At the end of 2008, prospects for Madagascar were high with a projected economic growth rate above 7 percent. About twelve months later, unfortunately, the situation looks very different with the impact of the global financial turmoil and the persistence of the political crisis. The local economy has been certainly in recession since the second quarter of 2009 and perspectives are even somber for 2010.

Assessing the current economic situation in Madagascar is hard because of the lack of monitoring and reporting. The Government has not communicated detailed information; with the notable exception of the 2010 Law of Finance (adopted at end December 2009) that estimates 0.6 percent GDP growth in 2009 and projects 2.7 percent for 2010. Those figures must be taken with a grain of salt, in the absence of the IMF program and so many unknown variables, including those linked to the resolution of the current political crisis such as official aid flows, private investment, and fiscal spending by sectors.

In this context, any diagnostic of the economic situation in Madagascar has to rely on imperfect/incomplete information. This was true a year ago, and this is even more factual today.

**Economic growth: is Madagascar in recession?**

The (short-term) driver of growth in an economy like Madagascar has been traditionally the accumulation of capital rather than innovation/technology gains. The economy is going well, when investment flows go up; and vice-versa. This is corroborated by the high and positive correlation between (public and private) investment and GDP growth rates in Madagascar over the past two decades (Figure 1).

![Fig.1: Investment and Growth are moving together](source: Ministry of Economy)
Over the past year, there is no doubt that total investment went down significantly in Madagascar. The decline in public investment is estimated around US$200 million (30 percent down in real terms) between 2008 and 2009, reverting the recent positive trend of an average increase of 30 percent per year observed between 2003 and 2008. Clearly, fiscal policy did not play its role of driver of growth in 2009; at the contrary its fall would explain a relatively large economic contraction.

During 2009, private sector activities suffered simultaneously from the global recession and the political crisis. It has been well reported that export-oriented sectors were in disarray, with plummeting production and job losses in textiles, shrimps, and tourism (see Figures 2-3 and 4).\(^1\) Producer organizations (e.g. Syndicat des Industries de Madagascar) have also indicated that the domestic industrial sector was negatively impacted by the crisis, first by violent incidents and then by the loss of confidence by entrepreneurs and

---

\(^1\) According to the National Office of Tourism, the number of tourist arrivals was only 162,687 in 2009 or 56 percent less than in 2008. As a consequence, revenues are estimated to have declined from US$465 million in 2008 to US$180 million 2009.
consumers. Another key sector exposed to the crisis has been construction, while contributing to almost 1/5 of economic growth between 2003 and 2008, its production decreased by an estimated 40 percent in 2009. Of course, this decline is linked to the fall in public investment, notably in infrastructure.

A few economic sectors were isolated from the global recession and the political crisis. First, the agricultural sector benefited from previous investments and good climatic conditions, as evidenced by the 10-15 percent expansion in rice production (in volume) between 2008 and 2009 (reaching the record level of 4.5-5.0 million tons). The second sector that moved positively in 2009 was mining because of the start in the production of Rio Tinto in May 2009. The mining project –Sheritt, has continued its construction activities, fueling this latter sector, perhaps at a lower speed, but its production is not anticipated to start before early 2011. Oil prospection and explorations activities have continued, notably by Total in the region of Bemolanga (Western Madagascar) with the drills of 130 core wells for a cost estimated at more than US$200 million between 2008- and early 2010.

It remains unclear to what extent the drop in most formal private activities was compensated by an increase in informal/illegal activities. The household survey conducted by UNICEF in Antananarivo showed that workers who have lost their jobs in formal sectors (tourism and construction) moved to informal trade and distribution activities, others went back to the fields (including in urban centers). There are plenty of reports (by NGOs) that have also highlighted the recent increase in illegal activities, notably in the trade of precious wood.

