



UNION OF THE COMOROS

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION— DEBT SUSTAINABILITY ANALYSIS

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Prepared by the staffs of the IMF and World Bank

Based on the external LIC DSA, Comoros' risk of debt distress is assessed as moderate rather than high, as was the case in the previous DSA update for the sixth review under the previous ECF completed in December 2013. The full inclusion of remittances in the analysis is the main reason for the improved debt sustainability outlook. Public sector domestic debt and private sector external debt are minimal in Comoros and are expected to remain so for the foreseeable future.¹

¹ Figure A2 shows the public sector debt dynamics.

BACKGROUND

1. Comoros reached the completion point under the HIPC Initiative in December 2012.

Following agreements with all, but one,¹ bilateral creditors, Comoros received extensive irrevocable debt relief in 2013 which resulted in a decline in nominal external debt from 40.3 percent of GDP at end-2012 to 18.5 percent at end-2013 (Text Table 1, Table A1). In 2014, France unilaterally cancelled a debt of about \$6.6 million Comoros owed to the French Post Office. All the debt and debt service indicators were brought to well below their respective thresholds of the debt sustainability framework. Since the completion point, Comoros has contracted only one external loan, with India of about \$42 million for the construction of a heavy-fuel electricity generation plant that is projected to be disbursed over 2015–18. Comoros has incurred some arrears (about \$1 million) on rescheduled payments under the bilateral agreements; these are expected to be paid before end-2014.

Text Table 1. Nominal Stock of External Debt, 2014¹ (Millions of U.S. Dollars; end-of-period)	
Total External Debt	125.0
Multilateral Creditors	80.8
IMF	19.9
IDA	14.2
BADEA	28.3
Other multilateral creditors	18.4
Official Bilaterals	44.2
Paris Club Creditors	6.9
Non-Paris Club Creditors	37.3
Mauritius	0.8
Kuwait	27.3
India ²	0.0
¹ Following Paris Club cancellation of all its HIPC-eligible debt, rescheduling of short-term debt in arrears, and restructuring non-Paris club debt.	
² Disbursements of \$41.6 million are expected over a 4-year period, starting in 2015	
Source: Comorian authorities	

¹ Mauritius is the remaining holdout; negotiations are ongoing.

UNDERLYING ASSUMPTIONS

2. **The medium-term macroeconomic framework has been updated for the 2014 Article IV consultation and the long-term assumptions revised since the last DSA update was prepared in December 2013.**¹ The long-term assumptions on growth and inflation have been retained broadly unchanged from the previous. However, the projected current account deficits have been revised upwards to reflect an upward revision in project grants and external financing.

- **Real GDP growth** is assumed to be 3.3 percent and 3.5 percent in 2014 and 2015, respectively, and stabilize at 4 percent per year thereafter. This represents a growth acceleration relative to the historical record reflecting improved prospects for political stability and governance, as well as the planned reforms in the electricity and telecom sectors, the coming on stream of a large fishing project, and continues strong investment financed by donors in the construction of roads, schools, and hospitals. However, with population growth at about 3 percent per year, this growth assumption is modest in per capita terms.
- **Inflation** is assumed to average around 3 percent per year, anchored by Comoros' exchange rate peg under the monetary cooperation agreement with France.
- The **current account deficit** is projected to average around 10.5 percent of GDP per year over the medium term and thereafter decline gradually to 6 percent of GDP by the end of the projection period, representing a continuation of net resource transfers to Comoros in support of growth and development, albeit at a slowly declining rate. The drop in international commodity prices will also help contain the imports bill. In addition to the full inclusion of remittances, this is the most significant difference with respect to the previous DSA which had the current account deficit narrowing more significantly over the long term. The projected current account deficit is also larger than before because of a technical upward revision of non-factor service imports.
- **Exports** are assumed to grow somewhat faster than **imports** over the projection period but from a very low base.
- **Private remittances from** the diaspora in France, which have been resilient in the face of the recession and slowdown in Europe, are projected to continue to growth in nominal terms but decline gradually relative to GDP, from 26.4 percent in 2014 to 24 percent by 2019 and 16 percent by 2034. These remittances are assumed to continue to finance a substantial part of imports to Comoros.

¹ Appendix 2, Staff Report for Sixth Review under the ECF.

- **Gross investment** in support of growth and development is assumed to stabilize at close to 24 percent of GDP. Reforms in key sectors such as energy and telecommunications are expected to lead to higher FDI inflows during the projection period.
- **Public investment** is projected to account for more than half of investment, initially mainly financed by project grants. Over time, foreign borrowing (on somewhat concessional terms; a grant element of 32 percent, corresponding to non-Paris Club bilateral terms in the LIC DSA template) is assumed to gradually replace some of the grant financing so that by 2034 grants account for two-thirds of foreign-financed capital spending and semi-concessional loans for one-third. This assumed pattern of external financing would seem justified in view of the limited growth in per capita GDP that is projected over the next two decades. Domestically-financed capital spending is projected to rise modestly over the projection period. No domestic borrowing by the government is assumed.
- The overall **fiscal deficit** is projected to average around 2-3 percent of GDP and be mainly financed through external loans for investment purposes.

EXTERNAL DSA

A. Remittances Scenario

3. Comoros qualifies for the inclusion of private remittances in the denominator of the debt and debt service indicators for the purposes of the baseline of the DSA. For Comoros, private remittances represent a large and reliable source of foreign exchange—currently well in excess of 25 percent of GDP—and sizable inflows are expected to continue over the medium and long term. That said, the debt sustainability outlook is sensitive to the level of remittance flows, which more than doubled relative to GDP between 2003 and 2013, and are potentially subject to downside risk.

