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# Thoughts from a Renaissance man

## ECOWAS single currency in 2020? Not credible

**Despite the leaders of the Economic Community of West African States (ECOWAS) declaring last month that they will push ahead with a single currency by 2020, we think this is not credible. Nigeria's critique that a single currency is unwise at this time is valid. We think an East African single currency by 2024 is also unlikely.**

### Ghana says it's keen for a single ECOWAS currency by 2020, even without Nigeria

The market has entirely ignored the leaders of ECOWAS who on 21 February reaffirmed their commitment to a single currency for up to 15 ECOWAS member states, to be enacted by 2020. This is partly explicable because Nigeria has made clear its lack of interest in joining the single currency at this stage. While ECOWAS had a GDP of $566bn in 2017 (IMF estimate) or 25% of Africa's and 37% of SSA's GDP, without Nigeria, the figures are less significant at $171bn and 8% and 11%, respectively, of which half would be accounted for by Ivory Coast and Ghana alone. But more important for the market is that 2020 looks impossible to achieve, in our view, which raises the question as to why the target was reiterated and whether it is in fact a good idea.

### A nascent West African central bank was already established in 2001

A single currency for ECOWAS has been on the agenda for at least a generation. Over a decade ago, the target was a single currency for the West African countries not already in the CFA franc zone, to be established in 2015, and then integrated with the West African Economic and Monetary Union (WAEMU) countries by 2020. A West African Monetary Institute was set up – and still exists – to enact this single currency. Its last annual report was for 2015 and the latest statistical data on its website are for 2011-2012. Nothing we can find suggests the "by 2020" date is realistic.

### Ghana might like to see borrowing costs drop by 50-90% and the stock market boom

We can guess why Ghana may be keen to join a single currency with others in the region. The Bank of Ghana policy rate is 20%, while WAEMU short rates are around 2-3%. Ten-year bond yields at 15.7% in Ghana would halve if they could converge at WAEMU borrowing costs. Ghana could enjoy a boom as its local debt servicing costs would plunge by 50-90%, and the cost of private sector borrowing could fall sharply too. It is a similar incentive to Greece's in 2000, which this analyst recognised at the time, but warned would have severe repercussions for the country in 2005 (three years too early). The Greek stock market trebled in just over a year as it became clear it would join the euro, lost all those gains within three years, then more than trebled again in the subsequent four years before collapsing back to 1995 levels today.

### But we think deep structural differences will emerge

Encouraging an extreme boom-and-bust cycle is not our primary concern though with the ECOWAS plan. Our core worry is that Ghana in particular is well placed to pull ahead of WAEMU countries in a dramatic fashion in the coming decade. Literacy data imply it can industrialise now, and grow at a sustainable 6-9% annually, while WAEMU countries cannot do so for another generation, and Nigeria is unlikely to do so for a decade. This would lead to very significant structural differences within ECOWAS, which will be highly challenging for any central bank to manage. Meanwhile we struggle to see why WAEMU countries would drop the CFA which seems to be working well, for an untested new currency regime. Last, we agree with Nigeria's President Muhammadu Buhari who raised many valid and economically insightful reasons to suggest a common currency is unwise at this time.

At present, we see no credible reason to believe that a single currency – in either East or West Africa – should be taken seriously by market investors within a five-year horizon.

Below we outline some key indicators relevant to the common currency.

