Country Report

# Senegal

## Senegal at a glance: 2003-04

**OVERVIEW**

With their overwhelming support in parliament, the president, Abdoulaye Wade, and the pro-government alliance, Convergence des actions autour du Président en perspective du 21ème siècle (CAP 21), are expected to remain in power throughout the forecast period. Real GDP growth will rise to 3% in 2003 and 5% in 2004, driven by a partial recovery in agricultural production, the expansion of mining and manufacturing activity, and the start of several large infrastructure projects. The average exchange rate will mirror movements in the euro, strengthening to CFAfr584:US$1 in 2003 and CFAfr555:US$1 in 2004. The current-account deficit is forecast to narrow to 5.4% of GDP in 2003, mainly owing to an increase in current transfers inflows, and to 4.4% of GDP in 2004, helped by narrowing deficits on the services and income accounts (the former owing to slower growth in imports, the latter to ongoing HIPC debt relief).

### Key changes from last month

#### Political outlook

- Following the fleeting visit of the US president, George Bush, to Dakar in early July, the political focus has returned to domestic issues. However, there has been no significant change on any of the main issues, such as progress in establishing peace in Casamance or development of the agricultural strategy law.

#### Economic policy outlook

- There has been no change to the economic policy outlook.

#### Economic forecast

- Annual inflation was -0.3% in June, compared with -0.9% in May. But on a monthly basis, the index fell by 0.2 percentage points from May to June as a result of prices falling in transport and other goods and services. Annual inflation remains extremely low, but does appear to be on the rise now, given that private consumption is also on the increase following the disastrous agricultural marketing season in 2002/03.
- However, the tight monetary policy of the regional central bank and weak private consumption will help cut average inflation to 0.8% in 2003. It will rise, in line with accelerating GDP growth, to 1.8% in 2004.

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“n/a” means not available; “–” means not applicable

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# Outlook for 2003-04

## Political outlook

**Domestic politics**

Owing to their overwhelming support in parliament, the president, Abdoulaye Wade, and the governing coalition, Convergence des actions autour du Président en perspective du 21ème siècle (CAP 21), are expected to remain in power throughout the forecast period. However, Mr Wade and the government—which is largely composed of members of Mr Wade's party, the Parti démocratique sénégalais (PDS)—are under pressure to tackle urgent economic matters. Unemployment has risen and rural incomes have fallen since early 2000 when Mr Wade came to power, and there is considerable popular disillusionment with the government. To tackle its loss of popular support—and with an eye on the legislative election in 2006 and the presidential election in 2007—the PDS will try to revitalise its organisation and the government will promote further economic and political reforms. The economic reforms will aim to raise living standards, and large donor commitments suggest that the government will have sufficient resources to carry through many of them. The start of public consultations in April on a law setting out a new strategy for agriculture, focused explicitly on poverty reduction, should help to ease tension in the countryside (which arises from lower crop production because of poor weather and the mishandled restructuring of agricultural marketing), although those parts of the bill that challenge the existing system of land tenure may stir up new opposition. Political reforms include the establishment of a new anti-corruption commission and an advisory Council of the Republic. That the PDS is considering its electoral prospects so far in advance of the elections reflects its anxiety over the strength of the main opposition parties, grouped in the Cadre permanent de concertation. The Economist Intelligence Unit expects the government to carry out most of its economic reforms, with varying degrees of success, and to neutralise much opposition criticism. But if it fails to implement important reforms, such as those of the agricultural sector, the opposition will present an increasing challenge to the governing coalition.

The prospects for peace in Casamance, in southern Senegal, have been given a new lift by Mr Wade's meeting in early May with a political leader of the rebel Mouvement des forces démocratiques de Casamance (MFDC), at which both sides committed themselves to move the peace process forward. However, talks between the government and the MFDC are hampered by divisions in the political and military leadership of the movement. The death in late May of Sidy Badji, an influential MFDC figure, may increase uncertainty. Sporadic fighting, rebel attacks on the civilian population and banditry will continue, hindering peace efforts and rehabilitation programmes in the region in 2003-04.

