

COUNTRY REVIEW

Burkina Faso



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EULER HERMES COUNTRY RISK GRADE: C

Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.

Strengths

- Good international relations guarantee continued financial aid
- Low transfer and exchange rate risk thanks to membership of the CFA franc zone
- Public and external debt levels are currently still adequate

Weaknesses

- Regional instability, especially in neighbouring Côte d'Ivoire
- Autocratic regime that creates high potential for public unrest
- Low income country with high poverty rates and limited natural resources
- Over-dependence on the primary sector, in particular on cotton
- High vulnerability to exogenous factors (weather, plant diseases, world prices, euro-dollar exchange rate)
- Weak fiscal position
- Continued high current account deficits
- Weak business environment

Country Risk Assessment

| Ratings | Burkina Faso | | Median Grade C | Peers | | |
|---------------------------------|--------------|------------|-------------------|------------|------------|------------|
| | Latest | Previous | | Senegal | Tanzania | Grenada |
| Systemic Political Risk: | P3- | P3+ | P2- | P3- | P2- | P2- |
| Systemic Economic Risk: | E5 | E5 | E5 | E5 | E5 | E5 |
| ME rating: | ME5 | ME5 | ME5 | ME5 | ME5 | ME5 |
| <i>Structure</i> | 6.0 | 6.0 | 5.9 | 6.0 | 6.0 | 6.0 |
| <i>Policy</i> | 6.0 | 5.1 | 5.2 | 6.0 | 6.0 | 4.0 |
| <i>Solvency</i> | 3.2 | 3.9 | 2.8 | 2.5 | 4.6 | 4.5 |
| <i>External Liquidity</i> | 4.6 | 4.2 | 4.2 | 4.6 | 3.3 | 4.8 |
| SBE rating: | SBE5 | SBE5 | SBE4 | SBE5 | SBE5 | SBE4 |
| COUNTRY GRADE: | C | C | | C | C | C |

Nomenclature:

Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).

Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).

ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).

The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).

SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).

Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Economic Studies

ECONOMIC STRUCTURE

| Country Profile | |
|------------------------|--|
| Capital city: | Ouagadougou |
| Population: | 14.365 mn (2009) |
| GDP: | USD 8878 mn (2009) |
| Currency: | Communauté Financière Africaine franc (CFA franc; XOF) |
| Form of state: | Republic |
| Head of government: | President Blaise COMPAORE (since 1987) |
| Next elections: | Presidential: November 2015 / Legislative: May 2012 |

| Major Industries (% of GDP at market prices, 2006) | | Global Assumptions | | 2010 | 2011 |
|---|-------|---------------------------|--|------|------|
| Services | 41.3% | Real GDP grth (% yr/yr) | | 3.3 | 2.9 |
| Trade, transport and communications | 14.1% | Inflation (% av) * | | 1.2 | 1.4 |
| Agriculture, forestry and fishery | 35.5% | Dated Brent (USD/b) | | 80 | 110 |
| Industry | 23.1% | * Major economies | | | |
| Manufacturing | 14.1% | | | | |

| Main Exports (% of total, 2006) | | Main Imports (% of total, 2005) | |
|---|-------|---|-------|
| Cotton | 65.0% | Capital goods | 29.0% |
| Livestock | 13.0% | Intermediary goods | 27.5% |
| Leather & hides | 6.0% | Petroleum products | 21.5% |
| Lead Export Markets (% of total exports, 2008) | | Lead Import Markets (% of total imports, 2008) | |
| Singapore | 16.6% | Côte d'Ivoire | 24.8% |
| Belgium | 12.6% | France | 18.6% |
| China | 11.0% | Togo | 7.4% |
| Thailand | 8.9% | Libya | 4.3% |

Basic indicators

| Selected economic indicators | 2007 | 2008 | 2009 | 2010f | 2011f |
|--|-------------|-------------|-------------|--------------|--------------|
| Nominal GDP (USD mn) | 7,095 | 8,841 | 8,879 | 8,759 | 9,210 |
| Population (mn) | 13.73 | 14.04 | 14.37 | 14.70 | 15.03 |
| GDP per capita (USD) | 517 | 630 | 618 | 596 | 613 |
| Real GDP growth (% yr/yr) | 3.6 | 5.2 | 3.2 | 4.0 | 4.0 |
| Inflation (% eop) | 2.3 | 11.6 | -0.3 | -0.3 | 4.0 |
| Fiscal balance (excl. grants, % of GDP) | -12.1 | -8.4 | -10.6 | -11.2 | -9.6 |
| Current account balance (excl. grants, % of GDP) | -12.5 | -15.1 | -8.9 | -9.3 | -9.6 |
| External debt/GDP (%) | 18.5 | 21.7 | 23.7 | 24.9 | 26.2 |
| External debt/Exports of goods & services (%) | 195.8 | 202.9 | 201.2 | 207.6 | 202.6 |
| Debt-service ratio (%) | 6.3 | 6.0 | 4.8 | 6.2 | 6.0 |
| Foreign exchange reserves (USD mn) | 1,017 | 916 | 1,209 | 900 | 900.0 |
| Import cover (months) | 5.7 | 3.8 | 5.6 | 3.8 | 3.4 |
| Exchange rate assumption, XOF:USD (av) | 479.3 | 447.8 | 472.2 | 495.3 | 504.6 |
| Exchange rate assumption, XOF:EUR (av) | 656.0 | 656.0 | 656.0 | 656.0 | 656.0 |
| f: CRU central forecast | | | | | |

