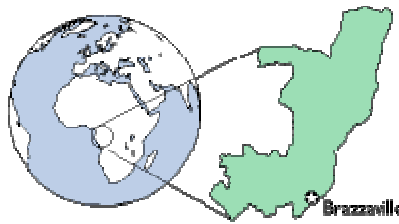


COUNTRY REVIEW

Congo, Republic



16 October 2009

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EULER HERMES COUNTRY RISK GRADE: D

Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.

Strengths

- Sub-Saharan Africa's 5th largest oil producer
- A period of high oil prices in 2004-08 led to large FX inflows and improved economic data, albeit from a low base
- Use of the CFA franc provides some mitigation against inconvertibility risk
- A peace accord in 2003 is holding
- President Sassou-Nguesso has overseen introduction of an electoral system

Weaknesses

- Oil and related products account for 90% of export revenues and FX inflows are therefore susceptible to volatility reflecting international oil prices; proven reserves will be exhausted in 21 years at current rates of extraction
- Despite some pledges to improve transparency, there are concerns relating to the finances in the oil sector
- Security and political stability remain fragile
- The business environment is weak, with relatively poor protection of rights and inefficient and opaque regulatory practices
- Poor data provision

Key Risks

- **A collapse in international oil prices would leave the fiscal and current accounts in large deficit and restrict growth prospects**

Country Risk Assessment

Ratings	Congo, Republic		Median	Nigeria	Peers	Cameroon
	Latest	Previous	Grade D		Niger	
Systemic Political Risk:	P3-	P3-	P3-	P3-	P3-	P3-
Systemic Economic Risk:	E6	E6	E6	E6	E6	E5
ME rating:	ME5	ME4	ME6	ME4	ME6	ME4
<i>Structure</i>	6.0	6.0	6.0	6.0	6.0	6.0
<i>Policy</i>	6.0	4.5	5.6	6.0	6.0	4.3
<i>Solvency</i>	4.8	5.2	4.5	1.9	4.2	2.0
<i>External Liquidity</i>	1.3	2.3	4.6	1.9	4.8	2.8
SBE rating:	SBE6	SBE6	SBE5	SBE6	SBE6	SBE5
COUNTRY GRADE:	D	D	D	D	D	C

Nomenclature:

Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).

Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).

ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).

The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).

SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).

Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Country Risk Unit

ECONOMIC STRUCTURE

Country Profile

Capital city:	Brazzaville
Population:	3.62 mn (2008)
GDP:	USD 12528 mn (2008)
Currency:	CFA Franc BEAC (XAF)
Form of state:	Republic
Head of government:	President Denis Sassou-Nguesso
Next elections:	Presidential mid-2016, legislative by June 2012

Major Industries (% of GDP at market prices, 2008e)		Global Assumptions	2009f	2010f
Agriculture	7%	Real GDP grth (% yr/yr) *	-3.9	0.9
Industry	68%	Inflation (% , av) *	-0.1	1.3
Services	25%	Dated Brent (USD/b)	61	72
		* major economies		

Main Exports (% of total, 2008e)		Main Imports (% of total, 2008e)	
Crude petroleum	90%	Items for the petroleum sector	33.0%
Timber	6%		
Lead Export Markets (% of total exports, 2007)		Lead Import Markets (% of total imports, 2007)	
US	41.0%	France	18.1%
China	36.5%	South Korea	14.7%
Taiwan	5.3%	China	12.6%
South Korea	2.5%	Italy	10.3%

Basic indicators

Selected economic indicators	2006	2007	2008	2009f	2010f
Nominal GDP (USD mn)	7,450	7,641	12,528	12,447	14,301
Population (mn)	3.49	3.55	3.62	3.69	3.76
GDP per capita (USD)	2,135	2,153	3,461	3,373	3,803
Real GDP growth (% yr/yr)	6.2	-1.6	5.6	7.0	10.0
Inflation (% , average)	6.5	2.7	7.3	7.0	5.0
Fiscal balance (% of GDP)	-	-	-	-	-
Current account balance (% of GDP)	1.7	-28.5	-6.4	-9.6	2.4
External debt/GDP (%)	80.7	67.5	39.1	38.2	31.5
External debt/Exports of goods & services (%)	94.1	83.2	48.5	67.9	53.6
Debt-service ratio (%)	1.4	1.2	0.7	1.0	0.8
Foreign exchange reserves (USD mn)	1,840	2,173	3,871	3,500	3,750
Import cover (months)	3.5	3.1	5.2	5.4	4.9
Exchange rate assumption, XAF:USD (av)	522.9	479.3	447.8	474.0	465.0
f: CRU central forecast					

