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Democratic Republic of the Congo and the IMF

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Democratic Republic of the Congo: Letter of Intent

February 27, 2009

The following item is a Letter of Intent of the government of Democratic Republic of the Congo, which describes the policies that Democratic Republic of the Congo intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Democratic Republic of the Congo, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

TRANSLATED FROM FRENCH

DEMOCRATIC REPUBLIC OF THE CONGO
LETTER OF INTENT

Kinshasa, February 27, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington DC

Dear Mr. Managing Director:

Prudent macroeconomic policies and progress in national reconciliation—after a decade-long conflict—have contributed to significant progress in reining in inflation, the rebuilding of the country's official gross reserves, and the economic recovery recorded in recent years. Inflation averaged 12.6 percent between 2003 and 2007. Over the same period, the level of reserves averaged US$200 million, while economic growth exceeded 6 percent.

However, the Congolese economy was recently confronted by two exogenous shocks—namely, a steep fall in prices of export commodities (in particular, copper, cobalt, and oil) arising from the global financial crisis and a resurgence of the conflicts in the eastern provinces of the country beginning in third quarter 2008. In fact, the decline in export commodity prices resulted in a sharp reduction in foreign exchange–denominated revenues. Conflicts in the eastern provinces resulted in an increase in security spending in an effort to maintain public order and protect the affected populations. The combined effect of these two shocks contributed to a rapid reduction in gross official reserves to a five-year low (US$83 million—i.e., less than a week of import cover). At end-January 2009, they had declined further to US$56 million, thus placing severe pressure on the exchange rate.

The impact of sharp declines in commodity prices on the real economy caused a large number of mining operators to scale down production or cease activity; job losses are estimated at about 200,000. Economic growth in 2008 thus turned out at about 8 percent—i.e., 2 percentage points below projections. Annualized inflation fell from 33 percent in June 2008 to 28 percent by the end of the year, due to the decline in world food and oil prices.

Despite the difficulties described above, the government endeavored to maintain prudent fiscal policies in the context of its staff-monitored program (SMP) in 2008. Deviations from program targets at end-September were largely due to unanticipated and unavoidable higher government spending on security and humanitarian-related activities in the eastern provinces. These deviations widened by end-2008 as government revenues slowed in a context of expanding security, humanitarian, and social spending, resulting in rapid depreciation of the exchange rate and an increase in domestic prices. To address this situation, the government tightened fiscal policy. At the same time, in order to mop up excess liquidity, the Central Bank raised its indicative interest rate and the reserve requirement. The indicative rate was changed on three occasions, moving from 28 percent to 65 percent between late December 2008 and early January 2009, while the reserve requirement increased from 5 percent to 7 percent.[1] The increase in the indicative interest rate was designed in particular to boost sales of central bank bills (billets de trésorerie) through auctions. Lastly, the Central Bank sold USD 10 million in the foreign exchange market.

On the structural reform front, the government regrets the delays in executing the envisaged reforms due to institutional constraints connected with the formation of the new government and pressures to deal with the escalation of the conflicts in the eastern provinces. However, the government is committed to implementing the reforms.

The effects of the global financial crisis on the Congolese economy are expected to intensify in 2009. A severe deterioration of the terms of trade (about 23 percent) and reduced foreign direct investment could further affect balance of payments sustainability in 2009. In fact, export receipts are projected to decline by 45 percent, while imports should adjust to offset part of the loss of foreign exchange, given the lower FDI-related imports and world prices. However, the external current deficit is expected to widen. Given minimal gross official reserves and the country's priority spending needs, without donor support the risk of macroeconomic instability will be heightened. Worsening unemployment, especially in the mining zones, also carries the risk of insecurity and instability at a critical time when the government is endeavoring to bolster national cohesion.

The government is committed to pursuing prudent fiscal and monetary policies to help address the effects of the exogenous shocks. However, in the near term the government's policy options to adjust them fully are limited. Fiscal policy adjustment is in part constrained by the constitution-mandated fiscal decentralization (inclusive participation by decentralized entities in national recovery efforts) that requires the transfer of 40 percent of national revenue to the provinces. The scope for reducing other discretionary spending is also limited by the need for fiscal policy to help mitigate the impact of the decline in domestic demand. Nevertheless, the government's 2009 economic program aims to:

[1] The BCC lowered the reserve ratio back to 5 percent in late January 2009.

- Keep the deficit at a sustainable level and target zero net credit to the government—a reduction of 1 percent of GDP relative to 2008. Attainment of this objective will require heightened revenue efforts, strict adherence to a cash budget, improved control over spending, and alignment of the budgetary commitment and treasury plans. Continued progress in reinforcing tax and customs administration, the full-year effect of tax policy measures adopted in mid-2008, and the reversal of the reduction of the prix fiscal should allow us to achieve our revenue target (18 percent of GDP). The government will limit domestically financed spending to 17.6 percent of GDP (a marginal 0.6 percent of GDP increase relative to 2008). To achieve this objective, better public financial management is planned, especially through the implementation of new urgent spending and procurement procedures.