Sources: UEMOA, BCEAO, IMF, AfDB, OECD, IHS Global Insight, Euler Hermes Economic Studies

Political Stability

After repeated military coups during the 1970s and 1980s, multi-party elections were introduced in the early 1990s. However, incumbent President Blaise Compaoré, who came to power in a 1987 military coup, and his party, the Congress for Democracy and Progress (CDP), have kept a tight grip on power since then. Compaoré has won four consecutive elections overwhelmingly, in 1991 and 1998 largely thanks to the opposition's boycott of the polls, and in both 2005 and 2010 with around 80% of the vote. Likewise, the CDP has won all four legislative elections since 1992. In the latest, in May 2007, it increased its number of parliamentary seats from 57 to 73 (of 111). The next legislative election is scheduled for May 2012.

The political system is less stable, however, than it appears. Generally, the strong election results have been undermined by poor voter participation and regular opposition allegations of electoral fraud, although monitors from the African Union and the Economic Community of West African States (ECOWAS) declared the latest presidential poll as largely fair. Public protests have also occurred several times over the past decade. In the early 2000s, political stability deteriorated, with mass—though rarely violent—opposition and civil society demonstrations against the unpunished murder of a leading independent journalist as well as against Compaoré's decision to stand for a third term in the 2005 presidential election. The latter was controversial as it claimed that a constitutional amendment from 2000 limiting the presidency to two five-year terms was not retroactive. But the protests eventually faded away. In 2008, the rising cost of living caused by soaring food and energy prices re-ignited public dissatisfaction, which resulted in violent protests and public strikes. The government calmed the situation with the introduction of several short-term emergency measures aimed at easing prices and public frustration. In February-March 2011, a wave of student protest following the death of a fellow student while in police custody has resulted in the closure until further notice of all universities in the country. The potential for further social unrest is high. And recent events in Tunisia and Egypt have underlined that autocratic regimes are not invulnerable. In Burkina Faso, a potentially critical point could be reached if the CDP goes ahead with its plan to abolish the presidential two-term limit in order to allow Compaoré to extend his rule beyond 2015.

Regionally, Burkina Faso continues to be involved in conflicts of neighbouring countries in this unstable area, particularly in Côte d'Ivoire where about three million Burkinabe nationals live and work. In the past, Burkina Faso was also alleged to be engaged in destabilising alliances with rebels in other West African states. However, President Compaoré's crucial mediating roles in the negotiation of political agreement in Togo in 2006 and the peace deal in Côte d'Ivoire in 2007 (Ouagadougou Accord) have helped promote his image as a regional peacemaker. More recently, the risk of incursions by the regional Islamist insurgent group Al-Qaida in the Islamic Maghreb (AQIM) across the country's borders with Mali and Niger has arisen.

Burkina Faso is a member of ECOWAS and the West African Economic Monetary Union (WAEMU). It has reasonably good relations with the World Bank and the IMF. The Fund supported the country with a poverty reduction and growth facility (PRGF) covering the period 2007-2010 and approved a new three-year arrangement under the Extended Credit Facility (ECF), worth about USD68mn, in June 2010. Burkina Faso's relations with bilateral donors are also good, particularly with France.

Economic Stability

Burkina Faso's high population density, landlocked situation and limited natural resources are serious constraints on development, as are infrastructural deficiencies. It is one of the poorest countries in the world, with estimated GDP per capita of about USD600 in 2010, and income distribution is highly uneven. Around 80% of the population is engaged in (mainly subsistence) agriculture, which is vulnerable to sharp variations in rainfall. The small industrial sector remains dominated by unprofitable government-controlled corporations. The economy is over-dependent on the export of cotton, which accounts for about 65% of merchandise exports, and as a result is highly exposed to exogenous factors such as weather, plant diseases and pests, world prices of agricultural products, and the Euro-USD exchange rate. Moreover, since 2002, Burkina Faso has been adversely affected by the political crisis in Côte d'Ivoire which has heavily impaired the export transit route to the harbour of Abidjan.