Nevertheless, it is hard to believe that the exceptions described above, while notable, were sufficient to compensate for the negative impact of the “twin” crises on the overall

---

2 SIM review and survey
3 The «Syndicat des Entrepreneurs du Bâtiment et des Travaux Publics » reports that the decline in the value of signed contracts is projected at 38 percent for 2009 compared to 2008
4 FAO, MISSION FAO/PAM D’ÉVALUATION DE LA SÉCURITÉ ALIMENTAIRE, A MADAGASCAR, 6 août 2009
5 Bemolanga is a large ultra heavy oil field (8º to 13º API) holding a potential resources of 16.6 billion barrels, with approximately 2.5 billion barrels of recoverable reserves. Madagascar Oil and Total intend to set up a production pilot ahead of rolling out a full scale development (with a price tag of $5 to $10 billion). If development is successful, Bemolanga is expected to produce 180,000 barrels of oil per day for at least 30 years. Appraisal and planning work began mid-2009, while the development project is planned for 2013, split Madagascar Oil 40 percent and Total 60 percent (source: http://en.wikipedia.org/wiki/Madagascar_Oil).
7 See, Global Witness report.
economic rate of activity. A look at a series of indicators, closely linked to GDP growth, corroborates that the economy was most likely in recession during 2009:

- Energy and petroleum products consumption was down by 15 percent in real value (average decline per month in 2009 compared to the same month a year ago).\(^8\)
- Credit to private sector increased by only 5 percent between end-December 2008 and end November 2009, reflecting not only a decline in real terms but it was 6 times slower than the 30 percent increase reported during the same period of 2008. Another financial indicator of economic difficulties faced by private firms is the increase in the level of non-performing loan (up by 16.8 percent in November 2009).
- Imports declined by 22 percent between September 2008 and 2009, including a significant drop in capital goods imports.
- Job losses are estimated around 228,000, principally in urban areas.\(^9\)

When an economy sees a significant decline in its energy consumption, credit to the private sector, imports, and jobs; there is little doubt that its general level of activity is going down.

All in all, income per capita went down in 2009.\(^{10}\) Even with the (optimistic) official estimates of 0.6 percent GDP growth, the standard Malagasy household is poorer today than one year ago because the population growth rate is estimated at 3.0 percent per year. It is worth underscoring the differential impact between urban and rural areas, since like for previous political crises, the decline in economic activities was mainly concentrated in urban centers where are located most industries and services. Yet, the good rice harvest offered a crucial buffer to many households, helping to preserve social stability since access to food is viewed by most households as the prime factor in determining whether they are in or out of poverty. Furthermore, the recession in 2009 was not as deep than the 12 percent GDP decline that occurred during the 2002 crisis.

**Prospects.** A major turnaround in the downward trend of economic activities is unlikely to occur in 2010. First, most export oriented sectors will suffer from the suspension of the AGOA trade privileges, de facto closing the US market for a variety of goods and products, including textiles. Although the US represents only about 20 percent of Malagasy exports, the signaling impact of this measure is likely to discourage further potential investors. Second, the growing interferences of the Government in business activities have raised

---

\(^8\) The gap is smaller at end 2009 than at mid 2009, suggesting some rebound in the economy.

\(^9\) UN note on the assessment of the impact on suspending development partners ‘Assistance and international trade agreement in Madagascar, July 2009.

\(^{10}\) Some observers have advanced a decline in GDP that can reach 5 percent in 2009 but any precise figure is difficult to confirm in the absence of detailed information on national accounts.
suspicion and discourage entry of new operators and new investments by existing firms.\textsuperscript{11} Third, part of the activities conducted in 2009 was the result of investment decisions taken before the start of the political crisis. Such inertia was especially visible in construction (linked to the African Union summit that was to be held in June 2009) and mining with the start of QMM/Rio Tinto production. Restoring confidence is a long way process and the negative impact of the current political crisis will drag over time—tourists will not return immediately, international investors went to competing destinations. Fourth, the agricultural sector is unlikely to see a record production in 2010 (like in 2009) because investments and inputs are reported to have been substantially lower over the past few months (even though the value of production will be largely influenced by climatic conditions and international prices—two unknown variables). Lastly, the global domestic demand will continue to be constrained by the impoverishment of many households, and it is highly unlikely that the authorities will be able to launch a counter-fiscal policy that will produce lasting positive effects on economic growth (see below).

**Public sector: is the adjustment sustainable?**

Prudent fiscal policy has been a key feature of economic management since the beginning of the political crisis.

