INTERNATIONAL MONETARY FUND

IMF Country Report No. 12/337

SENEGAL

Staff Report for the 2012 Article IV Consultation, Fourth Review Under the Policy Support Instrument, and Request for Modification of an Assessment Criterion—Staff Report; Staff Supplements; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Senegal

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2012 Article IV consultation with Senegal and the fourth review under the Policy Support Instrument and request for modification of an assessment criteron, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, fourth review under the Policy Support Instrument, and request for modification of an assessment criterion, prepared by a staff team of the IMF, following discussions that ended on September 19, 2012, with the officials of Senegal on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 26, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- **Staff Supplement** on Financial Depth and Macro-Stability, dated November 26, 2012.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its December 10, 2012 discussion of the staff report that concluded the Article IV consultation.
- **Press Release** on the completion of the review.
- **Statement by the Executive Director** for Senegal.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Senegal*
Memorandum of Economic and Financial Policies by the authorities of Senegal*
Technical Memorandum of Understanding*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

SENEGAL

November 26, 2012

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION, FOURTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT, AND REQUEST FOR MODIFICATION OF AN ASSESSMENT CRITERION

Context: After a tense campaign, President Sall was elected by a large majority and the governing coalition secured a broad majority at the legislative elections in July 2012. With a strong popular mandate, the government is now facing the challenge of accelerating reforms and meeting people's high expectations. Despite an uncertain external environment, a moderate growth pick up is expected in 2012 and 2013.

Article IV discussions: Fiscal deficits have increased in recent years, constraining the room for fiscal maneuver and raising sustainability concerns. The deficits need to be kept under control in 2012 and reduced in 2013. Growth has been sluggish in the recent past, with adverse implications for poverty reduction. The main medium-term challenge is to move to higher, sustainable, and inclusive growth. The government has an important role to play in raising the growth potential by providing critical infrastructure, improving the business environment, and deepening the financial sector.

Exchange restrictions and regime: Senegal, a member of the WAEMU, accepted the obligations under Article VIII, Sections 2(a), 3 and 4 of the Fund's Articles of Agreement as of June 1, 1996, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions. The WAEMU's exchange regime is a conventional peg to the euro.

Policy support instrument (PSI) implementation: The program remains on track. Staff supports the authorities' request for modification of an assessment criterion.

Main policy recommendations:

- ***Ensure fiscal sustainability***. Keep the 2012 fiscal deficit below 6 percent of GDP and reduce it below 5 percent of GDP in 2013, and further in the medium term.
- ***Improve public spending efficiency.*** Reconcile deficit reduction with addressing the country's social and development needs by reducing the cost of running the government and improving the targeting and efficiency of public expenditure.
- ***Improve public infrastructure***. Finalize and promptly implement the strategy on new energy investments and SENELEC restructuring, given its impact on growth and the well-being of the population.
- ***Focus on inclusiveness in growth strategy***. Ensure that growth is broad-based and sustainable, and its dividends are widely shared.

Approved By
Roger Nord (AFR) and Peter Allum (SPR)

A staff team consisting of Mr. Joly (head), Mr. Kireyev, Ms. Kolerus, Mr. Mpatswe (all AFR), Mr. Mulas Granados (FAD), Mr. Jewell (SPR), Mr. Imam (MCM), Mr. Issoufou (RES), Ms. Fichera (Res. Rep.), and Mr. Ba (Res. Rep. office) conducted the discussions in Dakar September 6–19, 2012. Deputy Managing Director Zhu visited Senegal November 4–6, 2012. Messrs. Assimaidou and Sembene (OED) participated in the discussions.

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RECENT DEVELOPMENTS, THE OUTLOOK, AND RISKS

1. **Senegal's peaceful political transition has strengthened the country's democratic tradition**. After a tense campaign, President Sall was elected in March 2012 with a large majority. In July 2012 the governing coalition secured a broad majority at the legislative elections. The government therefore has a strong popular mandate and now faces the challenge of meeting people's high expectations of better government, more jobs, better basic services, and a reduction of the cost of living. Senegal so far has been moderately affected by regional instability, but the situation in northern Mali is a source of concern.

2. **Senegal's growth has been sluggish in recent years, with implications for poverty reduction**. Average growth was relatively strong in 1995–2005 (4.5 percent) and accompanied by a large drop in poverty incidence (from 68 to 48 percent). Due partly to a series of exogenous shocks (i.e., food and fuel global prices, global financial and economic crisis, and more recently, the electricity sector crisis and drought in the Sahel), growth decreased to an average of 3.3 percent in 2006–2011. As a result, poverty incidence barely decreased during this period and still stood at 47 percent in 2011. Wide disparities exist between rural areas, where poverty incidence is higher than the national average (at 57 percent), and urban areas (at 33 percent).

3. **The authorities' policies since the last Article IV consultation have been broadly in line with IMF recommendations.** In successive PSIs, the authorities have pursued prudent macroeconomic policies and implemented a number of structural reforms, including strengthening public financial and debt management. However, because of a series of exogenous shocks and the crisis in the energy sector, fiscal deficits in the past two years have been higher than projected.

4. **A moderate growth pick up is expected in 2012 and 2013.** Economic activity in early 2012 was affected by the political tensions ahead of the presidential election and the crisis in Mali and Guinea Bissau. A rebound in agriculture after last year's drought would, however, boost real GDP growth to 3.7 percent (from 2.6 percent in 2011). Growth would slightly increase in 2013 (to 4.3 percent) mostly owing to the completion of a number of large infrastructure and mining projects. Inflation, which so far has not been significantly affected by higher international food prices, would remain below 2 percent. The current account deficit would increase to 7.6 percent of GDP in 2012, because of higher fuel and (drought-related) food imports, and the overall balance of payments would record a small deficit.

5. **In the medium term, growth is expected to return gradually to about 5 percent a year**, i.e., close to the level recorded before the global financial crisis. The high fiscal deficit would be gradually reduced to maintain debt sustainability and meet commitments made in the context of the West African Economic and Monetary Union (WAEMU). This would also allow a reduction of the current account deficit. Inflation would remain moderate. This scenario assumes the full implementation of the authorities' ambitious plans to reform the state, address the energy sector crisis, and improve the business environment.

6. The economy remains exposed to substantial risks. Domestic risks include insufficient fiscal consolidation, which could compromise debt sustainability; slow improvement in public resource management, which could affect fiscal consolidation; and delays in the energy sector reform, which could have a negative impact on growth and the budget. External risks include an intensification of the crisis in Europe and a further slowdown in the world economy, food security concerns related to higher international cereal prices and possible spillovers from political instability in Mali.

POLICY DISCUSSIONS

7. Discussions focused on the policies required to move back to higher, sustainable, and inclusive growth, while reducing vulnerabilities, and were grouped in three main themes: (i) fiscal policies to reduce vulnerabilities and foster inclusiveness; (ii) policies to rekindle growth; and (iii) strengthening the financial sector and external stability. There was broad agreement between the authorities and staff on the issues facing Senegal and the policies to address them.

A. Fiscal Policy to Reduce Vulnerabilities and Foster Inclusiveness

8. Fiscal deficits and debt ratios have increased in recent years. The fiscal deficit, which was below 4 percent of GDP in 2007, stood at 6.7 percent of GDP in 2011. Higher deficits were justified to a large extent by the response to successive shocks. Meanwhile, the public debt-to-GDP ratio has increased continuously and is expected to exceed 45 percent in 2012.

9. High deficits constrain fiscal policy and raise sustainability issues. Fiscal space has decreased in recent years and this limits the authorities' ability to conduct counter-cyclical policies. In addition, the financing of deficits at the current level is challenging. An updated debt sustainability analysis (DSA, Supplement 1) shows that current fiscal deficit levels are incompatible with long-term sustainability. Vulnerabilities have increased, as illustrated by financing difficulties in early 2012 ahead of the presidential election that led to delays in paying suppliers, which have since been largely resolved. Senegal remains at a low risk of debt distress only under the assumption of fiscal consolidation and further strengthening of debt management.

10. The authorities are fully aware of these challenges and have taken action to keep the fiscal deficit under control in 2012. Budget execution was prudent in the first half of the year. Efforts to deliver on President Sall's promise of a more modest, accountable, and efficient state are underway. The number of ministries was reduced significantly, the senate and the vice-presidency were abolished, the rationalization of diplomatic representation abroad has started, and a number of public agencies were closed or merged. Efforts are also made more broadly to reduce the cost of running the government (e.g., use of telephone lines, water, and vehicles). These measures, together with some delay in implementing certain energy investments, are likely to keep the 2012 fiscal deficit below 6 percent of GDP, a welcome development bucking earlier trends. However, such a deficit level still raises financing challenges, which this year will be addressed through high recourse to the regional market and a large loan from France.

MEFP ¶11-12

11. The authorities intend to keep reducing the fiscal deficit in 2013 and the medium term, while addressing the country's social and development needs. Their fiscal objective, supported by staff, is to reduce the deficit below 5 percent of GDP in 13–142013 and below 4 percent by 2015. Reconciling these various objectives will require a significant improvement in public spending efficiency. Staff noted that it would take sustained efforts over several years to deliver lasting results and to make space for critical new programs, such as the recently announced multi-year plan to address floods. This will also require strong political leadership to overcome vested interests as well as good administrative capacity. The authorities acknowledged this and have already taken action in a number of areas. Efforts to reduce the cost of running the government will continue and produce their full impact in 2013 and beyond. A comprehensive streamlining of agencies starting in 2013 is also expected to generate substantial savings in the medium term. Finally, the authorities are working on rationalizing expenditure in key sectors such as education and health (with World Bank assistance) and on more cost-effective support to the most vulnerable segments of the population. In this regard, energy subsidies will be substantially reduced next year and in the medium term.

MEFP ¶13-14

12. Improving the efficiency of the social safety nets is another important objective. Social safety nets remain very limited and as a result the authorities rely to a large extent on food and fuel price subsidies.[1] Staff recognized that these subsidies are easy to implement but they have the major drawback of being poorly targeted, which makes them very costly. Explicit subsidies to electricity consumption, as measured by the annual budgetary transfer to the power utility SENELEC to compensate for the tariff gap, are expected to amount to about CFAF 100 billion in 2012 (1.4 percent of GDP), as last year. Total losses in the electricity sector, which eventually have to be borne by the budget, may even exceed significantly this amount (Annex I). Electricity subsidies exceed public health spending and reduce the scope for priority expenditures. They tend to benefit richer households; the poor, particularly in rural areas, are indeed typically not connected to the electricity grid. For these reasons, the authorities intend to cap electricity subsidies at CFAF 80 billion in 2013, which will require substantial savings based on current projections (about CFAF 45 billion, or 0.6 percent of GDP). Part of the savings would come from efficiency gains at the power utility SENELEC, which will be restructured operationally and financially; there is indeed significant scope for such gains, given that power losses exceed 20 percent of supply. The envisaged savings would also require reconsidering the tariff if oil prices remain high. In parallel, the authorities are working on broader and better-targeted social safety nets to be introduced in 2013.

MEFP ¶15, 27-28

13. Better public financial management (PFM) will improve government efficiency and transparency. The authorities have almost completed the transposition into national law of the WAEMU directives on PFM and are now working on their implementation. A comprehensive audit of agencies is ongoing, and its conclusions will be used to

MEFP ¶20–25

[1] Another issue is the regional distribution of public expenditure affecting social outcomes, which is highly concentrated in the Dakar area.

design a restructuring plan in 2013. An audit of the civil service is also ongoing, which will help the authorities control the government payroll. To improve expenditure efficiency, the authorities will start using cost-benefit analysis for larger investment projects included in the 2014 budget, based on the the project evaluation guide they expect to have by end-2012. The completion of the single treasury account, expected by early 2013, will facilitate cash management. Finally, the authorities intend to improve transparency in land operations.

14. Strengthened debt management will also contribute to reducing vulnerabilities. Progress was made last year in building capacity with the creation of a public debt directorate combining the two units that had previously managed domestic debt and external debt separately. The new directorate prepared the authorities' first medium-term debt strategy, which recommends extending the maturity of the debt issued on the regional market–which has a very short average maturity–to reduce rollover risks, as well as continued priority to concessional financing to keep borrowing costs low. Occasional recourse to nonconcessional borrowing would be considered when needed.

MEFP ¶16

B. Moving to Higher, Sustainable, and Inclusive Growth

15. Further poverty reduction requires sustained high growth. Developments in the past two decades suggest that poverty reduction is highly sensitive to growth in Senegal (Annex II). Substantial poverty reduction was achieved when growth was robust (1995–2005). Conversely, lower growth in the recent period has not allowed for significant poverty reduction or increase in living standards. A growth accounting exercise suggests that growth is mostly explained by factor accumulation. Total factor productivity (TFP) has actually declined since 2006 (Annex III).

16. Growth is hampered by a range of obstacles, as clearly shown in the authorities' new poverty reduction strategy. Among them infrastructure gaps (energy and transportation); access to land and financing and protection of property rights; and inefficiencies in government operations. This includes a range of issues, such as a complex and distortive tax system; the quality of public expenditure; anti-competitive regulations and practices; and lack of transparency. Finally, some sectors with large growth potential (e.g., agriculture, tourism) have performed poorly in recent years.

17. The authorities and staff agreed that improving transport and energy infrastructure was critical for growth prospects. Some of the related challenges are being addressed through a number of large projects, such as the new international airport, which is expected to be completed by 2014, and the toll highway (whose section to Diamniadio is expected to be completed by the summer of 2013). They will help deal with the excessive concentration of economic activity in the Dakar area. A comprehensive reform of the power sector is also critical. With a lack of proper maintenance and delays in making investments, the supply of electricity has become insufficient, unreliable, and costly. This situation culminated in a major power crisis in 2010–11. An emergency plan ("Takkal") was put in place in 2011, which has allowed a significant reduction of power outages but at a very high cost. Large investments to restore power supply and increase generation capacity with more cost-effective

MEFP ¶26-28, 32

technologies would help lower the cost of doing business, especially in manufacturing.[2] From this perspective, the strategy on new investments and restructuring SENELEC, the power utility, needs to be finalized and implemented as soon as possible.

18. Addressing infrastructure gaps will raise challenges. Based on a general equilibrium model developed by staff, the authorities and the mission discussed the possible impact of different public investment and financing paths on growth and debt sustainability. The results confirm that increased public investment would have a positive impact on growth, but also that the mode of financing matters a lot. Relying exclusively on fiscal adjustment to finance higher public investment looks unrealistic, while relying on nonconcessional borrowing could lead to permanently higher debt ratios and debt sustainability problems. The best option from a growth and debt sustainability perspective is therefore to rely on concessional resources. The model also illustrates the importance of improving the public investment management process to improve investment efficiency (Annex IV and Box 1). Raising TFP through reforms actually seems as high a priority as scaling up public investment at the current juncture.

19. There is significant scope for further improvement in the business climate. Despite the progress made in a number of areas (e.g., creation of a one-stop shop for business registration, easing of administration procedures for exports and imports), Senegal still ranks poorly in the 2013 *Doing Business* survey (166th out of 183 countries). Reform efforts are especially needed in the areas where Senegal is still lagging well behind comparator countries, such as paying taxes, registering properties, protecting investors, enforcing contracts and dealing with construction permits. A more effective provision of business-friendly public services would contribute to private sector development too.

20. An ambitious reform of the tax and customs system will be a big step in the right direction. A new tax code will enter into force in 2013. The reform aims at establishing a simpler, equitable and efficient tax system. A new customs code will also be implemented in the course of 2013. This, together with ongoing reforms to improve tax and customs administration, should go a long way towards reducing tax distortions and facilitating the payment of taxes and importation by businesses.

MEFP ¶17-19

[2] The cost of electricity in Senegal is indeed among the highest in sub-Saharan Africa.

Box 1. Impact of Risks on Medium-Term Growth

An alternative scenario explores risks related to insufficient improvement in public expenditure efficiency. Not all investment spending leads to effective capital accumulation. In the model-based simulations described in Appendix V, it is assumed that one dollar in public investment spending increases the capital stock by 70 cents on average, a relatively high ratio by LIC standards. To explore the risk that public investment may not deliver expected growth because of capacity and/or governance problems, an alternative scenario was developed which assumes a much lower ratio (25 cents to the dollar). This assumption is based on the public investment management index, for which Senegal scores 0.94 out of 4. This would reduce long-term annual growth by about one percentage point, i.e., it would correspond to no TFP increase in the growth accounting framework. Such an outcome would make fiscal consolidation more challenging.

	Act.	Projections					
Scenario	2011	2012	2013	2014	2015	2016	2017
		Real GDP growth (percent)					
PSI baseline	2.6	3.7	4.3	4.8	5.0	5.1	5.2
Lower investment efficiency in 2013-17	2.6	3.7	4.2	4.2	4.1	4.1	4.1
		Fiscal deficit (percent of GDP)					
PSI baseline	-6.7	-5.9	-4.9	-4.3	-3.9	-3.7	-3.5
Lower investment efficiency in 2013-17	-6.7	-5.9	-5.5	-4.9	-4.5	-4.3	-4.1

Additional downside risks to growth are related to external factors. Exogenous shocks could affect Senegal significantly, with trade, remittances, FDI, the terms of trade, and aid being the main channels of transmission.

- Under a protracted lower global growth scenario (an annual average 1.6 percentage points below the baseline in 2014–16, a 30 percent drop in oil prices after three years and 20 percent lower nonfuel commodity prices), Senegal's growth in 2015 would be lower by about ½ percentage point.

- Under a sharp downturn in global growth scenario (2 percentage points lower growth in 2013), Senegal's growth would be lower in 2013 by about 1 percentage point.

21. Staff underscored that with an external environment less supportive than before the global financial crisis, domestic engines of growth will be needed too. The focus of the new development strategy (below) on inclusiveness is welcome and will be critical from this perspective, to ensure that growth dividends are widely shared. Growth relying on capital-intensive natural resource projects is unlikely to create a lot of jobs and benefit the rest of the economy, unless these activities are adequately taxed. Conversely, growth relying on higher farm productivity and broader rural job opportunities is likely to generate additional demand and to lead to faster poverty reduction. Financial sector development should also be an important element of an inclusive growth strategy (below).

22. The authorities' new poverty reduction strategy addresses many of these points. The National Strategy of Economic and Social Development (NSESD) was finalized in November 2012, after extensive consultations with stakeholders.[3] It builds on the experience with previous strategies and articulates policies and reforms around three strategic pillars: (i) boosting economic growth, productivity, and wealth creation; (ii) promoting human capital, social protection and sustainable development; and (iii) strengthening governance, institutions, peace and security. It underscores the importance of achieving development objectives within a stable macroeconomic environment. The NSESD includes three macroeconomic scenarios and their costing, which provide a framework for resources mobilization and expenditures prioritization. Preliminary IMF and World Bank staff analysis suggests that the NSESD provides a good diagnostic of issues to be addressed and constitutes a good framework for poverty reduction in Senegal. Staffs recommend the development of more detailed programs in certain sectors, based where possible on existing strategies, to translate the NSESD into specific action plans. Given the level of financing needs (and the projected financing gaps under the various scenarios), staffs recommend that a particular attention be given to the realism, sequencing, cost and financing of programs, including opportunities for private sector participation. Staffs support the authorities' plan to link priority actions with the budgetary process and emphasize the need to strengthen budgetary planning through development of a medium-term expenditure framework.

C. Strengthening the Financial Sector and External Stability

23. The financial system in Senegal is dominated by the banking sector.[4] It is composed of 19 commercial banks operating mostly in the three largest cities and representing about 90 percent of the financial system. The banking sector is relatively concentrated, with foreign banks accounting for a large part of the shareholder base. The five largest banks account for 66 percent of assets and collect 79 percent of deposits. A large number of microfinance institutions (MFIs) supply limited financial services targeting lower income households. While they cover both urban and rural regions, about half of the sector's activity is concentrated in greater Dakar. More people have accounts at MFIs than at banks; this helps raise overall access to the financial system to about 20 percent of the population. Insurance companies (25) account for most of the remainder of the domestic financial system. The regional securities and equity market is a marginal source of funding, except for the government. The interbank market remains underdeveloped.

24. The banking system appears to be relatively robust, with concentration of lending and quality of assets being the main risks. Stress-tests conducted in recent months by the authorities and Fund staff found that liquidity risks and interest rate risks could be withstood, given that banks

[3] The English translation will be circulated to the Executive Board, together with the related JSAN, as soon as possible. They will be discussed by the Board at the time of the next review.

[4] An overview of Senegal's financial system and issues was produced in the context of the pilot on strengthening financial sector surveillance in LICs. More detailed analysis can be found in Supplement 2. Since many financial sector policies rest with the regional authorities, the pilot will be completed with the next annual discussion with the WAEMU authorities, scheduled for early 2013.

are highly liquid and the maturity mismatch between assets and liabilities is rather small. Only the concentration of lending was found to be a major source of vulnerability, as loans are extended to a few sectors and companies, and banks' exposure to the public sector is large. These findings are corroborated by the usual financial soundness indicators, which suggest that Senegalese banks are on average well capitalized, profitable, and liquid, with asset quality being the main concern.[5]

25. Financial depth has increased in recent years. The ratio of broad money to GDP increased from 36 percent in 2006 to 40 percent in 2011. Credit to the economy is currently almost 30 percent of GDP, higher than in most WAEMU countries; it has increased strongly in recent years but remains largely short-term and directed toward trade and food and fuel imports. A benchmarking exercise suggested that Senegal's financial system's development and performance were broadly in line with the country's structural characteristics. However, a comparison with selected countries (Côte d'Ivoire, Kenya, and Morocco) suggested substantial scope for further deepening. Kenya in particular has overtaken Senegal on a number of indicators over the past five years.

26. The still relatively shallow financial system constrains macroeconomic policies, as well as growth and poverty reduction. Constraints on fiscal policy include, among others, rollover risks, higher fiscal costs, and narrower scope for counter-cyclical policy. Shallowness also limits firms and households' access to financial services, making it difficult to deal with volatility and hampering private investment. Finally, financing long-term public investment, which is crucial to build adequate infrastructure, is difficult.

27. Micro-prudential regulation of banks could be enhanced and supervision strengthened. Some prudential ratios and rules are not in line with international best practices. Banks' compliance with prudential rules will also need to improve. Some prudential ratios are indeed missed by a large number of banks. Low compliance may point to the need to reconsider certain ratios, but also suggests a need to strengthen bank supervision. New challenges, such as the need to monitor the rapid development of banking groups in Senegal and more generally the region, also call for strengthened supervision. These issues will need to be addressed at the regional level.

28. Staff also suggested that the authorities develop a holistic view of the financial system and systemic risk. At present, no single entity within Senegal has a comprehensive view of the entire financial system, the interconnection of its various components, and where the potential pockets of systemic risk may lie. Such a function should be developed in Senegal as systemic risk is likely to rise in the coming years, with increasing interconnectedness and diversification of the financial system.