4. The inclusion of remittances in the debt sustainability analysis leads to a marked improvement in the debt and debt service indicators relative to the previous traditional non-remittances baseline scenario. Under the remittances baseline, there are no breaches of debt or debt service thresholds in the baseline. (Figure A1, Tables A1 and A2). Debt burdens rise gradually toward the end of the projection period reflecting the assumption of only a modest level of external borrowing during the projection period, based on Comoros' continuing status as a fragile low income country. The ratio PV of debt to exports plus remittances shows a modest breach of its threshold under the shocks to non-debt creating inflows¹ and the same indicator breaches the threshold late in the projection period in the historical scenario. The initial improvement in the debt and debt service indicators under the historical scenario mainly reflects the fact that the projected current account deficits in the baseline are larger than the historical deficits over the medium term. The historical scenario is, therefore, over-financed during this

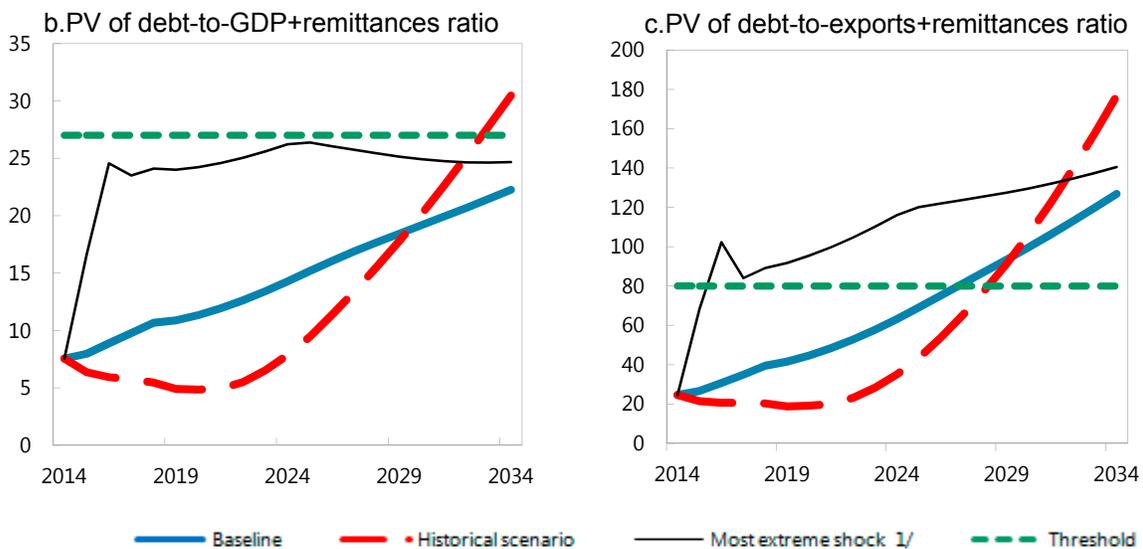
¹ These non-debt creating inflows represent mainly remittances in the case of Comoros. As the remittances have been growing rapidly over the last decade their historical standard deviation is large, which accounts for the severity of this shock.

period. The opposite is the case for the latter part of the projection period, when the projected current account deficit falls below the historical average, leading to under-financing and the need for additional borrowing.

B. Customized Scenarios—Lower Remittances and Higher Borrowing

5. A customized scenario with lower remittances than in the baseline underscores larger debt vulnerabilities. Rather than assuming a gradual rise in the nominal value of remittances, this scenario assumes that levels stabilize at current nominal levels (thereby declining faster in relation to GDP than in the baseline). The DSA is much less favorable on this basis, with a sustained breach of the PV of debt-to-GDP plus remittances threshold in both the baseline and in the stress tests (Text Figure 1). Given the recent marked changes in the level of measured remittances and corresponding uncertainties about the future path, this alternative scenario further underpins for a “moderate” risk rating for external debt distress.

Text Figure 1. Comoros: Indicators of Public and Publicly Guaranteed External Debt under Lower Remittances Scenario Including Remittances, 2014–2033 1/



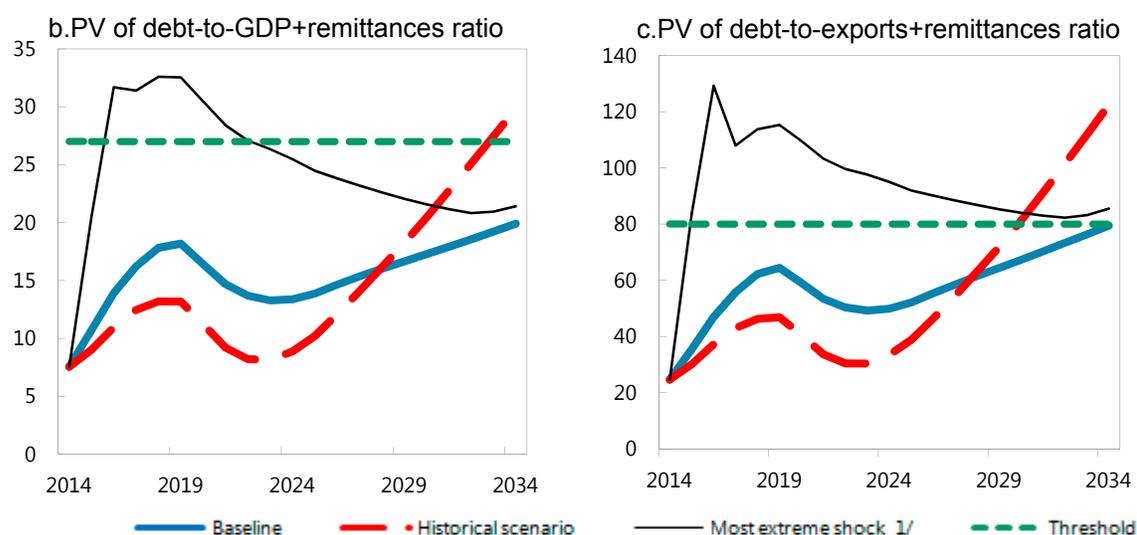
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024. In figure b, it corresponds to a Non-debt flows shock; in c, to a Non-debt flows shock

6. The debt sustainability outlook for Comoros would also deteriorate somewhat were the country to engage in significant external borrowing over the medium term, particularly if that borrowing were on commercial or near-commercial terms. Additional external borrowing on commercial terms amounting to about 5 percent of GDP per year would not on its own lead to breaches of thresholds under the baseline but to several breaches under alternative scenarios and stress tests (Text Figure 2). While it is unlikely that Comoros could find creditors that would be willing to extend this amount

of credit to the country on an ongoing basis, this scenario underlines that Comoros's scope for external borrowing, especially on commercial terms is limited

Text Figure 2. Comoros: Indicators of Public and Publicly Guaranteed External Debt under High Borrowing Scenario Including Remittances, 2014–2033 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024. In figure b, it corresponds to a Non-debt flows shock; in c, to a Non-debt flows shock

DEBT DISTRESS CLASSIFICATION AND CONCLUSION

1. In light of the revised DSA, it is the view of the staffs of the IMF and the World Bank that Comoros' risk of debt distress rating should be upgraded from high to moderate, a view that the country authorities share. The analysis shows that, taking remittances into account, the debt and debt service indicators remain below the applicable thresholds in the baseline, and that there are only modest breaches under alternative scenarios and stress tests. However, customized scenarios show that debt sustainability is sensitive to both the level of remittance flows and to external borrowing levels over the medium-term. These findings underline the importance of fostering a climate conducive to maintaining high levels of remittances that can be used productively, and limiting recourse to external financing, particularly on non-concessional terms. It also highlights the importance of striving to maintain higher growth levels compared to historical average by implementing planned structural reforms in infrastructure and the businesses environment, the electricity and the telecom sectors in a timely fashion.

