

Introduction

Located in Central Africa, Chad is the fifth-largest country on the continent in terms of land mass. It is strategically located sharing borders with six countries to the North, South, East and West of the continent these being Libya, Nigeria, Niger, Cameroon, Sudan the Central African Republic. Although the country has no access to the sea, it is home to Lake Chad, one of the largest and economically important trans-boundary water bodies in Africa. Chad is heavily dependent on oil—ever since becoming an oil-producer in 2003 with the completion of a US\$4bn oil-pipeline linking its oilfields to terminals on the Atlantic coast via Cameroon—but also rich in gold and uranium. Chad faces a number of socio-political challenges linked in part to a young and rapidly expanding population and terrorist activities in the Lake Chad Basin. According to the UN Population Fund, its population reached 14.5 million in 2016 with an annual growth rate of 3.3% per annum, a dependency ratio of 100.1% and a life expectancy of 51 years for men and 54 years for women. Chad is ranked 185 out of 188 countries, according to the 2015 United Nations Development Program (UNDP) Human Development Index but has recently achieved some modest gains in child and maternal mortality.

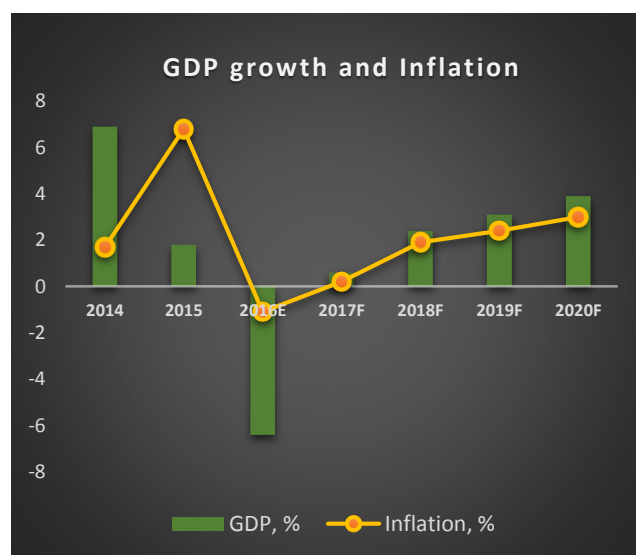
Political Environment

President Idriss Deby Itno, who has been in power since 1990, won a fifth Presidential election in 2016 and will serve another five-year term—there is currently no Presidential term limit in Chad. President Deby is credited with ushering in multiparty politics to Chad and promoting stability within the central African region which has been victim of terrorist attacks. In particular, he has been at the forefront of the operation to root out terrorism promulgated by the Boko Haram group in the region and targeting countries in the Lake Chad Basin. Conflicts in neighboring countries, and the fallout from climate change through the desertification and the drying up of Lake Chad have also fuelled political tensions in the region. Chad is ranked 48th out of 54 in the 2016 Mo Ibrahim Index of African Governance with a score of 34.8/100. While this is still below the African average (50) it is the country's best score on record, a sign of improving political and democratic governance of the the last few years.

Economic Overview

GDP: The Chadian economy contracted sharply in 2016 by 6.4%—compared with an expansion of 1.8% in 2015 and 6.9% in 2014—on account of the oil price shock in a country where prior to 2014 oil exports accounted for more than 80% of fiscal revenues and 60% of foreign exchange earnings. The precipitous decline in the price of oil, from US\$94/bbl in 2014 to US\$36.2/bbl in 2016 had a severe impact on the economy even though oil production remained relatively strong throughout the period. The government's attempt at adjusting to sluggish public revenues through a reduction in public sector wages and investment outlays significantly dampened disposable incomes and consumption and slowed down economic activity. The economy has also strained under the weight of refugees, primarily from the Central African Republic, as well as government's involvement in regional peace-keeping efforts which take up already scarce financial resources. Although the relative rebound in oil prices over the last few months has slightly reduced the pressure on government finance, fiscal and current account deficits remain important.

Figure 1: GDP Growth and Inflation



Source: IMF, 2017

In the near to medium term, Chad's economy is projected to return to modest growth with a forecast of up to 0.7% pick up in 2017 before firming to 2.4% in 2018 and averaging 3.5% thereafter. This is premised on the stabilization of oil prices at around US\$55/bbl coupled with an

expected increase in oil production. Economic growth will also be strongly supported by the government's commitment to diversifying the sources of growth and export-promoting value addition under its National Development Plan 2017-21 which focuses on a number of sectors, including agriculture, livestock and mining.