[5] Only one bank was undercapitalized at the time of the mission, but because of small size and limited interconnectedness, it does not raise a systemic risk, and it is being restructured. The ratio of gross nonperforming loans (NPLs) to total loans is relatively high The ratio reflects to a large extent the portfolios of three banks with NPLs in excess of 20 percent, while most other banks have NPLs below 5 percent. In addition, the relatively high level of provisioning for NPLs mitigates risks.

29. There was a broad agreement between the authorities and staff on the main obstacles to further financial development. Many of these obstacles which have been well identified in the past few years are commonly found in low-income countries. They include:

- ***Informational asymmetries***. Lack of information on borrowers, due to the limited size of the formal sector, the limited availability of audited company statements and the absence of credit bureaus (and limited use of existing databases at the central bank), increases adverse selection and moral hazard issues, and ultimately leads to credit rationing. Information asymmetries are also an issue for the development of the interbank market.
- ***Business and judicial environment.*** A key issue is the absence of formalized property rights in large parts of the country, which increases the difficulty of using land as collateral in lending. Moreover, the judicial process tends to be costly and slow.
- ***Tax regime.*** Taxes and fees on banking and stock exchange operations are relatively high, raising the cost of financial services.
- ***Regulatory and supervision issues.*** Some regulatory ratios are perceived as excessively constraining and curbing the development of medium and long-term credit. Also, some ratios are not observed by a number of banks, which may affect the credibility of the regulatory and supervisory framework. Another issue is whether the prudential framework is sufficiently responsive to new needs that are likely to emerge first at the national level, but will eventually need to be regulated at the regional level.
- ***Skills.*** The lack of appropriate skills may explain why in recent years some MFIs that moved from dealing with micro-enterprises to dealing with SMEs saw their profitability decrease. Banks may face similar challenges moving from larger enterprises to SMEs. The lack of an ingrained financial culture is also often blamed for the very limited recourse to the stock exchange.

MEFP ¶29–31

30. The authorities have a strategy to address a number of these issues, whose implementation they intend to accelerate. The national consultation on credit took place in 2010 and led to an action plan with specific measures to improve access to credit for both households and firms (particularly SMEs). These measures are grouped in broad categories covering among others: facilitating the use of guarantees; SME debt and equity financing and general support to SMEs; availability of information; cost of credit; financial intermediation and the judicial environment. Progress was made in some areas, such as registering land titles and information provision. Actions to improve the efficiency of the judicial process, such as the training of judges in economic affairs, are however behind schedule, and so are measures aiming at streamlining and improving public support in favor of SMEs. Staff is of the view that this action plan remains largely relevant and that its implementation should be accelerated. A number of identified obstacles will however need to be addressed at the regional level. The regional authorities are working on the development of the interbank market and the strengthening of the public debt market, which they see as priorities. They also intend to review certain prudential rules. These issues will be discussed in more detail during the next regional consultation in early 2013.

31. An external stability assessment suggests that external sector risks are manageable (Annex V). Senegal has recorded continuous current account deficits for nearly two decades. Low savings relative to large investment needs imply continued deficits over the medium term, which could become difficult to finance if aid was to decline. Although export performance has been sluggish, inward FDI has picked up somewhat, and remittances have become an important source of foreign exchange. The real exchange rate is broadly in line with economic fundamentals and reserves are adequate. To reduce external vulnerabilities, Senegal needs to implement prudent fiscal and borrowing policies, increase non-price competitiveness, and reduce further external vulnerabilities.

PROGRAM ISSUES

32. The program is on track. The end-June 2012 fiscal deficit target was met by a substantial margin, reflecting expenditure restraint on goods and services and lower domestically financed capital spending. All structural benchmarks were met, although some with delays reflecting the time needed to build broad support for sensitive measures (electricity subsidies and tax reform; Text Table 1). Preliminary data for end-September suggest that all indicative and structural targets have been met, with the exception of the ceiling on budgetary float, which was missed by a small margin (0.01 percent of GDP) because of continued weaknesses in expenditure controls (Appendix I, MEFP, Table 1).

Text Table 1. Structural Measures: Fourth PSI Review

Measures	Implementation Date	Status	Macroeconomic Significance
Adopt an action plan on subsidies to electricity consumers	August 31, 2012	Done with delay (October 2012)	Reform the energy sector
Prepare a medium-term debt strategy	September 30, 2012	Done	Improve debt management
Finalize the new tax code and submit it to parliament	September 30, 2012	Done with delay in November 2012	Improve efficiency of the tax system

33. A number of changes are proposed in program monitoring. The end-2012 fiscal deficit assessment criterion would be revised downward to 5.9 percent of GDP and new fiscal targets for end-June 2013 and end-2013 are proposed. The structural benchmark on preparing a plan for restructuring agencies would be rescheduled from end-2012 to end-July 2013 to reflect procurement delays. The program would also include new structural benchmarks in the area of debt management, tax and customs reform, public investment appraisal, and transparency (Text Table 2). The authorities are planning to use the remaining space for nonconcessional borrowing (US$200 million), and it is proposed to broaden the scope of investment expenditures which could be financed this way to road infrastructure (not only the highway), and urban water and sanitation. Use of such financing would close the financing gap in 2013.

MEFP ¶33-34

Text Table 2. Structural Measures: Fifth and Sixth PSI Reviews

Measures	MEFP §	Implementation Date	Benchmark for Review	Macroeconomic Significance
Prepare a project evaluation guide	24	December 31, 2012	5th	Improve investment planning
Publish information on land transaction of the government (new)	23	January 31, 2013	5th	Reinforce transparency of public finances
Finalize the single treasury account	25	February 28, 2013	5th	Strengthen public financial management
Prepare a plan for restructuring agencies and similar entities	22	Rescheduled to July 31, 2013	6th	Strengthen public financial management
Transmission to parliament of the new Customs Code (new)	19	June 30, 2013	6th	Enhance government revenue and private sector development
Implement electronic declaration in tax payments by large enterprises (new)	18	June 30, 2013	6th	Improve efficiency of public policy and the business climate
Use cost-benefit analysis for projects of over CFAF 10 billion included in the 2014 budget (new)	24	July 31, 2013	6th	Improve efficiency of government expenditure
Start using the new payroll management software (new)	14	August 31, 2013	6th	Strengthen public financial management

STAFF APPRAISAL

34. **Despite a challenging external environment, a moderate growth pick up is expected in 2012 and 2013.** A rebound in agriculture after last year's drought would boost real GDP growth to 3.7 percent in 2012. Growth would slightly increase in 2013 to 4.3 percent mostly owing to the completion of a number of large infrastructure and mining projects. Inflation would remain moderate.

35. **The authorities' determination to keep the fiscal deficit under control in 2012 and to reduce it in 2013 is welcome.** Fiscal deficits and debt ratios have increased in recent years, reducing room for fiscal maneuver and raising sustainability issues. Restoring fiscal space and keeping low the risk of debt distress require reducing deficits. The authorities' objective of keeping the fiscal deficit below 6 percent of GDP in 2012 and below 5 percent of GDP in 2013 is adequately ambitious. Debt sustainability considerations call for further reduction of the fiscal deficit and strengthening of debt management in the medium term.

36. **Reducing the fiscal deficit while addressing the country's social and development needs will require improving public spending efficiency**. Beyond reducing the cost of running the government and a further streamlining of agencies, a rationalization of expenditure and more cost-effective support to the most vulnerable segments of the population will be needed. In this regard, staff welcomes the authorities' intention to phase out costly and poorly targeted food and fuel price subsidies and to broaden and improve social safety nets. Streamlining efforts will have to be sustained over several years to deliver lasting results and to make space for critical new programs. This will require strong political leadership to overcome vested interests, as well as good administrative capacity.

37. **The main medium-term challenge for Senegal is to move to higher, sustainable, and inclusive growth.** Growth has been sluggish in recent years, with adverse implications for poverty reduction. Growth is not hampered by one single major obstacle, but rather by a range of issues. The government has an important role to play in raising the growth potential, for instance through the provision of critical infrastructure and reforms to improve the business environment. In this regard, staff urges the authorities to finalize and implement as soon as possible their strategy on new energy investments and restructuring SENELEC. The focus of the new development strategy on inclusiveness is welcome and will be critical to ensure that growth dividends are widely shared, jobs are created in large numbers, and domestic demand is robust. Financial sector development should also be an important element of an inclusive growth strategy, and staff urges the authorities to accelerate the implementation of their strategy in this area.

38. **The economy will remain exposed to substantial risks**. The main domestic ones would be delays in reforming the energy sector and difficulties reforming the state, which would affect growth and fiscal sustainability. External risks mostly reflect the current uncertainty about world economic prospects. External vulnerabilities are manageable but could be reduced by implementing prudent fiscal and borrowing policies and increasing non-price competitiveness.

39. Staff recommends completion of the fourth PSI review. The program is on track and the authorities' policies for the coming period are fully consistent with the objectives of the program. It is proposed that the next Article IV consultation take place on the standard 24–month cycle for program countries.

Table 1. Senegal: Selected Economic and Financial Indicators, 2011–17

	2011	2012		2013	2014	2015	2016	2017
		EBS/ 12/85	Proj.			Proj.		
	(Annual percentage change)							
National income and prices								
GDP at constant prices	2.6	3.9	3.7	4.3	4.8	5.0	5.1	5.2
Of which: nonagriculture GDP	4.8	3.2	2.9	4.0	4.8	5.1	5.2	5.3
GDP deflator	4.3	2.2	2.2	2.4	2.4	2.5	2.4	2.5
Consumer prices								
Annual average	3.4	2.5	1.5	1.6	1.8	1.8	1.8	1.8
End of period	2.7	2.2	1.6	1.8	1.8	1.8	1.8	1.8
External sector								
Exports, f.o.b. (CFA francs)	7.1	3.2	4.4	6.9	3.6	5.4	8.4	9.2
Imports, f.o.b. (CFA francs)	8.9	9.0	9.5	4.2	3.4	3.3	6.1	7.0
Export volume	-2.7	0.4	-1.0	4.4	4.9	5.5	6.1	6.4
Import volume	4.3	4.7	3.4	3.2	4.2	4.4	4.5	4.8
Terms of trade ("–" = deterioration)	5.6	-0.4	-0.4	1.7	-0.7	0.7	0.6	0.5
Nominal effective exchange rate	1.4	…	…	…	…	…	…	…
Real effective exchange rate	1.1	…	…	…	…	…	…	…
	(Changes in percent of beginning-of-year broad money, unless otherwise indicated)							
Broad money	6.7	7.5	6.0	7.4				
Net domestic assets	9.0	7.6	10.4	7.4	…	…	…	…
Domestic credit	10.2	7.0	9.5	7.0	…	…	…	…
Credit to the government (net)	-2.0	1.7	1.8	1.3	…	…	…	…
Credit to the economy (percentage growth)	18.8	5.6	10.6	7.6	…	…	…	…
	(Percent of GDP, unless otherwise indicated)							
Government financial operations								
Revenue	20.2	20.7	20.9	20.8	20.9	20.9	20.6	20.7
Grants	2.2	2.7	2.9	2.7	2.7	2.7	2.6	2.6
Total expenditure and net lending	29.0	29.8	29.7	28.4	27.9	27.5	26.9	26.7
Overall fiscal surplus (+) or deficit (–)								
Payment order basis, excluding grants	-8.9	-9.1	-8.8	-7.6	-7.0	-6.6	-6.3	-6.0
Payment order basis, including grants	-6.7	-6.4	-5.9	-4.9	-4.3	-3.9	-3.7	-3.5
Primary fiscal balance [1]	-5.2	-4.9	-4.3	-3.1	-2.7	-2.4	-2.1	-1.9
Gross domestic investment	28.7	30.8	30.3	30.1	30.2	30.5	30.5	30.5
Government	10.5	12.6	12.1	11.8	11.8	11.9	11.7	11.6
Nongovernment	18.2	18.2	18.2	18.3	18.4	18.6	18.7	18.9
Gross domestic savings	12.5	12.8	12.8	13.5	14.3	15.5	16.4	16.9
Government	5.4	7.7	7.9	8.8	9.1	9.5	9.6	9.8
Nongovernment	7.1	5.1	4.9	4.7	5.3	5.9	6.7	7.1
Gross national savings	22.6	22.5	22.7	23.0	23.5	24.2	24.5	24.9
External current account balance								
Including current official transfers	-6.1	-8.3	-7.6	-7.1	-6.7	-6.3	-5.9	-5.7
Excluding current official transfers	-6.8	-8.9	-8.4	-7.8	-7.4	-7.0	-6.5	-6.3
Total public debt	40.0	44.9	45.0	46.8	48.1	48.7	49.0	49.0
Central government domestic debt	11.3	12.2	12.3	12.2	12.7	12.9	13.0	12.8
External public debt	28.8	32.6	32.7	34.6	35.4	35.8	36.1	36.2
External public debt service								
Percent of exports	14.0	7.4	7.3	7.6	6.8	7.4	7.2	7.0
Percent of government revenue	17.2	8.7	8.4	8.7	7.5	8.1	8.0	7.7
Gross domestic product (CFAF billions)	6,818	7,243	7,225	7,718	8,286	8,921	9,600	10,351

Sources: Senegalese authorities; and IMF staff estimates and projections.

[1] Total revenue and grants minus total expenditure and net lending, excluding interest expenditure.

Table 2. Senegal: Balance of Payments, 2011–17

	2011	2012		2013	2014	2015	2016	2017
		EBS/ 12/85	Proj.			Proj.		
	(CFAF billions, unless otherwise indicated)							
Current account	-415	-601	-546	-551	-556	-564	-567	-585
Balance on goods	-1,055	-1,241	-1,215	-1,232	-1,272	-1,286	-1,331	-1,391
Exports, f.o.b.	1,148	1,218	1,199	1,282	1,327	1,399	1,517	1,656
Imports, f.o.b.	-2,203	-2,459	-2,414	-2,514	-2,599	-2,685	-2,847	-3,047
Services and incomes (net)	-134	-138	-126	-122	-110	-123	-100	-79
Credits	660	663	663	684	714	766	833	881
Debits	-794	-800	-788	-807	-824	-889	-933	-959
Of which: interest on public debt	-62	-57	-56	-64	-68	-64	-80	-87
Unrequited current transfers (net)	774	778	795	803	825	845	864	885
Private (net)	750	761	761	783	800	818	836	854
Public (net)	24	18	34	20	25	27	29	31
Of which: budgetary grants	37	32	48	39	42	45	48	51
Capital and financial account	345	582	409	533	561	594	608	635
Capital account	119	183	218	172	282	238	207	218
Private capital transfers	6	5	5	5	4	3	2	1
Project grants	113	164	164	169	181	195	206	218
Debt cancellation and other transfers [1]	0	14	49	-1	96	40	-1	-1
Financial account	226	399	191	361	280	355	401	417
Direct investment	133	184	136	88	91	93	94	94
Portfolio investment	210	119	119	57	220	138	141	144
Other investment	-117	95	-64	215	-31	124	166	179
Public sector (net)	224	283	255	293	239	251	264	281
Of which: disbursements	399	372	344	384	310	326	337	355
program loans	40	107	118	37	40	43	46	50
project loans	135	221	221	217	228	238	243	253
other	224	44	6	130	41	45	48	52
amortization	-175	-89	-89	-91	-71	-76	-76	-79
Private sector (net)	-349	-188	-320	-78	-270	-127	-98	-102
Errors and omissions	9	0	0	0	0	0	0	0
Overall balance	-70	-19	-137	-18	5	30	41	50
Financing	70	19	137	18	-5	-30	-41	-50
Net foreign assets (BCEAO)	8	0	0	0	-23	-48	-60	-69
Net use of IMF resources	-2	3	-3	-3	-9	-19	-21	-20
Purchases/disbursements	0	0	0	0	0	0	0	0
Repurchases/repayments	-2	3	-3	-3	-9	-19	-21	-20
Other	10	-3	3	3	-14	-29	-39	-49
Deposit money banks	49	1	119	0	0	0	0	0
Exceptional financing (debt relief)	13	18	18	18	18	19	19	19
Residual financing gap	0	0	0	0	0	0	0	0
Memorandum items:								
Current account balance								
Including current official transfers (percent of GDP)	-6.1	-8.3	-7.6	-7.1	-6.7	-6.3	-5.9	-5.7
Excluding current official transfers (percent of GDP)	-6.8	-8.9	-8.4	-7.8	-7.4	-7.0	-6.5	-6.3
Gross official reserves (imputed reserves, billions of US$)	2.0	1.9	1.9	1.9	1.9	2.0	2.1	2.2
(percent of broad money)	36.7	34.2	34.7	32.3	30.6	29.6	29.0	28.3
WAEMU gross official reserves (billions of US$)	15.0	…	…	…	…	…	…	…
(percent of broad money)	56.2	…	…	…	…	…	…	…
(months of WAEMU imports of GNFS)	6.2	…	…	…	…	…	…	…
Gross domestic product	6,818	7,243	7,225	7,718	8,286	8,921	9,600	10,351

Sources: Central Bank of West African States (BCEAO); and IMF staff estimates and projections.

[1] Includes Millennium Challenge Account (MCA) grants in 2011–15.

Table 3. Senegal: Government and FSE Financial Operations, 2011–17

	2011	2012		2013		2014	2015	2016	2017
		EBS/ 12/85	Proj.	EBS/ 12/85	Proj.		Proj.		
	(Billions of CFA francs, unless otherwise indicated)								
Total revenue and grants	1,526	1,692	1,723	1,812	1,813	1,953	2,102	2,233	2,410
Revenue	1,376	1,497	1,511	1,608	1,605	1,730	1,862	1,979	2,142
Tax revenue	1,287	1,411	1,421	1,495	1,492	1,612	1,737	1,882	2,038
Income tax	346	379	379	384	382	418	458	497	539
Taxes on goods and services	729	830	817	835	835	906	986	1,069	1,157
Taxes on petroleum products	212	202	225	277	276	288	292	316	342
Nontax revenue	50	50	50	78	77	83	90	96	104
FSE [1]	39	35	40	35	35	35	35	0	0
Grants	150	196	212	204	208	223	240	254	268
Budgetary	37	32	48	34	39	42	45	48	51
Budgeted development projects	113	164	164	170	169	181	195	206	218
Total expenditure and net lending [1]	1,980	2,155	2,149	2,179	2,190	2,308	2,450	2,586	2,767
Current expenditure	1,233	1,250	1,282	1,274	1,278	1,334	1,388	1,462	1,565
Wages and salaries [2]	428	450	454	467	467	497	535	576	621
Interest due	104	110	122	125	146	132	136	154	167
Of which : external	62	57	56	64	64	68	64	80	87
Other current expenditure	702	690	706	672	665	705	717	733	776
Transfers and subsidies	335	312	328	291	291	290	252	258	284
Of which : SAR and butane subsidy	15	4	4	0	0	0	0	0	0
Of which: SENELEC/energy	124	105	99	80	80	65	10	0	0
Of which: Food subsidies	0	8	8	0	0	0	0	0	0
Goods and services	356	366	366	379	363	403	453	463	480
HIPC and MDRI current spending	11	12	12	12	12	12	12	12	13
Capital expenditure [3]	718	913	875	906	912	974	1,063	1,124	1,203
Domestically and nonconcessionally financed	475	504	504	507	515	578	644	691	749
HIPC and MDRI-financed	46	48	48	47	47	49	51	52	54
Non-HIPC/MDRI financed	429	456	456	460	468	529	593	639	695
Externally (concessionally) financed	244	409	370	398	397	396	419	433	453
Net lending	28	-8	-8	0	0	0	0	0	0
Of which : On-lending	36	12	12	13	13	14	15	16	17
Selected public sector entities balance [4]	0	0	0	0	0	0	0	0	0
Primary fiscal balance	-356	-357	-307	-247	-236	-227	-216	-203	-193
Overall fiscal balance (excluding grants)	-605	-658	-637	-571	-585	-578	-589	-607	-626
Overall fiscal balance (including grants)	-455	-463	-425	-367	-377	-355	-348	-353	-357
Financing	455	463	425	367	377	355	348	353	357
External financing	422	389	362	400	328	437	365	377	391
Drawings	175	328	339	282	254	268	281	289	303
Program loans	40	107	118	41	37	40	43	46	50
Project loans	135	221	221	242	217	228	238	243	253
Nonconcessional loans	224	44	6	100	130	41	45	48	52
Amortization due	-175	-89	-89	-91	-91	-71	-76	-76	-79
T-bills and bonds issued in WAEMU (net)	184	89	89	91	17	180	97	97	96
Debt relief and HIPC Initiative assistance	13	18	18	18	18	18	19	19	19
Domestic financing	12	100	90	-33	48	-82	-17	-24	-34
Banking system [5]	12	50	50	-33	38	-82	-17	-24	-34
Of which : T-bills and bonds (net)	64	37	38	-19	52	-62	15	9	-6
Nonbank financing	0	50	40	0	10	0	0	0	0
Settlement of payment delays	21	-26	-26	0	0	0	0	0	0
Errors and omissions	0	0	0	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0	0
Memorandum items:									
Budgetary float (program definition)	50	50	50	50	50	50	50	50	50
New issues of government securities	417	518	518	540	538	...	...	...	...
Priority expenditure (percent of total expenditure) [6]	35	35	35	35	35	…	…	…	…
Gross domestic product	6,818	7,243	7,225	7,779	7,718	8,286	8,921	9,600	10,351

Sources: Senegalese authorities; and IMF staff estimates and projections.

[1] Starting in 2011, the data covers the FSE operations.

[2] Excludes project-related wages and salaries included in capital spending and the salaries of autonomous agencies and health and education contractual workers included in transfers and subsidies.

[3] In 2012 includes drought-related expenditure.

[4] Local governments, autonomous public sector entities (e.g., hospitals, universities), and the civil servants pension fund (FNR).

[5] Includes the 10-year CFAF loan from the BCEAO in 2009 equal to the general SDR allocation.

[6] Expenditure on health, education, environment, the judiciary, social safety nets, sanitation, and rural water supply.

