

Cote d'Ivoire Macro View

Thinking beyond the 2012 Eurobond rally

- **The 2012 Eurobond price rally** — In many ways, the rapid recovery in the price of the Ivorian Eurobond in 2012 mirrors the political and economic turnaround in the country during the year. But, like all price rallies, the current one cannot continue indefinitely. So, arguably, the real question for investors in 2013 is where does the price rally end?
- **A changing growth story** — The new government of President Ouattara has ambitious plans to push the economic growth rate up to 10% by 2014. This will be driven by building on existing strengths of the economy, high levels of investment and growth in new sectors of the economy, such as mining. But we believe an important change in the economic story of Cote d'Ivoire will be the potential emergence of significant current account deficits even if the government can keep the fiscal deficit under control. Moreover, fiscal consolidation would require some domestic debt rescheduling in 2013 and strong domestic revenue growth.
- **History, growth, jobs and political stability** — Why do we think this ambitious growth agenda matter in Cote d'Ivoire more than in other countries in Sub-Saharan Africa (SSA)? We see two main reasons. Firstly, there is a very strong political narrative in Cote d'Ivoire for the country to reclaim its former economic pre-eminence in SSA. Secondly, there is a strong belief that growth equates to jobs and that jobs are the key to ensuring future political stability. In particular, President Ouattara is under real pressure to create jobs not just for a young population, as in many countries in SSA at a similar position in their demographic development, but also for ex-combatants to foster a return to political normality. In a post conflict environment such as in Cote d'Ivoire, a high level of underemployment can provide a fertile recruiting ground for what can perhaps be best be described as "thug supporters" of political parties.
- **What does this all mean for the Eurobond?** — Despite the rally in the price for the Ivorian Eurobond in 2012, it is still one of the highest yielding Eurobonds in SSA and West Africa. This reflects a number of specific factors, notably a limited repayment history and the country's recent political history. But the reality is that the Eurobond has still rallied close to its comparators in the region, and it is plausible that, if the economic scenario outlined by the government plays out, even if only in part, then if Cote d'Ivoire were to come back to the market at some point in the next few years, from a purely macroeconomic perspective we think it would represent a better credit risk than both Senegal and Ghana, even if the political legacy of the last decade will continue to hang over the country.

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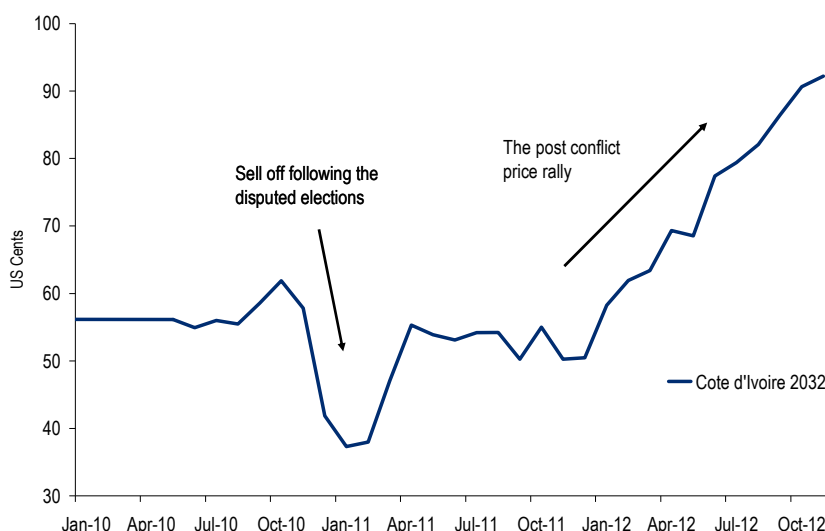
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What next for the Ivorian Eurobond?

The resumption of coupon payments against the background of political and economic consolidation after just over a decade long civil war has driven a major rally in the price of Cote d'Ivoire's Eurobond. As a result, it has arguably been among the best performing investment assets in the world in 2012. But, like all price rallies, the current one cannot continue indefinitely even if the Eurobond still remains a relatively high yielding asset.

Figure 1. The Ivorian Eurobond 2012 price bounce



Source: Bloomberg

So the real question for investors in 2013 is at what level does the price rally end? Is early 2013 the best selling point, or should the bond continue to be held as a high yielding bond? We think that this decision, in turn, largely reflects the emerging political and economic dynamics in the country.

