainability *a*nalyses do not fully reflect the global financial crisis, the four WAEMU countries with low to moderate risk of debt distress—Mali, Benin, Senegal, and Niger—should in principle be well-positioned to tolerate a temporary fiscal expansion. More prudence is warranted for the other four countries.[5]



16. **The analysis suggests that although fiscal policy can play a useful role to counter the impact of the economic crisis, the scope differs by country.** In general, WAEMU countries that achieved macroeconomic stability and do not face binding financing and debt sustainability constraints would have scope for a fiscal expansion. In detail:

- Senegal seems to have the most scope for fiscal expansion. It has large secondary and tertiary sectors, a low risk of debt distress, and may have available financing, including privatization receipts. In addition, the government appears on track to settle its payment delays vis-à-vis the private sector, affording it some fiscal room.

- Benin, Mali, and Niger could have some margin for a moderate and temporary fiscal expansion to counter the effects of the global crisis.

- Burkina Faso could tolerate a modest temporary increase in the fiscal deficit target in 2009, given the projected decline of revenues and the need to preserve anti-poverty spending and provided that concessional financing is available. At the same time, continued commitment to a prudent medium-term fiscal policy is critical to reduce Burkina Faso’s high risk of debt distress.

[5] If these countries reach the completion point under the Highly Indebted Poor Country (HIPC) initiative, the additional debt relief could change the debt vulnerability assessment and enhance fiscal space.

- In Togo, despite significant concern about debt sustainability, special factors—especially the urgent need to repair flood damage and infrastructure—could justify revising the fiscal deficit target upward should the impact of the global downturn worsen. However, this would hinge on the availability of concessional financing.

- Although the formal economy in Côte d'Ivoire is large, financing and debt sustainability concerns argue against loosening fiscal policy at this point. When financing becomes available, there also is a need to first clear the large stock of domestic arrears—which would effectively help support economic activity.

- A fiscal expansion is impossible in Guinea-Bissau, where the debt situation is very fragile, the informal sector is large, revenues are expected to fall in nominal terms, and financing constraints are severe.

17. **In most cases, countries could loosen their fiscal stance by keeping spending at or close to planned levels, despite falling revenues.** This approach would help protect social programs and investment outlays, given that current spending, such as wages and transfers, is politically difficult to cut even in normal times. Avoiding spending cuts could critically hinge on development partners deciding to step up their support during this difficult period. However, keeping spending as budgeted may not always be appropriate, particularly if recurrent spending, such as transfers and subsidies, surged during the run-up to the crisis due to higher food and petroleum prices. It will also be important to ensure in the fiscal programming that sufficient progress is made in paying off any overdue payments to the private sector.

18. **As in all countries, any discretionary fiscal stimulus should be focused on projects that bolster employment, have low import content, and foster growth.** This could comprise labor-intensive public works programs and an acceleration of infrastructure projects already in the pipeline. Public wage increases would not be cost-effective—they are not well targeted and are difficult to reverse. By contrast, spending to boost targeted social safety nets could be accommodated if that can be done speedily to help preserve social peace and support ongoing efforts to reduce poverty. However, in most WAEMU countries, lags in identifying and implementing suitable discretionary spending measures and weaknesses in public financial management systems raise the risk that a discretionary fiscal stimulus will come too late and that fiscal policy could ultimately become procyclical.

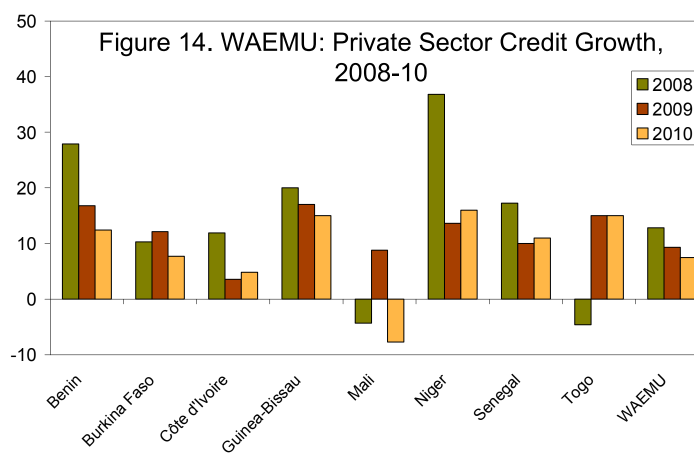
19. **For most countries, any fiscal expansion—which would probably stem from holding expenditures at or close to planned levels despite falling revenues—should be initiated preemptively in 2009.** In some cases, it may be advisable to preserve the current strong fiscal positions and delay the expansion to next year, if it is expected that potential shocks such as declines in foreign aid and tax revenue (profit taxes are based on the previous year's results) may hit countries with a lag. However, during economic downturns, revenue collections may also decline because compliance worsens, which should not be

accommodated. A careful reassessment of the fiscal situation and outlook should take place in mid-2009, when the 2010 budgets are being prepared.

C. Scope for an Accommodating Monetary Policy

20. **It should be feasible to relax monetary conditions in the WAEMU given recent developments with real effective exchange rates (REERs), the absence of pressure on reserves, and monetary policy in the euro area.** The REER has recently reversed some of the appreciation that gave rise to concerns about the zone's competitiveness in 2008;[6] the import coverage of reserves is projected to remain above 4 months; and recent interest rate cuts by the European Central Bank (ECB) by a total of 200 basis points have been only partially followed by the BCEAO, with a reduction in its key policy rate by 50 basis points in mid-June. This seems to suggest room for further monetary easing. The case for such relaxation is strengthened by the recent decline in the inflation differential vis-à-vis the anchor region and the expected further disinflationary impact of lower commodity prices and lower domestic growth. However, any steps to relax monetary conditions should be undertaken carefully, with a view to safeguarding the exchange rate peg and the level of international reserves.