Table A1. Comoros: External Debt Sustainability Framework, Baseline Scenario, 2011-2034
1/(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average ^{6/}	Standard Deviation ^{6/}	Projections					2014-2019		2020-2034		
	2011	2012	2013			2014	2015	2016	2017	2018	2019	Average	2024	2034	Average
External debt (nominal) 1/	44.7	40.5	18.5			17.5	17.5	18.4	19.3	20.3	20.0		22.7	30.7	
<i>of which: public and publicly guaranteed (PPG)</i>	44.7	40.5	18.5			17.5	17.5	18.4	19.3	20.3	20.0		22.7	30.7	
Change in external debt	-4.5	-4.2	-22.0			-0.9	0.0	0.9	0.9	1.0	-0.2		0.7	0.9	
Identified net debt-creating flows	2.1	7.6	6.1			4.8	8.4	8.2	7.7	7.9	7.3		5.2	2.9	
Non-interest current account deficit	10.9	7.9	11.2	7.7	2.7	7.3	10.9	10.7	10.3	10.7	10.2		8.3	6.2	7.8
Deficit in balance of goods and services	33.9	39.0	42.2			36.5	38.7	37.3	36.1	35.7	34.5		30.1	23.9	
Exports	16.2	14.9	14.9			14.5	14.5	14.4	14.3	14.2	14.1		13.6	12.7	
Imports	50.2	53.9	57.2			50.9	53.2	51.7	50.4	49.9	48.6		43.7	36.6	
Net current transfers (negative = inflow)	-22.8	-31.4	-30.8	-22.8	6.4	-29.2	-27.8	-26.6	-25.7	-24.9	-24.1		-21.6	-17.3	-20.3
<i>of which: official</i>	2.2	4.1	-0.5			0.2	1.0	1.3	1.3	1.3	1.3		1.2	1.0	
Other current account flows (negative = net inflow)	-0.2	0.3	-0.2			0.0	0.0	0.0	-0.1	-0.1	-0.1		-0.2	-0.5	
Net FDI (negative = inflow)	-3.8	-1.7	-1.4	-1.4	1.2	-2.0	-2.0	-2.0	-2.1	-2.3	-2.5		-2.7	-2.7	-2.7
Endogenous debt dynamics 2/	-5.0	1.4	-3.7			-0.5	-0.5	-0.5	-0.5	-0.5	-0.5		-0.4	-0.5	
Contribution from nominal interest rate	0.3	0.3	0.1			0.1	0.1	0.1	0.2	0.2	0.3		0.4	0.6	
Contribution from real GDP growth	-1.0	-1.4	-1.3			-0.6	-0.6	-0.6	-0.7	-0.7	-0.7		-0.8	-1.1	
Contribution from price and exchange rate changes	-4.4	2.5	-2.5			...	...	...	...	...	...		...	...
Residual (3-4) 3/	-6.6	-11.8	-28.1			-5.7	-8.5	-7.2	-6.9	-7.0	-7.5		-4.4	-2.0	
<i>of which: exceptional financing</i>	-4.0	-0.1	0.0			-0.9	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	13.1			12.3	12.7	13.6	14.4	15.2	15.2		18.0	24.0	
In percent of exports	...	...	87.6			85.3	87.7	94.4	100.7	107.2	108.0		132.4	188.4	
PV of PPG external debt	...	...	13.1			12.3	12.7	13.6	14.4	15.2	15.2		18.0	24.0	
In percent of exports	...	...	87.6			85.3	87.7	94.4	100.7	107.2	108.0		132.4	188.4	
In percent of government revenues	...	...	84.5			84.6	83.6	86.4	87.9	89.5	88.8		95.2	105.1	
Debt service-to-exports ratio (in percent)	10.1	10.4	2.1			2.5	2.4	4.2	4.7	5.6	6.1		5.0	12.2	
PPG debt service-to-exports ratio (in percent)	10.1	10.4	2.1			2.5	2.4	4.2	4.7	5.6	6.1		5.0	12.2	
PPG debt service-to-revenue ratio (in percent)	10.2	8.0	2.0			2.4	2.3	3.8	4.1	4.7	5.0		3.6	6.8	
Total gross financing need (Millions of U.S. dollars)	53.5	46.2	66.4			40.5	70.2	75.7	78.4	87.4	88.1		91.0	142.9	
Non-interest current account deficit that stabilizes debt ratio	15.4	12.1	33.3			8.2	10.9	9.7	9.5	9.7	10.5		7.6	5.2	
Key macroeconomic assumptions															
Real GDP growth (in percent)	2.2	3.0	3.5	1.9	1.4	3.3	3.5	4.0	4.0	4.0	4.0	3.8	4.0	4.0	4.0
GDP deflator in US dollar terms (change in percent)	9.8	-5.2	6.5	5.5	6.8	5.4	2.2	3.5	3.9	3.7	3.7	3.7	3.0	2.7	3.0
Effective interest rate (percent) 5/	0.8	0.7	0.2	0.6	0.2	0.4	0.6	0.8	1.0	1.2	1.4	0.9	1.9	2.1	1.9
Growth of exports of G&S (US dollar terms, in percent)	15.7	-10.3	10.5	6.0	9.0	5.6	5.8	7.0	7.2	7.0	7.0	6.6	6.3	6.3	6.3
Growth of imports of G&S (US dollar terms, in percent)	12.7	5.0	16.9	14.4	10.3	-2.9	10.5	4.5	5.3	6.7	4.9	4.8	4.7	5.0	5.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	38.3	32.0	32.0	32.0	32.0	32.0	33.1	32.0	32.0	32.0
Government revenues (excluding grants, in percent of GDP)	16.1	19.3	15.5			14.6	15.2	15.7	16.4	17.0	17.1		18.9	22.8	20.1
Aid flows (in Millions of US dollars) 7/	45.6	54.9	171.1			63.8	68.5	70.8	76.5	82.4	87.5		113.8	187.7	
<i>of which: Grants</i>	45.6	54.9	171.1			63.8	68.5	70.8	76.5	82.4	87.5		113.8	187.7	
<i>of which: Concessional loans</i>	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			8.9	9.5	9.5	9.6	9.6	9.1		8.7	7.8	8.4
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			100.0	91.3	84.0	83.8	82.8	87.9		83.6	75.0	81.0
Memorandum items:															
Nominal GDP (Millions of US dollars)	611.0	596.3	657.7			716.6	758.2	816.1	881.2	949.8	1023.9		1442.5	2854.5	
Nominal dollar GDP growth	12.2	-2.4	10.3			9.0	5.8	7.6	8.0	7.8	7.8	7.7	7.1	6.9	7.1
PV of PPG external debt (in Millions of US dollars)	...	...	86.2			88.0	96.6	111.3	127.2	145.0	156.3		260.5	686.3	
(Pvt-Pvt-1)/GDPt-1 (in percent)	...	...	...			0.3	1.2	1.9	2.0	2.0	1.2	1.4	2.0	2.3	2.0
Gross workers' remittances (Millions of US dollars)	112.6	152.6	159.2			167.3	170.8	176.8	183.7	192.3	201.4		260.3	469.1	
PV of PPG external debt (in percent of GDP + remittances)	...	...	10.5			10.0	10.4	11.2	11.9	12.7	12.7		15.3	20.6	
PV of PPG external debt (in percent of exports + remittances)	...	...	33.4			32.6	34.3	37.7	41.0	44.2	45.1		56.9	82.2	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	0.8			0.9	0.9	1.7	1.9	2.3	2.5		2.1	5.3	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - \rho(1+g)] / (1+g+\rho+g\rho)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

