

**WEST AFRICAN MONETARY AGENCY
(WAMA)**



ECOWAS MONETARY COOPERATION PROGRAMME

***MACROECONOMIC CONVERGENCE REPORT
2007 BURKINA FASO***

FREETOWN, JUNE 2008

The Burkinabe authorities set a growth rate target of 6.5% for 2007. This was based on the assumption that the growth in the agricultural sector would be sustained and there would be satisfactory performance in the manufacturing, construction, public works, transport, tourism and telecommunication industries.

The positive trends expected in the real sector should lead to the strengthening of budget indicators thanks to measures that should be implemented as part of the budget adjustment programme with the Fund. Consequently, the expected increase of 22.0% in budget revenue coupled with 18.9% growth in total expenditures and net borrowings should lead to an overall deficit excluding grants of 11.5% of GDP.

At the end of the year, the main growth target could not be achieved due to the unfavourable world economic situation and especially poor weather conditions which devastated large areas under cultivation. Nevertheless, the overall production grew relatively by an appreciable rate of 4.2%. This was achieved within a context of a relative control of prices, as the end of period inflation settled at 2.3% against 1.5% in 2006.

1. Sector Analysis

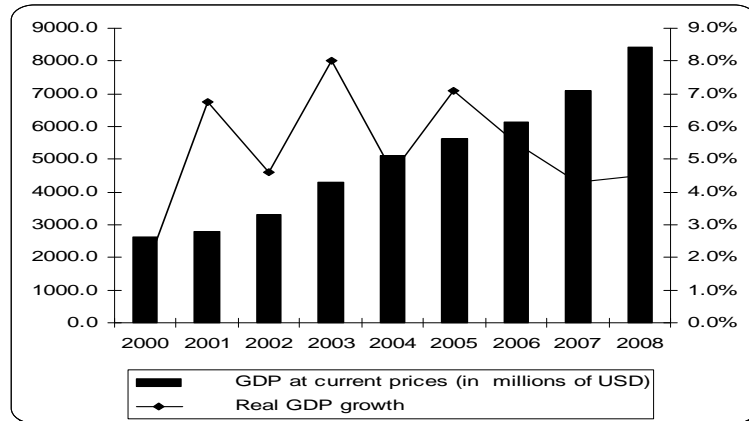
1.1 Real Sector

In 2007, economic activity recorded a growth rate of 4.2% against 5.5% in 2006. This down turn stemmed largely from the difficulties in the primary sector partly due to the fall in cotton production. On the whole, agriculture was adversely affected by the poor spread of rainfall both in time and space as well as floods experienced in some regions. This led to a growth rate of -0.5% in the primary sector against 0.9% in 2006. Particularly, cotton production slumped by 33.2%, falling from 649 400 tons during the 2006/2007 farming season to 434 000 tons during the 2007/2008 farming season in view of the continuous drop in the producer price and delays in payments as well as the low morale among producers. On the other hand food production recorded a growth of 4.4% of its value added, driven largely by cereal production.

The secondary sector recorded a growth rate of 7.2% fuelled mainly by the construction sector against 6.4% in 2006. The growth rate in the construction and public works sector was 33.3% against 14.1% in 2006 as a result of the intensification of projects, especially, the construction of socio-economic infrastructure and the administrative and commercial activities zone (ZACA) as well as investments made by financial institutions and telecommunication companies. Extractive industries recorded a growth of 14.8% of their value added further to 70.0% in 2006. This sub sector is currently experiencing increased activities with the exploitation of the Taparko and Kalsaka gold mines as well as the Perkoa zinc mines. With regard to value added in the manufacturing sector, it grew by 3.0% against 7.4% in 2006. This slowdown is due, on one hand, to a rise in intermediary consumption following the hike in petroleum prices and unfair competition as well as fraud on the other hand.

Growth in the tertiary sector stood at 5.1% against 8.1% in 2006. The 3.6% growth recorded in trading services is linked to the vitality in commercial activities as well as "post and telecommunication" services which grew by 7.9% and 6.6% respectively.

Graph 3.5: Trends in Nominal GDP and Real Growth Rate



With regard to demand, GDP growth was fuelled largely by investments. The Gross Fixed Capital Formation (GFCF) grew by 39.9% against 25.8% in 2006, as a result of an increase in its two components. The private component rose by 64.5% in line with the intensification of infrastructure building works as well as investments made by financial institutions and telecommunication companies as part of the expansion of their activities across the country. As for the public GFCF, it went up by 11.3% as a result of the implementation of the public investment programme. Final consumption grew marginally by 1.0% against 6.9% in 2006 in view of the insignificant increase in the private component (+0.2%) due largely to the reduction in cotton farmers and other stakeholders' income in the sub sector. However, the public component recorded a significant growth of 3.3% against 2.6% in 2006. Concerning external trade, it was marked by a drop in exports by 3.9% and an increase in imports by 8.0%.

