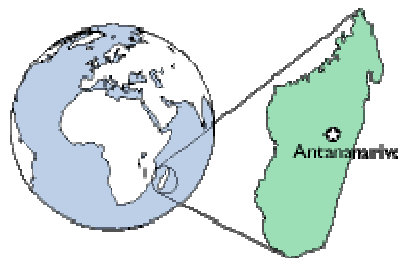


COUNTRY REVIEW

Madagascar



5 August 2010

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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.**

COUNTRY PROFILE

Capital city:	Antananarivo
GDP:	USD9.6bn (2009e)
Population:	19.6mn (2009e)
GDP per capita:	USD490 (2009e)
Currency:	Ariary (MGA)
Form of state:	Republic
Head of government:	(De facto) President Andry Rajoelina
Next elections:	Legislative by September 2010; presidential by November 2010 (but timetable is subject to change)

Andry Rajoelina is head of a transitional authority, Haute autorité pour la transition (HAT), and performs a largely presidential role, although this is not accepted by all domestic or international agencies. Rajoelina has scheduled a referendum on constitutional reform for August 2010, legislative elections for September and a presidential poll for November but this **electoral timetable is subject to change**. Moreover, the intentions of Rajoelina, who announced that he will not stand in the November polls, are uncertain and he may yet seek to remain in power. Resolution of the political impasse—President Marc Ravalomanana and his government were forced out of office in early 2009—is far from assured. International aid is on hold because of the political deadlock and the associated loss of funding is **increasing social pressures and tensions**. **If a political compromise cannot be worked out, the security forces may feel the need to intercede directly in order to stabilise the country.**

Regional relations focus on Madagascar's ties with the mainland, in general, and the Southern African Development Community (SADC), in particular. In terms of wider international relations, **links with France and the EU (an interim Economic Partnership Agreement, EPA, was signed in 2008) remain strong** and Madagascar generally maintains sound ties with the IFIs and wider donor community. However, **concerns are raised about human rights, governance and transparency** and recent domestic political developments have interrupted funding flows and inward investments. As with other resource-rich African states, China is increasing its investments and trade links.

The **economy is vulnerable to exogenous shocks**:

- intermittent cyclones and drought;
- volatility in key commodity prices (notably for oil imports and vanilla exports);
- termination at the end of 2004 of the Multi-Fibre Arrangement (MFA), which opened global markets to increased competition in the ready-made garment sector (providing Madagascar's principal shipments from its Export Processing Zones, EPZ) from large producers such as China and India; and
- the limited openings under the revised US African Growth and Opportunities Act (AGOA). Indeed, because of the current political crisis, US trade privileges (particularly for the textile sector) are suspended.

Mining is a growth industry, with **precious gems (particularly emeralds and sapphires—Madagascar is the world's main supplier of the latter)** to the fore but with known reserves of nickel, cobalt, titanium and gold, among other ores and minerals. Most mining is still conducted by small-scale operators and output is often channelled through unofficial sources. Control and regulation of the mining sector is a challenge for the government going forward but also offers considerable scope for improving fiscal and export receipts. In addition, **discoveries of oil indicate that Madagascar could become a small commercially-viable producer** within a few years (pilot wells pumped the first crude in 2008), with a potential annual income of around USD1bn from that source. The oil sector could become the principal contributor to the country's GDP but Madagascar, in addition to resolving its current political crisis and engendering a more-positive environment for foreign investment, will have to guard against a privileged elite benefiting from oil revenues to the detriment of the population at large.

The domestic political crisis following the overthrow of the Ravalomanana government coincided with the global economic downturn and we estimate that **real GDP contracted by 1-2% in 2009**. The economic and business outlook is highly uncertain, with much depending on resolution of the political impasse and re-instatement of aid and other disbursements. In any event, key European markets are

likely to be lacklustre in the ST. As a result, **we forecast that annual real GDP growth will contract further, by 2% in 2010, and positive growth is unlikely to exceed 2-3% in 2011.** Even that presupposes that the elections will proceed broadly according to schedule and that aid and other funding is restored in early 2011. In June 2010, the EU renewed its suspension of development aid and the AU still applies sanctions, so that all budgetary assistance is on hold. Madagascar does not have a current IMF programme or active lending facility from the Fund.

At the beginning of 2005, the official unit of **currency was changed from the Malagasy franc to the ariary**, at a conversion rate of one new unit to five old francs. The ariary was phased in over a number of years and its replacement of the franc was intended to show the country's independence from the old colonial power but also was introduced to nullify the widespread counterfeit francs in circulation. The Malagasy franc had itself replaced the CFA franc in 1973 when Madagascar abandoned the currency's fixed link with the French franc. Reflecting negative political and economic environments, **the ariary is likely to depreciate over the next twelve months, at least.**

The external accounts improved through debt relief under the Multilateral Debt Relief and HIPC initiatives. However, the trade and current accounts are vulnerable because the leading export categories are all subject to market uncertainties outside the control of local authorities. The **textile sector (contributing over 30% of exports)** has to adjust to changing global circumstances, following the expiry of the Multi-Fibre Arrangement at the beginning of 2005. **Vanilla constitutes the second largest export category** but prices have fallen because of synthetic substitutes (now accounting for 99% of production) and increased output from Papua New Guinea, Uganda, India, Costa Rica and Colombia. Overall, **we forecast that the current account deficit will remain in a range of 6-10% of GDP in 2010 and 2011**, again indicating a need to resolve the political crisis and associated withholding of aid and other inward financial flows.

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