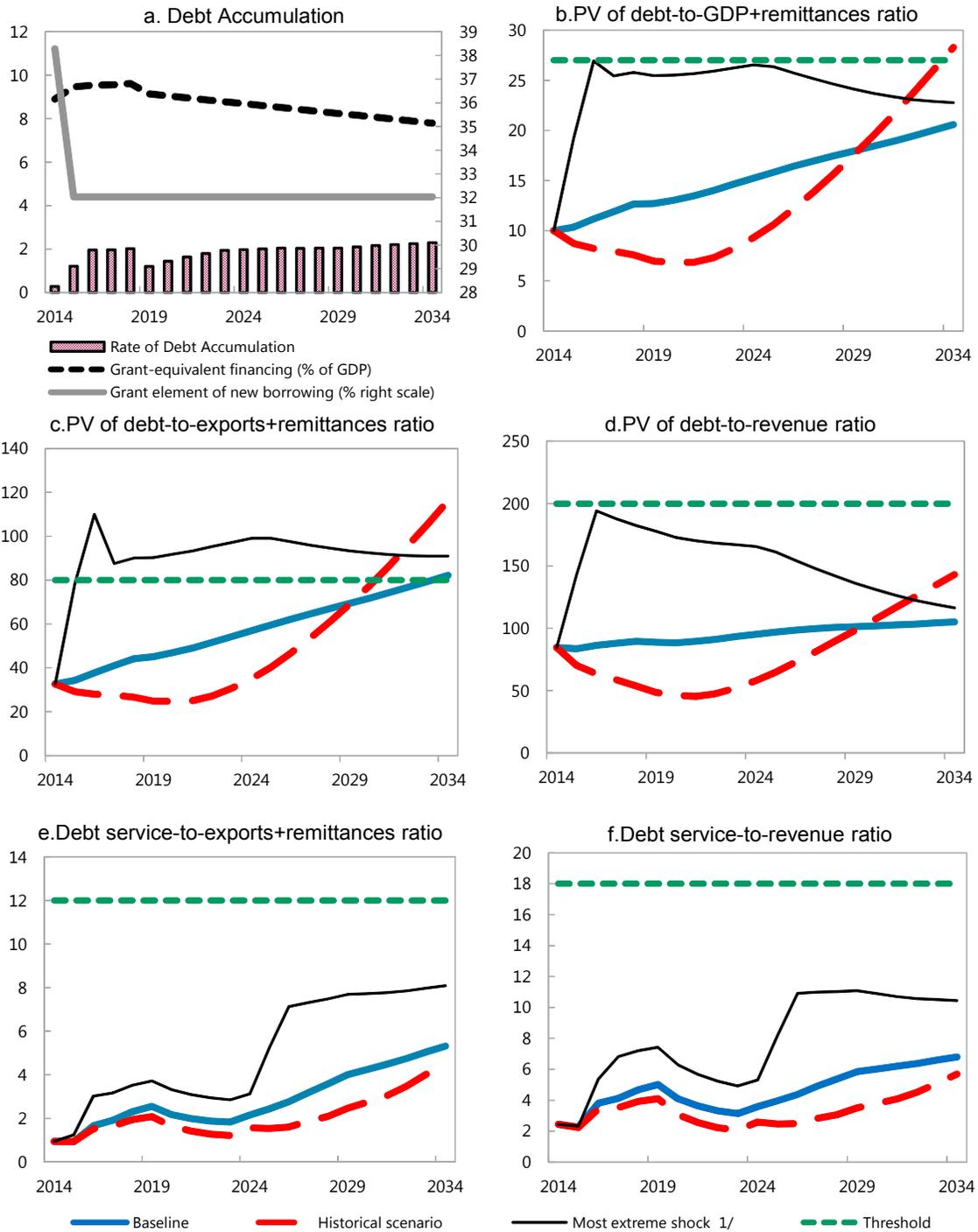
5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Figure A1. Comoros: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2014-2034 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024. In figure b. it corresponds to a Non-debt flows shock; in c. to a Non-debt flows shock; in d. to a Non-debt flows shock; in e. to a Non-debt flows shock and in figure f. to a Combination shock

Table A2. Comoros: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014-2034
(In percent)

