Editorial

Birth of the eco: essentially a symbolic change

The end of the CFA franc and its replacement with the eco scheduled for next June address the legitimate desire of WAEMU member countries to manage what is already their single currency. Governance of the currency regime will change as the French Treasury pulls out of WAEMU entities, although it will still serve as the lender of last resort. Though the euro peg will limit monetary policy's independence, it is necessary to shore up the macroeconomic stability of WAEMU, which is still fragile.

The CFA franc officially ends

On 21 December 2019, the presidents of Ivory Coast and France announced the end of the CFA franc and the operational reform of the West Africa Economic and Monetary Union (WAEMU). This is the first step towards creating a single currency for the 15 countries of the Economic Community of West African States (ECOWAS), comprising the 8 WAEMU countries plus Nigeria, Ghana, Gambia, Liberia, Guinea, Cape Verde and Sierra Leone. In June 2020, the eco will officially replace the CFA franc, and France will no longer participate in the governance of WAEMU, although it will still serve as the lender of last resort, at least initially. This reform reflects the perfectly legitimate desire of WAEMU countries to manage what is already their single currency. Its success will depend on maintaining its peg to the euro.

Change of governance

In addition to the name change, the decisions made by France and the WAEMU countries end the requirement that the Central Bank of the West African States (BCEAO) deposit at least 50% of its foreign reserves with the French Treasury[1]. French representatives also withdrew from the decision-making bodies and management of the region's monetary policy.

Yet France will continue to guarantee the unlimited convertibility of the new currency at the same fixed exchange rate of 655.957 eco for 1 euro. Technical details have not been released yet, especially the support mechanisms in case foreign reserves come under pressure. An unlimited credit line will probably be set up. Yet over the course of its existence, WAEMU has already demonstrated its resilience in the face of political and financial shocks: the state guarantee has only been activated once since its creation, just prior to the 50% devaluation of the CFA franc in 1994[2]. It resisted the 2002-2003 political crisis in Ivory Coast (the zone's biggest country) and the drop-off in commodity prices in 2015-2016. WAEMU has since rebuilt its foreign reserves to a suitable level (EUR 13 bn, the equivalent of 5.1 months of imports of goods and services at Q3 2019), thanks in part to Eurobond issues by Ivory Coast and Senegal over the past two years (totalling USD 5 bn).

Obstacles to greater flexibility

In practice, gaining monetary sovereignty will not give the region more freedom to conduct monetary policy. Although the exchange rate is fixed, the BCEAO will have to maintain the spread that already exists between its key rate (2.5%) and that of the eurozone, even though most WAEMU member countries already comply with all of the convergence criteria defined in the monetary union proposal for the ECOWAS region[3].

It is worth asking, however, if the WAEMU countries shouldn't have seized the occasion to introduce more flexibility into the currency regime, by adopting a peg to a basket of currencies with a fluctuation band. This would have given it more manoeuvring room to conduct monetary policy.

The main reason for the peg is to secure financial stability of WAEMU, which is still fragile. Since 2016, the region's current account deficit has exceeded 6% of GDP, and the IMF does not foresee any improvements before 2022, with the start-up of oil production in Senegal. Above all, public debt has increased rapidly in recent years. From 35% of GDP in 2014, the region's public debt rose to 47.6% of GDP in 2019 despite robust growth. Debt in foreign currency has followed a similar trend, gaining 11 percentage points of GDP over the past five years to 33% of GDP in 2019. Interest charges have also increased rapidly to more than 10% of the public revenues (including aid) of the Ivory Coast and Senegal.

Moreover, the price elasticity of export and import volumes is low[4] due to the high proportion of non-transformable commodity exports to total exports (54%) and an insufficient industrial base to serve as a substitute for imports. In other words, their economies are not diversified enough for currency depreciation to have a positive impact. The CFA franc's stability relative to the euro has neutralised fluctuations in oil prices (which are largely imported) given their negative correlation to the dollar. Most importantly, the states have extremely high foreign currency debts: external debt accounts for 70% of the region's total debt.

Stephane Alby - François Faure

[1] BCEAO will lose revenues on half of its foreign reserves, since the ECB paid a preferential deposit rate of 0.75%.

[2] Before 1994, it was called WAMU (West Africa Monetary Union) but the main operating principles and modes were the same (unlimited convertibility, guaranteed by the French state, existence of "comptes d'operations").

[3] Inflation of less than 10%, a fiscal deficit of less than 3% of GDP, monetary financing of the fiscal deficit of less than 10% of fiscal revenues, and a reserve coverage ratio of at least 3 months of imports.

[4] See M. Diarra "Is the balance of payments restricting economic growth in the WAEMU countries? BCEAO Economic and Monetary Review, June 2014.