KEY MESSAGES

As the Ivoirian saying goes: "One should not wait for the rain to take a shower". Côte d'Ivoire has been enjoying an impressive economic recovery since the return of political stability in 2012, with a growth rate around 9% on average per year. The country has become one of the African champions in a somewhat difficult regional environment. The success of Côte d'Ivoire is visible through the planes full of businessmen and women from all parts of the world, the increase in the ratings of international credit rating agencies, the commitment of donors with more than 15 billion dollars pledged during the recent Consultative Group meeting held in Paris and the new constructions raising in many residential suburbs of Abidjan.

Yet, this economic upturn, although it brings opportunities, also imposes responsibilities to the policy-makers of the country. Indeed, maintaining rapid growth will have to be accompanied by an increase in productivity gains and a sharing of its benefits with the majority of the population. Although progress has been made in the last few years, almost half of the Ivorian households still live below the poverty threshold. The country also suffers from deficiencies in the management of its public resources and from insufficient competition in a set of priority sectors. In short, the country must improve its competitiveness and its governance, to achieve more efficiency and equity over time.

One of the current weaknesses of Côte d'Ivoire is the underdevelopment of its financial system, which appears not performing and inclusive enough compared to standards observed in emerging economies. At present, the Ivorian financial system offers 3 to 4 times less credits, in percentage of GDP, than in African middle income countries such as South Africa and Morocco and even less than in Senegal and Togo. Because this insufficiency can harm the ambition of Cote d'Ivoire to achieve its emergence, it is the focus of the second part of this third economic update.

Part 1: State of the Ivorian economy

The Ivorian TGV continues to run at high speed. The economy continues to grow at a rate close to 10%, so much so that the GDP of the country almost doubled since 2011. This growth is multidimensional as it is driven by the good performance of agriculture and the expansion of the manufacturing sector and services. The external accounts have also been able to fare well, due in part to favourable terms of trade, whilst the Government continued its fiscal policy oriented towards investments in infrastructure, including through partnerships with the private sector.

Most indicators are positive, with inflation under control (even if the prices of some food products –attiéké and fresh vegetables – have considerably increased in the last quarter) and with stabilized external trade as well as fiscal deficits. The expansion of credit granted by the financial system, which stood at more than 30% in 2015, reflects the strong demand of the private sector and an increased competition due in part to the entry of new banks over the last few years.

The real question today is to determine how long the Ivorian economy will be able to continue with this pace of accelerated growth. The catch-up effect which prevailed when the country was coming out of the crisis has arguably started to wane. For instance, the contributions of donors and those of foreign investors may have reached a ceiling, at least in terms of GDP. The external context could also prove to be less favourable, especially the evolution of commodity prices on international markets as well as the tightening of the US monetary policy, which has already increased borrowing costs for African countries, including Côte d'Ivoire, on global financial markets.

The Ivorian economy should continue to grow around 8% in the next few years. This forecast will be influenced by the evolution of external risks the country will have to face. These risks are not insignificant, ranging from the terrorism threat to the instability of commodity prices and of global financial markets. The climate risks, in particular the rainfall unpredictability, will continue to influence the performance of agriculture both in the short to long terms.

There is a broad consensus that the economic future of Côte d'Ivoire will also greatly depend on its capacity to generate productivity gains while ensuring a better sharing of the benefits of economic growth with a vast share of poor households. Yet, achieving these goals will require reforms and changes in behavior that go to the very heart of the functioning of the economy and the Ivorian society.

Two examples can be provided. The first one concerns productivity, which will require a sustained effort to reduce the barriers at entry and hence increase competition, which remains the best way to encourage innovation and a cost reduction (as well as an improvement in the quality) for consumers. This implies an improvement of the business environment, especially a reduction in the multiple and complex administrative barriers that are often a disguised protection for existing business operators. The supply of better quality and cheaper services also requires higher competition in priority sectors such as communication, energy, transportation and financial services, which all have a cross-cutting impact

on all economic operators in the country. President Ouattara has well understood this challenge and announced opening up the energy sector to private operators in his speech of 1 May 2016.