21. **The key to countering the economic downturn will be to enhance liquidity support to WAEMU economies.** It is unlikely that monetary policy could be used effectively to directly stimulate economic activity, and the stickiness of interest rates in the WAEMU suggests that any downward adjustment of the key policy rate would only partially feed through to the private sector. On the other hand, the BCEAO could usefully strengthen its liquidity support to shore up the soundness of banking systems, facilitate bank financing of the private sector, and enhance access of governments to the regional financial market. Country team projections suggest rising recourse by governments to the regional financial market and solid, though declining, growth in credit to the private sector. There is a risk of crowding out the private sector if government credit demand rises, and this necessitates an increase in liquidity. It is thus welcome that the BCEAO has begun increasing its liquidity provision under its one-week facility, recently introduced a new one-month facility, and reduced reserve requirements in mid-June. The stepped-up liquidity



Source: IMF, African Department database.

[6] A full-fledged REER assessment will be undertaken in the summer in the context of the regional consultations.

support could also help ease a major bottleneck experienced over the last few years by strengthening financial intermediation and access to credit in the region; it would provide some impetus to the development of the regional financial market—a key recommendation in the regional Financial Sector Assessment Program (FSAP).

22. **Liquidity support will also be crucial to smooth functioning of the financial sector.** The BCEAO should closely monitor bank liquidity and be prepared to rapidly step up liquidity injections if necessary. In addition to providing additional liquidity through its open market operations of various maturities and its lowering of reserve requirements, the BCEAO may also want to consider expanding the set of collateral eligible for use in discount and open market operations, provided the assets are of good quality.

D. Need to Enhance Monitoring of Banks

23. **The worsening economic outlook and the expected surge in demand for liquidity necessitate a proactive and preemptive monitoring of the banking system.**[7] This is to detect credit risks and solvency and liquidity problems. In particular, the focus should be on identifying nonperforming loans, providing adequate provisioning, avoiding excessive risk concentration (including off-balance-sheet risks) and asset-liability mismatches, and anticipating spillovers from problems in parent companies abroad, such as with respect to cross-border credit lines. In the same vein, the authorities should systematically assess the outstanding maturity of bank liabilities at home and abroad so as to minimize rollover risks in the current unsupportive environment. Also deserving of special attention are depositor concentration and the vulnerability of banks to a deposit run. Monitoring liquidity more closely could provide impetus for further refining the BCEAO's liquidity forecasting and management framework, consistent with recent FSAP recommendations.

24. **The national and regional authorities should be prepared to act swiftly as soon as vulnerabilities are identified**. This includes intervening in problem banks if necessary to protect depositors or avoid systemic repercussions.

25. **Preventive contingency plans and a bank restructuring strategy should be prepared to deal with worst-case scenarios**. The plans should identify trigger points at which liquidity assistance would become too risky or ineffective and there would be a need for resolution procedures or public recapitalization programs, with appropriate safeguards for public funds. A bank restructuring strategy designed to restore profitability and solvency would identify measures to firm up viable banks, improve the operating environment for all

[7] As a first step, the BCEAO recently created a new Financial Sector Stability Directorate. It has also begun with the close monitoring of key banking indicators and established a dialogue with commercial banks to gauge potential vulnerabilities. An expansion of bank stress tests is also underway. The BCEAO has also been tasked by the WAEMU Council of Ministers to produce various studies on the impact of the global crisis, including on the financial sector.

banks, and deal with nonviable banks. That would usually require creating a decision-making framework for liquidating, merging, selling, or recapitalizing banks and restructuring and recovering bank assets and operations.

26. **It is advisable at this stage not to loosen the WAEMU's restrictive exchange rate regulation, which has provided temporary protection to the banking sector.** The regulation has limited the ability of banks to hold foreign exchange abroad and has thereby somewhat protected their balance sheets from the global financial crisis. Furthermore, lending in foreign currency to local companies is not permissible in the WAEMU, which prevents the risk of a currency mismatch. Nonetheless, the evidence about possible growing currency substitution in Benin—to a large extent related to informal trade with Nigeria—needs to be carefully monitored.

27. **Trade financing developments need to be tracked.** Although limited anecdotal evidence suggests there has not been any noticeable increase in the cost of trade financing, the authorities should assess whether the recent slowdown in import and export growth is in any way related to a drying up of trade credit, such as prepaid letters of credit. If such developments are noticed early enough, a policy response could be formulated.[8]

28. **Finally, institutional coordination should be enhanced:**

- There is a need to further deepen the dialogue and coordination between the authorities and banks so as to better anticipate and understand bank liquidity and solvency problems, tightening corporate credit conditions, and the financing needs of member governments. The latter would require a more predictable and measured recourse of governments to the financial sector, based on well-developed plans to access the regional financial market.

- In view of the systemic importance of foreign-owned banks, stepped-up coordination and information exchange between the WAEMU authorities and home supervisors, especially those in less advanced countries, would minimize the risk of contagion from parent banks and clarify responsibilities for lending of last resort. Such cooperation already exists to some extent, but the current environment suggests a careful stocktaking of existing and needed mechanisms of coordination (e.g., existing and outstanding Memoranda of Understanding between the affected supervisory agencies) and reflection upon other forms of cooperation, such as creation of interagency councils or committees.

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[8] For example, the Central Bank of Brazil has auctioned financing for export credit lines.