Inflation. The consecutive contraction in broad money supply in 2015 and 2016 by 4.7%, the deceleration in private sector credit and an improvement in agricultural production during 2016 resulted in deflation, with consumer prices averaging -1.1% in 2016 compared with 6.8% in 2015. The progressive drawdown in the country's external reserves in the face of the steep decline in export earnings, following the end of the commodity super-cycle, also closed-off access to a major source of government liquidity, further fanning deflationary pressures. Consumer prices are expected to rise as the economy troughs although price pressures will be contained by the CFA franc currency's peg to the euro.

Fiscal balance: Despite the improving headline numbers, fiscal pressures in Chad remained relatively high in 2016 on account of a drop in both oil and non-oil revenues linked to the collapse in oil prices and the ripple effect on business activities. Non-oil tax revenue, which is already low by regional standards, dropped to 7 percent of non-oil GDP, its lowest level since 2009, although this was offset by income related to old tax disputes. Oil revenue also fell to around 3.5% of GDP in 2016 compared with 4.9% in 2015 and 11.7% in 2014. Government servicing of a loan from commodities trader Glencore also exacerbated pressures on public finances and, as a consequence, triggered domestic and external arrears. As such, the interest expense on external loans rose to 109 billion CFA francs (\$US218 million) in 2016 compared with 22 billion CFA francs (\$US44 million) in 2014.

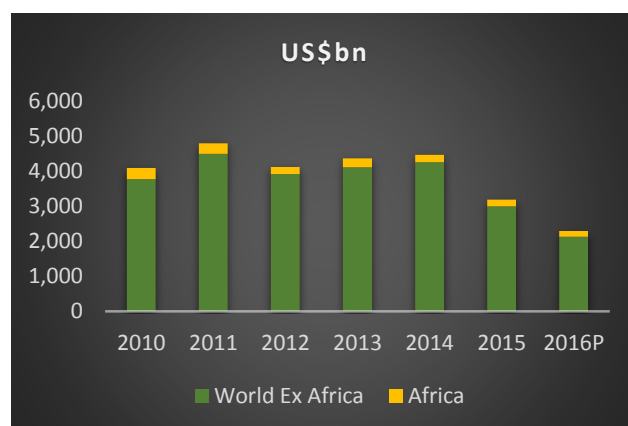
In response to the difficult economic environment, the government has implemented a number of policy reforms, including spending cuts with sharp declines in capital expenditure, emergency measures in the second half of 2016 to reduce the wage bill, transfers and subsidies. The government is also taking measures to increase non-oil revenue (with some success) partly through the introduction of a tax on oil products and an excise tax on communications. Other reforms being introduced by the government include the use of technology to monitor tax collection and a simplification of personal income tax.

Overview of Trade, Reserves and Financial Sector

Total Trade. Chad is the 129th largest export economy in the world and the 33rd largest export economy in Africa. In 2015, Chad exported US\$2.41 billion and imported US\$935 million, resulting in a trade surplus of US\$1.48 billion – one of the few countries enjoying a surplus in the region. Chad sources over 50% of the value of its imports from France, China, Cameroon, India and the United States. The top export destinations of Chad are the United States, India, Japan and China which collectively account for over 85% of exports. The top exports of Chad are Crude Petroleum, Raw Cotton, Insect Resins, Refined Petroleum and Other Oily Seeds. Its top imports are Packaged Medications, Refined Petroleum, Tractors, Soap and Telephones.

Intra-African Trade: Although total trade with Africa is modest, Chad sources around 20% of its imports from Cameroon and Senegal—with Cameroon alone accounting for around 15% of total imports. However, African destinations only account for under 2% of total exports owing in part to excessive dependence on natural resources and primary commodities and the fact that the country does not have access to the sea. Chad relies heavily on Cameroon's port of Douala and both countries have now agreed to carry out a feasibility study into the extension of a railway line linking Ngaoundéré in northeast Cameroon with Ndjamena, the Chadian capital. The leading African trade partners with Chad include Nigeria, Egypt and the Central African Republic which accounts for 42% of total trade between Chad and the rest of Africa.

Figure 2: Chad Total Trade



Source: IMF DOTS, 2017

Current and capital account balances: Balance of Payment figures suggest that Chad has started to emerge from an extremely weak external position although its current and capital accounts continue to show signs of significant stress. The current account is expected to improve to -2.2% of GDP in 2017, compared with -9.2% in 2016 and -12.3% in 2015. The current account has been pressured by the country's deteriorating terms of trade, primarily reflecting a decline in oil exports in 2015 and 2016. However, over the last few months, the deterioration in the current account balance has been stemmed by improving oil prices and a reduction in imports, although the deficit in the services account remains high and may be related in part to transportation and pipeline fees.