In nominal terms, the investment rate stood at 18.8% in 2007 against 14.2% in 2006. Also, gross domestic savings rate to 3.0% against 1.1% in 2006.

In the area of prices, it is worth noting that real GDP growth was achieved within context of relative price control. Trends in the Harmonized Consumer Price Index (HCPI) led to an end of period inflation rate of 2.3% at the end of December 2007 against 1.5% in 2006. This result reflects to a large extent the effectiveness in price control in sub sectors such as "foodstuffs and non alcoholic beverages", "accommodation, water, gas, electricity and other fuels" and "transport" especially. The downward trend in prices at the level of "foodstuffs and non alcoholic beverages" function was as a result of a good performance in the sector during the 2006/2007 farming season which ensured regular supply of cereals on the markets. Concerning transportation, the hike in oil prices on the international market was not systematically passed on to the ex-pump price.

1.2 Public Finances

The execution of public finances ended up with an overall deficit excluding grants of 11.8% of GDP against 10.7% in 2006. This development was attributed to a disproportionate growth in total expenditures and net borrowings in relation to total revenues including grants.

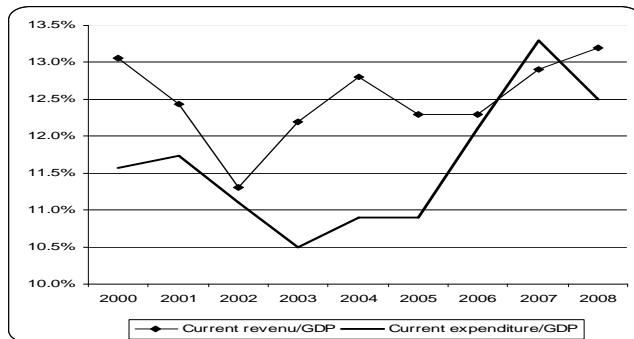
In fact, total revenues including grants rose by 10.1% at end of December 2007, leading to a ratio of 20.2% in relation to nominal GDP. This situation stems from the 12.1% and 42.3% increases in budget revenues and grants respectively.

As regards budget revenues, they stood at 12.9% of nominal GDP in 2007 against 12.3% in 2006. This growth reflects trends that marked the major components of the budget. Indeed, tax revenues rose by 13.7% thanks to the impact of reforms involving the computerization of the Head office of Major Enterprises in the Revenue service, the strengthening of fiscal controls as well as the use of all functionalities of SYDONIA. Similarly, non tax revenues grew by 20.3% thanks to an upward adjustment in the cost of licenses for telecommunication companies.

Grants went up by 224.9 billion, representing a ratio of 6.9% of GDP in 2007 against 5.9% in 2006. This high level of grants mobilization was achieved thanks to the solidarity exhibited by the international community during the floods that occurred in several regions of the country in the last rainy season.

Total expenditures and net borrowings grew by 14.4% representing 24.7% of GDP in 2007 against 22.9% in 2006. This growth stems from two components of the expenditure. In fact, recurrent expenditures increased by 17.1%. This is due mainly to the increase in the wage bill, operational expenditures and those related to the decentralization process. With regard to the increase in the wage bill, it is linked to the recruitment of new agents in social sectors and the part payment of the back pay resulting from the promotion of public servants.

Graph 3.6: Recurrent Revenue and Expenditures



Capital expenditures dropped by 1.8% as a result of a squeeze in internally funded investments (-7.0%). The externally funded component increased by 2.2% due to foreign capital inflows for the implementation of the poverty reduction strategy. Despite the drop in the internally funded component, it accounted for over a third of tax revenues (35.6%).