	Projections							2034
	2014	2015	2016	2017	2018	2019	2024	
PV of debt-to-GDP+remittances ratio								
Baseline	10	10	11	12	13	13	15	21
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	10	9	8	8	8	7	9	28
A2. New public sector loans on less favorable terms in 2014-2034 2	10	11	12	13	14	15	19	29
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	10	11	12	13	13	13	16	22
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	10	11	13	14	15	15	17	21
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	10	11	12	13	14	14	16	22
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	10	19	27	25	26	25	27	23
B5. Combination of B1-B4 using one-half standard deviation shocks	10	18	25	24	25	25	26	24
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	10	14	15	16	17	17	20	28
PV of debt-to-exports+remittances ratio								
Baseline	33	34	38	41	44	45	57	82
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	33	29	28	28	27	25	35	116
A2. New public sector loans on less favorable terms in 2014-2034 2	33	35	40	45	50	52	71	115
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	33	34	38	41	44	45	57	83
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	33	38	48	51	55	56	68	91
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	33	34	38	41	44	45	57	83
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	33	78	110	88	90	90	99	91
B5. Combination of B1-B4 using one-half standard deviation shocks	33	67	96	80	83	83	93	90
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	33	34	38	41	44	45	57	83
PV of debt-to-revenue ratio								
Baseline	85	84	86	88	89	89	95	105
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	85	70	63	59	54	49	58	143
A2. New public sector loans on less favorable terms in 2014-2034 2	85	86	92	97	102	103	119	147
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	85	86	92	94	96	95	102	112
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	85	89	103	103	103	102	106	107
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	85	87	94	96	98	97	104	115
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	85	143	194	188	182	178	166	116
B5. Combination of B1-B4 using one-half standard deviation shocks	85	134	189	184	179	175	165	122
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	85	119	123	125	127	126	135	149

Table A2. Comoros: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014-2034 (continued)
(In percent)

Debt service-to-exports+remittances ratio								
Baseline	1	1	2	2	2	3	2	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	1	1	2	2	2	2	2	5
A2. New public sector loans on less favorable terms in 2014-2034 2	1	1	2	2	3	3	3	8
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	1	1	2	2	2	3	2	5
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	1	1	2	2	3	3	2	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	1	1	2	2	2	3	2	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	1	1	3	3	4	4	3	8
B5. Combination of B1-B4 using one-half standard deviation shocks	1	1	3	3	3	4	3	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	1	1	2	2	2	3	2	5
Debt service-to-revenue ratio								
Baseline	2	2	4	4	5	5	4	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	2	2	3	4	4	4	3	6
A2. New public sector loans on less favorable terms in 2014-2034 2	2	2	4	4	5	6	5	11
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	2	2	4	4	5	5	4	7
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	2	2	4	5	5	5	4	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	2	2	4	4	5	5	4	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	2	2	5	7	7	7	5	10
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	5	7	7	7	5	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	2	3	5	6	7	7	5	10
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	31	31	31	31	31	31	31	31

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

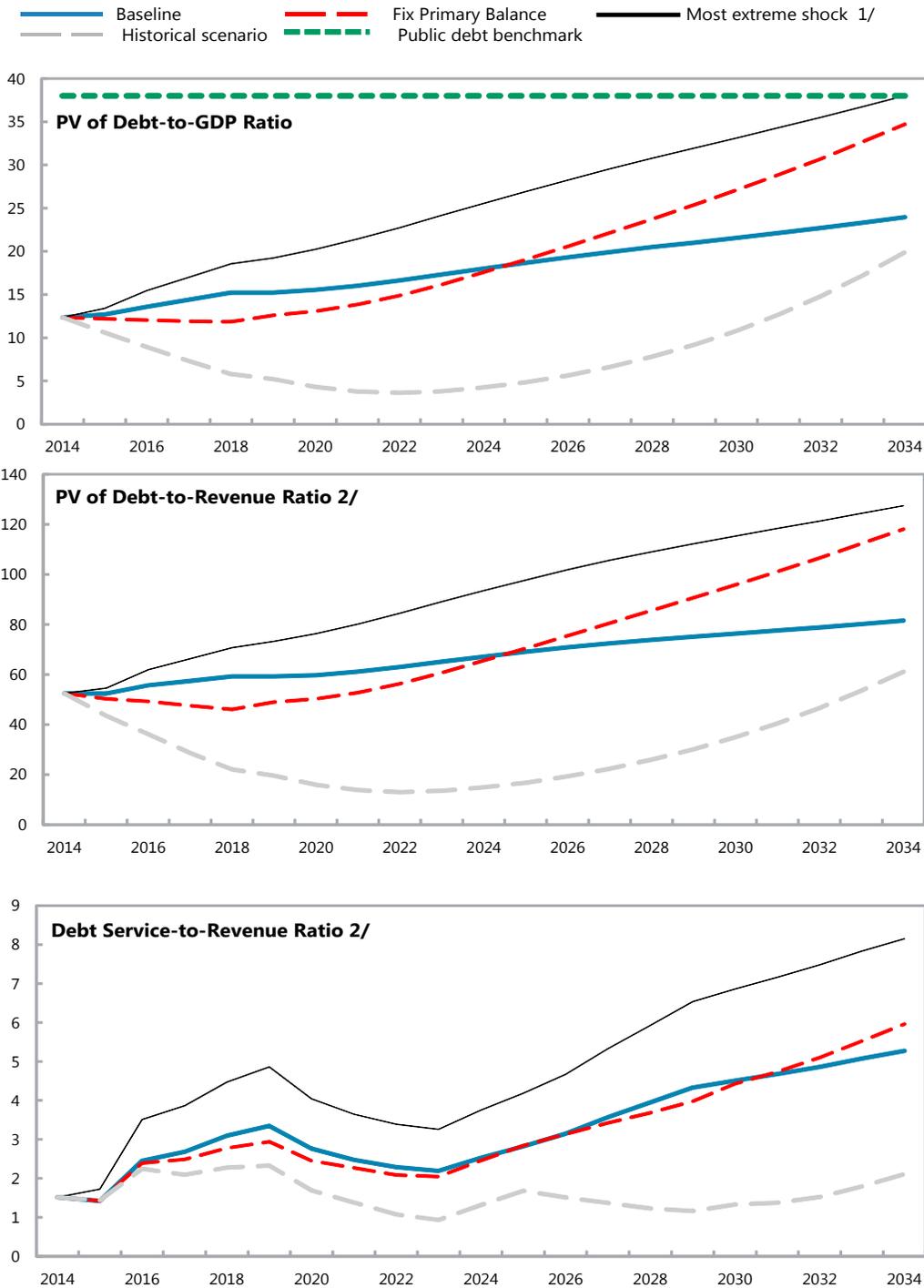
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure A3. Comoros: Indicators of Public Debt Under Alternative Scenarios, 2014-2034 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024.