Sources: Central Bank, IMF, World Bank, Euler Hermes Country Risk Unit

Political Stability

The Republic of Congo's post-independence history is one largely of political instability, reflected in a long period of single-party rule, regular coups, political assassinations and civil wars. The latest major internal conflict ended officially in March 2003 following a formal ceasefire between the government and Nsilulu rebels. This followed the endorsement via referendum of a new constitution and the election of Denis Sassou-Nguesso as president in 2002—he had held the post unofficially following a military coup in 1997. Despite reports of electoral irregularities, relative peace returned and the ruling Parti congolais du travail (PCT) now commands a large parliamentary majority and has faced little opposition in implementing policies. The PCT is supported by a loose coalition of former opposition groups, and together they hold around 70% of seats in the National Assembly. Despite allegations of electoral malpractice and a low turnout, **Sassou-Nguesso was re-elected to the presidency following polls in July 2009, thereby engendering a degree of policy continuity.** However, in September, Sassou-Nguesso announced a cabinet reshuffle and abolished the role of prime minister, taking over those duties himself under the mantle of the presidency. With executive powers effectively concentrated in one person there are concerns relating to autocracy and to succession.

Regional stability has improved following the end of civil wars in Angola and DR Congo but remains poor overall. International relations remain fragile, with lingering concerns relating to the electoral system and with reports of violations of human rights. The IMF has had an uneasy relationship with Congo and has had to suspend staff monitored programmes (SMP) and interrupt a Poverty Reduction and Growth Facility (PRGF) because of concerns relating to fiscal transparency—particularly with regard to oil revenues—and the government's intransigence with respect to resolving widespread arrears. The IMF currently oversees a PRGF that is scheduled to expire in December 2011 but **Fund disbursements and further facilities depend on government commitment to implement reforms and its achievement of a track record in attaining macro-economic targets.** Similarly, Congo will only gain maximum benefits under debt relief schemes (including enhanced HIPC) if performance matches pledges.

Links with France have been strong historically and, although the relationship suffers from periodic difficulties, commercial interests are likely to help maintain close links. However, the US, which is the lead export market for Congo oil and seeks alternative sources of oil to Middle East suppliers, is reticent in extending its relations. This fact has enabled **China to increase its influence and extend its sourcing of oil, forestry and mining supplies** from Sub-Saharan Africa.

Economic Stability

The lower-middle income economy remains structurally weak:

- armed conflict, population displacement and infrastructure demolition resulted in significant economic destruction, which will take many years to rectify
- **significant oil resources indicate a dependency on that sector (over 40% of GDP and 90% of export receipts)**
- there is as yet little track record of proven sound economic management
- despite receiving formal access to debt relief under the enhanced HIPC initiative in March 2006 a write-off under this scheme will only take place after “completion point”, the timing of which is uncertain and depends on performance criteria being achieved under assistance programmes.

A three-year IMF Poverty Reduction and Growth Facility (PRGF) was granted in December 2008 and remains central to long term prospects but depends on the authorities' ability to meet specific targets. The government initially attempted to strengthen fiscal management through tighter control on spending, settlement of some of the arrears to external creditors and instigation of reforms to the pension fund and the audit of the National Oil Company (Société nationale des pétroles du Congo, SNPC). However, Congo has a **history of failure or inability to adhere completely to Fund targets, particularly in terms of fiscal restraint**, and this has led to problematic relations with the international agency. Given a need to promote social welfare and improve living conditions through state funding, it is unlikely that fiscal tightening will receive high priority in terms of policy considerations.

Fiscal policy will therefore remain a key challenge to the local authorities and is likely to be consistently cited by the IMF as an area of economic management that requires further tightening.