**Figure 1: Key indicators that might have relevance for a single currency – ECOWAS members**

| | GDP $bn, 2017 | Per capita GDP $, 2017 | Budget balance % of GDP, 2017 | Budget balance % of GDP, 2018 | End-year CPI (%, 2017) | End-year CPI (%, 2018) | End-year CPI (%, 2019) | GDP estimates start after | Population (m, 2017) | C/A balance (% of GDP, 2017) |
|---|---|---|---|---|---|---|---|---|---|---|
| Benin | 9.4 | 826 | -6.1 | **-4.0** | 2 | **2** | 2 | 2014 | 11.4 | -8.7 |
| Burkina Faso | 13.2 | 696 | -5.5 | -4.6 | 2 | 2 | 2 | 2015 | 18.9 | -7.2 |
| Cape Verde | 1.7 | 3,213 | -4.0 | **-4.4** | 1 | **2** | 2 | 2016 | 0.5 | -6.1 |
| Ivory Coast | 39.9 | 1,599 | -4.5 | **-3.7** | 2 | **2** | 2 | 2014 | 25.0 | -2.9 |
| Gambia | 1.0 | 488 | -2.5 | **-3.6** | 8 | **6** | 5 | 2015 | 2.1 | -9.4 |
| Ghana | 45.5 | 1,608 | -4.5 | **-3.8** | 10 | **8** | 6 | 2016 | 28.3 | -5.8 |
| Guinea | 9.2 | 708 | -0.5 | **-1.9** | 8 | **8** | 8 | 2011 | 13.0 | -25.0 |
| Guinea-Bissau | 1.3 | 761 | -1.9 | **-2.1** | 3 | **3** | 3 | 2004 | 1.7 | 0.1 |
| Liberia | 2.1 | 475 | -7.9 | -7.3 | 12 | 9 | 8 | 2009 | 4.5 | -26.7 |
| Mali | 15.0 | 794 | -3.5 | **-3.3** | 1 | **1** | 2 | 2013 | 18.9 | -7.0 |
| Niger | 7.9 | 421 | -7.5 | -6.2 | 2 | 2 | 2 | 2009 | 18.8 | -18.6 |
| Nigeria | 394.8 | 2,092 | -5.0 | -4.5 | 16 | 15 | 14 | 2012 | 188.7 | 1.9 |
| Senegal | 16.1 | 998 | -3.7 | **-3.0** | 2 | **2** | 2 | 2015 | 16.1 | -5.1 |
| Sierra Leone | 3.9 | 594 | -5.9 | -5.4 | 12 | 10 | 9 | 2016 | 6.6 | -21.1 |
| Togo | 4.8 | 622 | -4.6 | **-2.7** | na | **na** | na | 2013 | 7.7 | -8.3 |
| ECOWAS | 565.8 | 171.0 | | | | | | | | |
| CFA Franc | 108 | | | | | | | | | |

| | | ECOWAS as % of | ECOWAS (ex-Nigeria) as % of |
|---|---|---|---|
| Africa | 2,262 | 25% | 8% |
| SSA | 1,529 | 37% | 11% |

Source: IMF

Among the indicators noted above, just two are convergence criteria for the ECOWAS single currency. End-year inflation must be in single digits, and the budget deficit should be 4% of GDP or less. We assume that to have a single currency by 2020 (we assume this means 1 January 2020) would require 2018 budget deficits and December 2018 inflation rates within those limits. We assume a 4.4% of GDP fiscal deficit would be acceptable. This means that an ECOWAS currency could not include Nigeria (it would miss both targets), and due to excess budget deficits would also exclude Burkina Faso, Liberia, Niger and Sierra Leone. The CFA zone would therefore shrink to include just Burkina Faso and Niger.

Note we have not tried to work out which of the remaining 10 countries that would hit the budget and inflation targets (as per IMF forecasts) would also meet the foreign exchange reserves target (three months of import cover) and the rule that central banks must not finance deficits to the tune of 10% of the previous year's tax revenues.

The East African Community (EAC) has far more stringent convergence criteria, which we think are more likely to produce a successful currency union (but are not achievable in the medium term).

**Figure 2: Single currency convergence criteria**

| | ECOWAS | EAC |
|---|---|---|
| Inflation | Under 10% | Under 5% |
| GDP growth | | 7% sustainably |
| Budget deficit | 4% or less | Under 5% |
| C/A | | Sustainable |
| Reserves | 3 months | 6 months |
| National savings | | 20% of GDP or more |
| Central bank deficit financing | No more than 10% of tax revenues | |
| | | Stable market determined interest rates |
| | | Prudential banking regulation |

Source: AfDB, local media

We think there are significant structural differences within the ECOWAS zone already, as shown by per capita GDP which ranges from $421 in Niger to $3,212 in Cape Verde. We assume this would eventually put a fiscal burden on richer countries (Cape Verde, Nigeria, Ghana and Ivory Coast) to support poorer countries, which will be politically difficult to manage as the eurozone has demonstrated in recent years.

We think it is also worth questioning whether CFA member states would like to become less important in a broader currency union. At present, Ivory Coast and Senegal represent half of the WAEMU GDP. This would shrink to a third if they joined a currency union with Ghana, and to just 10% of ECOWAS GDP if Nigeria ever joined. Nigeria would be so dominant and important within an ECOWAS single currency that any other country's interests would be of negligible importance.