**International relations**

Mr Wade will continue to play a leading role in promoting political and economic co-operation among African states—the visit of the US president, George Bush, to Dakar on July 8th points to the high regard in which Mr Wade is held and to the prospect of additional US funds to tackle HIV/AIDS and the war against international terrorism (Senegal has a large Muslim population). Mr Wade will also remain one of Africa's most active supporters of the New Partnership for Africa's Development (Nepad), a development strategy which aims to increase donor support and inflows of foreign direct investment to African countries in exchange for improvements in governance. As president of the Union économique et monétaire ouest-africaine (UEMOA) and a past chairman of the broader Economic Community of West African States (ECOWAS), Mr Wade will play an active part in encouraging national reconciliation in Côte d'Ivoire—Senegalese troops have been sent there as part of a regional peacekeeping force (assisted by French troops). Relations with Guinea-Bissau and The Gambia will centre on transport disputes, border security and mediation in the Casamance conflict. Relations with Mauritania will be strengthened by Senegal's extradition to Mauritania of one of the minor participants in an unsuccessful coup in that country on June 8th.

## Economic policy outlook

**Policy trends**

The government is expected to continue pursuing the donor-supported economic reform programme begun by its predecessor, which involves modernising agriculture, improving infrastructure and creating new jobs. Economic reforms focused on redistributive growth and meeting the basic needs of the poor through economic development and capacity building will also carried through, as envisaged in the poverty reduction strategy paper (PRSP) published in October 2002. Project funding has been partly secured following a donors' consultative group meeting in mid-June, which pledged nearly US$1.4bn for 2003-05. This followed the IMF's April 29th announcement that a new US$33m, three-year, poverty reduction and growth facility (PRGF) had been approved. The PRGF, grounded in the development priorities identified in the PRSP, will support government efforts to maintain macroeconomic stability and debt sustainability. However, disbursement of these pledges will be liable to delay caused in part by problems of capacity and mismanagement. The liberalisation of the groundnut and energy sectors and proposed reforms of public expenditure face difficulties—ranging from attracting interested buyers to poor institutional capacity. Although the IMF is no longer insisting on rapid privatisation of the state electricity company, Société nationale sénégalaise d'électricité (Senelec), following the failure of two attempts owing to a lack of interest, it is pressing for improved performance and for further private-sector participation. The government has confirmed its plans to invite offers to buy the groundnut processing parastatal, Société nationale de commercialisation des oléagineux du Sénégal (Sonacos), by the third quarter of 2003. But growing rural discontent caused by the failure of the private sector to fill the vacuum left by Sonacos's abrupt withdrawal from groundnut marketing in the 2002 season will complicate the privatisation process. Nonetheless, we assume that the government will sell Sonacos to allow it to reach completion point under the heavily indebted poor countries (HIPC) debt-relief initiative in late 2003.

 

**Fiscal policy**

The government aims to achieve fiscal balance in 2003-04, in line with the convergence criteria for eventual economic union set by the UEMOA. The other criteria are: no increase in arrears on external or domestic debt payments; government debt (domestic and external) of less than 70% of GDP; keeping the public-sector wage bill at less than 35% of fiscal expenditure; funding at least 20% of the government's share of public investment from fiscal receipts; and increasing fiscal receipts to at least 17% of GDP. Senegal has met most of these criteria in the last three years and is expected to make further progress in 2003-04, but a balanced budget will remain out of reach. During the forecast period we expect revenue to increase in line with economic growth and higher tax receipts (owing to changes in value-added tax made in September 2001). Improvements in tax administration, including at the local government level, will also increase the share of direct taxes, creating a more balanced tax structure. On the expenditure front, spending on priority social sectors such as healthcare and education will rise, as debt relief granted under the HIPC initiative frees up resources and donors provide further assistance to achieve the poverty-reduction targets set out in the PRSP. Overall, the fiscal deficit will narrow from a manageable 1% of GDP in 2003 to 0.8% of GDP in 2004, which will largely be financed by donor inflows.

**Monetary policy**

Monetary policy will continue to be determined by the regional central bank, Banque centrale des Etats de l'Afrique de l'ouest (BCEAO), whose priority is to maintain the CFA franc's peg to the euro. Accordingly, the BCEAO will continue to pursue tight monetary policies similar to those of the European Central Bank (ECB). We expect the euro area's three-month interbank rate to fall in 2003, to an average of 2.1%, reflecting concerns over low growth and deflation. As growth in the euro area is expected to remain weak in 2004, the ECB will keep interest rates at an average 2.1%, as deflation concerns persist. On June 6th the ECB lowered its rate by 50 basis points to 2%; the BCEAO followed on July 7th by cutting its rate by 100 basis points to 5.5%, which slightly narrowed the differential between its money-market rate and that of the euro area. We expect the differential to remain unchanged and the BCEAO rate to stay at 5.5% throughout the rest of 2003. The BCEAO is likely to follow the ECB in holding its money market rate steady in 2004, thereby maintaining the interest rate differential.