Table 4. Senegal: Government and FSE Financial Operations, 2011–17

	2011	2012		2013		2014	2015	2016	2017
		EBS/12/85	Proj.	EBS/12/85	Proj.		Proj.		
	(Percent of GDP)								
Total revenue and grants	22.4	23.4	23.9	23.3	23.5	23.6	23.6	23.3	23.3
Revenue	20.2	20.7	20.9	20.7	20.8	20.9	20.9	20.6	20.7
Tax revenue	18.9	19.5	19.7	19.2	19.3	19.5	19.5	19.6	19.7
Income tax	5.1	5.2	5.2	4.9	4.9	5.0	5.1	5.2	5.2
Taxes on goods and services	10.7	11.5	11.3	10.7	10.8	10.9	11.1	11.1	11.2
Taxes on petroleum products	3.1	2.8	3.1	3.6	3.6	3.5	3.3	3.3	3.3
Nontax revenue	0.7	0.7	0.7	1.0	1.0	1.0	1.0	1.0	1.0
FSE	0.6	0.5	0.6	0.5	0.5	0.4	0.4	0.0	0.0
Grants	2.2	2.7	2.9	2.6	2.7	2.7	2.7	2.6	2.6
Total expenditure and net lending[1]	29.0	29.8	29.7	28.0	28.4	27.9	27.5	26.9	26.7
Current expenditure	18.1	17.3	17.7	16.4	16.6	16.1	15.6	15.2	15.1
Wages and salaries	6.3	6.2	6.3	6.0	6.1	6.0	6.0	6.0	6.0
Interest payments	1.5	1.5	1.7	1.6	1.9	1.6	1.5	1.6	1.6
Other current expenditure	10.3	9.5	9.8	8.8	8.6	8.5	8.0	7.6	7.5
Of which: goods and services	5.2	5.1	5.1	4.9	4.7	4.9	5.1	4.8	4.6
Of which: transfers and subsidies	4.9	4.3	4.5	3.7	3.8	3.5	2.8	2.7	2.7
Of which: energy and food subsidies	2.0	1.6	1.5	1.0	1.0	0.8	0.1	0.0	0.0
HIPC and MDRI current spending	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Capital expenditure [2]	10.5	12.6	12.1	11.6	11.8	11.8	11.9	11.7	11.6
Domestically and nonconcessionally financed	7.0	7.0	7.0	6.5	6.7	7.0	7.2	7.2	7.2
Externally (concessionally) financed	3.6	5.6	5.1	5.1	5.1	4.8	4.7	4.5	4.4
Net lending	0.4	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Selected public sector entities balance [3]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary fiscal balance	-5.2	-4.9	-4.3	-3.2	-3.1	-2.7	-2.4	-2.1	-1.9
Overall fiscal balance									
Payment order basis, excluding grants	-8.9	-9.1	-8.8	-7.3	-7.6	-7.0	-6.6	-6.3	-6.0
Payment order basis, including grants	-6.7	-6.4	-5.9	-4.7	-4.9	-4.3	-3.9	-3.7	-3.5
Financing	6.7	6.4	5.9	4.7	4.9	4.3	3.9	3.7	3.5
External financing	6.2	5.4	5.0	5.1	4.3	5.3	4.1	3.9	3.8
Domestic financing	0.2	1.4	1.2	-0.4	0.6	-1.0	-0.2	-0.2	-0.3
Settlement of payment delays	0.3	-0.4	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:	(Percent of GDP, unless otherwise indicated)								
Priority expenditure [4]	9.0	10.2	10.4	10.2	10.4	...	...	...	...
Wages and salaries (percent of revenue)	31.1	30.1	30.0	29.0	29.1	28.7	28.8	29.1	29.0

Sources: Senegalese authorities; and IMF staff estimates and projections.

[1] Starting in 2011, the data covers also the FSE operations.

[2] In 2012 includes drought-related expenditure.

[3] Local governments, autonomous public sector entities (e.g., hospitals, universities), and the civil servants pension fund (FNR).

[4] Expenditure on health, education, environment, the judiciary, social safety nets, sanitation, and rural water supply.

Table 5. Senegal: Monetary Survey, 2010–13

	2010	2011	2012		2013
			EBS/ 12/85	Proj.	Proj.
		(CFAF billions)			
Net foreign assets	988	931	930	812	812
BCEAO	735	726	726	726	726
Commercial banks	253	204	203	85	85
Net domestic assets	1,552	1,781	1,987	2,062	2,273
Net domestic credit	1,847	2,106	2,297	2,364	2,566
Net credit to the government	200	150	200	200	239
Central bank	202	103	105	105	91
Commercial banks	0	46	93	93	145
Other institutions	-2	2	2	2	2
Credit to the economy	1,647	1,956	2,097	2,164	2,327
Other items (net)	-295	-326	-310	-302	-293
Broad money	2,540	2,711	2,917	2,874	3,085
Currency outside banks	561	588	582	580	587
Total deposits	1,979	2,123	2,335	2,293	2,498
Demand deposits	988	1,061	1,166	1,145	1,247
Time deposits	991	1,063	1,170	1,149	1,251
(Change in percentage of beginning-of-period broad money stock)					
Net foreign assets	5.8	-2.3	0.0	-4.4	0.0
BCEAO	0.4	-0.3	0.0	0.0	0.0
Commercial banks	5.4	-1.9	0.0	-4.4	0.0
Net domestic assets	8.3	9.0	7.6	10.4	7.4
Net credit to the government	4.0	-2.0	1.7	1.8	1.3
Credit to the economy	7.0	12.2	5.3	7.7	5.7
Other items (net)	-2.6	-1.2	0.6	0.9	0.3
Broad money	14.1	6.7	7.5	6.0	7.4
Memorandum items:		(Units indicated)			
Velocity (GDP/broad money; end of period)	2.5	2.5	2.5	2.5	2.5
Nominal GDP growth (percentage growth)	5.6	7.1	6.2	6.0	6.8
Credit to the economy (percentage growth)	10.4	18.8	7.4	10.6	7.6
Credit to the economy/GDP (percent)	25.9	28.7	28.9	30.0	30.2
Variation of net credit to the government (yoy; CFAF billions)	88.5	-49.7	45.3	49.7	238.6
Central bank refinance rate (eop; percent)	4.25	4.25	…	…	…

Sources: Senegalese authorities; and IMF staff estimates and projections.

Table 6. Financial Soundness Indicators for the Banking Sector, 2006–12

(Percent, unless otherwise indicated)

	2006	2007	2008	2009	2010	2011	2012 March	2012 June
Capital adequacy								
Capital to risk-weighted assets	12.9	13.5	13.8	16.3	18.0	16.0	16.7	16.9
Regulatory capital to risk-weighted assets	13.1	13.6	13.9	16.5	18.2	15.9	16.3	16.5
Capital to total assets	8.3	8.3	9.1	9.3	10.0	9.8	12.1	12.0
Asset composition and quality								
Total loans to total assets	63.8	58.8	62.8	59.5	57.5	60.6	73.3	73.7
Concentration: loans to 5 largest borrowers to capital	103.7	88.5	100.9	71.7	70.6	69.8	58.6	58.1
Sectoral distribution of loans								
Industrial	28.9	25.1	19.5	27.5	26.4	22.2	21.0	21.5
Retail and wholesale trade	18.9	14.4	18.5	24.5	23.8	19.2	19.5	19.1
Services, transportation and communication	30.0	29.6	31.1	34.1	41.9	34.0	34.3	34.4
Gross NPLs to total loans [1/]	16.8	18.6	17.4	18.7	20.2	16.2	14.8	17.5
Of which: without ICS	…	12.7	14.2	15.8	15.8	13.2	12.5	15.7
Provisions to NPLs [1/]	52.0	53.8	51.5	53.1	54.9	54.0	43.0	55.4
Of which: without ICS	…	74.6	65.7	64.7	65.3	68.3	52.4	62.8
NPLs net of provisions to total loans [1/]	8.8	8.6	9.3	9.7	9.1	8.1	8.4	7.8
Of which: without ICS	…	3.6	5.4	6.2	6.1	4.6	5.9	5.9
NPLs net of provisions to capital [1/]	67.9	60.7	63.9	62.3	52.3	50.4	45.7	43.4
Of which: without ICS	…	23.8	35.3	38.4	41.5	35.7	45.7	43.3
Earnings and profitability								
Average cost of borrowed funds	2.2	2.3	2.8	3.4	2.2	2.0	…	…
Average interest rate on loans [2/]	11.3	11.6	13.9	15.4	8.1	8.4	…	…
Average interest margin [3/]	9.2	9.3	11.1	12.0	5.9	6.4	…	…
After-tax return on average assets	1.6	1.6	1.4	1.3	1.6	2.2	…	…
After-tax return on average equity	14.6	15.3	13.0	16.0	15.4	22.6	…	…
Noninterest expenses/net banking income	49.4	50.7	51.3	60.3	56.7	56.0	…	…
Salaries and wages/net banking income	21.7	22.2	21.1	23.0	24.8	23.8	…	…
Liquidity								
Liquid assets to total assets	…	…	…	74.9	…	74.9	…	…
Liquid assets to total deposits	…	…	…	…	…	…	…	…
Total deposits to total liabilities	75.8	73.6	70.3	74.9	76.0	62.8	81.1	81.0

Source: BCEAO

[1/] NPL changes in 2005 due to ICS (Industries Chimiques du Sénégal). In 2008, ICS was recapitalized and the government guarantee for its bank loans was lifted. However, the loans in question remain classified as non-performing for the time being, although without the need to provision.

[2/] Break in the series in 2010 due to a methodological change.

[3/] Excluding the tax on banking operations.

Table 7. Quantitative Assessment Criteria and Indicative Targets for 2011–12[1]

(CFAF billions, unless otherwise specified)

	December 31, 2011			March 31, 2012			June 30, 2012				September 30, 2012			Dec. 31, 2012
	Prog.	Act.	Status	Prog.	Act.	Status	Prog.	Adj.	Act.	Status	Prog.	Prel.	Status	Rev. prog.
Assessment criteria														
Floor on the overall fiscal balance [2] [3]	-427	-455	not met	*-102*	*-70*	met	-213	-181	-102	met	*347*			-425
Ceiling on the contracting or guaranteeing of new nonconcessional external debt by the government (in US$ millions) [4]	500	300	met	500	300	met	500	…	300	met	500			500
Ceiling on spending undertaken outside normal and simplified procedures [4]	0	0	met	0	0	met	0	…	0	met	0			0
Ceiling on government external payment arrears (stock) [4]	0	0	met	*0*	*0*	met	0	…	0	met	*0*			0
Ceiling on the amount of the budgetary float	50	50	met	*50*	*49*	met	50	…	40	met	*50*	*51*	not met	50
Ceiling on nonconcessional debt with a minimum grant element of 15 percent [4]	44	0	met	44	0	met	44	…	0	met	44			44
Indicative targets														
Quarterly ceiling on the share of the value of public sector contracts signed by single tender (percent)	*20*	*16*	met	*20*	*14*	met	*20*	…	*11*	met	*20*			*20*
Floor on social expenditure (percent of total spending)	*35*	*37*	met	…	…	met	*35*	…	*35*	met	…			*35*
Maximum upward adjustment of the overall deficit ceiling due to														
Shortfall in program grants relative to program projections	15	…	…	15	…	…	15	…	-6	…	15			15
Shortfall in concessional loans relative to program projections	50	…	…	50	…	…	50	…	-11	…	50			50
Shortfall in energy sector and autoroute investment relative to program projections	50	…	…	50	…	…	50	…	-27	…	50			50
Memorandum items:														
Program grants	37	37	…	9	…	…	19	…	13	…	28			48
Concessional loans	210	175	…	52	…	…	105	…	94	…	157			328
Investment in the energy sector and the autoroute [5]	66	66	…	*44*	…	…	60	…	*33*	…	*122*			120

[1] Indicative targets for March and September 2012, except for the assessment criteria monitored on a continuous basis. See Technical Memorandum of Understanding for definitions. Indicative targets shown in italics.

[2] Cumulative since the beginning of the year.

[3] The ceiling on the overall fiscal deficit will to be adjusted in line with the TMU definition.

[4] Monitored on a continuous basis.

[5] Investment in the autoroute plus investment under the plan Takkal financed from internal and external concessional resources.

Table 8. Quantitative Assessment Criteria and Indicative Targets for 2012–13[1]

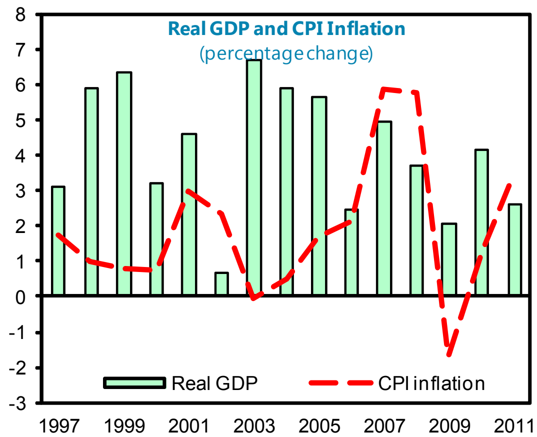
(CFAF billions, unless otherwise specified)

	December 31, 2012	March 31, 2013	June 30, 2013	September 30, 2013	December 31, 2013
	Prog.	Prog.	Prog.	Proj.	Proj.
Assessment criteria					
Floor on the overall fiscal balance [2] [3]	-425	*-94*	-188	*-283*	-377
Ceiling on the contracting or guaranteeing of new nonconcessional external debt by the government (in US$ millions) [4]	500	500	500	500	500
Ceiling on spending undertaken outside normal and simplified procedures [4]	0	0	0	0	0
Ceiling on government external payment arrears (stock) [4]	0	*0*	0	*0*	0
Ceiling on the amount of the budgetary float	50	*50*	50	*50*	50
Ceiling on nonconcessional debt with a minimum grant element of 15 percent [4]	44	44	44	44	44
Indicative targets					
Quarterly ceiling on the share of the value of public sector contracts signed by single tender (percent)	20	*20*	*20*	*20*	*20*
Floor on social expenditures (percent of total spending)	35	…	*35*	…	*35*
Maximum upward adjustment of the overall deficit ceiling owing to					
Shortfall in program grants relative to program projections	15	15	15	15	15
Excess in concessional loans relative to program projections	50	50	50	50	50
Excess in energy sector and autoroute investment relative to program projections	50	50	50	50	50
Memorandum items:					
Program grants	48	12	24	36	39
Concessional loans	328	82	164	246	254

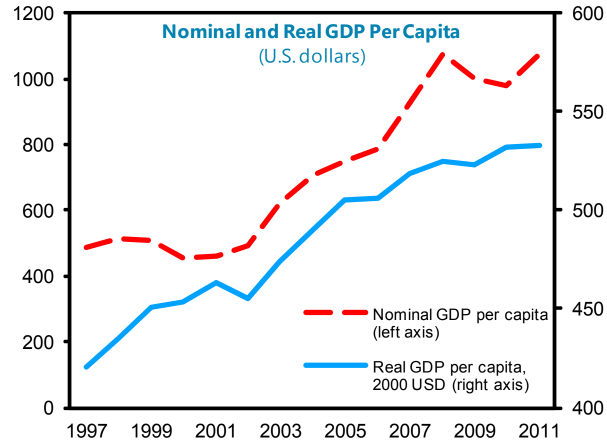
[1] Indicative targets for March and September, except for the assessment criteria monitored on a continuous basis. See Technical Memorandum of Understanding for definitions. Indicative targets shown in italics.
[2] Cumulative since the beginning of the year.
[3] The ceiling on the overall fiscal deficit will to be adjusted in line with the TMU definition.
[4] Monitored on a continuous basis.

Figure 1. Senegal: Historical Perspective, 1997–2011

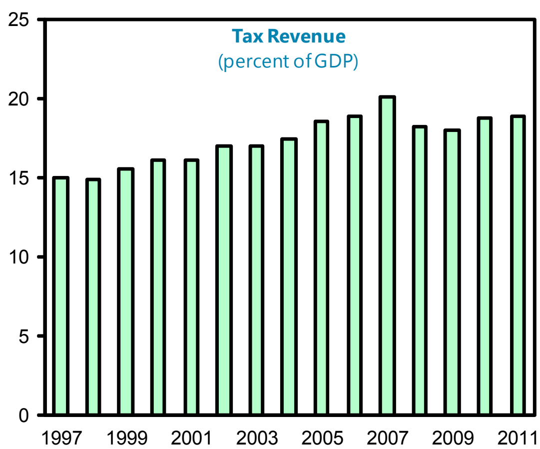
Historically, growth and inflation have been volatile...



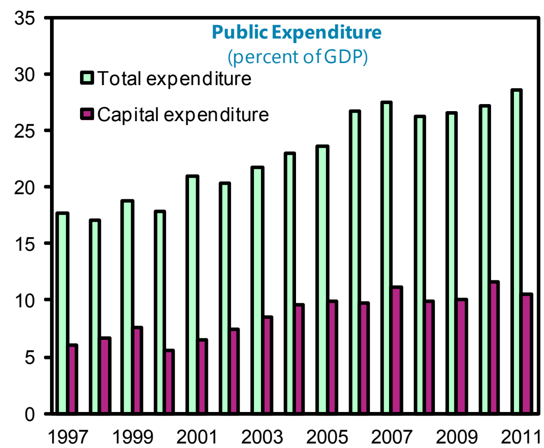
...but per capita income has risen steadily.



A rising revenue trend, interrupted by the 2008 crisis,



allowed for higher spending, including on capital projects.



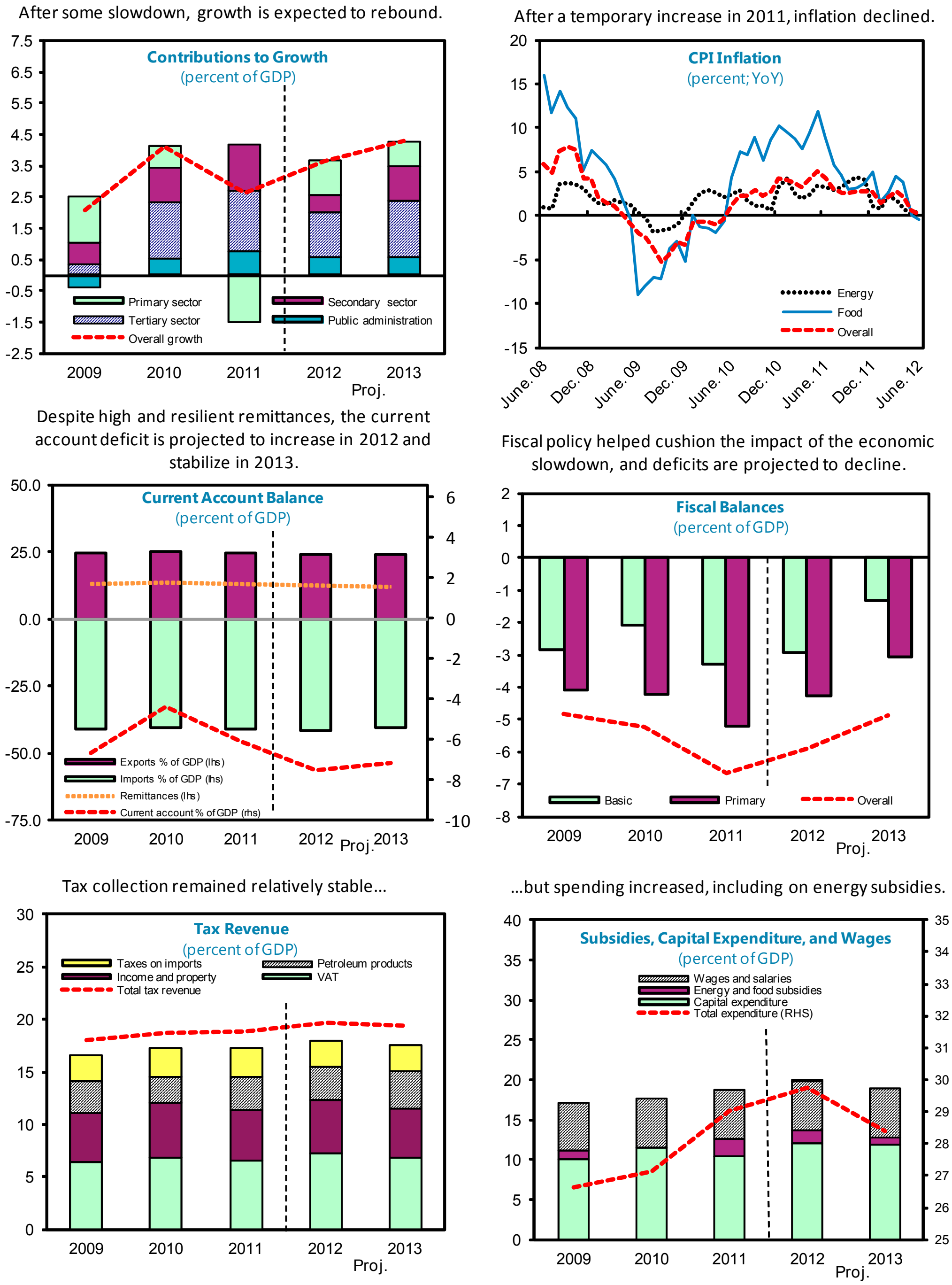
Sources: Senegalese authorities; World Bank; and IMF staff calculations and estimates.

Progress has been made toward the Millennium Development Goals.

Millenium Development Goal	1990	1995	2000	2005	2010
Poverty headcount ratio at $1.25 a day (PPP) (% of population)	66	54	44	34	..
Literacy rate, youth female (% of females ages 15-24)	28	..	41	45	56
Total enrollment, primary (% net)	45	50	58	72	78
Ratio of female to male primary enrollment (%)	72	76	87	97	106
Mortality rate, infant (per 1,000 live births)	70	68	63	56	50
Mortality rate, under-5 (per 1,000)	139	134	119	95	75
Births attended by skilled health staff (% of total)	..	47	60	52	..
Prevalence of HIV, total (% of population ages 15-49)	0	0	1	1	1
Improved water source (% of population with access)	61	63	65	68	72

Source: Millennium Development Goals Database, World Bank, 2012.

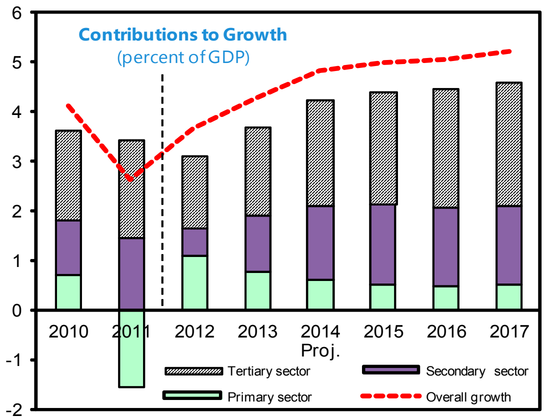
Figure 2. Senegal: Recent Developments and Short-Term Projections, 2009–2013



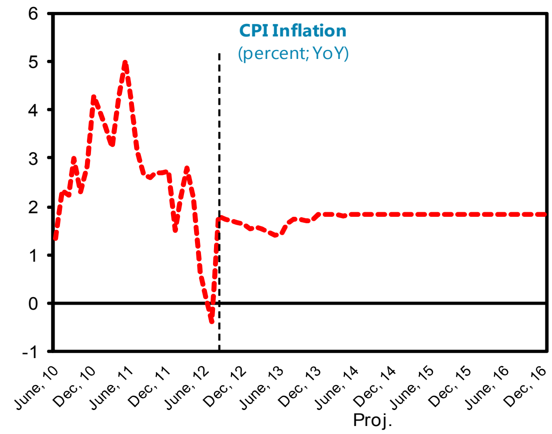
Sources: BCEAO; Senegalese authorities; and IMF staff estimates.

Figure 3. Senegal: Medium-Term Outlook, 2010–2017

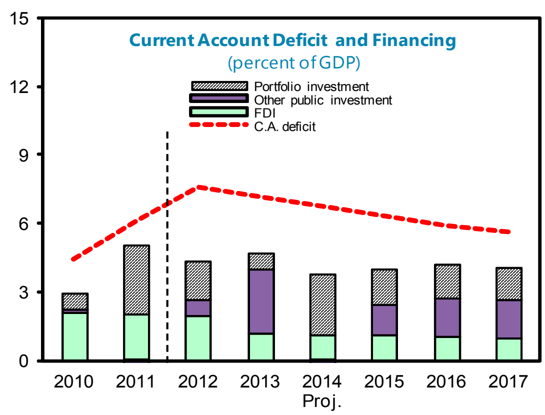
Output growth would to be driven by services, the energy sector and construction related to investment projects.