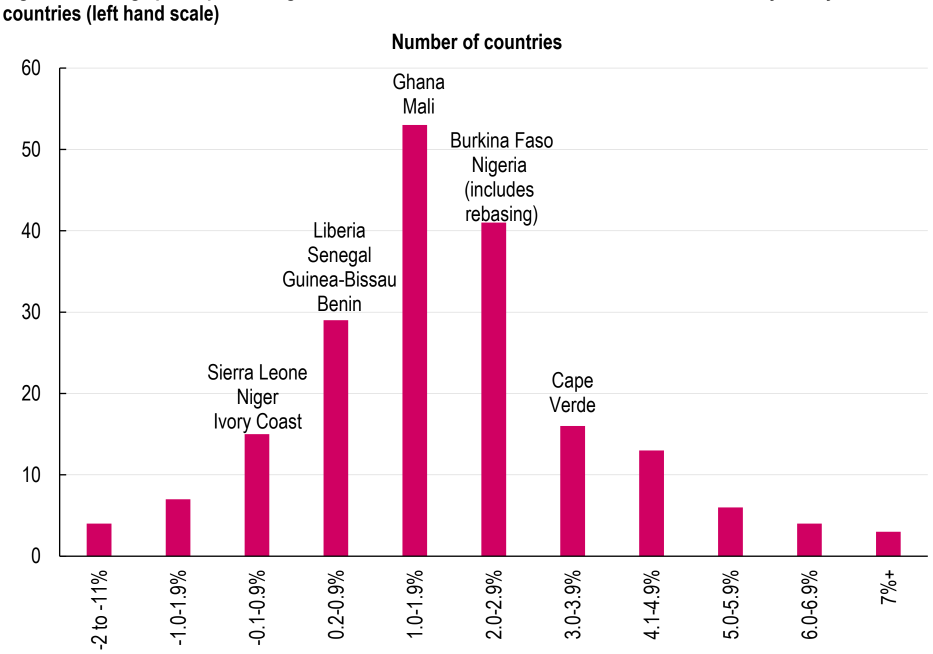
**Figure 3: GDP in $bn and as percentage ECOWAS, an ECOWAS ex-Nigeria, and as % of current CFA GDP**

| | GDP ($bn, 2017) | Incl Nigeria | Excl Nigeria | Within CFA |
|---|---|---|---|---|
| Nigeria | 395 | 70% | | |
| Ghana | 45 | 8% | 27% | |
| Ivory Coast | 40 | 7% | 23% | 37% |
| Senegal | 16 | 3% | 9% | 15% |
| Mali | 15 | 3% | 9% | 14% |
| Burkina Faso | 13 | 2% | 8% | 12% |
| Benin | 9 | 2% | 6% | 9% |
| Guinea | 9 | 2% | 5% | |
| Niger | 8 | 1% | 5% | 7% |
| Togo | 5 | 1% | 3% | 4% |
| Sierra Leone | 4 | 1% | 2% | |
| Liberia | 2 | 0% | 1% | |
| Cape Verde | 2 | 0% | 1% | |
| Guinea-Bissau | 1 | 0% | 1% | 1% |
| Gambia | 1 | 0% | 1% | |
| | | 100% | 100% | 100% |

Source: IMF

Most important though is the structural differences across West Africa that derive from very different literacy rates. Ghana's literacy rate now is high enough for it to industrialise, meaning per capita GDP could rise by 3-6% above the population growth rate, a rate Cape Verde is already achieving because of its high literacy rate. The rest of West Africa is unlikely to grow at more than half that rate.

**Figure 4: Average per capita GDP growth rates since 1980 or the most recent available base year, by number of countries (left hand scale)**