Congo is a member of the Central African Monetary and Economic Community (CEMAC) and thereby is required to adhere to a common budgetary discipline and to convergence criteria. However, while budgetary revenues improved because of robust oil prices in 2004-Q3 2008 and associated FX inflows, government expenditures have consistently exceeded projections in fiscal capping plans. Data provision relating to fiscal accounts is relatively poor but it is estimated that the deficit excluding oil is one of the largest in Africa and overall public debt remains high at around 60-80% of GDP, thereby supporting the Fund's advice for a firmer management of budgetary policy.

Membership of the Central African Monetary and Economic Community (CEMAC), provision under a joint central bank (Banque des états de l'Afrique centrale (BEAC) within that regional union and use of the CFA franc as a common currency provide monetary stability. Accordingly, **with little difficulty in raising FX, transfer risk is minimal**. Inflationary pressures are relatively subdued, although high global prices for food and commodities increased annual average inflation from 2.7% in 2007 to over 7% in 2008. **Inflationary pressures will ease through the remainder of this year and into 2010, with average inflation next year of around 5%.**

The **external accounts are dependent on the vagaries of international oil markets** and, as such, we estimate that a **current account deficit equivalent to over 6% of GDP was recorded in 2008** when benchmark Brent oil prices reached a peak of USD146/barrel, compared with a deficit of 28.5% of GDP in 2007 when oil averaged USD72/b. We forecast that the current account deficit will expand to 9.6% of GDP before registering a small surplus in 2010 as some import demand for large oil-related projects tails off. Despite some debt relief through the London and Paris Clubs of creditors, foreign debt stock remains onerous, given the development needs of the economy. We forecast that foreign debt in 2009 will be 38% of GDP and 68% of export earnings, although foreign debt service will consume only 1% of export earnings. There are some uncertainties relating to the transparency of loans from China and whether these transactions are recorded in official debt statistics. **Without a satisfactory record with IMF loan conditionality, Congo is unlikely to reach its completion point under the HIPC initiative.** In any event, further debt relief is unlikely through that mechanism until H2 2010, at the earliest.

Although public buyer risk is considerable, **private sector transfer risk is largely mitigated by CEMAC membership and use of the CFA franc.**

Structural Business Environment

The **business environment is weak and well below average** for the countries we assess. The Heritage Foundation's Index of Economic Freedom (IEF) 2009 classifies the country in its lowest category, labelled as "repressed", and ranks Congo 166 out of 179 countries covered, below Chad, Angola and Guinea-Bissau but above Belarus, Iran and Libya. The IEF indicates that **business is particularly hampered through regulatory problems** (corruption, inefficient government services and bribery), **insufficient property rights** (including a judicial system that is not independent) **and an inefficient trade policy** (high non-tariff barriers, bureaucracy and a poor customs service). The World Bank's Doing Business 2010 survey instructively ranks Congo 179 out of 183 countries assessed in terms of the overall ease of doing business, below Eritrea, Burundi and Chad and above only São Tomé & Príncipe, Guinea-Bissau, Democratic Republic of Congo and Central African Republic. Congo is among the worst countries for indicators such as trading across borders, paying taxes, registering property and protection of investors. The World Bank indicates that the recovery rate because of insolvency is slightly better than the regional average but the cost of resolving bankruptcies is higher than average. Enforcing contracts in Congo is more costly (53% of the debt) and requires more procedures (44) than the regional averages (49% and 39, respectively) but the procedure takes less time (560 days rather than the average 643 days). In terms of corruption, Transparency International's Corruption Perceptions Index 2008 ranks the country 158= (with Angola, Guinea-Bissau and Sierra Leone) out of 180 countries assessed, below Côte d'Ivoire, Ecuador and Papua New Guinea but above Cambodia, Turkmenistan and Democratic Republic of Congo.

Commercial banking is now dominated by the private sector but institutions were adversely affected by the country's history of civil conflicts and bad debts remain a challenge. The state is still dealing with non-performing loans (NPLs) accumulated by state-owned banks before privatisation because of poor management and political interference. Bank accounts are held by less than 5% of the population and the generally poor availability of formal financial institutions has led to rapid growth in micro-financing.

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Charts