2/ Revenues are defined inclusive of grants.



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Washington, D.C. 20431 USA

IMF Executive Board Concludes 2014 Article IV Consultation with the Union of Comoros

On February 4, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the 2014 Article IV consultation¹ with the Union of Comoros.

Comoros is a small, low-income and fragile-three island state with limited natural resources and connectivity to the rest of the world. Political instability and fractious inter-island relations marked the country during the first decades after independence from France in the mid-1970s. Political stability and economic turnaround have been in place following the adoption of a new constitution in 2009. Under the 2009–13 Extended Credit Facility (ECF) arrangement the secular decline in per capita GDP slowed. Additionally, authorities made progress in consolidating macroeconomic stability and advancing structural reforms that enabled Comoros to complete the Heavily Indebted Poor Countries (HIPC) Initiative in December 2012.

Economic growth was 3.5 percent in 2013 but is estimated to have eased to 3.3 percent in 2014, adversely affected by electricity disruptions and slower-than-expected implementation of the public investment program. Inflation has remained subdued in the low single digits. The current account deficit is projected to narrow to 7.4 percent of GDP in 2014 from 11.3 percent in 2013, reflecting a contraction in imports that resulted from lower imports of investment goods and lower fuel import prices, as well as higher remittances.

Economic growth is expected to firm to 3.5 percent in 2015, despite continuing headwinds from the electricity sector and a tight fiscal situation, supported by an acceleration in the pace of implementation of foreign-financed public investment and lower fuel prices. For the

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

medium term, staff's baseline assumption is that economic growth will average around 4 percent per annum, provided that reforms are implemented.

Implementation of the 2014 budget was challenging, particularly after mid-year. While revenues were broadly on target, resources were inadequate to meet the higher-than-budgeted wage bill resulting from an increase in teacher salaries and previously un-budgeted expenditures. Domestically-financed investment spending was severely constrained and temporary arrears were incurred on salaries and external debt.

The key short-term challenge is to find a better balance between available resources and expenditures so that arrears can be avoided. Spending plans need to be based on realistic expectations of the resources likely to be available. The 2015 budget is premised on this principle, but the scope for domestically-financed investment is inadequate, as obligatory spending on wages and salaries and debt service absorb most of domestic revenue.

For the medium term, the key challenges are to create fiscal space for infrastructure investment and social spending, accelerate inclusive growth and employment generation, and reduce poverty. The authorities need to focus their efforts on strengthening revenue administration and public financial management to expand fiscal space and improve transparency. Weaknesses in the business environment, including inadequate infrastructure, especially in the energy sector, and difficulties in contract enforcement represent important challenges.

Based on the external low income country debt sustainability analysis, IMF and World Bank staff have re-assessed Comoros' risk of debt distress as moderate rather than high, which was the case in the previous DSA update completed in December 2013. The full inclusion of remittances in the analysis is the main reason for the improved debt sustainability outlook.

Executive Board Assessment²

Executive Directors welcomed Comoros's improved policy implementation and economic performance in recent years. However, Directors noted that significant challenges remain—including high poverty, inadequate infrastructure, and vulnerabilities characteristic of small island economies. Prudent macroeconomic policies and stepped-up reform efforts are needed to bolster resilience, enhance competitiveness, and foster inclusive growth.

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and the summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Directors saw achieving fiscal stability as a key near-term objective. Regretting the incurrence of domestic arrears in 2014, they encouraged the authorities to strike a better balance between available resources and expenditures. In this regard, Directors welcomed the government's decision to base the 2015 budget on more realistic assumptions, and advised both enhanced prioritization and restraint, including containment of the wage bill.

Directors called for efforts to strengthen revenue mobilization and public financial management, and encouraged the authorities to implement quick-win reforms in both areas. They noted that revenue collection trails that of peer economies, and recommended strengthening administration through more effective management of the large tax payer list, better enforcement of compliance, and streamlining exemptions. Strengthening public financial management would help to limit the incurrence of arrears, enhance fiscal transparency and credibility of the budget, and create space for infrastructure investment and priority social spending. Directors noted the improvement in Comoros's debt distress rating, and encouraged the authorities to continue to rely on grants and concessional financing.

Directors cautioned against excessive reliance on the potentially volatile proceeds from a new Economic Citizenship Program, and advised allocating these resources to investment projects, restructuring public enterprises, and strengthening external buffers. Strong safeguards are also needed to help prevent misuse of the program.

Directors stressed the need to develop the financial sector, and strengthen the central bank's regulatory and supervisory oversight, including through risk-based supervision. They called for the development, with Fund technical assistance, of a resolution strategy to accelerate the recapitalization and restructuring of the Postal Bank.

Directors encouraged the authorities to expedite the pace of structural reforms in order to boost external competitiveness and growth prospects. Efforts are needed to strengthen the business climate through the removal of key supply-side constraints in the electricity, telecommunications, and financial sectors. Directors welcomed the progress in preparing a new Poverty Reduction Strategy, while calling for a strong private sector development component aimed at improving the attractiveness of the Comorian economy.

Directors encouraged the authorities to improve data quality and timeliness by prioritizing allocations to the new statistical agency and working with technical assistance providers.

Directors agreed that assistance from development partners is critical, given Comoros's limited capacity to undertake complex reforms. They acknowledged the role that a new Fund arrangement could play in supporting the authorities' reform efforts taking into account the small states' challenges that Comoros is facing, and looked forward to early engagement on this issue.