## Economic forecast

**International assumptions**

**Senegal: international assumptions summary**
(% unless otherwise indicated)

| | 2001 | 2002 | 2003 | 2004 |
|---|---|---|---|---|
| **Real GDP growth** | | | | |
| World | 2.2 | 2.9 | 2.9 | 3.7 |
| OECD | 0.9 | 1.8 | 1.6 | 2.2 |
| EU | 1.5 | 1.0 | 0.7 | 1.8 |
| **Exchange rates** | | | | |
| ¥:US$ | 121.5 | 125.3 | 117.1 | 115.5 |
| US$:€ | 0.896 | 0.945 | 1.123 | 1.183 |
| SDR:US$ | 0.785 | 0.772 | 0.717 | 0.701 |

 

| | | | | |
|---|---|---|---|---|
| **Financial indicators** | | | | |
| € 3-month interbank rate | 4.26 | 3.33 | 2.15 | 2.06 |
| US$ 3-month commercial paper rate | 3.61 | 1.70 | 1.01 | 1.33 |
| **Commodity prices** | | | | |
| Oil (Brent; US$/b) | 24.5 | 25.0 | 26.8 | 18.9 |
| Rice (US$/tonne) | 177.5 | 197.3 | 205.0 | 222.5 |
| Food, feedstuffs & beverages (% change in US$ terms) | -1.9 | 12.7 | 2.1 | 1.8 |
| Industrial raw materials (% change in US$ terms) | -9.7 | 2.2 | 9.1 | 3.9 |

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

The world economy will remain extremely sluggish until late 2003. From then on the situation will start to improve—but only gradually. Growth in the EU—Senegal's main trading and financial partner—will fall to 0.7% in 2003 before rising to 1.8% in 2004. We do not expect the US to return to a trend pace of growth until the first half of 2004. Owing to the weak economic recovery, annual average world GDP growth in 2003 will be disappointing, at just 2.9% using purchasing power parity (PPP) weights—much the same as last year. But a forecast return to a more normal rate of growth in most major markets by the second half of 2004 suggests that world GDP growth will average a healthier 3.7% in 2004. The prices of Senegal's main exports–fish and phosphate products– will be reasonable, but the price of groundnut products—the country's traditional export—will remain weak because of oversupply.

## Economic growth

Despite Senegal's poor agricultural prospects, real GDP is forecast to rise by 3% in 2003, largely owing to the growth of investment in mining. In 2004 real GDP growth will rise to 5%, owing to the growth in the number of donor-supported infrastructure projects (some of them started in 2003) and improved performance in the services sector. In the primary sector, cereal and groundnut output will be constrained in the 2002/03 agricultural year (November-October), mainly because of continuing drought, a decline in the amount of cultivated land and problems in groundnut marketing owing to low prices and the purchasing problems that affected 2001/02. Assuming that normal weather returns in 2003/04 and 2004/05, cereal output should increase, but groundnut production in 2003/04 will be affected by organisational problems resulting from the expected privatisation of Sonacos in 2003. Fish output will remain relatively large, but will continue to held back by worn-out equipment and a lack of investment. The combination of lower food production and the decline in farm incomes will stifle private consumption in 2003 and early 2004. The secondary sector will remain buoyant, owing to new mining investment which will result in increased production of phosphate products, and will be supported by increased construction activity. The tertiary sector will remain subdued in 2003 because of low domestic purchasing power and weak agricultural output and investment. This situation will be reversed in 2004 as agriculture picks up. Throughout 2003-04, bureaucracy and corruption will continue to dissuade potential investors, as will the weakness of the legal and judicial system.

## Inflation

Despite the effects of drought on food prices in 2002/03, inflation will remain subdued, falling to an average of 0.8% in 2003, owing to weak growth in private consumption (due to constrained economic activity) and the tight control of money supply growth exercised by the BCEAO. In addition, the government is expected to follow prudent fiscal policies in line with the convergence criteria for eventual economic union set by the UEMOA, thus reducing the likelihood of any unbudgeted spending decisions. Within a continuing tight monetary environment, assuming that normal weather returns in 2003/04 and 2004/05 and leads to higher cereal output and thus higher disposable incomes, average annual inflation is forecast to rise slightly to 1.8% in 2004.