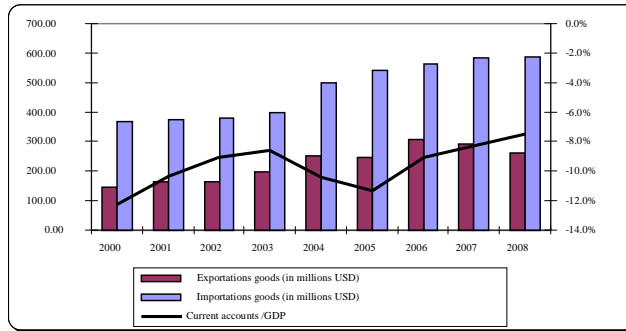
Outstanding public debt as at end of December 2007 stood at 724.0 billion francs, representing 22.1% of nominal GDP against CFA F 687.0 billion at the end December 2006. Debt servicing accounted for 5.8% of budget revenues. The relatively low level of the various ratios of indebtedness is explained mainly by a debt relief to the tune of CFA F 708 billion enjoyed under the Multilateral Debt Relief Initiative.

1.3 External Sector

Concerning external accounts, the overall balance of payment position recorded a surplus of 188.3 billion. This surplus is mainly as a result of proceeds from the divestiture of ONATEL in 2007.

The trade deficit balance worsened by 15.6% to settle at 294.2 billions. Total exports reached 290.9 billion, indicating a drop of 5.4% due mainly to a 17.7% reduction in cotton exports, whilst non monetary gold, livestock product, oilseeds, fruits and vegetable exports increased. Total imports went up by 4.1% 2007 to settle at 585.1 billion, driven by a recovery in internal economic activity which led a growing demand for petroleum products, capital equipment and other consumer goods. The deficit in services was 168.9 billion, worsening by 1.1% in line with a drop in other services whilst net revenues also deteriorated to settle at -6.5 billion.

Graph 3.7: Trends in imports and exports

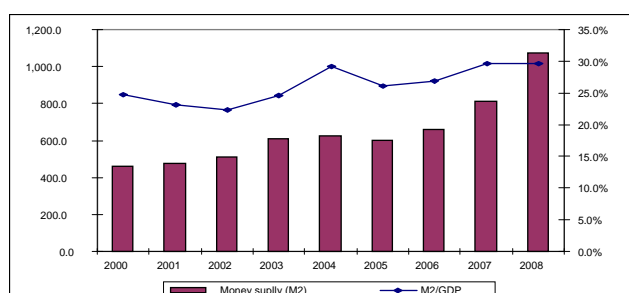


Net inflows in respect of current transfers reached 196.6 billion in 2007 against 133.4% in 2006, representing a 47.4% increase as result of current public transfers. Similarly, net inflows on account of financial operations and capital transfers, including debt relief stood at 461.3 billion in 2007 against 337.4 billion in 2006, which is a 36.7% increase. This is due to the high level of direct investments resulting from the privatization of ONATEL (144.3 billion).

1.4 Monetary Sector

Within the UEMOA Zone, currency and credit management is based on interest rate policy and the mandatory reserves system. In a context where inflation was relatively under control, the Central Bank maintained its key rates at 4.25% for the pension rate and 4.75% for the discount rate. The mandatory reserve coefficient remained at 7.0% in Burkina. At the end of December 2007, this situation led to uneven growth in monetary aggregates.

Graph 3.8: Trends in money supply



In fact, net foreign assets of financial institutions rose by 188.2 billion to settle at 409.3 billion at end of December 2007. This development was ascribed to the increase in BCEAO's net foreign assets linked partly to the transfer of part of government interest in Office National des Telecommunication to (ONATEL) to a strategic partner for a sum of 144.3 billion.

Outstanding domestic debt went down by 11.6% to settle at 452.7 billion at the end of December 2007. The government's net position improved by 63.6 billion and settled at -93.8 billion as at end of December 2007. This development is due mainly to the exceptional inflow of resources for the State. Credits to the economy rose by 0.8% compared to the level in December 2006 following a growth of 13.2% in ordinary credits and a drop of 76.0% in seasonal credits. The increase in ordinary credits was as result of support provided for some cotton companies as well as companies operating in sectors such as energy, oil, telecommunication, construction and public works, agro-industry, general trading and services.

Money supply grew by 22.9% to settle at 813.2 billion, fuelled by the increase in bank deposits by 17.6% and cash circulation by 42.5%.

2 Performance in terms of macroeconomic convergence

The level of convergence improved slightly compared to 2006. Indeed, the number of targets achieved moved from five (5) in 2006 to six (6) in 2007. The results achieved since 2003 bring to the fore a high level of budget deficit which will require serious adjustment efforts to resolve in the short if not medium term. This situation is attributed, on one hand, to the substantial inflows of budget supports meant for poverty reduction that are not evenly taken into account in the calculation of the indicator, and on the other, to the low level of revenue mobilization, with the ratio remaining static and hardly exceeding 11% of GDP since 2003. This low level of tax revenue mobilization explains also a relatively high level of the wage bill which is however subject to drastic adjustment measures since 1993. On the other hand, serious efforts are made to sustain the level of capital expenditures to build support infrastructure for the economy.