Public spending was adjusted to the drop in fiscal revenues and decline in foreign aid (Figure 6). The overall budget execution rate was 58.8 percent in 2009 against 80 percent in 2008. Basically, the Government continued to pay for wages (94 percent of the amount budgeted was executed), and priority current spending, cutting investment and maintenance expenditures (with an execution rate of only 33 percent). The authorities fulfilled their external obligations by paying their debt-service.

\textsuperscript{11} The de-facto authorities have taken initiatives to set minimum prices in the vanilla sector, introduce export quotas for litchis, sell rice at subsidized prices, regulate the marketing of essential foodstuffs, and limit competition by undermining participation of new investors in some sectors such as beverages and telecommunication after heavy investments had already taken place. These signals have further undermined confidence in the business environment and increased the uncertainty concerning the authorities’ motivations in terms of economic policies. The lack of visibility or predictability of the sectoral policies has left space for the “ad hoc” functioning of the institutions especially in the area of regulations, enforcement and justice. The accelerated illegal logging of precious woods in national parks and its exportation under spurious conditions is another example.
The economic slowdown and efficiency losses in tax and custom administrations produced a large shortfall in fiscal revenues, down by about one quarter (or Ar603 billion) compared to the projections included in the 2009 Law of Finance (Figure 7). This decline was concentrated in customs revenues (64 percent of initial targets), while domestic tax revenues reached 84 percent of initial targets thanks to VAT receipts. It has to be noted that the collection of direct taxes (i.e., on profits and income) is based on the previous year results, mitigating the impact of the economic slowdown in 2009 but contributing to carry forward this negative impact in 2010. The amount of non-tax revenues remained at par with initial targets (around Ar47 billion), but there is a lack of transparency on the transfers received by the Government from its involvement in the mining sector, fishing (mainly shrimp), infrastructure (telecommunication and energy), and food/beverage.

Foreign aid declined significantly but, contrary to the general perception, was still present during 2009. Preliminary estimates indicate the total amount of official aid received by the authorities around US$150 million (against US$250-270 million in 2008) because most donors continued their activities up to March 17, 2009, while preserving their ongoing investment projects and humanitarian aid thereafter. Some donors have provided emergency relief through the UN system. The main cut—not marginal—concerns budget support (around US$100 million per year) that was actually suspended by December 2008.

The fiscal gap remained under control in 2009 (even if there no detailed figures, for example, on the amount of arrears). The use of domestic financing was limited both on the T-bill market and from the Central Bank for a total domestic borrowing of Ar. 360.6 billion (2.2 percent of GDP). At end 2009, the cumulative T-Bills outstanding amount due by the Government was only 13.8 percent higher than in 2008, while its debt with respect

---

12 It has been reported that the payment lag for non-wage outlays has grown from about one to 3-4 months, possibly resulting is a relatively large stock of budgetary arrears at year-end.
to the Central Bank was 18 percent higher than its level of December 2008. The absence of pressure on the T-Bill market was reflected by the decline in its yield from 9 percent in May-June to 6.5 percent in November-December.

**Prospects.** *Will the Government be able or willing to carry forward its prudent fiscal policy?* The Government approved the 2010 Law of Finance at the end of December 2009 because no budgetary expenditures would have been authorized without it in 2010. This Law, albeit indicative on some actions undertaken by the authorities (such as tax exemptions and wage increases) is highly speculative with regards to the availability of external financing\(^{13}\) and tax collection. For this reason, like in 2009, significant differences have to be expected on planned and executed expenditures during the remainder of the year.

The severe fiscal adjustment in public expenditures undertaken during most of 2009 has been costly in terms of economic growth and delivery of social services and infrastructure. Reports from NGOs and partners on the grounds reveal growing shortages in the provision of education and health (evidenced by recent strikes of teachers and doctors) and in the maintenance of roads. The failure of the State to play its basic role will grow over time, putting pressure on the authorities to abandon their prudent behavior. Additional expenses could also emerge in the near future to finance elections or emergency as the result of cyclones. The local private sector is also lobbying for a stimulus package with tax cuts and subsidies.