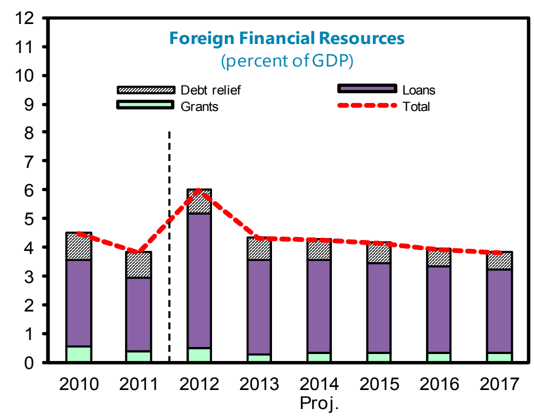
Inflation would return to historical trends.



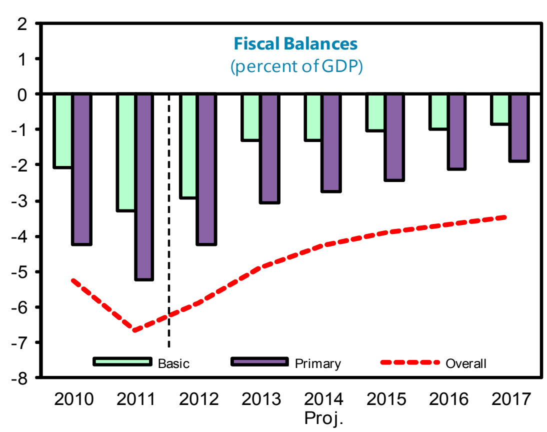
A decreasing current account deficit would be financed largely by public flows ...



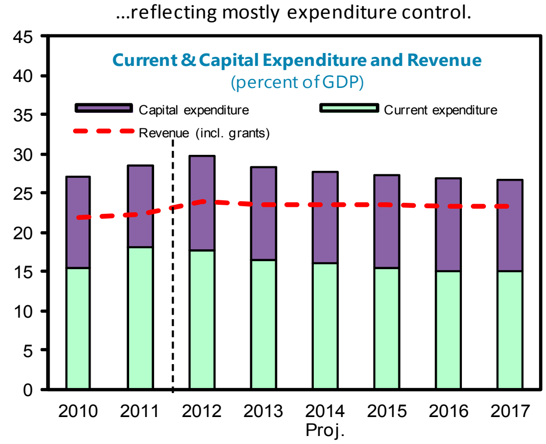
...while the economy would remain dependent on foreign financial resources.



The fiscal deficit would decline in the medium term...

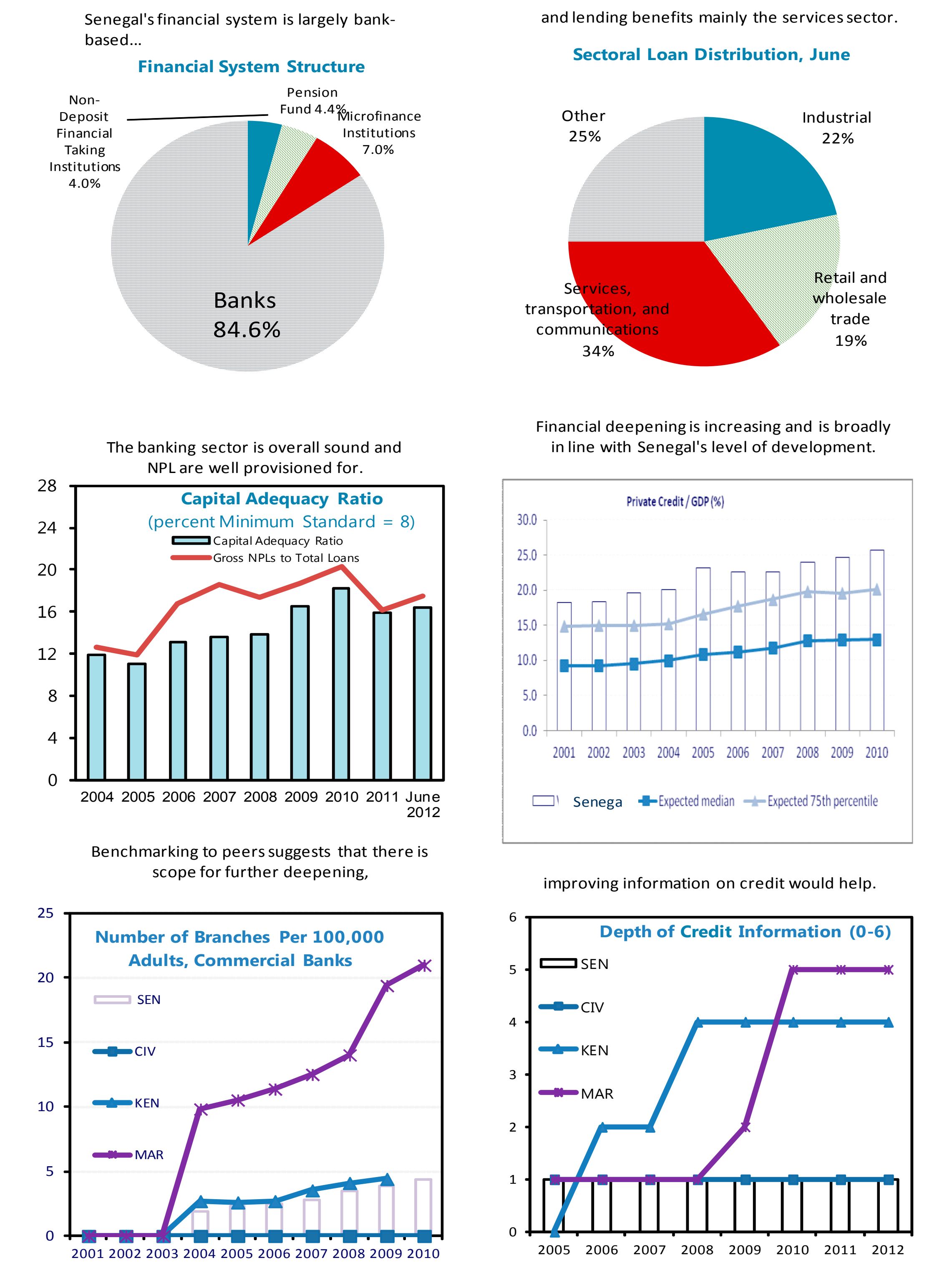


...reflecting mostly expenditure control.



Sources: BCEAO; Senegalese authorities; and IMF staff estimates.

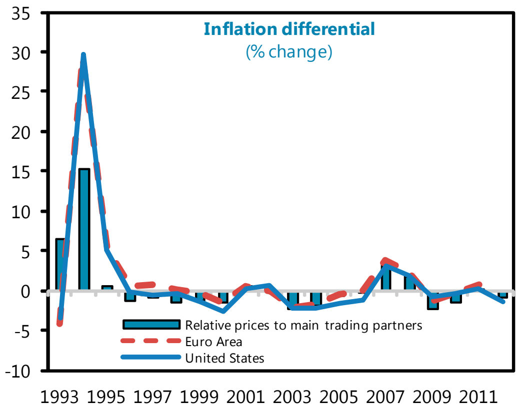
Figure 4. Senegal: Pilot on Financial Sector Surveillance



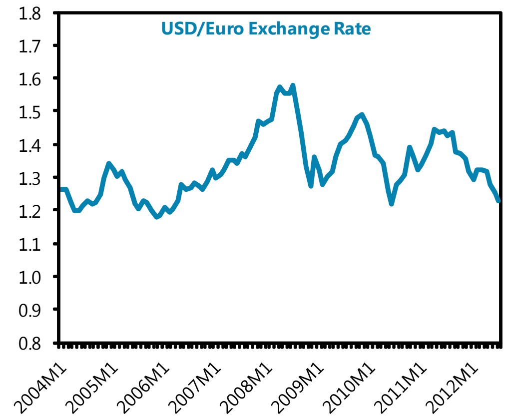
Sources: BCEAO; Senegalese authorities; and IMF staff estimates.

Figure 5. Senegal Exchange Rate and Competitiveness

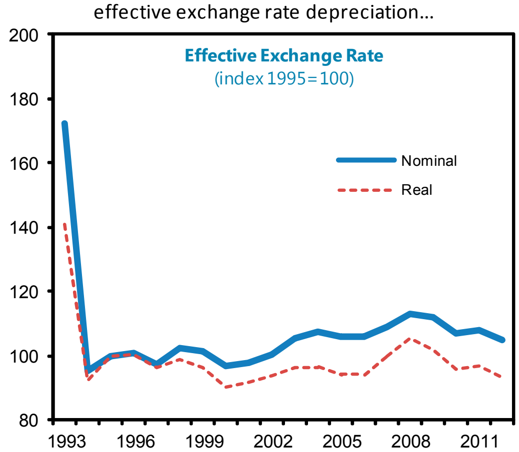
While Senegal's inflation remained on average close to trading partners...



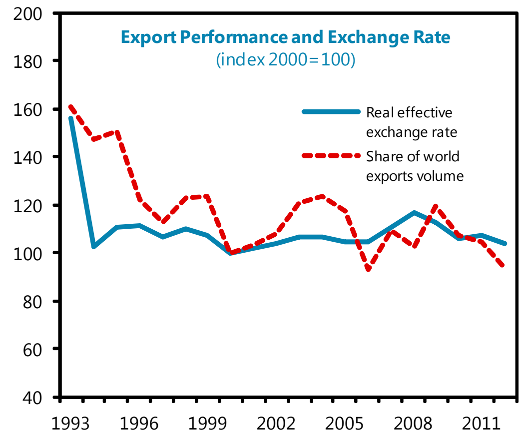
... the depreciation of the euro since 2008...



... has contributed to a moderate nominal and real effective exchange rate depreciation...



... which so far has little affected export performance.



Raising competitiveness rests on enhancing institutions and infrastructure...

Global Compeitiveness Index	2010/2011	2011/2012
Overall ranking	104	111
out of	139	142
Institutions	76	78
Transparency of gov. policy making	103	103
Diversion of public funds	99	107
Infrastructure	112	122
Quality of electric supply	125	133
Quality of roads	91	93
Quality of railroad infrastructure	89	94
Health and primary education	118	119
Primary enrollment	127	131
Labor market efficiency	109	99
Rigidity of employment	131	135
Financial market development	107	106
Ease of access to loans	98	100

... as well as the business climate.

Doing Business Indicators	2011	2012	2013
Overall ranking	152	154	166
out of	183	183	185
Starting a business	101	93	102
Dealing with construction permits	117	125	133
Registering property	167	171	173
Getting credit	152	126	129
Protecting investors	167	166	169
Paying taxes	170	174	178
Trading across borders	67	65	67
Enforcing contracts	148	145	148
Closing a business	79	…	…

Sources: IMF staff calculations and estimates; World Economic Forum; and World Bank.

ANNEX I. ELECTRICITY SUBSIDIES IN SENEGAL[1]

This note attempts to estimate the size of quasi-fiscal costs related to the power sector in Senegal. It then discusses the distributional effects of tariff subsidies to electricity consumers. At current oil prices and under current policies, the latter are expected to remain high until less costly technologies are introduced.

POWER SECTOR: CURRENT CHALLENGES

1. The Senegalese power sector faces tremendous challenges. The sector relies heavily on oil imports for power generation; only about 10 percent of available electricity supply is purchased from regional hydropower. Primarily as a result of increasing oil prices, tariffs set at levels well below full cost recovery, lack of proper maintenance and delays in making investments in capacity to match an increasing power demand, the supply of electricity has become insufficient and unreliable, and the financial situation of the national utility company (SENELEC) has weakened significantly over time. SENELEC has had a large structural operating deficit over recent years; despite significant budgetary transfers, its net income has been negative since 2005 (except in 2009). This situation culminated in a major power crisis in 2010–11, with regular power outages affecting the well-being of the population and economic activity. An emergency plan ("Takkal") was put in place in 2011 to address the situation.

Table 1. Electric Power Suply, Sales and Costs, 2005-2011

	2005	2006	2007	2008	2009	2010	2011
Total power supply (GWh)	2,171	2,192	2,306	2,400	2,489	2,618	2,559
Power supply (percent)							
SENELEC	67	66	69	64	76	69	53
Power purchase	33	34	31	36	24	31	47
of which: Regional hydropower	12	11	8	10	10	10	10
Power Sales & Losses (percent of supply)							
Electricity sales	79	79	77	78	79	79	80
Electricity losses	21	21	23	22	21	21	20
Historic sale prices and costs (CFA/kWh)							
Average tariff 1/	79	90	101	112	113	118	119
Average Tariff (Compensation incl.) 2/	94	109	122	144	133	132	169
Average operating cost 3/	97	129	112	126	110	130	147
Average cost 3/	113	148	127	141	127	148	166
Fuel costs (Senelec only)	49	77	67	105	71	111	163
SENELEC results (CFA billion)							
Operating subsidies received	26	33	37	60	40	28	103
Operating results (Compensation&subsidies excl.)	-33	-56	-40	-61	-27	-80	-100
Operating results (with subsidies)	-7	-23	-3	-1	13	-52	4
Net results	-4	-34	-6	-7	6	-55	-13

Sources: Authorities, World Bank and Staff estimates

1/ Sales receipts per kWh

2/ Sale receipts plus tariff compensations, per kWh

3/ Costs per kWh generated and available after normative losses

[1] Gaston Mpatswe is the author of this note.

TARIFF GAP AND QUASI-FISCAL COSTS

2. The setting of the tariff follows a well defined regulatory process. SENELEC's customers are billed based on the amount of kWh of electricity they consume. Prices are differentiated by voltage, with users of higher voltages billed higher prices. A price differential also applies within the same voltage band, with higher consumption priced at a higher tariff. Under the current regulatory framework, changes in tariff levels and/or schedule must be authorized by the Power Sector Regulatory Commission (CRSE in French) before taking effect. The regulatory framework includes mainly four elements: (i) a formula to determine, under baseline tariff and economic conditions, the maximum revenue the utility is allowed to collect to cover its operating and capital costs and make reasonable profits; (ii) conditions that could trigger a tariff adjustment; (iii) a compensation mechanism from the budget when tariff adjustments are not allowed by the government; and (iv) periods for revising the formula, the tariff conditions and for paying tariff compensation if any.

3. The tariff, in practice, has not been set to allow cost recovery; this has required substantial compensation from the budget. Some tariff adjustments were authorized between 2007 and 2009, though not high enough to reduce the large spread between the average price and the average cost per billed kWh.[2] Because of a flawed compensation mechanism that relied on overly optimistic assumptions about the future (e.g., when cost-effective technologies would become available), the tariff compensation received by SENELEC was insufficient and led to losses. In July 2011, the tariff formula was revised and became more realistic. This led to a substantial upward revision of the 2011 tariff compensation (from an initial estimate of CFAF 45 billion to about CFAF 96 billion). The tariff in 2011 was on average about 40 percent below the level suggested by the CRSE formula. Despite this large tariff gap, electricity remains very costly in international comparison.

4. The new tariff compensation system, while a major improvement, may not provide a full picture of the losses in the electricity sector. This reflects a number of issues, such as assumptions on the cost structure which are fixed for three years, or the existence technical and non-technical losses not be entirely compensated for by the formula. While the collection of billed electricity units has reportedly been close to 100 percent, the losses between production and billing have been about 20 percent. This is way above usual technical losses (e.g., related to transportation and transformation), which in efficient systems are contained below 10 percent. Total losses, measured as the difference between the cost of units actually supplied to the power grid and the amounts recovered, amounted in 2011 to an estimated CFAF 141 billion (2.1 percent of GDP). The tariff gap, as measured by the formula, made up about two thirds of this amount. The rest corresponds to "unaccounted" losses, basically reflecting SENELEC's inefficiencies. What matters from a public finance perspective is obviously total losses, given that SENELEC is government-owned. The losses not compensated through the formula eventually have to be borne by the taxpayer one way or another.

[2] Recent tariff adjustments: (i) a 6 percent increase in October 2007; (ii) a 17 percent increase and a new tariff structure in August 2008; (iii) a 12 percent reduction in January 2009; followed by (iv) an increase of 8 percent in July 2009.

Table 2. Power Sector Quasi-fiscal Costs and Subsidies, 2003-2011

	2005	2006	2007	2008	2009	2010	2011
			(In CFA billion)				
Total quasi-fiscal costs	**85**	**133**	**83**	**95**	**67**	**106**	**141**
Unaccounted losses	25	34	37	42	39	45	45
Underpricing (Estimated tariff gaps)	59	100	46	53	28	61	97
Subsidies transfers/received	***26***	***86***	***37***	***60***	***40***	***28***	***96***
SENELEC liabilities (stock)	**149**	**248**	**252**	**312**	**336**	**402**	**385**
Financial liabilities	87	110	121	141	149	164	128
Liabilities to suppliers	62	138	131	171	187	239	257
			(In percent of GDP)				
Total quasi-fiscal costs	**1.8**	**2.7**	**1.5**	**1.6**	**1.1**	**1.7**	**2.1**
Unaccounted losses	0.6	0.7	0.7	0.7	0.6	0.7	0.7
Underpricing (Estimated tariff gaps)	1.3	2.0	0.9	0.9	0.5	1.0	1.4
Subsidies transfers/received	**0.6**	**1.8**	**0.7**	**1.0**	**0.7**	**0.4**	**1.4**
SENELEC liabilities (stock)	**3.5**	**5.4**	**5.1**	**5.8**	**5.6**	**6.7**	**6.0**
Financial liabilities	1.9	2.2	2.2	2.4	2.5	2.6	1.9
Liabilities to suppliers	1.3	2.8	2.4	2.9	3.1	3.7	3.8

Source: Authorities, World Bank and Staff estimates

Fig 1. Quasi-fiscal costs as percent of GDP, 2005-11

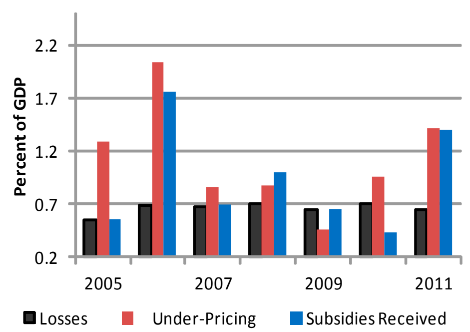
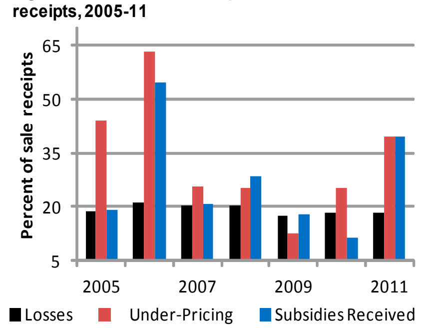


Fig 2. Quasi-fiscal costs as percent of Senelec sale receipts, 2005-11



5. **If oil prices remain high, electricity subsidies will remain large in 2012 and decline only gradually.** Absent any changes in the tariff and efficiency gains at SENELEC, the other main factors affecting electricity subsidies are the level of international oil prices, electricity consumption, and technology. With oil prices expected to remain high in the medium term and power consumption likely to increase, only the introduction of more efficient production units (such as natural gas, hydropower, or coal-fired plants, as envisaged by the authorities) could lead to a significant reduction of electricity subsidies. It therefore makes it critical to finalize the energy sector strategy and to implement expeditiously these investments in new production units, as it will take a few years before they come on stream and contribute to much lower electricity costs.

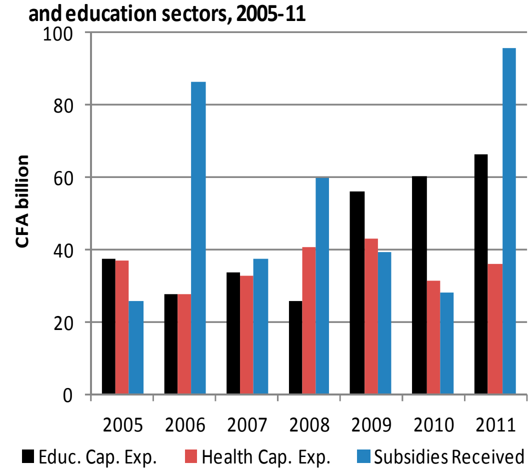
DISTRIBUTIONAL EFFECTS OF ELECTRICITY SUBSIDIES

6. **Beyond being a drain on the budget, electricity subsidies are poorly targeted**. Subsidies are typically justified by the need to make power services affordable to low-income and vulnerable

households. However, empirical evidence on Senegal (and elsewhere) from the mid-2000s suggests that tariff subsidies: [3]

- Are not necessarily benefiting the poor, primarily because most of them are not connected to the power grid. This access factor reflects not only the unavailability of electricity in the areas where poor households tend to live, but also poor households' choice not to connect to the power grid even when they can. Based on data from 2005–2006, a World Bank report shows that all indicators on electricity consumption increase with household income. Households with lower income are less connected, have less access, and even when they have access are less likely to connect to the power grid because of connection fees. Connection and access rates in rural areas were estimated at 15 percent and 39 percent, respectively.
- Even if they were benefiting the poor in absolute terms, their distributional effects have been regressive since electricity consumption is unevenly distributed across regions and income groups. Using a simple measure of targeting, the World Bank's analysis suggests that only 12.5 percent of the subsidies implicit to the tariff structure benefited the poor. Similarly, Fund analysis (Senegal Selected issues, 2008) concluded that the increase in tariff (22 percent) during 2005-2007 had a very limited effect on the welfare of poor households in rural areas.
- Distort prices, and as such constitute an inefficient way of allocating resources within the economy**.** A lower tariff gives an incentive to electricity customers (households and businesses) to consume more electricity than they would otherwise do and thereby exacerbates the burden on public finances.
- Divert important resources needed to finance pro-poor and priority spending. While most of the benefits go to individuals or businesses that do not need subsidization, their cost are very large and crowd out government spending in other areas, including the electricity sector itself. For instance, the cumulative transfers received by SENELEC over the last five years amounted to about CFAF 400 billion, which is nearly equivalent to resources needed for the construction of coal-fired plants that would increase production capacity by more than 50 percent. Similarly, annual transfers to SENELEC were comparable to, or higher than, the resources allocated for capital spending in the health or education sector (see Fig. 3).

Fig 3. Transfers to Senelec, capital spending in health and education sectors, 2005-11



[3] World Bank (2008): Senegal – Poverty Diagnosis, pp 83-88; IMF (2008): Senegal – Selected Issues ().