The economy rapidly rebounds

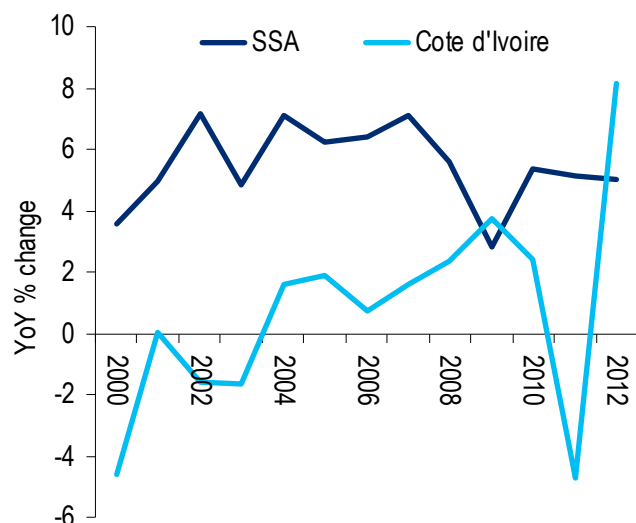
A sharp rebound in growth from the crisis

In many ways, the rapid recovery in the price of the Ivorian Eurobond in 2012 mirrors the political and economic turnaround in the country during the year. The reality is that just over a decade of conflict only came to an end in April 2011 with the eventual capture of the former president, Laurent Gbagbo, in his presidential bunker. This paved the way for the swearing in of Alassane Ouattara as president in May and the resumption of political normality in the second half of the year.

Given the political turmoil in the country in 2011, it was not surprising that real GDP fell by 4.7% that year. Moreover, this came on the back of a decade of poor growth reflecting the negative impact of the prolonged civil war. In the preceding decade, 2001-10, IMF data shows that real GDP in the country grew by an average of only 1.1% per annum compared to 5.7% a year for SSA as a whole.

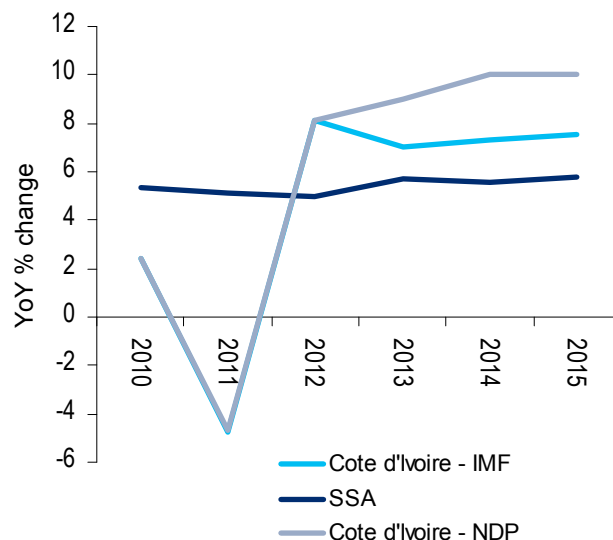
A political solution helps drives an economic turnaround

Figure 2. A decade of poor real GDP growth



Source: IMF

Figure 3. Optimistic real GDP growth projections for the future



Source: IMF and Plan National de Développement 2012-15

Growth forecasts are optimistic

In contrast to the negative growth in 2011, the IMF currently estimates that the Ivorian economy will have grown by 8.1% in 2012 and should continue to grow at rates of around 6-7% for the next five years. The new government of Mr Ouattara has even more ambitious targets for growth. As outlined in the government's Plan National de Développement (NDP) for 2012-15, it feels it can push the growth rate up to 10% by 2014 and keep it at around these levels going forward (in the NDP, this ambitious growth scenario is dubbed the Triomphe de l'Eléphant). But even on the more conservative IMF projections, growth in the 6-7% range would still be above the Fund's projections for SSA as a whole.

For a country to jump from such low to such high rates of growth is not uncommon in SSA. It can arise for example, when a prolonged conflict ends, as has been the case in Cote d'Ivoire. In this case, the resumption of even a degree of political and economic normality allows a rapid growth rebound. It can also happen when a country starts production of a new commodity, often the commencement of oil production.

Cote d'Ivoire's infrastructure and civil service are still good despite the conflict

What is interesting in the Ivorian case is not whether such a growth rebound is plausible, but the rebound is happening in a country that for decades was widely seen as having the most sophisticated economy in Francophone Africa and one where, despite a decade of conflict, much of the country's infrastructure remains intact. Yes, the country's infrastructure has clearly been eroded in quality after a decade of low rates of investment but, in comparative terms to the rest of SSA, we think it still remains impressive. This, in turn, partially reflects the nature of the conflict, which was limited in both its intensity and the periods of actual fighting, and partially the country's strong historical infrastructure inheritance.

The same arguments also apply to the country's government bureaucracy. Yes, staff have left during the conflict undermining its capacity, and in some ways the integrity and impartiality of the civil service has been dragged into the spotlight as a result of a highly partisan civil war. But the reality remains that, compared with many countries in SSA, the civil service still remains relatively competent and efficient.

These factors should help support a recovery

The combination of these factors means that the government's ambitious growth projections have a much better chance of being realised than in nearly any other post conflict country in SSA. But there is also a potentially more interesting aspect to the growth story going forward – that the structure of the Ivorian economy may also change significantly – which further supports an optimistic growth outlook.

A changing growth story

Building on existing economic strengths

Without wanting to dwell too much on what was often referred to as the “Ivorian miracle”, or the strong period of growth for a quarter of a decade from 1960-85, the reality is that the country does have a growth model it can restart. Historically, the key engine of growth was the agricultural sector, coupled with investment in infrastructure and education.