- Implement the constitutionally mandated decentralization policy. The government's program envisages the transfer of both resources equivalent to 40 percent of domestic revenue (6.9 percent of GDP) and of expenditure responsibilities for health, education, and rural sector development. However, the central government will continue to manage the wage bill of provincial civil servants, and transfers related to investment programs will be aligned with the institutional management capacities of provinces.

- Improve expenditure composition. The investment program of both central government and provinces is targeted to reach 3.4 percent of GDP, up from about 2 percent in 2008, and will be focused on projects with high multiplier effects to help mitigate the impact of the financial crisis on domestic demand. Spending on goods and services is programmed at CDF 256 billion (3.3 percent of GDP), compared with CDF 282 billion in 2008, which includes a healthy increase in nonmilitary spending after the large security-related spending overruns in 2008. The overall wage bill (including allocations to provinces) will be capped at CDF 541 billion (7 percent of GDP), up from CDF 452 billion in 2008, reflecting principally the full-year impact of the salary increase for health and education employees in mid-2008 and the new policy to harmonize the salaries of civil servants in Kinshasa with those in the provinces.

- Adopt additional corrective measures if expected external budget support or domestic revenues fall below expectations. These will involve delaying the harmonization of civil servant salaries, slowing the phasing of the decentralization program, and reducing low-priority spending.

- Maintain a prudent monetary policy and a flexible exchange rate regime. Monetary policy envisages reserve money growth of 12 percent (at constant exchange rate), consistent with the inflation target of 12 percent. The central bank will primarily use the sale of central bank bills to mop up excess liquidity and will gradually ease its indicative rate back to pre-December 2008 levels. To avoid pressure on the exchange

> rate, the BCC will sell foreign exchange to the private sector to offset liquidity injections caused by government expenditures financed through the expected increase in donor financial assistance and achieve its gross official reserve target.

The government is pursuing a twofold objective: first, to mobilize financing resources to develop the DRC's growth potential through the establishment of a core infrastructure platform, and second, to benefit from debt relief under the HIPC Initiative. The government is committed to refraining from contracting or guaranteeing new debt that would jeopardize debt sustainability and relief. The government has agreed with its Chinese partners to delay the second phase infrastructure projects (equivalent to USD 3 billion). The government is also studying with its partners the possibility of increasing the level of concessionality of the financing for the first phase infrastructure projects (USD 3 billion). At all events, the government is committed to working in close conjunction with all its partners to ensure that this agreement is consistent with debt sustainability. The government believes that prudent debt management, structural reforms, and infrastructure development will help to raise productivity and render the Congolese economy more resilient to future shocks.

In recognition of the challenges that the government faces, its development partners are scaling up their emergency assistance to the DRC. The World Bank has confirmed emergency assistance in the amount of USD 100.0 million while the emergency credit from the European Commission is under consideration. Bilateral partners are also considering additional support. Continued good macroeconomic performance and resolution of the problem of misreporting should also pave the way for concluding discussions on a new three-year PRGF arrangement, which would unlock further donor support from the African Development Fund among others.

Nevertheless, the Congolese government will urgently need additional financial support to build up its gross foreign reserves and to enhance the Congolese economy's ability to respond to future shocks. The government is thus requesting that the IMF allow the DRC to receive a disbursement equivalent to 25 percent of the DRC's quota from the Rapid-Access Component of the Exogenous Shocks Facility. The government remains committed to consulting closely with IMF staff on policy advice, especially through monitoring of the implementation of its economic program over the next few months (Tables 1 and 2). The government wishes to commit to undergoing a safeguards assessment update. The government also has no intention of introducing or intensifying exchange and international trade restrictions.

Sincerely yours,

_______/s/_______
Adolphe Muzito
Prime Minister

Table 1. Democratic Republic of the Congo: Quarterly Quantitative Benchmarks, 2007–08 [1]

(Millions of Congo francs; unless otherwise indicated)