A number of signs suggest that the authorities are increasingly tempted to augment the level of public expenditures. During the last quarter of 2009, their level of commitments went already up by Ar. 978 billion, which is approximately Ar. 200 billion more than during the same period in 2008, in sharp contrast with their behavior since the beginning of the political crisis.\(^{14}\) Those recent commitments will have to be paid even though a large increase in tax revenues and the resumption of budget support are unlikely to happen in the short-term. In the absence of these two options, the Government will need to borrow on the domestic market and/or accumulate arrears. Over the past couple of months, the T-Bill market has already reacted to the growing demand by the Government, with its yields increasing from 4.0 percent in early October 2009 to 8.2 percent in mid-January 2010 (Figure 9). Clearly, launching a fiscal expansive policy of relative large magnitude would present the risk to send the wrong signal to the local financial market, possibly leading to unexpected increases in the inflation and interest rates as well as too rapid depreciation of

\(^{13}\) The 2010 Law of Finance projects a total amount of foreign financing equivalent to US$500 million, approximately the same level that was anticipated in 2009.

\(^{14}\) To allow those commitments, the authorities extended the legal period to end December (instead of November). Most spending occurred in the following ministries: Finance and budget, public work, education, defense, public security and health.
the local currency (see below). At the end of the day, the results of such a policy might be counterproductive on economic growth.

**Financial Sector: Fragile Stability?**

Perhaps surprisingly, at times of the global financial crisis and domestic political confusion, key financial indicators remained relatively stable in Madagascar (Figures 8 and 9).

This stability reflects the isolation from the local financial market to external shocks, and cautious fiscal (see above) and monetary policies. Monetary aggregates weakly increased between end-2008 and end-November 2009 (M3 up by only 5 percent equivalent to a contraction of 3 percent in real terms) due to the prudent behavior of the Central Bank and commercial banks. There was no loss in confidence from operators in the commercial banks, since total deposits increased by 11 percent between December 2008 and November 2009, including 27 percent in saving deposits and 16 percent in foreign currency deposits held by residents. The slowdown in credit (see above) can be attributed to the lack of demand by large private firms (notably in the construction and export sectors), but also to the prudent behavior of commercial banks in the face of the political uncertainty and an increase in the volume of non-performing loans. In early December, the monetary authorities undertook a liquidity repurchase operation (Opérations d’Appel d’offres négatives) to absorb the financial system excess liquidity, as a result the excess liquidity ratio in commercial banks declined from 30 percent to 13 percent during December 2009.

---

**Figure 8 - relatively stable exchange rate in 2009**

**Figure 9 - Inflation and interest rate under control**

Source: Central Bank of Madagascar and National Statistics Office

---

15 One new investment bank has even opened a new office in Madagascar—the *Banque Gabonaise et Francaise Internationale* (BGFI).
Prospects. The financial system remains fragile because its thinness makes it very vulnerable to policy shifts or shocks. The daily value of transactions on the official local exchange market does not exceed US$8 to 10 million, while the size of the credit market is only equivalent to 11.5 percent of GDP. Those figures—low even by regional standards—emphasize the vulnerability of the local financial markets to any shift in policies and/or shocks. For example, as explained earlier, a significant increase in public spending (equivalent, say, to US$100 million), if financed by the domestic banking system, would lead to a jump of 10 percent in total domestic credit, which might rapidly crowd out private sector credit or lead to further monetary expansion, and ultimately to an acceleration of inflation.

External sector: competitiveness losses?

Between 2003 and 2008, export growth (up 20 percent per year), tourist arrivals (up by 8 percent per year) and FDI inflows went up significantly (140 percent per year). Those indicators indicated that Madagascar was becoming more attractive and competitive on international markets over time.

During 2009, Madagascar’s attractiveness was severely damaged in a world that became even more competitive because of the global financial crisis. Total exports declined by 18 percent during the first three quarters of 2009 (compared to the same period in 2008) (Figure 10). The main losers were textiles (down by 30 percent), vanilla (down by 60 percent), and shrimps (down by 42 percent). The exception was mining, because of the start of ilmenite exports by QMM/Rio Tinto in May 2009. Concurrently, FDI inflows declined by 19 percent between September 2008 and 2009 (partially anticipated because the end of construction activities by QMM), and the number of tourists fell by almost 60 percent.