This meant that Cote d'Ivoire had, and still has, a much more diversified agriculture sector than most countries in SSA, while also being the world's leading exporter of cocoa. When coupled with a strong service centre based on its role as the leading economy in the Franc zone, and even a relatively large manufacturing sector by the standards in SSA, it is not surprising that the country was seen as one of the jewels in the crown of France's former colonies (along with Algeria).

A diversified agricultural sector, with cocoa at its core

Given these existing strengths, on the one hand it could be argued that the challenge facing the current post-conflict government is simply to regain this lost pre-eminence. And in many ways, the ability of the government to achieve this does not seem all that difficult. Despite the civil war, and rising production in other countries, Cote d'Ivoire is still the leading cocoa producer and exporter in the world. Moreover, large parts of the diversified agricultural sector – which included coffee, palm oil, rubber, cotton, tropical fruits and cashew nuts – were untouched by the conflict. This means that the government's newly stated growth goal of strengthening the agricultural sector as an engine of growth, coupled with boosting the agro industry and processing sectors, should be very achievable.

A regional service centre

We also think that it will be relatively easy for the country to recapture a significant portion of its historical role as the regional centre for the Franc zone. There is plenty of anecdotal evidence that many companies shifted running their operations in the Franc zone during the conflict from Abidjan to Dakar. But, there are signs that this is now being reversed, even if a trickle has not yet become a flood. Arguably in the coming years, the most important barometer of sentiment towards this move back would be a decision by the African Development Bank (AfDB) to start to re-open its headquarters in Abidjan and crucially, start, at least in phases, to bring staff back into the country from Tunis.

But re-creating the past, plus some, will not be without problems, and competition is greater

But while possible, the development of both these historical engines of growth is also not without problems. For Cote d'Ivoire to re-emerge as the Franc zone's regional hub, notably in the transport sector, it will have to improve security on its roads and improve the ease of crossing its borders. Meanwhile, although the cocoa sector reforms introduced by the government are working, many in the sector still feel they are far from ideal and not conducive to the further, and rapid, development of a local cocoa processing industry.

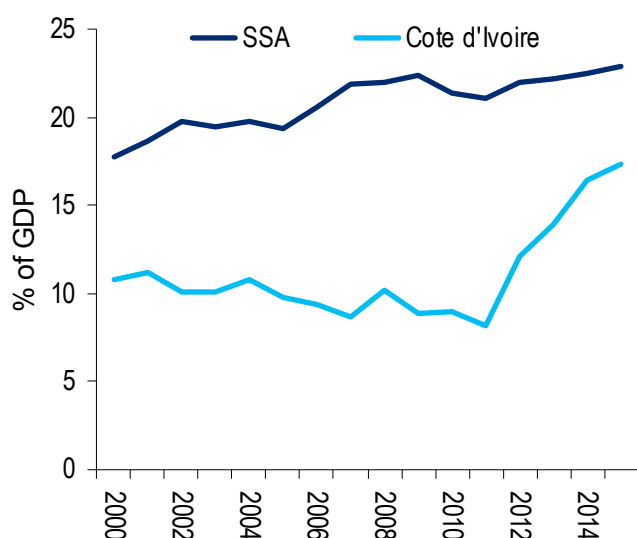
As such, we think that a major challenge for the government is to continually remember that a return to its past pre-eminence is not a given, but is something that must be worked hard for, especially as the regional environment has changed substantially in the last decade. In particular, the competition provided by both Senegal and Ghana as alternative regional hubs is now much more significant than in the 1970s and 1980s.

Investing in infrastructure

The government will also have to achieve its other goal, boosting investment, if its growth projections are to come to pass. As Figure 4 highlights, for over a decade the country has invested less than half the level of other countries in SSA as a result of the civil war. Moreover, this is in a region where overall levels of investment are already relatively low, at only 20% of GDP. In fact, it is a testament to the quality of the historical infrastructure investment that it is not as dilapidated as may be expected.

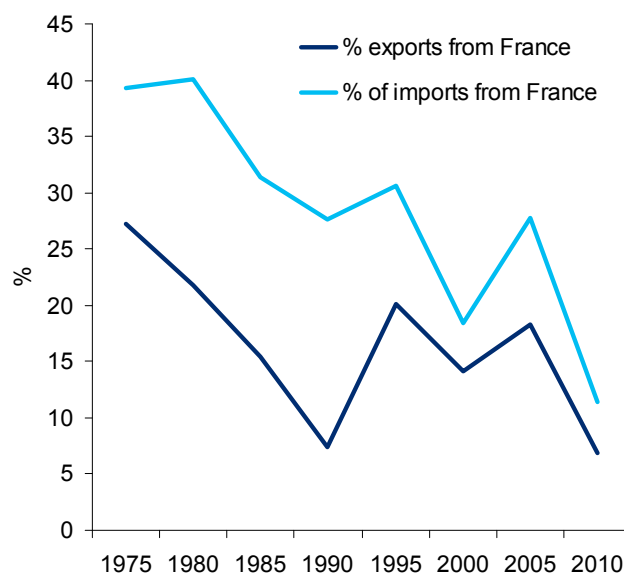
Another point to bear in mind is that, although under the IMF projections the aim is to nearly double investment in the coming years, it is estimated this will only push the investment level back up to the average for SSA by 2015. This further highlights the earlier point about increased regional competition: while Cote d'Ivoire has many strengths, the regional environment has changed substantially in the last decade and the country must increasingly run just to keep up.