	2007		2008												
	Stock Dec.		Sept.[2]						Stock Sep.	Dec.[2]					
	SMP	Rev Stock	Orig. Bench.	Rev. Bench.	Adj. Bench.	Act.	Difference	Observation Prel.	SMP	Orig. Bench.	Rev. Bench.	Adj. Bench.	Act.	Difference	Observation Prel.
a. Floor on net foreign assets of the BCC (U.S.$ millions)	-661	-663	-59	103	121	105	-17	Not Observed	-558	137	153	169	48	-121	Not Observed
b. Ceiling on net domestic assets of the BCC	619,738	621,728	56,693	-30,627	-39,593	-12,393	27,200	Not Observed	589,293	-5,359	-38,451	-44,756	66,354	111,111	Not Observed
c. Ceiling on net bank credit to government	182,343	187,773	39,490	-44,526	-53,492	-33,486	20,006	Not Observed	143,247	-28,296	-47,191	-53,497	65,411	118,908	Not Observed
d. Ceiling on the contracting or guaranteeing of new nonconcessional external debt with original maturity of less than one year by the government, including the EADs or the BCC	…	…	0	0		…	…		0	0	0		…	…	
e. Ceiling on the contracting or guaranteeing of new nonconcessional external debt with original maturity of more than one year by the government, and loans contracted by the EADs or the BCC (US.$ millions)	…	…	0	0		72		Not observed	0	0	0		72		Not observed
f. BCC payments of government expenditure (including urgent in nature) without authorization according to proper budgetary procedures by the ministries of finance and budget	…	…	0	0		…		Not observed	0	0	0		…		Not observed
Memorandum items:															
Narrow base money	283,009	283,557	25,216	19,840	19,840	41,088	21,248		303,032	61,013	35,969	35,969	91,288	55,318	
Project deposits	10,031	11,561	0	3,690	3,690	-3,220	-6,910		15,251	0	3,690	3,690	-1,564	-5,254	

Source: Congolese authorities; and IMF staff estimates.

[1] The program exchange rate is CF 502.99 per U.S. dollar. For definition and adjustors see the Technical Memorandum of Understanding of the 2007 SMP (IMF Country Report No. 07/328).

[2] The September and December quantitative benchmarks were revised in June 2008.

Table 2. Democratic Republic of the Congo: Structural Benchmarks for the Second Half of 2008

Measure	Deadline	Status
1. Submission to Parliament of a draft budget for FY 2009 that is consistent with the macroeconomic objectives and based on a package of legislative and administrative measures that are quantifiable and achievable at the start of the year and with a full-year impact in 2009.	End-October 2008	**Not observed**. The draft Budget was submitted to Parliament in December and was not consistent with macroeconomic stability. The authorities subsequently agreed with staff on a revised fiscal framework consistent with their macroeconomic objectives.
2. Finalization of the audit of domestic arrears accumulated as of end-December 2007, and government adoption of a plan for eliminating them over time.	End-December 2008	**Not observed**. The audit was completed in February 2009. The action plan is expected to be adopted by March 31, 2009
3. Collection of all income from the mining sector by a new unit specializing in mining taxation with the Large Taxpayers Department.	End-December 2008	**Not observed**: The unit is expected to be operational by March 31, 2009
4. Operational implementation of the National Financial Intelligence Unit (CENAREF) in the context of anti-money laundering efforts.	End-December 2008	**Not observed**: The unit is expected to be operational by March 31, 2009
5. Introduction of auctions of 28-days central bank bills (BTRs).	End-September 2008	**Observed**
6. Adoption by Cabinet of the regulations required to transfer the customs activities of the OCC to OFIDA.	End-December 2008	**Not observed**: expected to be completed by May 31, 2009

Table 3. Democratic Republic of the Congo: Quarterly Quantitative Benchmarks, 2008–09 [1]

(Millions of Congo francs; unless otherwise indicated)

	2008	2009				2009
	Stock Dec.	March	Juin	Sept.	Dec.	Stock Dec.
	Prel	Proj.	Bench.	Bench.	Bench.	Proj.
a. Floor on net foreign assets of the BCC (U.S.$ millions)	-615	34	88	60	67	-547
b. Ceiling on net domestic assets of the BCC	688,082	-16,454	-35,203	-13,718	12,814	700,896
c. Ceiling on net bank credit to government	253,185	-19,658	-41,610	-23,329	0	253,185
d. Ceiling on the contracting or guaranteeing of new nonconcessional external debt with original maturity of less than one year by the government, including the EADs or the BCC	…	0	0	0	0	0
e. Ceiling on the contracting or guaranteeing of new nonconcessional external debt with original maturity of more than one year by the government, and loans contracted by the EADs or the BCC	…	0	0	0	0	0
f. BCC payments of government expenditure (including urgent in nature) without authorization according to proper budgetary procedures by the ministries of finance and budget	…	0	0	0	0	0
Memorandum items:						
Narrow base money	374,845	800	9,194	17,183	47,232	422,077
Project deposits	9,997	0	0	0	0	9,997

Source: Congolese authorities; and IMF staff estimates and projections.

[1] The program exchange rate is CF 502.99 per U.S. dollar. For definition of adjustors see the Technical Memorandum of Understanding of the 2007 SMP (IMF Country Report No. 07/328).