**Exchange rates**

As the CFA franc is pegged to the euro at a rate of CFAfr656:€1, it will appreciate in line with the euro to CFAfr584:US$1 in 2003 and CFAfr555:US$1 in 2004. The euro has appreciated strongly against the US dollar from the second half of 2002 onwards; in late July the euro stood at €0.87:US$1. Despite the weak growth forecast for the euro area in 2003, investor sentiment towards the US will remain cautious owing to the substantial US current-account deficit, the struggling corporate sector and the failure of the economy to recover more strongly from the 2001 recession. Furthermore, the US administration seems to be weakening its "strong-dollar" rhetoric by talking about the advantages to exporters of a soft dollar. Thus we expect the dollar to weaken against the euro in 2003 to an average of US$1.12:€1. In 2004 we forecast that the euro will strengthen further, to US$1.18:€1, as the US will continue to find it difficult to attract the capital inflows needed to fund its large current-account deficit. With short- and long-term interest rates markedly higher in the euro area than in the US, the interest rate differential should also favour the euro over the US dollar.

**External sector**

The current-account deficit is forecast to narrow to 5.4% of GDP in 2003 and 4.4% of GDP in 2004. The improvement in the current account in 2003 (despite a widening trade deficit in that year) will be mainly due to an increase in current transfers inflows. The improvement in 2004 will be due to narrowing deficits on the services and income accounts. After growing rapidly in 2002 (in local and US dollar terms), exports are forecast to expand further (in US dollar terms) to US$1.22bn in 2003 and US$1.29bn in 2004, benefiting from the euro's appreciation against the US dollar. In CFAfr terms, despite new investment in Industries chimiques du Sénégal, exports receipts will fall in both years owing to a combination of weak agricultural and fish performance and a drop in the price of phosphate-related products. Imports are forecast to rise in 2003, as the infrastructure projects proposed by Mr Wade boost demand for capital goods and economic growth increases demand for imported consumer goods. Food imports are expected to fall in 2003 in CFA franc terms—as the widespread food shortages seen in 2002 are unlikely to continue—but they will rise in US dollar terms owing to the appreciation of the euro. Import growth will tail off in 2004, as most of the capital goods related to the infrastructure projects will have been imported. Despite the increase in costs associated with rising exports and imports, the deficit on the services account will narrow over the forecast period because of a recovery in tourism receipts (which make up around one-sixth of services receipts) following the downturn caused by the US-led war on Iraq; Mr Bush's early July visit may also help to boost tourist numbers. The deficit on the income account will narrow owing to the fall in interest payments on external debt due to HIPC debt relief. The surplus on the current transfers account will remain robust as donors will continue to support the government's reform efforts; most of the US$1.4bn donors pledged for 2003-05 at the consultative group meeting in mid-June will be disbursed, but not all, partly owing to capacity constraints within ministries.

**Senegal: forecast summary**

(% unless otherwise indicated)

| | 2001[a] | 2002[b] | 2003[c] | 2004[c] |
|---|---|---|---|---|
| Real GDP growth | 5.6[b] | 2.4 | 3.0 | 5.0 |
| Industrial production growth | 6.0[b] | 5.3 | 4.8 | 5.9 |
| Gross agricultural production growth | 7.6[b] | -8.9 | 0.2 | 4.2 |
| Consumer price inflation (av)[d] | 3.0 | 2.3[a] | 0.8 | 1.8 |
| Short-term interbank rate | 5.0 | 5.0[a] | 4.9 | 4.1 |
| Government balance (% of GDP) | -3.2[b] | -1.8 | -1.0 | -0.8 |
| Exports of goods fob (US$ bn) | 1.0 | 1.1 | 1.2 | 1.3 |
| Imports of goods fob (US$ bn) | 1.4 | 1.6 | 1.8 | 1.8 |
| Current-account balance (US$ bn) | -0.3 | -0.3 | -0.3 | -0.3 |
| Current-account balance (% of GDP) | -5.8 | -6.7 | -5.4 | -4.4 |
| External debt (year-end; US$ bn) | 3.5 | 3.1 | 3.1 | 3.0 |
| Exchange rate CFAfr:US$ (av) | 733.0 | 697.0[a] | 584.2 | 554.7 |
| Exchange rate CFAfr:¥100 (av) | 603.2 | 556.0[a] | 498.9 | 480.3 |
| Exchange rate CFAfr:€ (year-end) | 656.0 | 656.0[a] | 656.0 | 656.0 |
| Exchange rate CFAfr:SDR (year-end) | 935.4 | 850.4[a] | 794.8 | 800.1 |

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts. [d] UEMOA harmonised index; not compatible with quarterly data.

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