Figure 4. Reversing the lack of investment



Source: IMF

Figure 5. A strong, but declining trend in trade, with France



Source: IMF Direction of Trade Statistics

The pluses and minuses of new engines of growth

But what is perhaps more encouraging when thinking about the potential growth path for the country is that, in addition to rebuilding the old engines of growth, there are positive signs that there could be new engines of growth, notably in the mining and extractive industries sectors. In particular, there is considerable investment already moving into the gold mining and the hydrocarbons sectors.

Whether investment into the minerals and mining sectors is a help or hindrance to promoting overall economic growth in a country in SSA is often unclear. Growth driven by capital intensive projects tends to have less impact on incomes and poverty in SSA than growth driven by soft agricultural commodity production. Moreover, it is also associated with the potentially negative impact of the so-called Dutch disease (For more detailed discussion about these issues, see the September 2012 Citi GPS publication, [Citi GPS: Sub-Saharan Africa - The Route to Transformative Growth](#)).

But on the positive side, the government seems to recognise this and it has some factors working in its favour:

- Firstly, by retaining the existing fixed peg arrangement between the CFA Franc and the Euro, the pressures for excessive exchange rate appreciation, the main economic problem associated with the Dutch disease, are more limited. In fact, the government seems acutely aware of the need to preserve competitiveness as one of its other key sectors for growth is the development of a labour intensive manufacturing sector, led by textile production.
- Second, and arguably an important argument in favour of promoting mineral extraction in Cote d'Ivoire is that, given the existing known deposits, it may mean that it is possible to spread growth more widely around the country. At present, much agricultural production is located in the south of the country, although there are potential prospects all around the country. But, given that the civil war in the country helped exacerbate an existing north-south split, obtaining a more geographically balanced pattern of growth is clearly another important goal of the new government.

Widening investor and trade partners

A final aspect on the potential future growth story in Cote d'Ivoire is that the current government is keen to further reduce its economic links to France. Historically, France was the main source of investment into the country and Cote d'Ivoire's main trading partner (see Figure 5). And, while France will continue to be an important partner, the government is very keen to diversify its economic links to a wider range of countries in both Europe and Asia, and beyond.

A changing policy background

The emergence of twin deficits

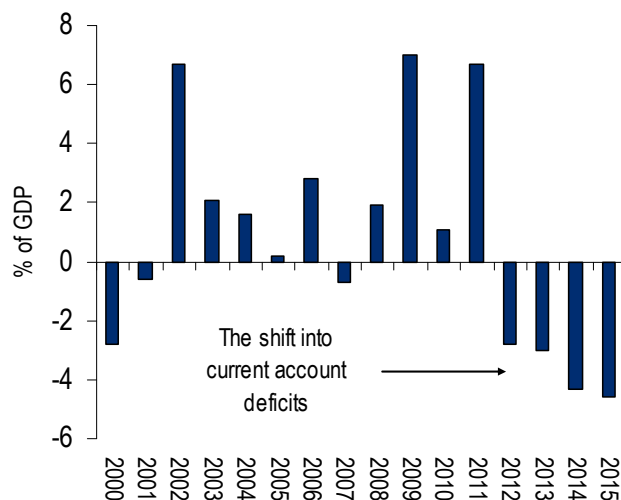
Reconstruction has a cost

Although the government and the IMF are projecting a strong economic recovery, there is another aspect to the country's emerging economic story worth looking at. Reconstruction has a cost and this will create a new macroeconomic dynamic for the country in terms of the fiscal and the current account outlook.

- As shown in Figure 6, historically Cote d'Ivoire has run a broadly balanced current account deficit, and even on average a surplus in the last decade. However, the move to this higher growth trajectory means that both the government and the IMF forecast that the country is now set to run a current account deficit for the foreseeable future (although by the standards of many countries in SSA, the forecast deficit is still relatively modest at around the 4-5% of GDP range).
- As shown in Figure 7, the other point about the projected economic recovery in Cote d'Ivoire is that the IMF and government are assuming that the fiscal deficit is brought back under control, or fiscal normality is restored. The IMF and government are projecting that the fiscal deficit will fall from the 5.7% recorded in 2011 to 4.4% in 2012 and then back towards historical norms of 2.5% of GDP by 2015.