The capital account surplus has also plummeted, undermined by a decline in Foreign Direct Investments and disbursements related to medium and other long term investments. As such, the current account deficit is likely to remain important. Going forward, the resulting (current account) deficit, which had hitherto been financed by external reserves, will now mainly be financed by concessional lending from the IMF under an Extended Credit Facility which supports the country's stabilization and recovery strategy.

Reserves: Chad's foreign exchange reserves have fallen precipitously and at the end of 2016 stood at negative US\$323 million (equivalent to about negative 1 month of imports), reflecting the countries' negative position at the regional central bank (BEAC). This compares with reserves of around 1.2 billion or 2.1 months of import cover in 2014 and 1 month of cover in 2015. Foreign exchange reserves are forecast to improve over the medium term as oil prices stabilise nearer US\$ 50/bbl but the recovery in liquidity will be at a very gradual pace.

Exchange rate: Chad is a member of the CFA Franc arrangement which is pegged to the Euro at CFA 655.96:€1 and therefore fluctuates in line with Euro-Dollar movements. However, the decline in the foreign exchange reserves at BEAC—to only two months of imports—much lower than the minimum threshold of the three months has—reignited the debate on the possible devaluation of the currency to achieve an orderly adjustment in the face of sustained deterioration of terms of trade. However, there appears to be little political will for such a move and risks for a change to the peg appear muted for now.

Financial Sector: Although Chad is part of the regional central bank (BEAC) arrangement, its financial system is still fledgling with limited capital and money market instruments available to the private sector. In all there are eight commercial banks, following the privatization of the country's four largest banks mainly by regional financial institutions including Ecobank, Orabank and Commercial Bank of Cameroon. The financial sector also hosts Libyan and Nigerian Banks — BCC, BSCIC and UBA, indicative of the country's progressive stance towards regional financial integration.

However, despite past and continuous efforts by the government to promote financial inclusion, especially with the expansion of commercial banks in the country, the use of financial services by Chadian households is still very limited. Official statistics indicate that the share of population with a bank account is around 13% compared with the regional average of 35%. Additionally, the agricultural sector which represents about 25% of GDP, receives around 2% of total credit provided by commercial banks. Given that the public sector is the major client to commercial banks, the liquidity crunch faced by the government and the subsequent accumulation of arrears has similarly strained banking sector liquidity. The resulting effects have been the rise of NPLs and deterioration in the capital adequacy ratio in the financial sector, estimated at 13.2% in 2016 compared with 22% in 2013.

Opportunities for Bank Support

As a result of poor infrastructure and distance to the sea in the absence of reliable cross-border transport infrastructure, Chad has one of the highest trade costs in the world. Anecdotal evidence suggests that the cost of transporting a cargo from a seaport in Cameroon to the capital N'Djamena could be as high as the cost of moving a cargo from East Asia to Cameroon. Although there have been some investments in infrastructure, the quality of the country's infrastructure trails its peers. The Bank could support ongoing collaboration between the Government of Cameroon and Chad in extending the Cameroon Chad railway which can potentially boost cross border and extra-African trade. There is also great merit in supporting the government's efforts at promoting technical education in tandem with investments in technology-intensive industries for value addition and diversification of sources of growth (perhaps through Special Economic Zones)

under the country's National Development Plan (NDP) which sees education as a critical element for economic diversification. Sectors such as agriculture and livestock, mining, and artisanal crafting are also given priority within the NDP and could benefit from additional support from the Bank. Further, the Bank could consider funding

communication technologies to the extent that they have the potential of lowering trade costs and fostering greater financial inclusion, a core component for expanding trade. Chad has been an Afreximbank member country since 2015.

Table 1: Chad: Selected Macroeconomic and Financial Indicators

	2014	2015	2016E	2017F	2018F	2019F	2020F
Real GDP %	6.9	1.8	-6.4	0.6	2.4	3.1	3.9
Inflation %, Annual average	1.7	6.8	-1.1	0.2	1.9	2.4	3.0
Exports of Goods and Services % y/y	1.4	-34.0	-15.4	29.4	5.7	4.6	5.7
Current acc.% GDP	-8.9	-12.3	-9.2	-2.2	-3.2	-3.5	-3.3
Gross reserves, Months of import	2.1	1.0	-1.0	-0.1	0.4	0.8	1.3
External Gov't debt, % GDP	29.1	25.0	27.1	28.6	27.8	26.3	24.2
Total Gov't debt, % of GDP	39.4	43.3	51.2	50.5	47.7	44.8	41.1

Source: IMF, 2017