ANNEX II: GROWTH INCLUSIVENESS IN SENEGAL[1]

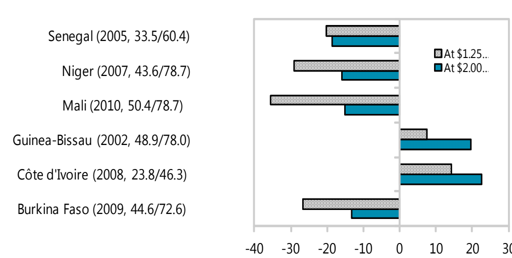
This note examines Senegal's recent growth performance from the perspective of its poverty-reducing and distributional characteristics and discusses some policies that might be considered to make growth more inclusive. The main findings are that poverty has fallen in the last two decades, although poverty reduction has slowed significantly in recent years. Senegal has performed better than many regional peers in terms of poverty reduction. Further poverty reduction will first and foremost require sustained high growth. Public policies also have a role to play in the reduction of poverty and inequalities. Better targeted policies would be more effective and less costly in reducing poverty. More attention to the regional distribution of public expenditure also seems desirable

POVERTY IN TIME AND REGIONAL PERSPECTIVES

1. **Poverty reduction in Senegal has slowed in recent years.** Household surveys conducted in 1994–95, 2001–02, and 2005-06 show that the number of people living below Senegal's poverty line (the poverty rate) declined from 68 percent in 1994–95 to 48 percent in 2005-06. This drop coincided with a period of robust growth (4.5 percent on average). However, a 2011 household survey indicates that poverty decreased only modestly between 2006 and 2011, a period of slower growth (3.3 percent on average). Poverty incidence therefore remains high in 2011, affecting about 47 percent of the population. In addition, there are wide disparities between rural areas, where poverty incidence is higher than the national average (at 57 percent), and urban areas, where the poverty rate is 33 percent.

2. **Progress achieved in poverty reduction has been more pronounced in Senegal than in some regional peers**. In 1994–2005, the share of the population living on less than US$1.25 a day declined by about 20 percentage points, and by about the same for people living on less than US$2 a day (Figure 1). By the latter metric, Senegal appears to be one of the WAEMU's best performers over that period.

Figure 1. Change in Poverty Rate



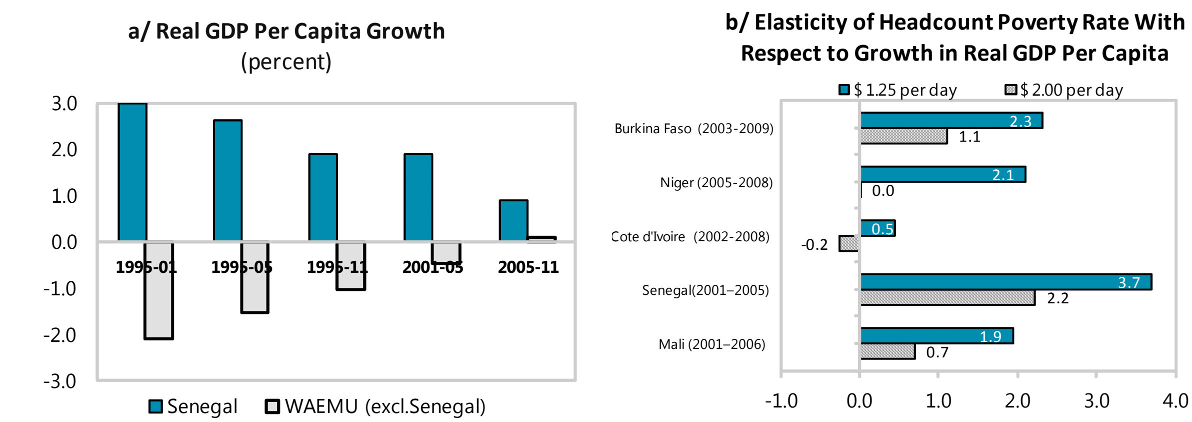
Source: PovcalNet, World Bank, 2012, http://iresearch.worldbank.org/PovcalNet.

3. **This outcome reflects higher growth and a higher sensitivity to growth of poverty reduction in Senegal**. Unlike a number of countries in the WAEMU, particularly those affected by internal conflicts or crises (e.g., Guinea-Bissau and Côte d'Ivoire in the 2000s), real per capita GDP growth in Senegal was always positive during 1995-2011 and some years quite significant. In addition, the elasticity of poverty reduction to per capita income growth has been large in Senegal in regional and even international comparison. During 1995–2005, this elasticity was about 3.7 in Senegal (using the US$1.25 poverty line), well above that of other fast-growing WAEMU countries (e.g., Burkina Faso

[1]The author of this note is Alexei Kireyev.

and Mali, where the elasticity was closer to 2). Thedifference is even larger when the US$2 poverty line is used (Figure 2).

Figure 2. Sensitivity of Poverty Reduction to Growth in the WAEMU



Source: WEO and IMF staff estimates.

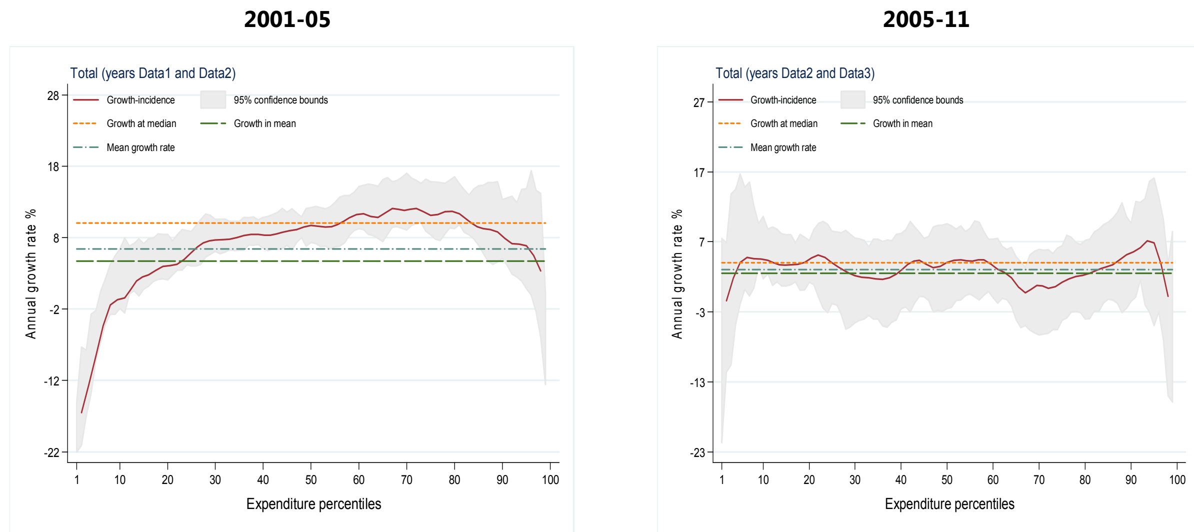
GROWTH AND INEQUALITY IN SENEGAL

4. Dynamics of inequality can be analyzed using growth incidence curves. Growth incidence curves identify the extent to which each decile of households ranged by their income level benefits from growth. The part of the curve above zero points at the deciles whose consumption increased with growth and the part below zero points at the deciles whose consumption decreased with growth. A positively sloped growth incidence curve indicates that consumption of relatively richer deciles of population increases faster than consumption of poorer deciles, which leads to higher inequality. A negatively sloped incidence curve suggests that inequality declines as consumption of poorer households grows faster than consumption of richer households.

5. The growth incidence curve for Senegal between 2001 and 2005 suggests an increase in inequality (Figure 3, left chart). Consumption increased for the groups of population from the third to the eighth decile because the growth incidence curve is above zero, but somewhat faster in the middle of the distribution. Therefore, the poorest three deciles of the population became poorer in relative terms (and the poorest decile in absolute terms too) and the richest three deciles also lost relative ground. The middle class improved their relative position.

6. Preliminary results of the 2011 household survey do not allow identifying a clear trend in inequality in recent years (Figure 3, right chart). The overall growth incidence curve is above zero but broadly flat, suggesting no clear trend in inequality between 2005 and 2011, and that any trend would be probably barely statistically significant. This overall result, however, may mask significant differences between rural and urban areas.

Figure 3. Growth in Real Household Expenditure by Decile per Capita



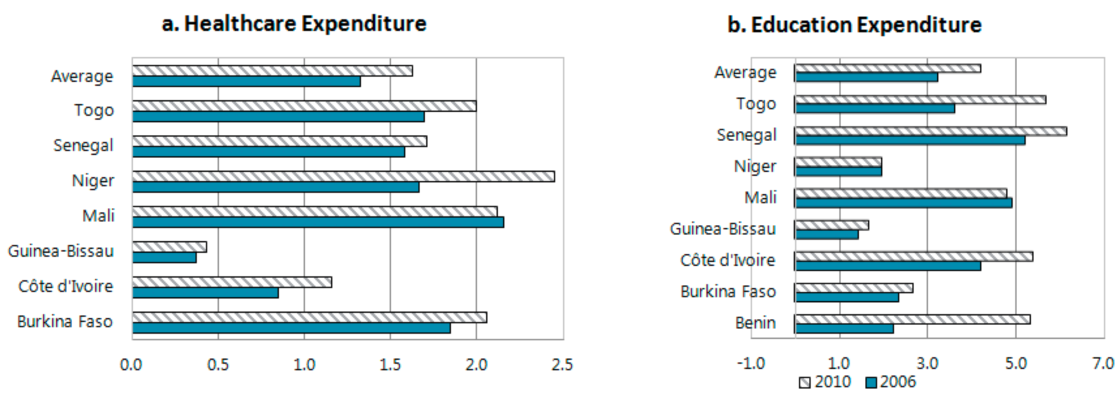
Source: World Bank, ESAM2001, ESPS2005, ESPS2011 databases processed using ADePT 5.1 platform for automated economic analysis, World Bank, 2012.

ARE SENEGAL'S PUBLIC POLICIES SUPPORTIVE OF INCLUSIVE GROWTH?

7. **Public policies may be considered supportive of inclusive growth if they help promote growth and reduce poverty and inequality.** Possible indicators include (i) the overall level of social spending, because cross-country experience suggests that countries with relatively higher spending on human capital, health care, pensions, and other aspects of the social safety net tend to have more inclusive growth (World Bank 2012); (ii) measures specifically targeted at raising incomes of people in the bottom deciles of income distribution relative to the average income; (iii) development of social safety nets for the population in general and programs aimed at its poorest segments; and (iv) the design of the tax system.

8. **The aggregate level of health and education expenditure in Senegal is comparable to that of WAEMU countries, but the composition is different.** Expenditure on education was higher in Senegal than the WAEMU average, while the reverse is true for expenditure on health care, where Senegal has lost ground since 2006 (Figure 4).

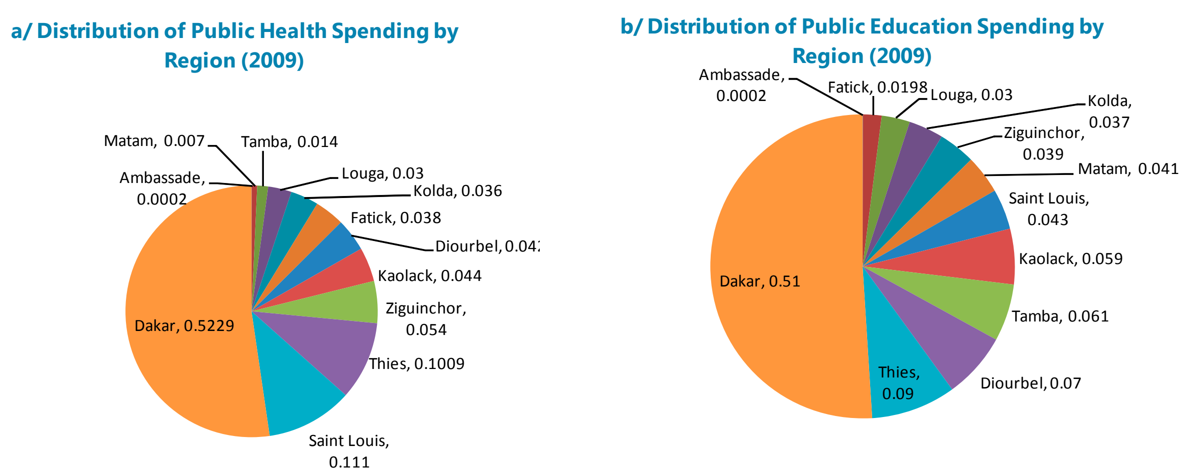
Figure 4. Senegal: Health and Education Expenditure (2006-10)



Source: WEO and IMF staff estimates.

9. Public expenditure, including in the social sectors, is concentrated on Dakar, which absorbs over a half of public resources. Other regions have lower access to public resources, including in such critical areas as healthcare and education, which may also contribute to inequality (Figure 5 a-b, based on World Bank analysis).

Figure 5. Senegal: Who Benefits from Public Expenditure?



Source: World Bank. Public Expenditure Review, 2012.

10. Senegal has used ad-hoc and untargeted measures to address the impact of shocks in the recent past. During the 2007–2008 food and fuel crisis the authorities took several measures to limit price increases on food and oil. They temporarily reduced the VAT and introduced excise tax exemptions and subsidies for butane for all consumers. The fiscal cost of these measures amounted to about 4½ percent of GDP during the 2-year period, with about a third stemming from a loss in revenue. The 2008 poverty and social impact analysis (PSIA) revealed that ad-hoc measures were in general poorly targeted, because almost 55 percent of the benefits accrued to households in the top 40 percent of the welfare distribution. In February 2011, the government froze retail prices for six key food items and temporarily limited price increases for petroleum products at the pump by reducing the VAT base. Some of these measures were reversed later in the year. In early 2012 the authorities introduced implicit subsidies for petroleum products.

11. The scope and coverage of the existing social safety nets in Senegal is limited, and most interventions are small and temporary. Senegal has two conditional cash transfer programs: for orphaned children and those affected by HIV and children in the poorest households. Also, Senegal has a noncontributory old-age pension, which in practice reaches only a very small and rapidly declining number of beneficiaries.

POLICIES TO INCREASE INCLUSIVENESS OF GROWTH

12. Sustained overall economic growth is a precondition for further poverty reduction. A number of studies confirm that sustained growth is a key factor in enhancing inclusiveness. Berg and Ostry (2011) argue that longer growth spells are robustly associated with more equality in the income distribution. Affandi and Peiris (2011) showed that growth is in general pro-poor as it leads to significant declines in poverty across economies and time periods. Senegal's experience seems consistent with this cross-country evidence.

13. Special attention needs to be paid to the distributional dimension of growth. An increase in inequality may offset and even exceed the beneficial impact on poverty reduction of an increase in income. Attention to inclusiveness when designing a growth strategy is therefore critical. For instance, increasing farm productivity and broadening rural job opportunities is important to address rural poverty.

14. Well-designed public policies are also important for promoting inclusiveness. In this regard, the recommendations of the 2008 Poverty and Social Impact Analysis (PSIA) for Senegal remain broadly valid. Poorer households could be protected against food and fuel price increases in the short term at a lower budgetary cost and more effectively by redirecting resources to better-targeted measures, including: targeting poor groups through measures such as school lunches and public works programs; and better-targeting tariffs for small quantities of electricity to protect some of the urban poor. In the medium term, a well-targeted and conditional cash transfer system is the best option for assistance for the poorest. Experience of other countries in the region suggests that a minimum social safety net can be provided more effectively at a relatively low cost. For example, in Burkina Faso, the World Bank estimates that a basic social safety net could be set up at a cost of around 1.5 percent of GDP.

15. Improving access to financial services would also increase growth inclusiveness in Senegal. A number of studies found that financial development generally increases incomes of the poorest households (Claessens, 2005), whereas unequal access to financial markets can reduce it by impeding investments in human and physical capital.

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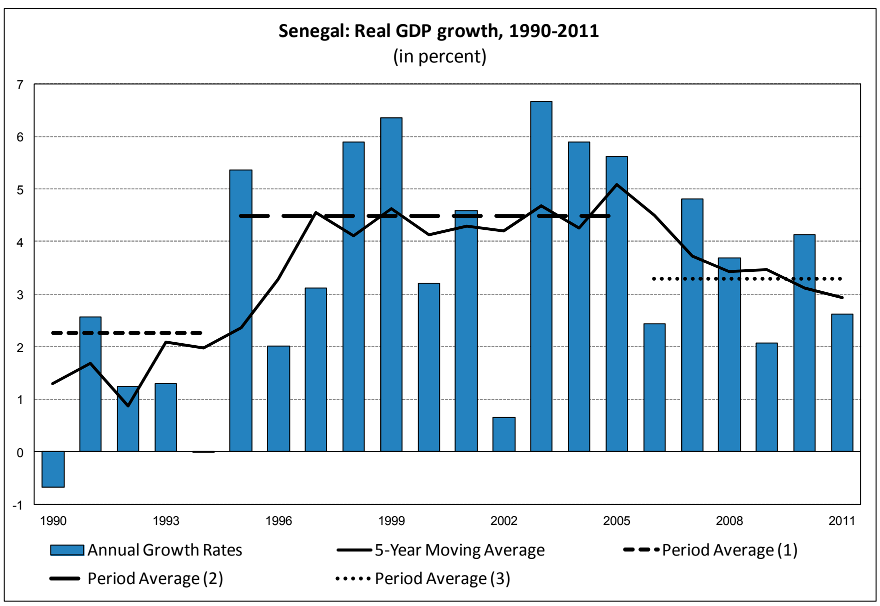
ANNEX III: GROWTH PERFORMANCE, OUTLOOK AND CHALLENGES IN SENEGAL[1]

This note gives a brief overview of Senegal's growth performance and its main drivers. While growth was relatively strong during the 1995–2005, the more recent growth performance has been disappointing. A number of structural obstacles will need to be addressed to put Senegal back on a higher and sustainable growth path

GROWTH PERFORMANCE OVER THE PAST 20 YEARS

1. Three growth periods can be identified over the past 20 years. Economic performance was poor in the early 1990s, before the 1994 CFA franc devaluation. Senegal then recorded a period of strong growth in 1995–2005, with growth averaging 4.5 percent. This average masks relatively large fluctuations (although less than during the previous decades) reflecting volatility in agriculture output, with growth approaching or exceeding 6 percent certain years or dropping below 3 percent. Due to a series of exogenous shocks starting in 2006 (i.e., food and fuel global prices, global financial and economic crisis, and more recently, the electricity sector crisis and drought in the Sahel), growth decreased to an average of 3.3 percent in 2006–2011.



2. Senegal's growth was less favorable than that of fast-growing sub-Saharan African (SSA) countries. Although growth in Senegal since the mid-1990s has been better than in a number of WAEMU countries and strong enough to ensure an increase in per capita income, it has fallen short of the authorities' target under successive poverty reduction strategies (PRS) and has been much

[1] Gaston Mpastswe is the author of this note.

lower than that of fast-growing Sub-Saharan African economies such as Cape Verde, Ethiopia, Rwanda, Tanzania and Uganda (Table 1).

Table 1. Senegal's Growth Performances vis-à-vis comparators, 1990-2011

	Average growth rates				Average per capita growth			
	1990-1994	**1995-2005**	**2006-2008**	**2009-2011**	**1990-1994**	**1995-2005**	**2006-2008**	**2009-2011**
Benin	4.0	4.6	4.6	3.3	0.5	1.5	1.5	0.4
Burkina Faso	2.7	6.6	5.4	5.0	-0.1	3.6	2.3	1.9
Cape Verde	3.9	7.0	8.3	4.7	1.5	5.0	7.2	3.7
Ethiopia	0.6	5.7	11.0	8.7	-2.7	2.9	8.6	6.4
Ghana	4.1	4.6	7.1	8.8	1.3	2.1	4.5	6.3
Mauritius	5.4	4.4	5.1	3.8	4.2	3.4	4.4	3.3
Rwanda	-11.5	11.3	8.6	6.6	-7.4	6.7	5.6	3.5
Senegal	0.9	4.5	3.7	3.0	-2.0	1.8	0.9	0.2
Tanzania	2.5	5.5	7.1	6.5	-0.8	2.8	4.1	3.4
Uganda	6.0	6.8	9.3	6.6	2.6	3.6	5.8	3.2
SSA, excl. S.A	1.0	4.5	6.7	…	-1.8	1.7	4.1	…

Sources: World Bank database and staff estimates

3. **Activity has increased faster in the tertiary sector.** This has been particularly the case in transport and telecommunication, which together have contributed by about one percentage point to GDP growth (Table 2). While the share of the tertiary sector in GDP has increased significantly, the share of the secondary sector has remained about constant and that of the primary sector (including agriculture) has decreased. The observed productivity increase in agriculture and the structural shift toward the services sector suggest that Senegal has experienced a pattern of economic transformation quite typical in developing countries.

Table 2. Senegal: Sectoral contributions to GDP, 1991-2011

	Sectors Real Growth Rates 1/			Contribution to Real Growth 1/			Shares of GDP 2/		
	1991-94	**1995-05**	**2006-11**	**1991-94**	**1995-05**	**2006-11**	**1990-94**	**1995-05**	**2006-11**
PRIMARY SECTOR	**1.9**	**2.9**	**1.8**	**0.3**	**0.4**	**0.2**	**17.7**	**16.2**	**13.8**
Agriculture	0.6	4.3	1.6	0.0	0.2	-0.1	10.3	8.9	7.1
SECONDARY	**2.8**	**4.6**	**3.7**	**0.5**	**1.0**	**0.8**	**21.2**	**21.3**	**20.7**
Industries	2.2	3.8	3.2	0.3	0.5	0.4	13.9	14.0	12.3
Public works and housing	6.6	8.7	4.8	0.2	0.3	0.2	3.1	3.7	4.3
TERTIARY	**0.7**	5.4	**4.2**	**0.3**	**2.4**	**2.0**	**42.9**	**44.0**	**46.4**
Trade	1.2	4.1	2.2	0.2	0.7	0.4	17.1	17.3	15.9
Transport & Telecom	-2.0	9.8	8.2	-0.2	0.8	1.0	6.9	7.4	10.6
PUBLIC SERVICES	**0.7**	**4.0**	**2.2**	**0.1**	**0.8**	**0.4**	**18.3**	**18.5**	**19.1**
GDP	**1.3**	**4.5**	**3.3**	**1.3**	**4.5**	**3.3**	**100**	**100**	**100**
Non-Agriculture GDP	**1.4**	**4.6**	**3.6**	**1.3**	**4.2**	**3.3**	**90**	**91**	**93**

Source: Authorities and Staff estimates

1/ Percentage change. 2/ In percent.