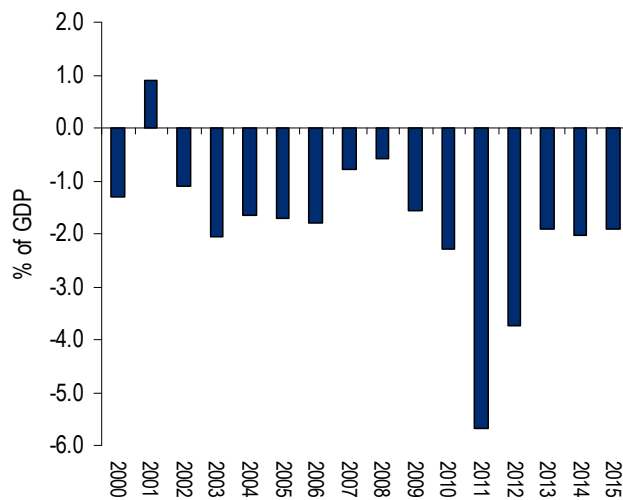
Moreover, financing the twin deficits has different implications in terms of economic policy for the government going forward.

Figure 6. A widening current account deficit



Source: Citi Research

Figure 7. Restoring fiscal discipline, but still in deficit



Source: Citi Research

Financing the deficits

Fiscal challenges in 2013

Raising domestic revenue and rescheduling domestic debt

Looking at the fiscal deficit first, the key goal of the government will be to ensure that the planned rise in spending is met by increasing revenue. This should be possible if the economic recovery picks up as forecast. But, given the gyrations in domestic taxes in recent years, some caution should be expressed. After all, tax revenue fell in 2011 as many companies in particular delayed making tax payments in the light of the political uncertainty. Although revenue rebounded strongly in 2012, the overall growth trajectory for domestic revenue is not entirely clear, and the prospects for further rapid increases in domestic revenue will only become apparent over the next 12-24 months.

The other complication on the fiscal side in 2013 is that the government will have to reschedule some of the domestic debt repayments that are due. At present, the government estimates that it has CFA759.6bn of debt maturing in 2013, with a large part, or CFA243bn due to mature in December (this reflects a rescheduling of short term domestic debt in December 2011). At present, the government is optimistic that these domestic debts can be rescheduled with local and regional banks with a longer repayment period. Moreover, this would mean that the current fiscal consolidation programme can remain on track. But the need to achieve this does provide a degree of uncertainty over the current fiscal projections.

New borrowing and HIPC

HIPC reduces debt, but puts some constraints on new borrowing

While the move back to modest fiscal deficits means that fiscal financing can come largely from domestic sources, arguably the same case cannot be made for the current account deficit which we expect will largely have to be funded from external borrowing. On a very positive note, at the end of 2012, the country will formally reach Highly Indebted Poor Country (HIPC) completion point. Although the exact impact of this is often quite difficult to tie down given the way in which external debt write-offs are implemented, IMF projections of gross government debt are that it should fall from over 90% of GDP in the early 2000s, to 62.5% at the end of 2012 and to below 60% by 2015.

Changing global realities mean that the government will likely borrow again despite the debt write-off

But it will also reduce its external borrowing options for some time going forward, as accepting the HIPC write off also means that there are constraints about what the country can borrow, especially on non-concessional terms. In fact, under the original HIPC framework, the idea was that, following debt relief, countries would not be allowed to borrow new money quickly given that this would undermine the rationale of writing off existing debts.

However, since the original HIPC framework was developed in the early 2000s, the global macroeconomic environment has changed significantly. In particular, financial constraints mean that European countries and the US are not in a position to provide all new assistance to the country in the form of grants even after a major debt write-off. This is especially the case as there seems to be a widespread acceptance amongst most major donors that the Ivorian government will need substantial external support to help fund reconstruction.

This new found reality clearly came to the fore at the recent conference held by the Ivorian government in Paris on December 4 and 5. The objective of this was to meet public and private partners to tie down the necessary external funding for the Ivorian government's ambitious Plan National de Développement (NDP).

Figure 8. Financing the Plan National de Développement (NDP) 2012-15
CFAbn

	2012	2013	2014	2015	Total
Total investment	1,521	2,263	3,130	4,162	11,076
Public financing	676	1,000	1,291	1,612	4,580
Private financing	845	1,263	1,838	2,550	6,496
Indicative US\$bn total investment ^a	3.0	4.5	6.3	8.3	22.2

^a Indicative US\$ total investment based on a XOF500:US\$1 exchange rate

Source: NDP, Stratégie de Financement

Donors step up with significant new commitments of support

Following the meeting, initial indications from the government are that it has secured pledges of around US\$8bn from donors to fund the NDP, although the full breakdown between loans and grants remains unclear. But the bottom line is that, not only is this double the US\$4bn it was hoping to secure, but not far short of its total public funding requirements from 2012-15 outlined in the NDP. And, while pledges often do not equal disbursements, we think that the government can still count on a significant level of donor support over the next few years.

Attracting private sector funding is less clear cut

But, while attracting funding from bi- and multilateral lenders is important, the government also needs to attract investment from the private sector to be able to fund all the investment projects outlined in the NDP. This was the focus of the second day of the conference and, given the different nature of the event, the level of commitment still remains unclear.