On the whole, three primary criteria were observed as at end of December 2007. The ratio of internally funded investments and tax revenues stood at 35.6%, representing a slight reduction compared to the level in 2006 (42.7%). The interest rate criterion was also met as the low level of inflation ensured real positives rate of returns on savings. Similarly, the effective real exchange rate fluctuated slightly showing a marginal appreciation of 1.6% at the end of 2007.

BURKINA FASO : CONVERGENCE POSITION	Target	2003	2004	2005	2006	2007	2008. (*)
Primary criteria							
Budget Deficit/GDP	≤ 4%	8.2	8.6	8.8	10.7	11.8	12.3
Inflation rate	≤ 5%	3.9	0.7	4.5	1.5	2.3	2.0
Monetary financing of budget deficit /Previous year tax revenue	≤ 10%	0.0	0.0	0.0	0.0	0.0	0.0
Gross external reserves in months of imports	≥ 6	6.0	6.8	4.5	4.2	7.6	5.6
Secondary criteria							
Tax revenue/GDP	≥ 20%	10.9	11.8	11.4	11.3	11.9	12.3
Wage bill./tax revenue	≤ 35%	41.7	38.8	42.0	44.1	46.5	43.5
Public invest. /tax revenue	≥ 20%	32.7	42.7	40.8	42.7	35.6	39.8
Real interest rates	≥ 0	-0.4	2.8	-1.0	2.0	1.2	1.5
Real exchange rate stability	± 5%	5.1	-0.6	3.0	0.3	-1.6	0.3
Total # of criteria met		5	6	5	5	6	5

Source: WAMA, BCEAO.

(*) : Annual estimates

3 Prospects for 2008

For 2008, the economic policy orientation is based on the assumption an economic growth of 4.9% would be achieved. This target, which appears measured, is set against the backdrop of the unfavourable world economic situation marked by the persistent hike in oil and basic foodstuff prices. In this context, economic prospects can only be affected and weakened. All sectors would contribute to the achievement of growth target of 4.9%. The growth rates in the primary, secondary and tertiary sectors would be 5.0%, 9.4% and 5.7% respectively.

The growth expected in the various sectors will depend on climatic conditions, the international environment and particularly the level of cotton and petroleum prices as well as the effective implementation of sector reforms and structural measures in the programme concluded with the Fund. This involves a policy aimed at intensifying village irrigation projects, improving seeds and soil fertilization. Besides, actions geared towards improving transportation and tourism would contribute to the diversification of the economy, this would help reduce in the long run the reliance on weather conditions. Economic diversification measures include providing supports for the development of the private sector as well as telecommunications.

With regard to prices, it is expected that inflation would be stabilized and would meet the community target. Inflation rate would be 1.7% at end of December 2008. However, in view of current trends in the crude oil price, which is beyond \$100 per barrel, the rise in food prices on the international market as well as the persistent appreciation of the euro against the dollars, the risk of high inflationary pressures in 2008 is also real.

In terms of public finances, budget fundamentals would remain fragile in 2008. The persistence of unfavourable economic conditions due to the hike in oil and food prices would worsen main budget balances. The overall budget balance excluding grants would settle at -12.3%, that is a 0.5 percentage point higher than in 2007.

4 Conclusions and Recommendations

After the positive results recorded in 2006, the unfavourable world economic situation led to a downward trend in performance especially in terms of economic growth. This trend illustrates the high level of vulnerability of the Burkinabe economy to external shocks in view of the predominance of cotton exports. The dependency on external aid is quite high and this seems to constrain the intensification of efforts at internal revenue mobilization as reflected in the tax pressure rate which has remained almost stagnant since 2003. Finally, Burkina Faso is facing institutional and absorption capacity constraints though it has improved considerably public finance management.

To consolidate gains and reduce structural constraints in order to ensure that the economy is moving towards achieving its targets in terms of macroeconomic convergence, the Authorities are called upon to :

- Improve tax revenue collection by widening the tax net, intensify the fight against fraud and tax evasion and control exemptions ;
- Pursue the programme for the diversification of animal and plant production in order to reduce the structural dependency on a single crop;
- Put in place an effective policy to support food production in order to limit the effects of the persistence of the current food crisis;
- Maintain the sustainability of public debt by monitoring rigorously trends in domestic debt and resorting to concessional resources.