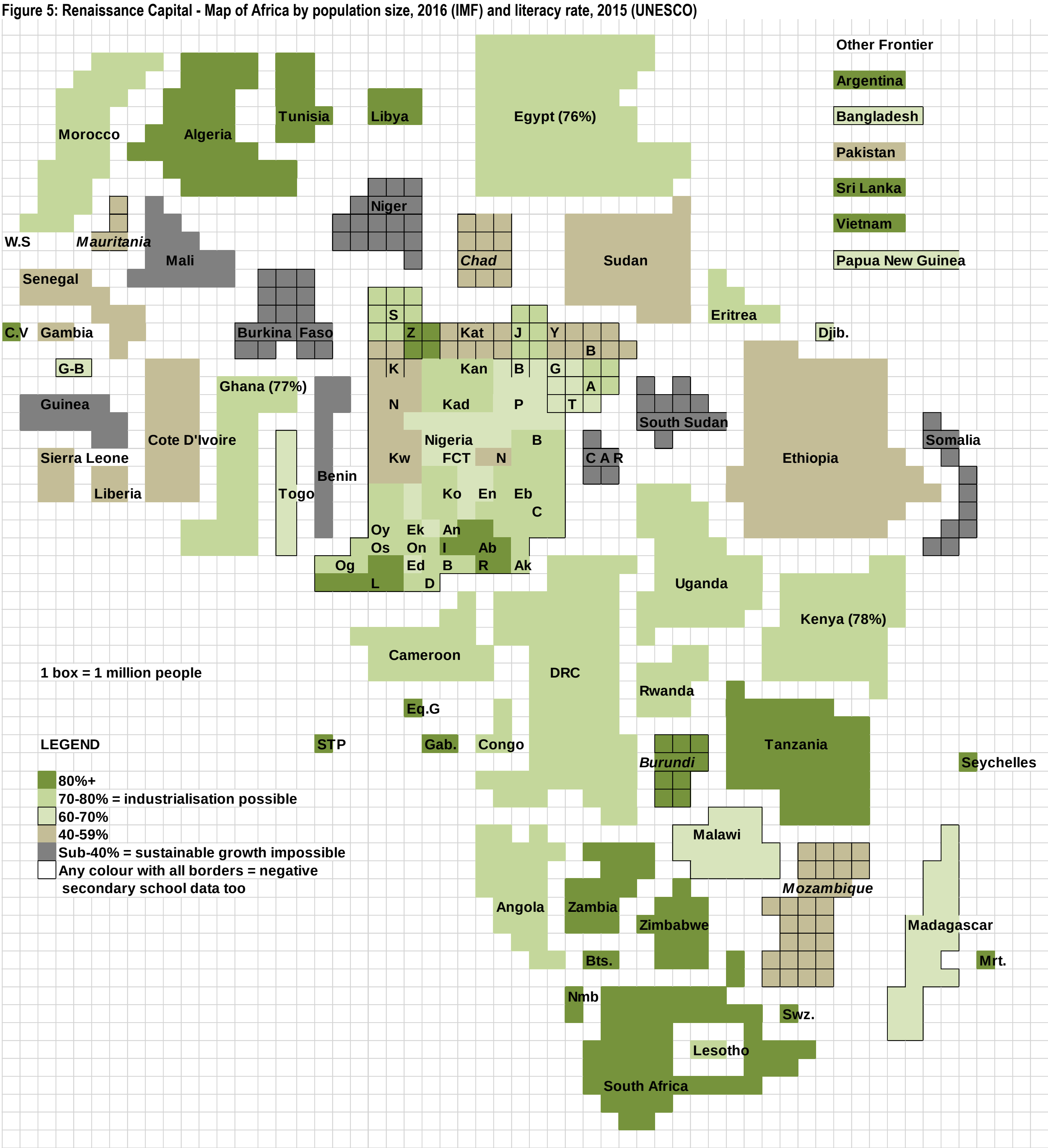



Source: IMF

Below is our map of Africa by population size (each box represents 1mn people) and shaded by the adult literacy rate. Note we are extremely sceptical about the reported adult literacy rates in DRC and Burundi, and some of the northern states in Nigeria (a malaria survey which also asked about literacy found some significant discrepancies, with Zamfara and Sokoto states among the more extreme examples). In West Africa, only Cape Verde and Ghana had an adult literacy rate above 70% in 2015. Most countries average about a 1-ppt improvement in literacy rates each year, which implies industrialisation (manufacturing above 20% of GDP) will not happen before 2045 in Benin, Burkina Faso, Guinea, Mali and Niger[1].

[1] See *Thoughts from a Renaissance Man: Literacy, development and industrialisation*, July 2017 and *Thoughts from a Renaissance Man: No take-off without education*, October 2017

Figure 5: Renaissance Capital - Map of Africa by population size, 2016 (IMF) and literacy rate, 2015 (UNESCO)




Source: Renaissance Capital

For more reading, we recommend *this 2014 AfDB report* and *this 2016 AfDB update*.

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