Comoros: Selected Economic and Financial Indicators, 2011-18

	2011	2012	2013	2014	2015	2016	2017	2018
			Prel.			Projections		
(Annual percentage change, unless otherwise indicated)								
National income and prices								
Real GDP	2.2	3.0	3.5	3.3	3.5	4.0	4.0	4.0
GDP deflator	4.7	2.6	3.1	3.2	3.1	3.0	3.0	3.0
Consumer price index (annual averages)	2.2	5.9	1.6	2.9	2.5	2.5	2.5	2.5
Consumer price index (end period)	4.9	1.0	3.5	2.8	1.8	2.5	2.5	2.5
Money and credit								
Net foreign assets	17.2	16.5	-9.8	0.6	-1.5	4.5	6.1	6.0
Domestic credit	4.9	7.6	21.0	15.0	14.1	9.3	8.1	8.2
Credit to the private sector	8.9	22.4	12.6	7.6	17.4	14.6	13.0	13.7
Broad money	9.6	16.0	2.8	6.7	6.7	7.1	7.1	7.1
Velocity (GDP/end-year broad money)	2.9	2.6	2.7	2.7	2.7	2.7	2.7	2.7
External sector								
Exports, f.o.b.	16.4	-19.0	-3.1	-6.7	9.5	7.4	7.0	7.0
Imports, f.o.b.	7.2	18.1	2.8	-6.2	5.1	8.5	5.9	6.4
Export volume	-24.3	-28.1	25.6	-8.6	6.1	4.6	3.9	3.9
Import volume	-6.9	12.1	7.5	2.7	10.5	9.2	6.7	7.0
Terms of trade	3.1	2.6	-0.9	4.0	5.4	2.2	2.3	2.1
(In percent of GDP, unless otherwise indicated)								
Investment and savings								
Investment	14.9	16.8	20.4	19.4	20.8	22.1	22.8	23.4
Public	5.4	6.8	9.8	8.0	10.0	11.0	11.6	12.3
Private	9.5	10.1	10.5	11.4	10.8	11.1	11.2	11.2
Gross national savings	-19.0	8.5	9.0	12.1	9.8	11.3	12.3	12.5
Public	2.2	5.5	2.0	0.2	1.4	2.0	2.6	3.2
Private	-21.3	3.0	7.0	11.8	8.4	9.4	9.8	9.3
Government budget								
Total revenue and grants	23.6	28.5	41.5	23.5	24.2	24.4	25.0	25.7
Tax Revenue	10.9	11.8	12.1	12.0	12.6	13.1	13.8	14.4
Total grants ¹	7.5	9.2	26.0	8.9	9.0	8.7	8.7	8.7
Total expenditure	22.0	25.1	24.6	23.8	25.3	26.3	26.9	27.5
Current expenditure	16.6	18.4	14.8	15.7	15.3	15.2	15.3	15.3
Capital expenditure	5.4	6.8	9.8	8.0	10.0	11.0	11.6	12.3
Domestic primary balance	1.6	3.0	-1.4	-1.4	0.1	1.0	1.1	1.3
Change in arrears	-3.4	-0.7	-0.9	-0.4	0.0	0.0	0.0	0.0
External (Interest)	-0.8	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0
Domestic	-2.6	-0.6	-0.9	-0.2	0.0	0.0	0.0	0.0
Overall balance (cash basis)	-1.9	2.5	15.5	-0.6	-1.0	-1.9	-1.8	-1.8
Excluding grants	-9.4	-6.7	-10.6	-9.5	-10.1	-10.6	-10.5	-10.5
Financing	0.3	-2.8	-15.4	0.6	1.0	1.9	1.8	1.8
Foreign (net)	-0.2	-1.1	-17.0	-1.1	1.1	2.2	2.2	2.4
Domestic (net)	0.5	-1.7	1.6	1.7	0.0	-0.3	-0.4	-0.5
Errors and omissions	-0.2	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External sector								
Exports of goods and services	16.2	14.9	14.9	14.5	14.5	14.4	14.3	14.2
Imports of goods and services	50.2	53.9	57.2	50.9	53.2	51.7	50.4	49.9
Current account balance	-11.3	-8.3	-11.3	-7.4	-11.0	-10.8	-10.5	-10.9
Excl. official and private transfers	-34.1	-39.7	-42.1	-36.5	-38.8	-37.3	-36.2	-35.8

Remittances	18.7	26.4	26.7	26.2	25.6	25.1	24.5
External debt, in percent of GDP ²	44.9	40.7	18.5	17.4	17.5	18.5	20.3
External debt, in percent of exports of goods and services ²	275.5	271.8	123.7	121.1	120.9	128.1	142.7
External debt service (in percent of exports of goods and services) ²	10.0	10.3	2.1	2.8	2.3	3.8	4.6
Overall balance of payments (in millions of U.S. dollars)	-25.5	-5.8	-32.5	0.0	-4.1	8.2	11.3
Official grants and loans (percent of GDP)	7.5	9.2	26.0	8.9	10.4	11.4	11.6
Gross international reserves (end of period)							
In millions of U.S. dollars	170.1	191.1	168.0	170.2	166.8	174.6	185.1
In months of imports of goods & services	6.7	7.1	5.4	5.6	4.9	5.0	5.0
Real effective exchange rate (2000=100)	100.2	95.5	99.0	98.4	...	...	...
Exchange rate CF/US\$ (period average)	353.6	382.7	370.4	363.0	...	...	...
<i>Memorandum items:</i>							
GDP (nominal, in billions of CF)	216.0	228.2	243.6	260.1	277.6	297.3	318.3
GDP per capita (nominal, in US Dollars)	860	815	873	923	948	991	1,039
Education and health expenditure (in billions of CF)	14.8	16.8	18.3	...	...	...	...

Sources: Comorian authorities; and IMF staff estimates and projections.

¹ Includes interim HIPC assistance (2010-12) and debt relief under HIPC and MDRI.

² External debt ratios after full HIPC, MDRI and beyond HIPC relief from end-2012.

**Statement by Mr. Ngueto Tiraina Yambaye, Executive Director
for Union of the Comoros and Mr. Sidi Bouna Mohamed,
Senior Advisor to the Executive Director
February 4, 2015**

I. Introduction

A coordinated effort by International Financial Institutions (IFIs), bilateral donors, and the Comorian authorities, led to a meaningful improvement in Comoros' macroeconomic performance during the 2009-13 period under the ECF arrangement. The country also achieved satisfactory progress on key structural reforms leading up to the HIPC completion point in 2012 while making advancements on key social indicators. The IMF's close involvement along with the authorities' resolve to undertake difficult reforms have enabled a sound economic performance while also, importantly, helping catalyze donors' support. Since then, however, preserving hard-won macroeconomic gains has been challenging, and progress on structural reforms has been limited.