Funding, investment and growth

Following the meeting in Paris, it is clear that the government will be able to fund a considerable number of the projects outlined in the NDP. While, this is positive news, there is an argument that, even if there is a funding shortfall, it should not be overplayed as a major concern. We think there is an argument that, even if the government only managed to implement 25-50% of the projects outlined in such detail in the NDP, then it still will have achieved more than most SSA governments over the next three years and the growth rate will not be too far short of its ambitious targets, although perhaps more along the lines of the NDP scenario, *Revél de l'Eléphant*, where growth is projected at around 6% over the 2013-15 period.

A blurring of difference between concessional and non-concessional borrowing?

To help it achieve its ambitious growth plan, the government has also made some tentative indications that it would also like to return the global private capital markets with a new Eurobond. In this respect, it could seek an initial sovereign rating in 2013 or 2014, which would then pave the way for a return, perhaps in 2015. The initial constraint to this is that the country will have a strict limit on the level of non-concessional borrowing it can take on after HIPC debt relief and under its IMF programme. Of course, it could move off the IMF programme, but this is unlikely.

But what is interesting is that, in a low global interest rate environment, it is increasingly difficult to draw a clear distinction between what is concessional and non-concessional borrowing on interest rate differentials alone. For example, when Ghana issued its debut 10 year Eurobond in 2007, the coupon rate was 8.5%. In contrast, the average interest rate on loans from official creditors at the time was 1.3%, with a grace period of just over 6 years and an average maturity of 26 years. In contrast, Zambia came to the market in 2012, also with a 10-year Eurobond, but this had a coupon rate of only 5.6%. This compares to official creditor average terms (the data is only available for 2011) of 2% with a maturity of 24 years and a six year grace period. In other words, the differential between concessional and non-concessional interest has fallen by around 3.5 percentage points in five years. The situation has also been complicated by the rise of Chinese lending. While the terms of this can be opaque, the reality is that the interest rate on Chinese loans often falls half way between concessional and non-concessional lending, providing yet another borrowing option for SSA countries.

But, in the end, in a period of low global interest rates in the US and Europe, the IMF is probably going to have to adapt its criteria on taking on new non-concessional lending to reflect the change in the lending environment facing countries in SSA. Whether this happens before Cote d'Ivoire chooses to come back to the market is unclear, but it is distinctly possible.

Some final points on financing the deficits

Repayment capacity could be strained in 2013

At present, we remain confident that the Ivorian and regional banking system will buy into a domestic debt restructuring in 2013. This should allow the government to continue to achieve its goal in terms of fiscal consolidation and to maintain its payments on the Eurobond. But nothing can be guaranteed and the government's own warnings in its presentation to investors in October that "its repayment capacity remains limited" in 2013 are very real.

No funding and import growth will be constrained

Secondly, it is also important to remember that, unlike most Anglophone countries in SSA running large current account deficits, notably in East Africa, Cote d'Ivoire has a fixed exchange rate to the Euro due to its membership of the Franc zone which acts as a major constraint on its policy leeway. The bottom line with this policy arrangement is that, if the financing for the projects does not materialise, then the level of imports will not rise as significantly as forecast and the deterioration in the current account will be much less marked than currently projected. In some ways, this is a positive outcome although, as argued earlier, it will be clearly accompanied by a lower growth outturn.

Politics still hangs over the recovery

History, growth, jobs and political stability

Are the country's growth plans more ambitious than elsewhere in SSA?

While Cote d'Ivoire's growth and policy plans are superficially similar to many other countries in SSA, in some ways they also seem to be more ambitious. So, a perfectly reasonable question would be: why does this ambitious growth agenda seem to matter more in Cote d'Ivoire than in other countries in SSA?

We think the response to this lies in a combination of the country's post independence history and the fact that some academic research shows that countries like Cote d'Ivoire, that have been through a major political crisis, can be more susceptible to further political crisis.

- In the case of the first point, we think that both politicians and the population at large throughout the country are very aware of the country's historical status as one of the strongest and most developed countries in SSA up to the mid-1980s. In this respect, regaining lost ground, or the country's economic pre-eminence, does seem to have a much stronger political narrative than in other countries.
- In terms of the second point, the new government, probably quite rightly, feels that it is under huge pressure not just to create jobs for a young population, as in many countries in SSA at a similar position in their demographic development, but also for ex-combatants to foster a return to normality. In a post conflict environment such as in Cote d'Ivoire, a high level of unemployment can provide a fertile recruiting ground for what can perhaps be best described as "thug supporters" of political parties, or that unemployed ex-combatants will remain susceptible to political radicalization.

Bringing the FPI back into the formal political space would help restore political normality

But creating a new political normality will be more complicated than just creating jobs. Arguably, the government also needs to bring the former ruling party, the Front Populaire Ivoirien (FPI), back into the formal political space if it is to create a new political normality. And, in this respect, the final piece of the jigsaw in terms of returning to political normality may well be the holding of combined local and municipal elections in early 2013: according to head of the Independent Electoral Commission (IEC), Youssouf Bakayoko, these will now take place in February along with several by-elections for the National Assembly¹.