4. **Growth has been driven mainly by public investment and remittances-fueled private consumption (Table 3).** Remittances grew by more than 20 percent per year between 1995 and 2005 and have become a major source of external financing for the economy. Public investment also grew substantially between 2000 and 2005. The export sector, however, performed relatively poorly (see the note on external stability)

Table 3. Senegal: Consumption, Investment and National Savings, 1991-2011

	Annual Growth Rates 1/			Share of GDP 2/		
	1991-94	1995-2005	2006-11	1990-94	1995-2005	2006-11
Consumption	**2.1**	**3.1**	**4.4**	**94.3**	**88.7**	**88.5**
Private	2.8	2.9	4.2	81.1	77.4	72.6
Public	-1.6	5.4	6.2	13.3	11.3	15.9
Investment	**0.4**	**7.6**	**4.6**	**12.3**	**20.2**	**30.6**
Public	-9.9	14.8	6.8	5.6	7.3	10.5
Private	4.6	5.4	3.8	6.7	12.9	20.1
National savings 3/	**6.4**	**23.4**	**10.0**	**6.4**	**13.6**	**21.9**
Remittances 3/	30.4	20.6	15.8	2.4	4.6	12.6

Source: Authorities and Staff estimates
1/ Annual percentage change. 2/ In percent.
3/ Nominal growth rates

5. **Growth has been factor-intensive.** A growth accounting exercise suggests that growth is mostly explained by factor accumulation (Table 4).[2] Total factor productivity (TFP) actually declined before the mid-1990s, and again since 2006. It only grew modestly during the decade of robust growth (1995–2005). A number of factors could explain this poor productivity performance. First, the TFP decline in the past five years coincides with the deterioration of Senegal's doing business and governance indicators, which could have affected the productivity of both public and private investment. Second, large and increasing remittances might have been invested in sectors less likely to spur growth (such as housing and informal trade).

Table 4. Senegal's Growth Rate Accounting, 1991-2011

	1991-1994	1995-2005	2006-2011
Output and productivity growth			
Real GDP Growth	1.3	4.5	3.3
Real per Capita Growth	-1.5	1.8	0.6
GDP per person employed 1/	-1.7	1.4	0.2
Agriculture output per worker 2/	-0.6	0.6	1.7
Growth accounting			
Labor Force	2.1	2.2	2.2
Capital	0.8	1.7	2.8
TFP	-1.7	0.6	-1.7
Growth accounting			
Active Population	1.4	1.7	1.7
Capital	0.8	1.7	2.8
TFP	-1.0	1.1	-1.2

Source: Staff estimates based on Authorities and World Bank's data
1/ Percent change in GDP per person employed (constant 1990 PPP $)
2/ Percent change in agriculture value added per worker (constant 2000 US$)

[2] The growth accounting exercise uses a standard Cobb-Douglas production function, with an elasticity of output with respect to capital of 0.3, and an annual depreciation rate of the capital stock of 6 percent. The economically active population and labor force (from World Bank database) are used as proxies for labor input.

MEDIUM TERM GROWTH OUTLOOK AND CHALLENGES

6. **The medium-term growth projections in the program assume a return to positive TFP growth. Growth is projected at 3.7 percent in 2012, 4.3 percent in 2013, and an average 5 percent per year over 2014–17.** Given the demographic trends and the assumptions made on investment, such a growth path implicitly assumes that ongoing and planned reforms will improve economic efficiency and restore TFP growth to levels comparable to those observed in 1995–2005 (Table 5).[3]

Table 5. Senegal's Growth Rate Accounting, 2012-2017

	2012	2013	2014-17
Real GDP Growth	3.7	4.3	5.0
Real per Capita Growth	1.0	1.6	2.3
Growth accounting			
Labor Force	2.1	2.1	2.1
Capital	2.1	2.0	2.0
TFP	-0.5	0.1	0.9
Growth accounting			
Active Population	1.7	1.7	1.7
Capital	2.1	2.0	2.0
TFP	-0.1	0.6	1.3

Source: Staff estimates

7. **Obstacles to higher and sustainable growth have been identified.** The authorities are finalizing their new growth strategy, which was not available at this writing. The previous one (the Accelerated Growth Strategy, or AGS) focused on five priority sectors: agriculture and agribusiness, fisheries, tourism, clothing and textiles, and telecommunication and ICT-enabled services. Some of these sectors, such as agriculture and tourism, are likely to remain the focus of the new strategy given their strong development potential:

- **Agriculture and agribusiness**. The authorities and World Bank staff see important opportunities for growth in horticulture for exports, and in rice and other cash crops production and livestock development, primarily for the domestic market. A favorable climate for year-round fresh vegetables and fruit and a relatively short distance to the European market put Senegal in a very good position. The potential for efficiency gains in the agriculture sector is large, as illustrated by the relatively low cereal yields (Table 6).

Table 6. Cereal's average yield (100 kg per hectare), 1994-2008

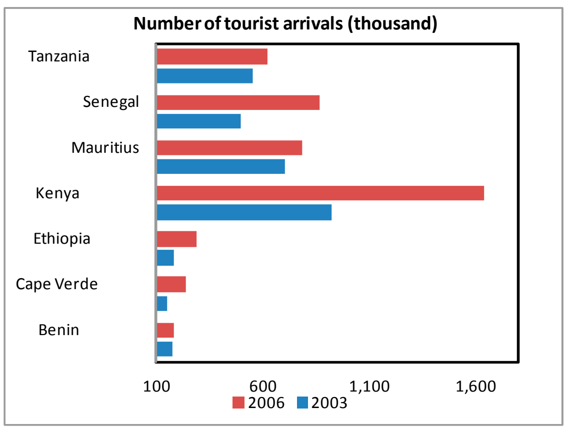
	1991-1995	1995-2000	2001-2005	2006-2008
Benin	9.7	10.9	10.9	11.9
Burkina Faso	8.6	8.6	9.9	11.3
Cape Verde	2.9	5.1	3.6	5.8
Côte d'Ivoire	9.0	14.1	18.0	17.4
Ethiopia	11.2	11.7	12.4	16.5
Ghana	12.7	13.3	13.5	13.3
Rwanda	11.5	10.1	10.1	10.8
Senegal	8.1	7.6	9.6	8.5
Tanzania	12.9	10.0	11.1	11.9
Uganda	15.3	14.2	15.9	15.2
SSA, excl. SA	9.4	9.9	10.5	11.8

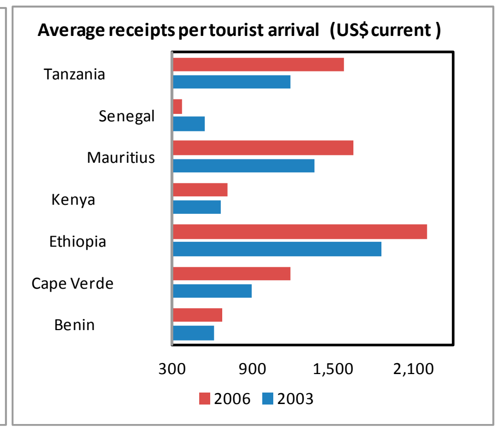
Sources: World Bank Database and Staff estimates

[3]This assumption is critical to medium-term growth prospects; without it, per capita income would continue to increase only very slow.

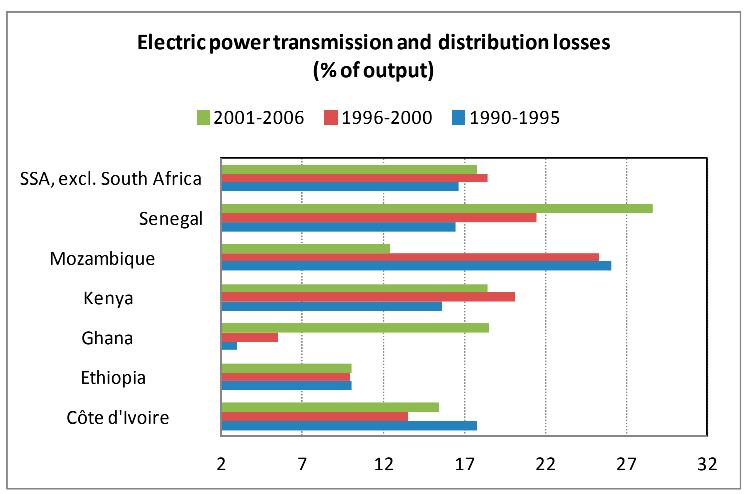
However, this will require modernizing the sector, which is primarily composed of small, family farming, and relies heavily on rainfall and the use of traditional production techniques. Obstacles to access to land and credit, which limit potential involvement of private businesses, will need to be addressed too.

- **Tourism**. Given its natural endowment and cultural heritage, as well as its proximity to Europe, the potential for the development of business and cultural tourism is substantial. Senegal scores fairly well in terms of the number of tourist arrivals, but poorly regarding spending per tourist. The sector has lost substantial market share in Africa over the last 15 years. This trend can probably be reversed, but it will take a range of measures to improve the offer and market the destination.

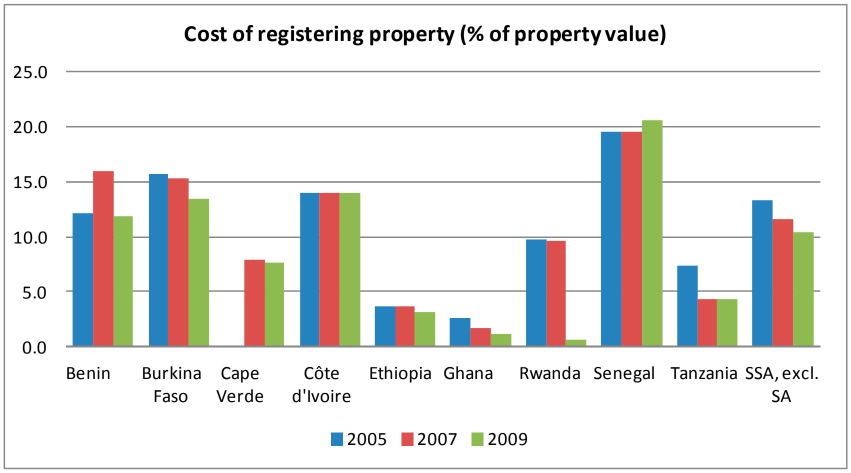




8. Improving energy and transport infrastructure is critical for growth prospects. Significant progress has already been achieved in upgrading Senegal's infrastructure, particularly in ICT, but substantial challenges remain in transport and energy. The latter are expected to be addressed in the coming years through a number of large projects. These include the Blaise Diagne International Airport (AIBD), the Dakar-AIBD highway (with later on possible extensions to Mbour and Thiès, and the Diamniadio Economic Special Integrated Zone (DESIZ). These projects will help deal with the excessive concentration of economic activity in the Dakar area, which makes up more than half of the Senegalese economy on less than 1 percent of the national territory. Large investments to restore power supply and increase generation capacity with more cost-effective technologies should also



help lower the cost of doing business, especially in manufacturing; the cost of electricity in Senegal is indeed among the highest in SSA (see chart).



9. More generally, there is significant scope for further improvement in the business climate. The development of a dynamic private sector in Senegal is still hampered by a range of issues. Despite the progress made in a number of areas (e.g., creation of a one-stop shop for business registration, easing of administration procedures for exports and imports), Senegal's still ranks only 154th out of 183 countries surveyed for the 2012 *Doing Business* report. Reform efforts are especially needed in the areas where Senegal still lagging well behind comparator countries, such as paying taxes, registering properties (see chart), protecting investors, enforcing contracts and dealing with construction permits. More generally, a more effective provision of business-friendly public services would contribute to private sector development.

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ANNEX IV: IMPLICATIONS OF PUBLIC INVESTMENT SCALING UP IN SENEGAL[1]

This note looks at the impact of higher debt-financed public investment on growth and debt sustainability, using an open-economy dynamic general equilibrium (DGE) model developed by Buffie et al. (2012). Several scenarios are constructed by altering assumptions about the composition of financing. The results of the model suggest that increased public investment would have a positive impact on growth, but could lead to debt sustainability problems if financed mainly by nonconcessional borrowing. This conclusion is consistent with latest debt sustainability analysis for Senegal.

INTRODUCTION

1. An ambitious investment policy has been central to Senegal's development strategy. Public investment as a share of GDP has doubled since 2000, rising from 5½ percent to nearly 11 percent in 2011. With the support of donors, the authorities have focused investment spending on expanding and modernizing transport infrastructure to facilitate access to markets. Major infrastructure projects include the Blaise Diagne International Airport, the Dakar-Diamniadio toll road, other road projects, and the modernization of the port of Dakar. These projects are intended to spur private sector development, diversify economic activity away from Dakar, and support poverty reduction.

2. This note explores the impact of a higher public investment path in the next few years. The public investment ratio is expected to remain relatively high in the program's macroeconomic framework for 2012–17. This note assumes a further scaling up of public investment to 15 percent of GDP in 2013 and a subsequent gradual decrease back to levels assumed in the program. The spike in the next few years, while not the program's central scenario, is based on the pipeline of current and future investment projects maintained by the authorities; it is therefore plausible, and implicitly corresponds to an early implementation of major investments in the energy and transport sectors.

MODEL CALIBRATION

3. The model's parameters were calibrated to match data for the Senegalese economy. Table 1 summarizes the calibration of the main parameters. In those instances where Senegal-specific estimates were not available, the parameters were set to fit a "generic" low-income country (LIC), as described by Buffie et al. Key parameters affecting debt dynamics are absorptive capacity, the return on infrastructure investment, investment efficiency, and user fees.

[1] Prepared by Andrew Jewell (SPR) and Salifou Issoufou (RES), in collaboration with Senegal's Ministry of Economy and Finance, Direction de la Prévision et des Etudes Economiques

Table 1: Calibration of Main Parameters

Parameter	Value	Source
Absorptive capacity parameter	11	IMF staff
Initial return on infrastructure investment	0.313	Dessus and Herrera (1996)
Efficiency of public investment	0.70	Briceño-Garmendia et al. (2011)
User fees for infrastructure services (% of recurrent costs)	0.83	IMF staff
Value added in non-traded sector	0.450	Authorities
Capital's share in value added in the traded sector	0.400	Authorities
Capital's share in value added in the non-traded sector	0.550	Authorities
Cost share of non-traded inputs in the production of capital	0.500	Authorities
Depreciation rate	0.10	Authorities
Trend per capita growth rate	0.017	Authorities
Initial real interest rate on domestic debt	0.035	IMF staff
Initial real interest rate on private external debt	0.035	IMF staff
Real interest rate on concessional loans	0.000	IMF staff
Initial real interest rate on public commercial loans	0.065	IMF staff
Initial public domestic debt-to-GDP ratio	0.10	IMF staff
Initial public external concessional debt-to-GDP ratio	0.192	IMF staff
Initial public external commercial debt-to-GDP ratio	0.103	IMF staff
Initial private external debt-to-GDP ratio	0.200	IMF staff
Grants-to-GDP ratio	0.026	Authorities
Remittances-to-GDP ratio	0.094	Authorities
Initial ratio of infrastructure investment to GDP	0.105	IMF staff
Initial consumption VAT	0.18	Authorities and IMF staff
Labor ratio of non-savers to savers	4.3	Authorities and IMF staff

4. **Absorptive capacity constraints are significant in Senegal.** When absorptive capacity is limited, high investment rates lead to large cost overruns, usually due to coordination problems or supply bottlenecks during the implementation phase of public investment projects. The assumption for Senegal is that, on average, public investment projects incur costs overruns equal to 74 percent of the size of the initial investment. This estimate is based on data provided by the authorities on initial estimates and final costs of large infrastructure projects in Senegal. To arrive at costs overruns equal to 74 percent of initial investment, taking into account the projected path of investment, the parameter that controls absorptive capacity constraints was set to 11.

5. **The gross return on infrastructure investment is assumed to be 31.3 percent.** Estimates of the return on infrastructure investment vary significantly. Foster and Briceño-Garmendia (2010) found returns ranging from 17 to 24 percent on electricity, water and sanitation, irrigation, and road projects. Estimates by Dalgaard and Hansen (2005) cluster between 15 percent and 30 percent. Buffie et al. assume a 30 percent return on infrastructure investment for a generic LIC. The assumption of a 31.3 percent return in Senegal is taken from

work by Dessus and Herrera (1996) on the impact of public investment on growth in developing countries.

6. **Not all investment spending is assumed to contribute to capital accumulation.** The investment efficiency parameter captures the idea that some investment spending may be wasted or spent on poor projects. The assumption here is that each dollar of public investment in Senegal increases the stock of productive infrastructure by 70 cents. This assumption is based on Briceño-Garmendia et al. (2011) and compares with a benchmark value of 0.60 used by Buffie et al. for sub-Saharan Africa.[2]

7. **User fees allow governments to recoup a significant share of recurrent costs associated with the use of public capital.** Even if investment has a high rate of return, it may not pay for itself from a fiscal perspective if user fees are low and the benefits of investment accrue mainly to the private sector. The estimate of 0.83 for Senegal is based on Briceño-Garmendia et al. (2011) and IMF staff estimates. According to Briceño-Garmendia et al. (2011), tariffs in the power and water sectors cover 72 and 91 percent of recurrent costs. Estimates of tolls collected on the Dakar-Diamniadio toll road point to 85 percent of recurrent costs covered by the collection of user fees. The estimate of 83 percent for Senegal compares to a sub-Saharan African benchmark value of 0.50 used by Buffie et al.

8. **Steady-state ratios and other parameters were set to either their average over the past 10 years or the level at end-2011.** The model generates results by comparing the projected values of certain variables with their steady state values. For example, the steady state value for investment spending was set to 9.5 percent of GDP, equal to the average level of public investment to GDP over the last ten years. The model then assesses the impact of a projected increase in investment spending from the steady state level.

BASELINE SCENARIO

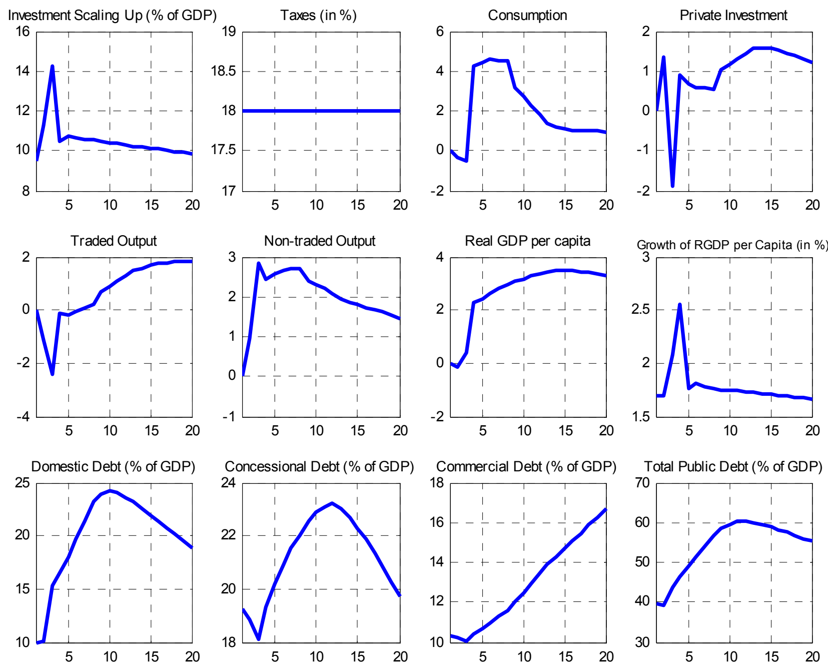
9. **Higher public investment, financed through a combination of concessional and nonconcessional external borrowing and domestic borrowing, would increase permanently per capita income but also raise significantly the debt ratio over the medium term.** This scenario most closely resembles the current financing mix in Senegal, where the government finances public investment through a combination of external and domestic sources.[3] The supply of concessional financing is assumed here to be finite and decreasing over time, while nonconcessional financing gradually increases (both variables are exogenous). Domestic financing is generated endogenously by the model to cover the remaining gap. Public debt rises to 60 percent by the 10th year of the projection period before starting to decline (Figure 1). The

[2] According to Briceño-Garmendia et al., 70 percent of public investment spending goes to capital expenditures and the rest goes to operations and maintenance. Based on the concept of efficiency of public investment in the model, this translates into a value of 0.70 for the efficiency parameter.

[3] Domestic borrowing in this case also includes borrowing from investors in the WAEMU area.

impact on growth is positive, but limited by some crowding out of private investment from domestic borrowing.

Figure 1: External and Domestic Borrowing



ALTERNATIVE SCENARIOS

10. Relying exclusively on fiscal adjustment to finance higher public investment looks unrealistic. In this first alternative scenario, the government is assumed to finance public investment by increasing consumption taxes as necessary while avoiding any recourse to borrowing. The results suggest that economic growth would accelerate and the ratio of public debt to GDP would decrease marginally, but the consumption tax rate would need to jump from 18 percent to 33 percent and remain at elevated levels over the medium term, which does not seem feasible (Figure 2).

11. Financing higher public investment with concessional borrowing, without any fiscal adjustment, appears to be the best option from a growth and debt sustainability perspective. If the government is assumed to have unlimited access to external concessional financing to cover all planned investment spending, the results would be generally favorable. Public debt to GDP would initially rise, reaching 57 percent by the eighth year of the projection period, but trend downward thereafter (Figure 3). The boost to growth would be even greater than in the fiscal adjustment and baseline scenarios, since consumption and private investment would not be impacted by higher taxes or domestic borrowing. The question, though, is whether unlimited access to external concessional financing is a realistic assumption. Recent history suggests that concessional resources are limited and will need to be supplemented by other types of financing.