The authorities acknowledge that in the short- and medium-term, part of regaining the reform momentum requires the kind of "quick-win" measures recommended by staff, for example, in the fiscal area. The authorities welcome the recommended measures and are taking the necessary steps in the 2015 budget to address identified fiscal weaknesses. However, to achieve more meaningful progress in other areas, there is a need to address a number of uncompleted reforms initiated in the context of the 2009-13 ECF and leading up to the HIPC completion point with the assistance of the donor community. This will require a stronger, more sustained and coordinated involvement of IFIs and other development partners, as the authorities lack the capacity, planning ability, and financial resources to finalize these reforms on their own. This is especially true for the restructuring of the electricity company, for example, which continues to exert a significant drag on the country's growth potential.

Comoros' distinctive features as a small island state also make the authorities' task of further enhancing growth particularly challenging. Limited natural resource endowment and a very small market, inhibit the realization of economies of scale. Furthermore, Comoros lacks the kind of dominant industries found in some other small island states such as tourism or a financial sector. The economy is dominated by the public sector with no alternative engines of growth coming from the private sector. Addressing these deep-rooted challenges requires a comprehensive approach to the development of the country and progress will be dependent on a strong and sustained involvement of donors. These structural weaknesses are generally shared among small island states and require a unique approach to development with a particular strong focus on growth compared to other LICs as noted in the "Staff Guidance Note on the Fund's Engagement with Small Developing States"¹.

¹Staff Guidance Note on the Fund's Engagement with Small Developing States (www.imf.org)

II. Recent Developments and Outlook

- *Growth* is estimated to have reached 3.3 percent in 2014 (from 3.5 percent in 2013) and is projected to revert to 3.5 percent in 2015 driven by public investment which remains one of the country's main engines of growth.
- *Inflation* remains in check within the 2.5-3 percent range on average in 2014 and 2015. Stable and low domestic food and fuel prices and a prudent monetary policy stance within the CFA zone have contributed to containing inflation.
- The *fiscal* stance has deteriorated in 2014 due to the substantial drop in nontax revenues—the previous Economic Citizenship Program (ECP) has been cancelled—, and to the increase in teachers' salaries despite a sizeable downward revision in capital spending. In 2015, the more limited use of tax exemptions along with cuts in goods and services expenditures and also the postponement of domestically-financed capital expenditures are projected to contribute to an improvement of the fiscal stance. On the new ECP, the authorities remain confident that they will be able to reach an agreement soon. They intend to discuss and seek advice from staff on how to optimize the use of these resources, as soon as they become available.
- While the *current account* deficit has declined in 2014 to 7.4 percent of GDP, it is projected to widen to 11 percent in 2015 despite strong remittances inflows. This development is driven by high imports associated with the public investment program. Consequently, international reserves are projected to decline from 5.6 months of imports cover in 2014 to 4.9 months in 2015.
- *Outlook*: the near-term outlook is mostly affected by the country's limited fiscal space and the associated reduction in capital spending along with long-standing weaknesses in the electricity sector. The longer term outlook, however, appears more favorable as new investments are launched in areas with comparative advantage such as tourism and fisheries along with the resumption of other public investments, including domestically financed.

III. Policy Adjustments

Following the 2014 fiscal slippages, the authorities have welcomed the staff's advice and recommendations aimed at redressing the situation. They have adopted a 2015 budget that aligns more closely revenues—based on more realistic assumptions—and expenditures—better prioritized— while limiting recourse to statutory advances from the central bank—which are contained by the ceiling under the CFA zone arrangements— with the goal of ultimately eliminating arrears both domestic and external. The focus of this year's budget is also to further limit the wage bill.

An important long-term fiscal challenge the authorities have been struggling with over the years is raising the country's revenue-to-GDP ratio. They welcome the annex on this issue

which will contribute towards this endeavor, and agree, in particular, with the foremost need to contain revenue leakages through the “freeze of the granting of any new customs and tax exemptions”. They also welcome the critical quick-win revenue administration reforms identified, and would like to reiterate their commitment to implementing all of the recommended measures.

The authorities also acknowledge weaknesses in PFM and welcome the recommended quick-win PFM reforms, including the “control of the government wage bill through the enforcement of a ceiling for each of the Union and the three islands” which they intend to fully implement.

The authorities very much appreciate the findings of the DSA update that take into consideration the impact of remittances, and indicate a revision of the rating from high to moderate of the country’s risk of debt distress. They would like to reiterate their commitment to seeking borrowing on concessional terms only, and continuing to address debt management weaknesses with the technical assistance of the IMF and other development partners.

IV. Small Island State

My authorities welcome the acknowledgement by staff of the country’s significant structural obstacles to growth and, in particular, the challenges with efforts to diversify the economy, as a result of the country’s very narrow resources base (3 crops —vanilla, cloves, and ylang-ylang— account for approximately 75 percent of all exports). Comoros is also a very small market which is further fragmented by the limited transport and communication links between the three islands that constitute the Union.

The authorities appreciate the efforts by staff to recommend realistic policy measures and reforms in their discussions, as stressed in the report, cognizant of the country’s limited capacity for implementing comprehensive and far-reaching reforms.

However, it is also clear from the staff’s analysis that devising and implementing a realistic and successful diversification strategy is beyond the reach of the authorities, and will require a strong involvement from development partners.

V. Conclusion

In spite of a challenging environment, Comoros, with the much-appreciated assistance of development partners, has been able to achieve satisfactory economic and financial progress, over the past years. However, much remains to be done. My Comorian authorities are eager to undertake the efforts needed to raise economic growth, improve the standards of living of the population and place Comoros on a sustainable economic and financial path. In this endeavor, the assistance of developing partners is of vital importance as Comoros has neither the technical nor financial capacity to undertake such reforms on its own. My authorities look forward to embarking on a medium-term program of reforms. Above all, they would like to

implement a program of adjustment with the Fund's assistance, under an ECF arrangement. My authorities believe that such an arrangement with a particular focus on addressing the country's structural impediments to growth would help catalyze the needed donor involvement to address the country's macroeconomic and structural challenges. They look forward to the Board's support for the start of rapid discussions with staff to address these challenges under a new ECF.