While the local and municipal elections are unlikely to register significantly on the radar of external investors, we think their importance lies in the fact that they will provide an important insight into understanding the current process of political reconciliation (or lack of it).

The elections will probably not undermine the RDR-PDCI coalition, but will give us insights into where the FPI goes from here

At present, the Rassemblement des Républicains (RDR) and Parti Démocratique de la Côte d'Ivoire — Rassemblement Démocratique Africain (PDCI-RDA) are committed to contesting these polls on a combined ticket, reflecting their current political coalition at the national level which came to power following the end of the civil war. Moreover, given that the recent cabinet reshuffle did not challenge the basic idea and strength of the coalition, this joint platform at the elections is likely to hold.

¹. According to the IEC, the by-elections will be held in six constituencies on February 3, followed by municipal and regional elections in 183 constituencies, as well as only municipal elections in the two autonomous districts Abidjan and Yamoussoukro on February 24.

Instead we think the real question is whether the FPI opts to contest the polls. This has several possible implications.

- If it does, then arguably it could be the start of the process of bringing the party and its supporters back into the mainstream political process. But, even if the FPI opts to boycott the polls, a sign of potential compromise will be the extent to which the party's members stand in the polls as independent candidates.
- Conversely, an unwillingness by the FPI and its supporters to move back into the political mainstream may raise our concerns about the ability of the government to restore greater security around the country, which seems is an ongoing policy priority. Moreover, this could be even more testing in 2013, if the trial of former president, Laurent Gbagbo, in the Hague moves ahead, thus exacerbating existing political tensions.

The November 2012 cabinet reshuffle

As we argued in the [Emerging Markets Economics Today](#) on November 15, when the coalition government first came to power its two main goals were political reconciliation and restoring macroeconomic stability. In both cases there has been progress, but most notably in the case of the economy where in some ways it is useful to think of the end of the stabilisation period as the reaching of HIPC completion point. With this now behind it, the government is moving to a new policy phase which will be dominated by implementing the huge number of projections outlined in the NDP. As a result, the main rationale behind the reshuffle was to put in place ministers in which the president has confidence and who can implement these plans.

Unsurprising in this light, *Africa Confidential* on December 14 argued that, more than anything else, the November 22 cabinet reshuffle "represented the importance of old loyalties and economic competence". As they highlight, a long time ally of the president, Daniel Duncan, was appointed as the new prime minister, while the cabinet now includes ministers with economic competence earned from spells at the IMF or World Bank, in the same vein as the president and the new prime minister, such as Jean Claude Brou. The cabinet also includes businessmen such as Jean Louis Billon and long standing competent ministers, such as Patrick Achi. Moreover, many of the new members of the cabinet are also fluent English speakers.

But there is also a longer political theme in play, as well as the move from reconciliation and stabilisation to implementation. If the president wants to stand for re-election in 2015 we think he will want to stand on a platform dominated by what he has achieved while in power, or on the basis of results. But, arguably, this also means that, at the heart, of the reshuffle lies an important contradiction: the cabinet is now dominated by apolitical technocrats, but this reflects a pressing political reality, the need to meet the government's ambitious growth targets through increased investment.

Restoring security moves centre stage

But assuming the local and municipal elections pass off peacefully, barring localized incidents, and whether the FPI contests the polls or, we still think that the central political scenario will be one of a period of national political calm until attention is turned on to the next presidential elections in 2015. But within this, the battle to quickly restore greater security around the country will remain challenging and a key measure of political progress in the run up to these elections. If security does not improve, then the outlook for the 2015 presidential elections will likely be challenging, raising the spectre of a repeat of the 2000 elections. But what else can we say about the political outlook over the next few years.

Towards presidential elections in 2015

The president is arguably on a “hiding to nothing”

The most obvious trend to try and monitor is how much support President Ouattara loses over the coming years. While this may sound negative, the reality is that incumbent is facing a very difficult task since assuming office in 2011. Expectations about the potential economic gains from the end of the conflict remain high, especially when coupled with a widespread belief that the country will quickly regain its former position of pre-eminence in the region. Moreover, these expectations seem to be heavily concentrated in the ability of the president, notably his perceived economic competence, to deliver much in a relatively short time frame.

Given this, we think that that it is likely that he will end up disappointing some of the electorate, as some of their expectations seem unrealistic, especially those seeking work. While a period of strong growth, if the results are relatively evenly spread, is probably the best ways to meet these expectations, the problem is significant and will probably not be resolved quickly, even if the government's recovery plan was to move ahead virtually seamlessly.

Will the incumbent stand in 2015?