Figure 2: Fiscal Adjustment Only

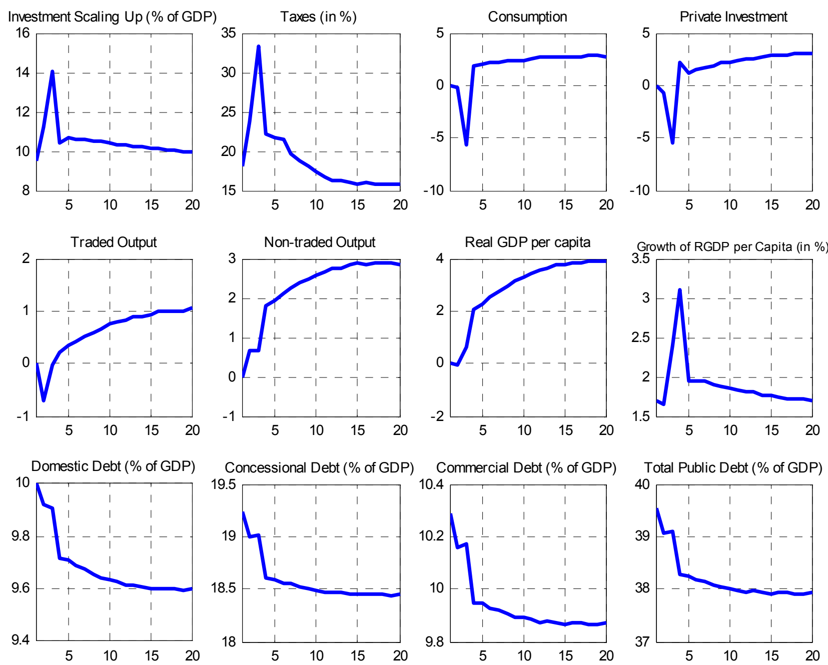
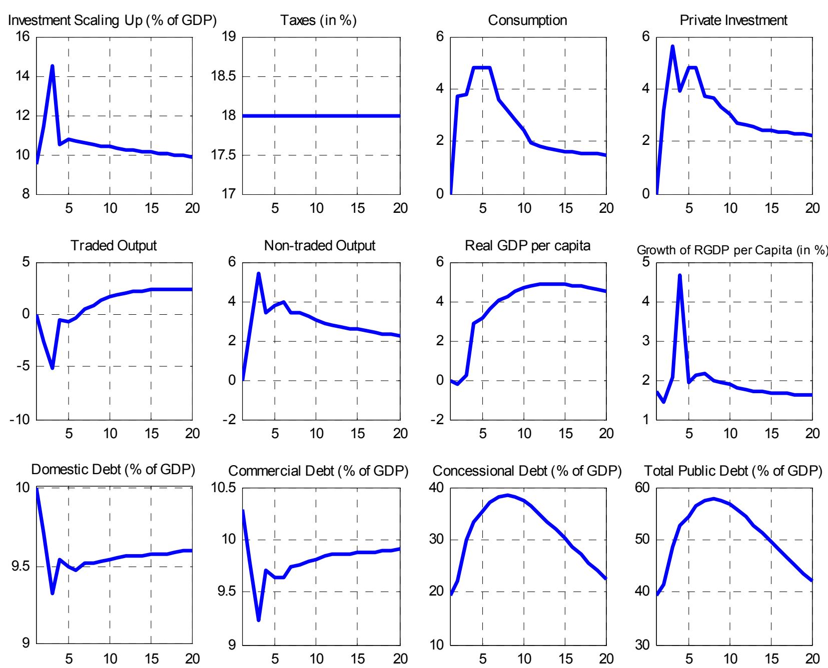
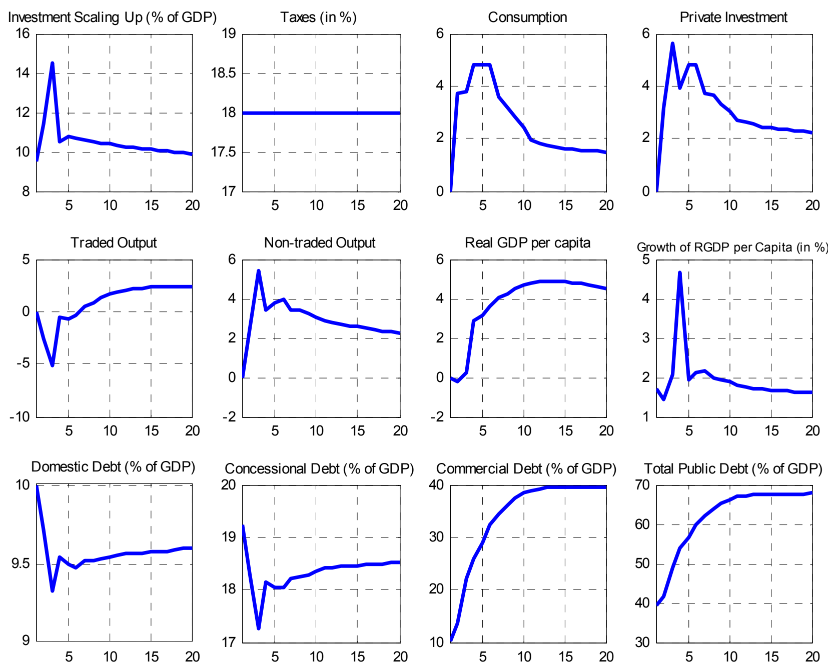


Figure 3: Concessional Borrowing Only



12. Relying exclusively on nonconcessional external borrowing would lead to a permanently higher debt ratio, raising debt sustainability concerns. Similar to the previous scenario, external borrowing without any fiscal adjustment would have a positive impact on growth, due to higher levels of public investment, private investment, and consumption (Figure 4). However, the higher cost of borrowing would result in a rapid and continuous increase in the debt, with the ratio of public debt to GDP reaching 68 percent by the end of the projection period.[4]

Figure 4: Nonconcessional Borrowing Only



CONCLUSION

13. The results of the model suggest that a modest scaling up of public investment would benefit growth without jeopardizing debt sustainability, provided it was not financed exclusively through nonconcessional borrowing. Financing public investment through concessional borrowing would yield even more favorable results, assuming such financing was available. It should be noted that the outcome depends critically on key structural conditions, such as absorptive capacity, the return on infrastructure investment, investment efficiency, and user fees. By improving the structural environment for public investment, Senegal could arguably pursue a more ambitious investment program without threatening debt

[4] Nonconcessional borrowing is assumed to carry a real interest rate of 6.5 percent, equal to a nominal rate of 9 percent (close to the initial yield on the 2011 Eurobond) minus a 2.5 percent world inflation rate.

sustainability. Conversely, a worsening of the structural environment would call for a more cautious approach.

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ANNEX V: EXTERNAL STABILITY ASSESSMENT AND MATRIX

This note assesses external stability in the Senegalese economy. Senegal has recorded continuous current account deficits over the past decade, financed mainly by official flows, including aid. The export sector has not gained market share, inward FDI has picked up somewhat, and remittances have become an important source of foreign exchange. The real exchange rate is broadly in line with economic fundamentals, and reserves are adequate. To enhance competitiveness, Senegal needs to implement structural measures to improve the business environment.

BALANCE OF PAYMENTS

1. **Over the past decade, Senegal has recorded continuous current account deficits, financed mainly by official flows, including aid.** Since 2000, current account deficits have averaged about 8 percent of GDP (Table 1). These deficits have been financed mainly by grants and government borrowing (particularly project loans and, more recently, nonconcessional commercial borrowing). Senegal is therefore exposed to shifting donor and market sentiment. The estimated 2011 current account deficit of 6.1 percent of GDP is in line with the estimated current account "norm" for Senegal of about 6 percent (see below).

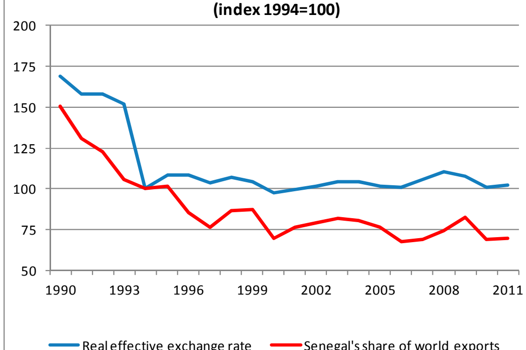
Table 1: Balance of Payments: Selected Items

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
						(in percent of GDP)						
Current Account Balance (including grants)	-7.0	-5.0	-6.0	-6.4	-6.9	-8.9	-9.2	-11.6	-14.1	-6.7	-4.4	-6.1
Current Account Balance (excluding grants)	-8.7	-6.5	-7.9	-8.2	-8.0	-9.1	-10.2	-13.0	-15.1	-7.5	-5.4	-6.8
Total grants	3.3	3.8	4.1	3.8	10.4	2.4	26.1	4.6	2.7	3.0	3.2	2.2
Capital and financial account (excluding grants)	5.3	2.4	7.1	5.5	-0.6	4.3	-15.4	9.6	10.6	6.9	3.0	4.9
Private flows	3.9	2.1	4.8	4.5	3.7	2.3	5.8	7.5	7.1	1.7	0.5	-2.7
Official flows	1.4	0.3	2.3	1.1	-4.3	2.0	-20.9	2.1	3.6	5.2	2.5	6.0
Errors and omissions	-0.5	2.3	-0.4	4.2	-1.2	-0.3	1.1	-0.3	0.0	-1.2	0.9	0.1
Overall balance	-0.6	1.9	2.8	5.4	0.6	-2.6	1.6	0.9	-1.8	1.3	1.7	-1.0

Source: Senegalese authorities and IMF staff calculations

2. **Despite a favorable enabling environment for exports, Senegal's export sector has not gained market share.** Senegal's share of world exports has been relatively flat over the past decade (Figure 1). This outcome is somewhat surprising considering that Senegal enjoys a strategic geographic position and a relatively competitive framework for exports, including the absence of taxes on exports and low shipping costs.[1]

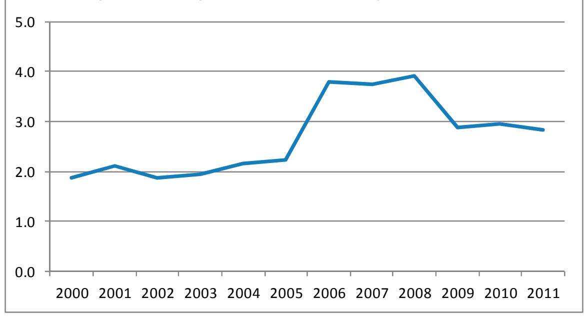
Figure 1: Senegal's export performance and exchange rate (index 1994=100)



[1] Senegal's best score in the 2013 Doing Business report is in the "Trading Across Borders" category, which measures the time and cost of exporting and importing a standardized cargo of goods. Senegal ranked 67 out of 185 countries in this category.

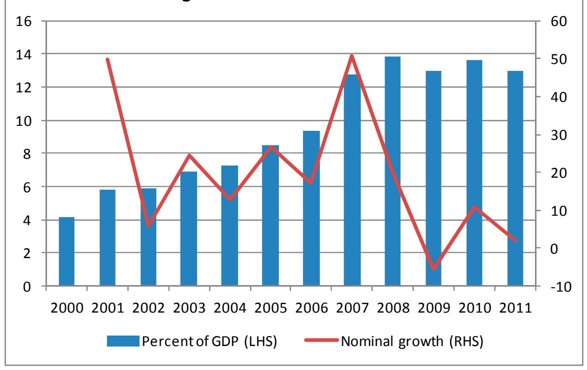
3. Foreign direct investment in Senegal has increased somewhat in recent years, but remains low compared to comparator Sub-Saharan African countries. Inward FDI averaged about 2 ercent of GDP from 2000-2005 before spiking in 2006 (Figure 2). For the last three years, FDI has averaged about 3 percent of GDP, compared to over 7 percent of GDP on average in other lower-middle-income Sub-Saharan African (LWI SSA) countries, as classified by the World Bank.[2]

Figure 2: Foreign Direct Investment (percent of GDP)



4. Workers' remittances are an important and relatively stable source of foreign exchange. Remittances have grown every year since 2000, with the exception of 2009, when they fell 6 percent following the onset of the global financial crisis (Figure 3). In 2011, remittances were equal to 13 percent of GDP, equal to nearly half of exports of goods and services and more than four times FDI inflows.

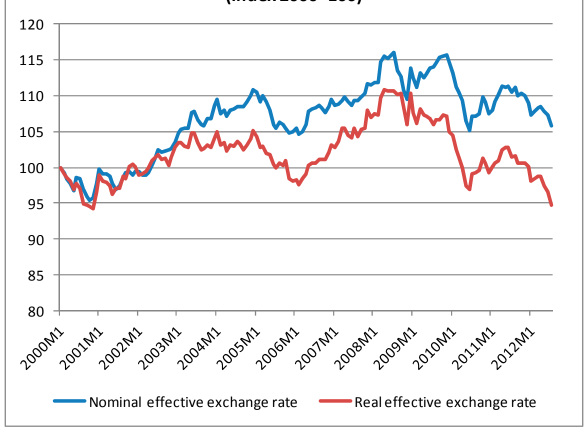
Figure 3: Workers' Remittances



EXCHANGE RATE

5. The real exchange rate has depreciated 6½ percent over the last year, reaching its lowest level in over a decade. Both the real and nominal effective exchange rates (REER and NEER) appreciated about 10 percent from 2006 to 2009, contributing to an erosion of price competitiveness. During the first half of 2010, however, the REER and NEER fell sharply due to weakness of the euro. Following a brief period of appreciation, the weakening trend has resumed over the past year.

Figure 4: Real and Nominal Effective Exchange Rates (Index 2000=100)



6. The real exchange rate is broadly in line with Senegal's macroeconomic fundamentals. The REER was assessed using three complementary methodologies developed by the Consultative Group on Exchange Rates (CGER). The results,

Table 2: Real Effective Exchange Rate Assessment

Methodology	REER misalignment[1]
Macroeconomic balance	
Lee et al. (2008)	-1.2%
Vitek (2012)	0.0%
Equilibrium real exchange rate	-8.5%
External sustainability	3.2%

[1] "-" signifies undervaluation.

[2] Other lower-middle-income Sub-Saharan African cou
Cote d'Ivoire, Ghana, Lesotho, Nigeria, Sao Tome and

summarized in Table 2, show no conclusive evidence that the real exchange rate is overvalued or undervalued. This finding is consistent with the exchange rate assessment made for the WAEMU as a whole in 2012.

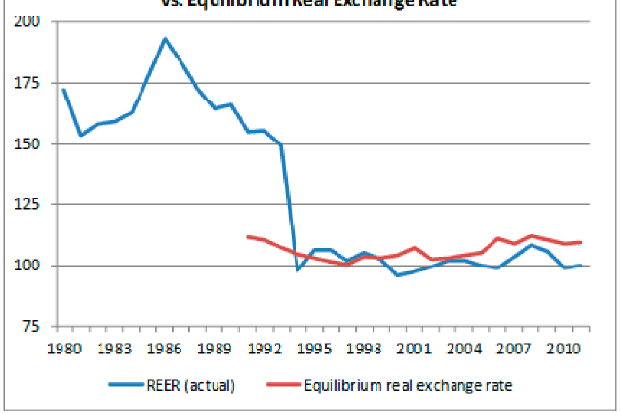
Macroeconomic balance approach

7. **The macroeconomic balance approach calculates the difference between the current account balance projected over the medium term (the "underlying" current account) and an estimated current account "norm" based on projected values of medium-term economic fundamentals.** The exchange rate adjustment that would eliminate this difference over the medium term is then calculated using an estimated elasticity of the current account with respect to the real exchange rate. Senegal's current account norm is calculated to be between -5.6 and -6.5 percent of GDP, based on coefficients estimated by Vitek (2012) and Lee et al. (2008) (Table 3). Assuming a trade balance elasticity of -0.71 for small countries, the difference between the underlying current account and the current account norm indicates an REER misalignment between -1.2 percent and 0.0 percent.[3]

Equilibrium real exchange rate approach

8. **The equilibrium real exchange rate approach directly estimates an equilibrium exchange rate as a function of medium-term fundamentals.** The exchange rate adjustment needed to restore equilibrium over the medium term is then calculated as the difference between the estimated equilibrium real exchange rate and its current value. In the case of Senegal, the REER at end-2011 was 8.5 percent below its estimated equilibrium value (Figure 5).

Figure 5: Real Effective Exchange Rate vs. Equilibrium Real Exchange Rate



External sustainability approach

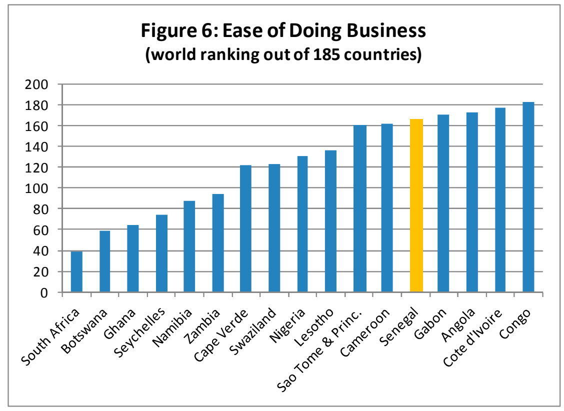
9. **The external sustainability approach calculates the difference between the underlying current account balance and the balance that would stabilize net foreign assets (NFA) at some benchmark level.** Using the same elasticity as in the macroeconomic balance approach, the exchange rate misalignment is equal to the adjustment necessary to bring the underlying current account in line with its NFA-stabilizing level. The current account balance necessary to stabilize Senegal's NFA-to-GDP ratio at its 2010 level (-48 percent) is estimated to be -3.4 percent compared to an underlying current account of 6.0 percent. Applying a trade balance elasticity of -0.71 implies a 3.2 percent REER overvaluation.

[3] See Tokarick, *A Method for Calculating Export Supply and Import Demand Elasticities*, 2009.

STRUCTURAL COMPETITIVENESS

10. Senegal's competitiveness depends critically on improving the business environment. Although Senegal has taken steps in recent years to improve the business environment, a number of competitiveness indicators suggest that much more needs to be done. According to various surveys, the business environment is notably hampered by poor investor protection, cumbersome procedures for paying taxes and registering property, inadequate supply of infrastructure, difficulty accessing financing, and corruption.

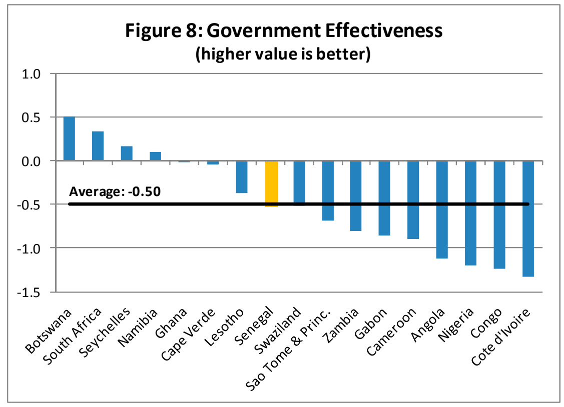
- In the 2013 edition of the World Bank's Doing Business report, Senegal ranks 166 out of 185 countries. Its worst ranking (180) is in the getting electricity category. Other categories where Senegal scores poorly include paying taxes (178), registering property (173), and protecting investors (169). Senegal ranks below most other lower- and upper-middle-income Sub-Saharan countries (Figure 6).

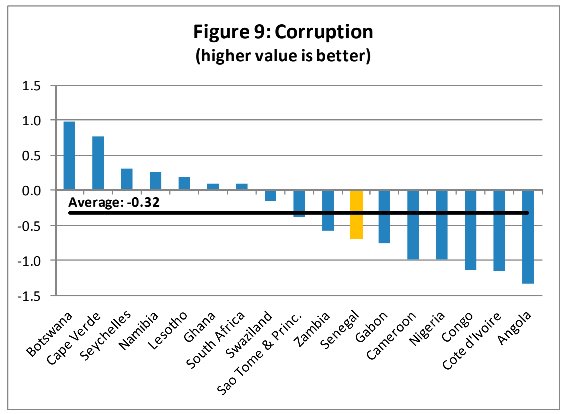


- The World Economic Forum ranks Senegal 111 out of 142 countries in its 2011-2012 Global Competitiveness Report (Figure 7). Weaknesses identified by the report include infrastructure (122), health and primary education (119), and higher education and training (110). The highest rankings are for business sophistication (86) and innovation (53).

Senegal's government effectiveness, as measured by the World Bank's Governance Indicators, is slightly below average compared to lower- and upper-middle-income Sub-Saharan countries and has been trending downward over the past decade (Figure 8).

- By several measures, corruption remains a problem. The World Economic Forum identifies corruption as the second most problematic factor for doing business in Senegal. Transparency International ranks Senegal 112 out of 182 countries in it 2011 Corruption Perception Index. Based on the World Bank's Governance Indicators, corruption in Senegal is worse than average compared to lower- and upper-middle-income Sub-Saharan countries (Figure 9).





RESERVE ADEQUACY

11. Foreign exchange reserve coverage appears adequate by traditional metrics. Reserves are pooled among WAEMU countries, and therefore reserve adequacy must be assessed at the regional level. Reserves amounted to CFAF 7,445 billion at end-2011, equal to more than 6 months of imports, 60 percent of broad money, and close to 100 percent of short-term domestic liabilities. Moreover, the peg to the euro is guaranteed by the French Treasury—an important factor that mitigates risk.

External Position Assessment Matrix

Current account	**Background**. The domestic saving rate is low, while investment needs are high. Despite large remittances, this generates high current account deficits, which are covered to a large extent by aid. The deficit has increased significantly in the past two years, reflecting a number of exogenous factors (e.g., oil prices, drought) and higher fiscal deficits. **Assessment**. The current account deficit needs to decrease in the next few years to remain financeable and reduce dependency on aid, which may be reduced with fiscal consolidation in advanced economies; fiscal consolidation will play an important role to achieve this.	**Overall assessment.** The external position has weakened recently, and is weaker than desirable, even though risks appear manageable at this juncture. Low savings relative to substantial investment needs imply substantial current account deficits. External liabilities are significant and growing. **Potential policy responses** Fiscal consolidation and prudent borrowing should help reduce external vulnerabilities. The real exchange rate is in line with fundamentals, but structural reforms would boost growth, increase competitiveness, and reduce further external vulnerabilities.
Real exchange rate	**Background**. Senegal is part of the WAEMU. The CFA franc is pegged to the euro, which depreciated significantly in recent months. **Assessment**. The three CGER methods do not suggest a significant misalignment (with results based on end-2011 data ranging from -8 to +4 percent). These findings are in line with those for the WAEMU. While the level of the real exchange rate is not an issue, competitiveness could increase through structural reforms to improve the business environment	
Capital account: flows and measures	**Background**. Official flows (both program and project) have accounted for a significant share of financing in recent years. FDI and portfolio investment are less significant. The overall balance of payments recorded a deficit last year, and is expected to record another one this year. **Assessment**. The sustainability of capital account flows depends mainly on donor and market sentiment toward Senegal's government, which depends on forceful fiscal consolidation and implementation of structural reforms to boost growth.	
Foreign exchange intervention and reserves	**Background**. At the WAEMU level reserves amount to over 6 months of imports, 60 percent of broad money, and 100 percent of short-term debt. Common reserves can be used to finance the needs of individual WAEMU countries. **Assessment**. The level of foreign exchange reserves of the WAEMU is adequate.	
Foreign asset and liability position	**Background**. Gross external debt is relatively low (at 30 percent of GDP) but has increased substantially in the past few years. It consists mainly of concessional loans from official creditors. **Assessment**. The net IIP position at -30 percent of GDP in 2012 currently presents limited risk, but the DSA shows that fiscal consolidation is required to stabilize it.	

ANNEX VI. LETTER OF INTENT

Dakar, Senegal

November 22, 2012

Mrs. Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C., 20431
USA

Madame Managing Director,

1. The attached Memorandum of Economic and Financial Policies (MEFP) reviews the implementation at end-June 2012 of the government's three-year macroeconomic and structural program (2010–2013) supported under the Policy Support Instrument (PSI). The memorandum also sets out the macroeconomic objectives for the remainder of 2012 and for 2013 and updates the structural reforms monitored under the program.

2. The government is satisfied with progress made in the implementation of the program and requests completion of the fourth review. All of the program's quantitative assessment criteria for end-June 2012 have been met. As a result of efforts to control public spending, the fiscal deficit at end-June 2012 was met by a substantial margin. All the structural benchmarks were met, although some of them needed more time than expected. Significant progress has also been made in implementing structural reforms.

3. The government is strongly committed to pursuing its efforts to control public spending with aim of reducing the fiscal deficit to levels consistent with debt sustainability. In this context, and taking into account recent fiscal developments, we are targeting a fiscal deficit of below 6 percent of GDP in 2012 and suggest modifying the relevant assessment criterion accordingly. The budget proposal submitted to Parliament for 2013 sets the deficit at 4.9 percent of GDP. The efforts to control the fiscal deficit will be pursued over the medium term. Reconciling this objective with the development needs of the country will require greater efficiency in public spending, a major undertaking we fully embrace.