Concurrently, the level of total imports decreased by about 22 percent during the first three quarters of 2009, fueled by lower domestic demand (Figure 11). This decrease would have been even higher if food imports (up by 35 percent in September compared to 2008) had not compensated for the quasi-paralysis of the Tiko conglomerate (dairy products and edible oil). There also exists a close positive correlation between lower exports and some categories of imports, for example less cotton was imported by EPZ companies.
The steep decline in imports compensated for lower exports and capital inflows, explaining the quasi-absence of pressure on the balance of payments in 2009.\textsuperscript{16} International reserves of the Central Bank only declined by 12 percent compared to their end-2008 level –are were equivalent to about 2 months of imports at end 2009\textsuperscript{17} and, as highlighted earlier, the correction in the exchange rate was modest during 2009.

\textbf{Prospects.} \textit{The decline in exports and FDI is likely to continue over the first few months of 2010, putting growing pressures on the balance-of-payments.} Simultaneously, the weakening of imports may have reached a floor –cannot go lower because of the minimal amount of products of first necessity. The recent acceleration in the depreciation of the local currency, about 11 percent vis-à-vis the US dollar since end of December 2009, might reflect such an adjustment even though significant volatility has to be expected in the current uncertain political context.

\textsuperscript{16} The n 22 \% decline in imports is equal to US$ 530 million, while the 18% decrease in exports is equivalent to US$ 178 million. This differential adjustment helps explain the absence of pressure on the balance of payments in 2009.

\textsuperscript{17} This does not include the IMF allocation of foreign currencies (about US$250 million) to the Central Bank of Madagascar in September 2009 as part of the global strategy followed by this institution to reduce the vulnerability of international financial markets.
Looking ahead: “For to foresee consists of projecting into the future what has been perceived in the past”.18

Projecting the way forward is hard for an economy like Madagascar. Not only information is scarce but the country is also highly vulnerable to internal and external shocks. Yet, perspectives for 2010 are somber as long as the way out to the current political crisis remains uncertain. Export oriented sectors (tourism, textiles, and fisheries) will continue to suffer from the lack of access to international markets and construction will be negatively affected by the quasi-suspension of official aid, the main source of funding for infrastructure projects. Given their weight in the economy, a negative growth in these sectors would exert a downward pull on overall GDP growth, which would be hard to be made up by a possible rebound in the other sectors (which is expected to be rather modest in any case given the uncertainty before the elections are held).

Considerable attention has been given to fiscal policy because this is perceived as the main instrument for reactivating the economy in the short run. Using a counter-cyclical fiscal policy would nonetheless be a risky option (in the absence of external resources) because an increase in domestic borrowing would put immediate pressure on the local financial market, possibly leading to higher interest rates and ultimately inflation. The lessons from the recent past (early 2004), should not be forgotten when the authorities launched an expansive fiscal policy that led to sudden a jump in the inflation rate (up from -0.2% in 2003 to 24% in 2004) and a 68 percent loss in the value of the local currency (vis-à-vis the US dollar) between January and May 2004. These non-intended effects had lasting negative impacts on the real economy and poverty.

In the short run, the only option left for the authorities seems to generate efficiency gains in the fiscal policy. In other words, the authorities need to get more for each dollar they spend. Areas of improvements include the governance in strategic sectors (most notably public agencies and enterprises) and key ministries as well as the better control of the wage bill. Another possible and complementary policy option would be to reduce the cost of doing business for operating firms. For example, the high level of energy prices is linked to high transport cost by road, while a safer and cheaper (as much as 40 percent) option would be to use the railway between Tamatave and Antananarivo. The price of electricity could also be pushed downward if JIRAMA was to be reimbursed its road charger fee paid to the Road Maintenance Fund, as intended by the Law.19 The lack of competition in the communication sector also contributes to higher cost for firms and households. Liberalizing further those strategic sectors would exert a downward pressure on energy

---

18 Prévoir consiste à projeter dans l'avenir ce qu'on a perçu dans le passé”, p.6, Creative Evolution (University Press of America by H. Bergson, Nobel Prize of Literature, 1927

19 The road charger fee of 7 percent is paid on the value of gasoil used by thermoelectric production centers owned by JIRAMA.
and communication prices and/or improve investment incentives, both effects would produce significant short-term pay-offs for firms and households in Madagascar.