Despite these challenges, real GDP growth has been solid, averaging about 6% annually in 2001-2006. A dramatic fall in the cotton harvest (about 30%) in combination with declining cotton prices and late rains reduced growth to 3.6% in 2007. In 2008 GDP expansion rebounded to 5.2%, followed by just 3.2% in 2009 in the wake of the global crisis. Annual economic growth is forecast at 4% or so in 2010-2011.

As a member of the WAEMU, Burkina Faso has benefited from monetary stability. The CFA franc issued by the Central Bank of West African states (BCEAO) is pegged to the euro at a rate of 655.96 francs/euro. This arrangement has helped to keep inflation low in the past—except for 2008 when soaring global food and oil prices pushed it to an average 10.7%—and provides for relatively low exchange rate and transfer risk. Following a period of deflation in Q4 2009 and most of 2010, we expect inflation to average about 3% in 2011.

Burkina Faso's fiscal position remains very weak. Although the government has been committed to consolidating tax and customs administration gains in line with IMF programmes, many weaknesses in the tax system still need to be addressed (narrow fiscal revenue base, too many and too generous exemptions, frequent tax avoidance). Accordingly, the fiscal deficit excluding grants is expected to remain at around 10% of GDP in 2010-2012. Even including grants, it is likely to remain at about 5% of GDP. Public debt in relation to GDP improved considerably to 22% in 2007 thanks to massive debt cancellation under the Multilateral Debt Relief Initiative (MDRI) in 2006 and a successful privatisation deal in 2007 (ONATEL, the former state-owned telecommunications company). The ratio has since rapidly climbed again, however, to an estimated 29% in 2010. Without more substantial fiscal consolidation in the next years, public debt will become problematic again in the medium term.

The structural current account deficit remains another reason for concern. After many years in which the deficit hovered around an unsustainably high 15% of GDP excluding grants, it has fallen to a still large 9% in 2009-2010. We do not expect a further improvement of the current account deficit in 2011-2012. Foreign direct investment (FDI) inflows usually cover less than 10% of the annual external deficits, leaving a large gap in the external financing requirements that needs to be covered by grants—which account for about 4% of GDP—and new external indebtedness. As a result, external debt has already risen again to 25% of GDP or 208% of export earnings in 2010, up from more favourable ratios of 18% and 196% in 2007, respectively, which had been achieved thanks to substantial debt relief in 2004-2006. However, at around 6% the external debt-service ratio is still manageable for the time being.

Meanwhile, foreign exchange reserves have been volatile, hovering around in the range of USD700-1,300mn since 2007. In November 2010 they stood at USD934mn which was sufficient to cover slightly less than four months of imports or more than twice of all external debt repayments falling due in 2011. Burkina Faso also has access to pooled BCEAO reserves guaranteed by the French Treasury. Together, this indicates relatively low transfer and convertibility risk.

Summarising, the risk of a debt default as well as transfer risk will be moderate in the next two years. But ongoing large deficits of around 10% of GDP of both the fiscal and current accounts are unsustainable and make clear that Burkina Faso will continue to be highly dependent on external aid.

Structural Business Environment

The Structural Business Environment is well below average, with serious impediments to strong, sustainable growth. Burkina Faso is classified in the second lowest category of our assessment model, ranking 153rd out of 212 countries, just behind Nepal and ahead of Tanzania. The government has committed itself to some large-scale privatisation projects and has had a few success stories, but overall progress on privatisation has remained slow owing to managerial delays and government inefficiency. Infrastructure deficiencies, a weak legal system where villagers still have their own customary or traditional courts, widespread corruption, a huge black market, low literacy rates and poor health indicators are obstacles to private investment.

The financial system is underdeveloped and the banking sector remains over-exposed to a few large borrowers, including the cotton industry. On a positive note, state participation in the banking sector is limited to 25% but financial intermediation continues to be very low, reflected in private sector credit accounting for just 16% of GDP.

Various sources confirm our assessment. Burkina Faso ranks 151st out of 183 economies in the World Bank's *Doing Business 2011* survey and 90th out of 179 in the Heritage Foundation's *2011 Index of Economic Freedom*. The United Nations' *2010 Human Development Index* ranks the country 161st out of 169 countries, revealing significant social weaknesses, and Transparency International's *2010 Corruption Perception Index* assigns it rank 98 out of 178 countries.

Charts