The second example is on the need to improve the management of public resources. Looking ahead the Government is unlikely to be able to continue to increase its expenses at the pace of the last few years (an increase of 50% from 2012 to 2015). As a result, the authorities will have to improve the efficiency of public spending or to get more value for money in social sectors as well as in public investment. This will require a strong effort to upgrade the allocative and financial efficiency of the budget.

One of the main challenges for Côte d'Ivoire will be to finance its economic development. Since independence, the country's strategy has been to rely on external financing, either in the form of aid or foreign direct investments. However, in view of what is done in emerging countries, such as Morocco and South Africa, domestic resources will have to play a major role in the future. This means improved tax collection by the Government and, above all, the development of a performing financial sector in the country.

Part 2: How can the Ivorian financial system respond to the challenge of emergence?

The challenge of emergence requires a performing and inclusive financial system. Yet, at present, the limited amount of credits delivered by the Ivorian financial sector explains that around two thirds of domestic private operators complain about the lack of access to external financing. This ratio is higher than in most other countries of the sub-region and far from the standards achieved in middle-income countries. The financial system is also insufficiently diversified, since commercial banks account for around 80% of total financial assets in Côte d'Ivoire.

To illustrate the stakes at play, it can be estimated that if Côte d'Ivoire was to reach a level of financial development similar to that achieved in Namibia or Cape-Verde today, its GDP growth rate would increase by an additional 2% per year. If it was to reach the level of South Africa, the impact would be around 5%.

The lack of depth of the Ivorian financial system is reflected by the relatively low level of credits but also by its lack of inclusion. Indeed, only one Ivoirian out of 8 report to own a bank account. The use of mobile accounts partially compensate for its low figure but even after including these mobile accounts, the proportion of adults who have a bank or a mobile account was lower

than 35% in 2014 when it was exceeding 70% and 59% in South Africa and Namibia respectively.

This lack of depth can be attributed to two main factors. The first one is that if the Ivoirians save more than the rest of Africa, they do not do so in financial institutions. There are no more than 15% of Ivorian savers who put their money in financial institutions; this is 3 times less than the average African. If there are several reasons behind this behaviour, it can be explained as a simple portfolio choice by savers, who want to optimize their benefits while minimalizing their costs. The transaction costs for opening an managing a banking account are high for costumers through lost time in transport, the long waiting lines in offices and the excessive commissions received by the banks.

The second reason is that the rate of transformation of the deposits into credit remains low in Côte d'Ivoire. This rate is equivalent to around 75% (against nearly 100% in Senegal), indicating that most banks prefer to keep excessive liquidity or invest in other placements, such as securities issued by the State. In addition, when commercial banks do lend to the private sector, they often do so for a select group of clients (5 clients constitute one third of all credits) and for less than one year. The reasons invoked by the bankers include incomplete or unattractive projects as well as the lack of guarantees provided by potential clients. The chronic lack of financial information on credit applicants is also a significant barrier. Unfortunately, Côte d'Ivoire, like most countries in WAMEU, still lack appropriate collective information mechanism (such as operational credit bureaux) that can help reduce this market failure.

This economic update suggests three possible pathways. The first one suggest that banks should aim at reducing transaction costs by coming closer to their potential customers. This can be done physically by building more bank branches and ATM machines like it was done in Kenya between 2006 and 2009. Clients continue indeed to prefer physical contacts with their bankers. This can also be achieved by taking advantage of the technological revolution in the communication sector. Although Ivorian banks have already taken initiatives, they can do much more to bring their activities in the computer or smartphone of their customers. In parallel to reducing transactions costs, the emphasis should be on lowering risks through the use of new financial instruments (such as leasing) and by making more effective collective information mechanisms (i.e., the credit bureau established by the BECAO) and alternative distribution networks (e.g., non-bank financial agents).

The second pathway would be to diversify further the financial system. Such diversification has been initiated through the emergence of non-banking operators, including mobile companies and microfinance institutions. The next step would to extend the range of activities performed by these new operators. For example, mobile operators could follow the example of their Kenya's counterparts and issue credits to customers. Microcredit establishments could be given the ability to deliver credit and debit cards to their clients. These innovations would nonetheless require changes in the legal and regulatory environment.

Finally, the third pathway would be to improve the stability of the financial system through the combination of comprehensive regulations, close monitoring (and eventual sanctions) as well as the education of clients. Several tangible examples are discussed in the main text.