The size of the task at hand and the pressure to achieve it could, in turn, raise the possibility that President Ouattara opts not to contest the elections in 2015. It is feasible that a combination of his workload during the coming years and some erosion of his popularity could be enough to make him consider stepping aside. If this were to be the case, the mantle of being the RDR's presidential candidate could feasibly pass to Guillaume Soros, the former leader of the Forces Nouvelles and since 2012 the leader of the National Assembly

At present, we think that it is extremely unlikely that Mr Soros would seek to undermine the incumbent president in any way over the coming years. We also think that he is very unlikely to create a new party to contest the polls. Instead, over the coming years we may see him looking to build a higher international profile as Mr Soros does not have the same level of buy-in with the international community that the current president has.

The other point to bear in mind is that, if Mr Ouattara were to step aside, we think the prospects of a RDR-PDCI coalition contesting the polls in 2015 would be limited. This would probably be a healthy outcome. While we envisage the coalition would likely remain instrumental in helping rebuild a divided country, there is a strong argument that by 2015 this process may well have run its course and then a new competitive political normality would need to be restored based on a new generation of politicians. In this respect, it is also important to understand in that scenario that, as well as a transition to a post-Ouattara RDR, there would at some point need to be a similar transition to a post Henri Konan Bédié PDCI-RDA and a post Laurent Gbagbo FPI.

The FPI will have to weigh up its options

But the question still hanging over all this is where the FPI fits into the evolving political landscape? We think there are several options that it could follow:

- It could continue to remain outside the formal political process and snipe from the sidelines, even supporting individuals and groups contributing to the poor security environment. This would clearly be a negative outcome.
- Or it could seek to re-engage in the formal political process and to contest the 2015 elections in a constructive fashion. There are many options here. It could seek to re-invent itself with a new leader, or even seek to build an alliance with

the PDCI to seriously challenge the RDR, arguably taking Ivorian politics in a full circle back to the late 1990s.

Political normality, but underlying chasms exists

In the end, all this uncertainty will only be resolved in time. But the underlying point is that, although on the surface there has been a rapid restoration of political normality in Cote d'Ivoire following just over a decade of conflict, we see the country as muddling through at this point against the background of high popular expectations and a number of important and underlying tensions which could potentially come to the surface. While a healthy and fit President Ouattara clearly has the experience and support to continue to negotiate this delicate balance, whether he has the desire to continue to do so beyond 2015 remains a very real, and open, question.

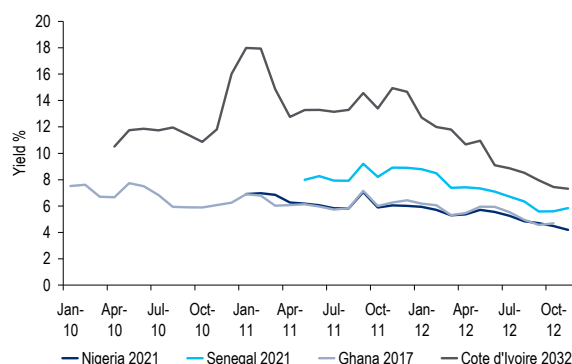
What does all this mean for the Eurobond?

Specific factors make Cote d'Ivoire a higher yielding Eurobond at present

Despite the rally in the price for the Ivorian Eurobond in 2012 shown in Figure 1, the reality is that it is still one of the highest yielding Eurobonds in SSA and West Africa. This reflects a number of specific factors:

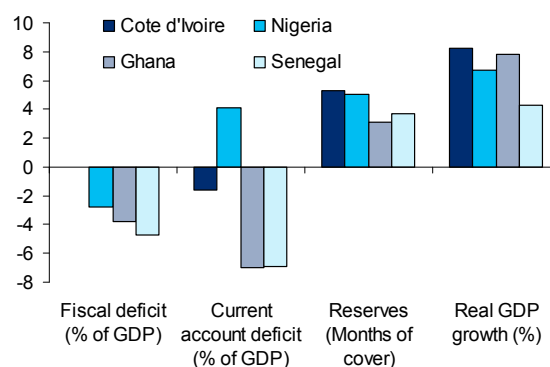
- Its longer maturity profile and the step up nature of the coupon payments;
- The limited repayment history to date and the recent past history of non-payment. This will arguably remain a concern in 2013 given the fiscal issues outlined earlier; and
- The ongoing concerns about the political and economic outlook for the country after such an extended period of internal conflict

Figure 9. West African Eurobond yields



Source: Bloomberg

Figure 10. Comparative macroeconomic indicators in 2013



Source: IMF forecasts

But ultimately, its macroeconomic indicators are likely to be superior

But the reality is that the Eurobond has still rallied close to its comparators in the region, and it is plausible that, if the above political and economic scenario outlined by the government plays out, even if only in part, then if Cote d'Ivoire were to come back to the market at some point in the next few years, from a purely macroeconomic perspective we think it would represent a better credit risk than both Senegal and Ghana. This is likely to reflect trends in both hard data, as shown in Figure 10, but also on less quantifiable data such as greater diversity of the economy or better economic management. But, even with this improved economic outlook, the country's recent political legacy, and its potential future implications, cannot be ignored.

Appendix A-1

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