4. More generally, reforms will be pursued to improve transparency, public governance and promote private sector development. In this context, the government proposes to reprogram the structural benchmark on action plan for the restructuring of government agencies from end-2012 to end-July 2013.

5. The government believes that the policies and measures set forth in the attached MEFP are appropriate to achieve the objectives of the PSI-supported program. Given its commitment to macroeconomic stability and debt sustainability, the government will promptly take any additional measures needed to achieve the objectives of the program. The government will consult with the IMF—at its own initiative or whenever the Managing Director of the IMF requests such a consultation—before the adoption of any such measures or in the event of changes to the policies contained in the attached MEFP. Moreover, the government will provide the IMF with such information as the IMF may request in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program.

6. The government authorizes the IMF to publish this letter, the attached MEFP, and the Staff Report relating to the current review.

Sincerely yours,

/s/
Amadou Kane
Minister of Economy and Finance

Attachments: - Memorandum of Economic and Financial Policies (MEFP)
- Technical Memorandum of Understanding (TMU)

ATTACHMENT I: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

Dakar, November 22, 2012

I. INTRODUCTION

1. **The government is pleased to have met its commitments in challenging circumstances and remains determined to pursue the program objectives.** The government has: (i) provided support for the rural environment, affected by the consequences of a poor crop year 2011/2012; (ii) worked to reduce prices for essential food staples (rice, oil, and sugar); (iii) taken steps to reduce the cost of running the government and streamline public expenditure; and (iv) continued the reforms in the energy sector. Furthermore, the government is pressing ahead with implementation of the program supported by the Policy Support Instrument (PSI) and broadly shares its objectives.

2. **This memorandum updates the PSI program over the period 2012–13.**[1] The four main objectives of the program are as follows: (i) conduct a cautious policy in the area of public finance and borrowing to preserve macroeconomic stability; (ii) raise revenue to generate more fiscal space to finance priority spending; (iii) further strengthen PFM and governance; and (iv) promote private sector development through structural reforms. The MEFP includes three sections. The first covers recent economic developments and program performance. The second section focuses on macroeconomic objectives for the remainder of 2012, 2013, and the medium term, as well as macroeconomic policy and structural reforms. The final section summarizes proposed changes in program monitoring.

II. RECENT ECONOMIC DEVELOPMENTS AND PROGRAM IMPLEMENTATION

Recent macroeconomic developments have been broadly in line with program assumptions. The year 2012 was characterized by a challenging pre-election environment in the country, sluggish economic activity in the first quarter exacerbated by sociopolitical tensions in Mali and Guinea-Bissau, social demands resulting from the poor harvest, and high prices for essential food items. However, economic activity in the non-agricultural sector, as measured by the general activity index, recorded an upturn of 2.3 percent year-on- year during the first half of 2012. Overall, the projected increase in real GDP in 2012 was revised slightly downward, from 3.9 percent to 3.7 percent, after 2.6 percent in 2011. Inflation turned out at 1.5 percent over the first six months of 2012, driven by rising prices of nonalcoholic beverages and foodstuffs, in particular unprocessed cereals. External merchandise trade was characterized over the first half of the year by a substantial increase in imports (approximately 34 percent, mainly foodstuffs and petroleum products), as well as by a slight downturn in exports. Credit to the economy grew sharply over one year (almost 17 percent), while the money supply expanded by just 5 percent.

[1] The content of this program was set out in the initial MEFP of November 10, 2010, and in the MEFPs of May 19, 2011, December 2, 2011, and June 22, 2012.

3. Program implementation has been satisfactory. All quantitative assessment criteria and indicative targets for the program at end-June 2012 were met, including the target for the budget deficit owing to efforts to curb government expenditure. The implementation of all structural reforms is also making significant headway:

(i) An action plan on subsidies for electricity consumers was prepared and adopted in October 2012;

(ii) An operational and financial restructuring plan for SENELEC was prepared and adopted in November 2012 with a view to its immediate implementation;

(iii) A medium-term debt management strategy was prepared and finalized by September 30, 2012;

(iv) The new general tax code was finalized and submitted to parliament in November 2012;

(v) The draft law on transparency was adopted at a meeting of the Council of Ministers and submitted to parliament, and the decree on the transposition of the WAEMU directive on budget nomenclature has been signed.

4. The government has continued its efforts to reduce the cost of running the government and streamline public institutions; the abolition of the upper chamber of parliament (the Senate) reflects this policy and illustrates our commitment to reform.

III. MACROECONOMIC POLICY AND STRUCTURAL REFORMS FOR THE REMAINDER OF 2012, 2013, AND THE MEDIUM TERM

A. Medium-term Objectives

5. Senegal's development strategy is designed to ensure that Senegal becomes an emerging economy, committed to the values of solidarity and self-respect, respect for others and the commonwealth, justice, fairness, and a sense of duty. The new National Strategy for Economic and Social Development (NSESD) was completed in November 2012.

B. Macroeconomic Context for 2013

6. Unfortunately, the external environment is expected to remain not very supportive. Despite the modest upturn in the global economy expected in 2013, high oil and cereal prices, as well as social and political tensions within the subregion (in Mali and Guinea-Bissau), will continue to have an adverse effect on economic activity, external accounts, and public finances in Senegal.

7. Notwithstanding the sluggish international environment, GDP growth is expected to tick up to 4.3 percent in 2013. This upturn would be supported primarily by the coming on-stream of major projects in the electricity, road and highway sectors, the improvement of electric power distribution, the continued recovery of the agricultural sector, the implementation of the Grande Côte heavy ores project (zircon) and the Golouma and Massawa gold mine projects, the launching of projects funded by the Millennium Challenge Account (MCA), as well as the execution of projects in the social sectors. Inflation is expected to remain moderate at around 2 percent in 2013. The current account deficit of the balance of payments, although declining, is expected to remain high because of imports related to investment in the energy and mining sectors. The overall balance of the balance of payments is expected to record a slight deficit.

8. The risks remain mainly on the downside. A resurgence of the euro zone crisis and global stagnation are primary downside risks for the Senegalese economy. Other downside risks are rising oil prices, food security (rising international prices of cereals and the threat of locusts), as well as spreading instability from Mali. Domestically, the main risks are related to flooding driven by poor sanitation, delays in implementation of energy sector reforms, and possible resistance to government reform or to improvements in the quality of public expenditure, which could adversely affect the objective of keeping public finances under control.

9. The progress recorded and new challenges in implementing the main measures under the program are presented in the remainder of this section, grouped in accordance with the four main objectives of the program.

C. Pursue Prudent Public Finance and Debt Policies to Safeguard Macroeconomic Stability

10. The objective of controlling the budget deficit for 2012 remains unchanged. This is a key commitment for the new government, which intends to proceed along the lines set during the third program review, in spite of challenging circumstances. Recent developments in international oil prices point to smaller than anticipated revenue losses associated with the stabilization of domestic oil prices; we intend to earmark these savings for reducing the budget deficit. Delays in implementation of certain investments in the energy sector partly explain why the deficit will be lower than the target of 6.4 percent of GDP. This reduction in the deficit will also make it possible to reduce reliance on borrowing in the regional market, which is quite costly.

11. Substantial efforts to reduce the cost of running the government are in progress. The commitment to reducing the cost of running the government is reflected in a smaller cabinet, the abolition of agencies, and the streamlining of diplomatic services. Additional savings are expected from the abolition of the Senate and the office of the Vice-President. For permanent expenditures, all mobile telephone lines—apart from certain lines used by the defense, security, and justice services—were suspended on May 1, 2012, with new subscriptions established on a case-by-case basis involving restrictions on the number of beneficiaries and usage ceilings. A physical audit of landlines, conducted by the General Inspectorate of Finance, is in progress. The hundred largest water consumers in government have been identified and monitored closely with a view to achieving significant savings in the central government's water bill. Efforts to enhance the accuracy of records have also been made and strengthened for water and electricity, and focal points for the monitoring of permanent expenditures have been appointed by ministers.

12. These efforts will continue in 2013 and will contribute to the reduction of the budget deficit. In accordance with the commitments undertaken by the new government to ensure fiscal sustainability, the budget deficit will be reduced to less than 5 percent of GDP in 2013. As indicated in the general policy statement of the Prime Minister to the National Assembly, the government intends to carry out its actions from a medium-term perspective and to conduct a budget policy designed to meet the country's development needs, while limiting the increase in public debt. Reconciling these objectives will require greater efficiency in public expenditure.

13. In the context of efforts to streamline government expenditure and gain long-term control over the budget deficit, several actions have been carried out, and others are planned, in particular:

- **In the education sector**, a performance-based university financing project designed to improve management in higher education is currently being finalized. Of the five performance contracts envisaged between the government and universities, three have already been signed and two others will be signed shortly. Specific actions have been identified—in particular, the approval of a financial framework for universities, the proposal for which has already been prepared, as well as efforts to achieve budgetary equilibrium for universities based on information derived from planned audits of their resources, expenditures, and procedures. The flows of extrabudgetary resources generated by universities and their management will undergo more effective regulatory supervision. These rationalization efforts will continue with support from the World Bank, and their findings are expected by end-December 2012. Temporarily, with respect to scholarships and education allowances, negotiations are in progress—on the basis of actions already identified—with a view to ensuring that the relevant budget outlays can be kept within manageable bounds during the period 2013–2014. The more extensive access to banking services has already allowed for more effective management of data on scholarship holders. On the basis of the findings of the scholarship audit planned with World Bank financing, discussions are in progress to identify measures to rationalize the distribution of scholarships, as well as to monitor and supervise them.
- In the **health sector**, efforts to improve the efficiency of hospitals will be supported by the gradual introduction and more widespread use of performance contracts between these autonomous public entities, the health ministry, and the finance ministry by end-2014. Grand Yoff General Hospital will be the priority for the year 2012.
- **A physical and biometric audit of government employees is in progress and will be completed by end-June 2013**. The wage bill should be automatically integrated into SIGFIP upon the effective implementation of the new payroll management software, scheduled for end-August 2013, after a period of a parallel use with the existing system.

14. Work is in progress to extend the social safety net, guarantee a minimum income for the most vulnerable families, and phase out generalized subsidies for energy and food prices. Results achieved in foreign countries, such as Brazil, show that it is possible to target the most vulnerable and disadvantaged groups of population on the basis of simple criteria. Senegal's own experience, acquired in conjunction with the World Bank, focused on the 2008 implementation of the Nutrition Enhancement Program (NEP), followed by the introduction of the project for "rapid intervention for nutritional security and money transfers or NETS)". The government will accordingly create a viable and sustainable mechanism to support the most disadvantaged families; this mechanism's feasibility will have been proven in advance. Allowances will be granted to such families in the form of a direct food subsidy and/or a family subsidy allowance. The targeting process will pay particularly close attention to rural and suburban households. With the decrease in household taxation, this mechanism will help to reduce gradually generalized subsidies for the prices of energy and food products, which constitute ineffective and more costly methods of supporting communities. At the same time, a mechanism for extending the social protection system—specifically, health insurance—will be established for informal sector workers. The Autonomous Fund for Universal Social Protection, to be implemented as of 2013, will help finance this initiative, as well as the Universal Health Coverage initiative.

15. The initial medium-term debt strategy (MTDS) was recently prepared by the new public debt directorate, in collaboration with the full range of entities involved in debt issues. On the basis of an in-depth diagnostic assessment, the strategy recommends reprofiling the debt, while gradually reducing the proportion of short-term instruments in domestic debt. The government intends to pursue this course of action carefully, based on regional market circumstances. Reliance on concessional borrowing will have priority, in accordance with the recommendations set forth in the borrowing strategy. However, in light of financing constraints, the government intends in 2013 to use the remainder of the program envelope for nonconcessional borrowing ($200 million), as well as the envelope for semiconcessional borrowing, to finance infrastructure investment. The debt database will be completely centralized by end-2012.

D. Raise Revenue to Create More Fiscal Space for Financing Priority Spending

16. The new tax code has been submitted to Parliament and is expected to enter into force on January 1, 2013. Tax reforms have been carried out transparently in a fully participatory approach. This inclusive approach began with requests for input, culminating in recent calls for comment on the provisional version of the draft of the new code; private sector and labor union representatives contributed to the technical work. As a result of these reforms, Senegal will have a tax system that is more simple, more equitable, and more efficient. A more favorable general regime will be put in place instead of the existing system, including inter alia a substantial rollback of tax exemption regimes, almost all of which will be incorporated into the new framework. With respect to the VAT, the new code is designed to make the system more neutral and more efficient. There are also plans to phase out the prepayment system in accordance with a three-step timetable; as of January 1, 2013 for taxpayers enrolled in the large enterprises center (CGE), as of January 1, 2014 for taxpayers listed at the medium enterprises center (CME), and as of January 1, 2014 for those taxpayers covered by other tax service centers. At the same time, the system for refunding VAT credits is being reformed in order to enhance its flexibility (shorter processing times for "citizen" enterprises, those engaging primarily in exports or those carrying out externally-funded contracts or other agreements), and their practical details (refund by check or bank transfer). Finally, the taxation system for individuals will be reformed and simplified.

17. Implementation of the tax administration modernization plan is continuing and is being regularly monitored by the General Directorate of Taxes and Government Property (DGID). The CME became operational in July 2012. Further structural reforms will be introduced, with the reorganization of the field offices of the DGID in order to institutionalize the distinction between functional and operational directorates (interregional directorates). A steering committee has been set up to put these measures into practice, and the DGID is on track to create the planned services in December 2012. Furthermore, computerization of the DGID will gather momentum inasmuch as e-filing and e-payment will be in operation at the future large enterprises directorate in June 2013, at other Dakar centers in December 2013, and in regions outside Dakar by December 2014.

18. The General Directorate of Customs (DGD) is continuing to implement the reforms included in the 2011-2013 Strategic Plan and defined in the form of commitments in the performance contract signed with the Ministry of Economy and Finance (see the MEFP of June 22, 2012). Cooperation between the DGID and DGD has been strengthened, with the August 29, 2012 signing of a memorandum of understanding on exchange of information which complements the obligation, already in effect, to use NINEA (national registration number for enterprises and associations) in customs operations. In the context of efforts to improve the DGD's contribution to domestic budget resources, an action plan for the mobilization, collection, and support of customs revenues generated by current imports has been implemented. This plan focuses inter alia on collection of suspended VAT, compliance with the periods of time which goods are stored in bonded warehouses, and the control of economic regimes. Furthermore, in the context of efforts to streamline tax expenditures, the proposed reform Decree 83–504 of May 17, 1983 on the conditions for applying duty-free entry has made progress and has been incorporated into the reform of the Customs Code, whose technical finalization is scheduled for December 2012 and which is expected to be submitted to parliament by end-June 2013 (new structural benchmark). On this point, the procedure joint with the DGID included in the General Tax Code is expected to result in a reduction of the revenue losses associated with exemptions.

E. Strengthen Public Financial Management and Governance

19. Senegal has made considerable progress in transposing the new WAEMU directives on government finance. The process is expected to be completed by end-December 2012 with the adoption of the draft law related to the code of transparency in fiscal management. An order adopted by the Prime Minister, announced in Decree 2012–673 of July 4, 2012 establishing government budget nomenclature, will set forth the annex pertaining to ministries' programs and allocations for constitutional institutions. To initiate the entry into force of the new regulatory framework resulting from this transposition, prior actions will include a learning period during which certain operations will be performed on a test basis with no legal impact, while assessing the complex innovations to precisely identify the various required changes to ensure a successful outcome. Accordingly, in 2013, in addition to the official documents associated with the budget law for the year, the authorities, in the interest of guidance and learning, will develop draft program budgets and multiyear expenditure programming documents for the ministries in charge of ecology and justice, as well as a 2013–2015 Multiyear Budgetary and Economic Programming Paper. The proposed World Bank project in support of fiscal reforms has already taken into account the need for the main studies, and included them among its activities scheduled for 2012. These include: (i) the diagnostic assessment of the institutional and legal changes arising from the new WAEMU directives on government finance; (ii) studies on the feasibility of decentralizing the expenditure authorization process and the evolving role played by supervision over government financial operations; (iii) communication and outreach efforts relating to the new public management and its implications for policymakers; (iv) training for financial and sectoral authorities, and nonstate actors regarding the strengthening of citizen control of public affairs; and (v) customization of IT applications in the areas of budget management (SIGFIP) and accounting (ASTER).

20. Efforts to improve PFM are continuing in other areas. With respect to the certification of public accounts, the draft budget execution law for 2011 will be submitted to the National Assembly during the first regular session that began in October 2012. With regard to the delays encountered in the review of the budget execution statements of public accountants, the Audit Court will address the delays dating back to 2002. The Audit Court will also ensure that executing agencies and other similar entities governed by the rules and regulations on public accounting regularly file their financial statements, or will be subject to applicable penalties. Finally, the government has submitted to the National Assembly the new draft organic law on the Audit Court.

21. Significant progress has been recorded in supervising the financial management of agencies. Transfers were centralized in 2011 with deposit accounts opened on the books of the Public Treasury. A financial and accounting framework has been set up, government accounting officers have been appointed, and the provision of subsidies is contingent on quarterly cash-flow plans; efforts in these areas will continue. In regard to the rationalization of agencies and other government entities, the assessment commission started it activities by conducting, at the first stage, a comprehensive survey of agencies and similar entities. On that basis, an initial decision to abolish 8 agencies was taken in 2012 and is currently being carried out. The sector will be streamlined more thoroughly on the basis of the recommendations made in the in-depth assessment study conducted by the national commission with assistance from the World Bank. As the launch was somewhat delayed, the study may not be completed until June 2013, when it will be shared with Fund staff. The government's action plan will be adopted by end-July 2013. In order to achieve immediate reductions in agency operating costs, the government intends to cap the remuneration of general directors. The financial supervision and governance of the parastatal sector by the Ministry of Economy and Finance will be strengthened.

22. The process of enhancing transparency in real estate transactions and advertising sales and transfers of holdings of the government's land is continuing. By end-January 2013, the government will publish on a website accessible for the public all information relating to the number of files involving final property sales and transfers from government holdings, indicating the land areas sold, the geographic location of the land, and the corresponding revenue received. The restructuring of the real estate holdings is already under way after a thorough diagnostic assessment, and will lead to the creation of the Directorate of Land and Government Property Affairs as of December 2012. The Urban Property Management Support Project *(PAGEF)* is primarily designed to computerize government property management. The DGID (i) is to embark upon and correctly carry out the comprehensive real estate management computerization process. Accordingly, an action plan will be put in place and implemented beginning in January 2013; (ii) it will record and track all government property revenues in SIGTAS as of June 2013; (iii) it will conduct an inventory of government property, with a view to preparing the general table of government property holdings to achieve greater transparency, by December 2013.

23. Cost-benefit analysis will be used more systematically in the draft budget law for 2014. The evaluation guide is currently being prepared, and will start to be used in early 2013. All investment projects exceeding CFAF 10 billion to be included in the draft budget for 2014 will undergo ex ante cost-benefit assessment using the guide. These assessments will be shared with Fund staff upon request.

24. The implementation of the single treasury account is continuing, despite certain difficulties. Only six banks responded to the circular from the Ministry of Economy and Finance requesting information on bank accounts. The following resolutions have been adopted to gather the necessary information and comply with the commitment to finalize the Single Treasury Account in February 2013: (i) ensure that accounting personnel at agencies transmit information on bank accounts to which they have access; (ii) make direct contact with the management of banks, with assistance from the Directorate of Money and Credit. A report on the status of implementation will be produced by the Parastatal Sector Directorate by end-November 2012

F. Private Sector Development

Energy sector

25. Execution of investments under the emergency plan for restructuring and reviving the energy sector has been delayed. Because of this the introduction of more efficient units that are intended to replace the leased units has also been delayed. The component pertaining to aggressive demand management has likewise fallen behind schedule. Nonetheless, implementation of the updated investment plan is continuing with the power plant rehabilitation program, and envisages installing more efficient heavy fuel power plants, accelerating the coal-fired power station projects (375 MW between 2014 and 2017), and introducing natural gas and renewable sources of energy (solar and wind power plants) into the energy mix.

26. A plan for the operational and financial restructuring of SENELEC has been prepared. On the basis of the financial evaluation of SENELEC, prepared on the basis of provisional financial statements for 2011, a financial restructuring plan has been adopted. The plan first envisages strengthening equity, in particular through the settlement of cross-debts (and conversion of net debt into equity) involving SENELEC, the government, and the Deposits and Consignations Fund, in addition to registering in accounts investments made by the government as investment subsidies. Efforts will be made to obtain debt relief for SENELEC, including through rescheduling negotiations with creditors and suppliers. With respect to operational restructuring, the performance indicators used to achieve sustainable increases in operation are the optimization of the various power plants, reduction of grid losses, reduction of operating costs, efforts to combat fraud, improvements in billing, and reduction of payment delays. In addition, a 2013–2015 performance contract between the government and SENELEC based on this restructuring plan is currently being finalized and is scheduled to take effect as of January 1, 2013.

27. The government's short-term objective is to ensure the quality of electricity supply while limiting subsidies that weigh heavily on public finances and impede efforts to finance other priority actions. The government intends to limit the electricity consumption subsidy to CFAF 80 billion in 2013. At current international oil prices, capping this subsidy will assume savings of approximately CFAF 45 billion which will require not only considerable efforts to control costs of the SENELEC, but will also make it necessary to revise the electricity tariff. Accordingly, tariff adjustments are under consideration for certain categories of consumers, while having in mind the need to protect low-income households and safeguard the competitiveness of the economy. In the medium term, the introduction of more efficient production units will make it possible to lower costs, which will be beneficial for all consumers.

Financial sector

28. The financial system has continued to deepen in recent years with no major negative impact on the system's stability. Micro-finance institutions (decentralized financial systems) have improved access to financial services for households and SMEs. The microfinance sector, which has developed very rapidly, has undergone in-depth restructuring in recent years. Capacity constraints and weak supervisory mechanisms at certain decentralized financial systems, as well as the high degree of market concentration, call for careful monitoring by supervisors. Banks are increasingly diversifying their customer base by offering more affordable basic services to the middle class and to SMEs, as a result of the entry of new banks and heightened competition on the market. This development poses no risk for bank stability at present. The main risk for banks is that their portfolios are concentrated among a handful of borrowers, including the government. Certain risks emanating from the growing interconnection of financial institutions (banks and insurance, banks and decentralized financial systems) should be evaluated, and strengthened surveillance may be required.

29. Most impediments to greater financial deepening have been clearly identified. In particular, these constraints include the legal environment, as well as the problems pertaining to information on the operating risks facing SMEs, which have been explicitly recognized in the national dialogue on SME access to credit. The ensuing action plan has focused on facilitating the use of collateral, the need to enhance the availability of information on customers, while lowering certain taxes to reduce the cost of credit, and improving the legal environment to streamline disputes. The implementation of the plan has been delayed, in spite of a number of important achievements such as the adoption of the law on leasing. The constraints identified at the national level are being monitored by the National Committee in charge of the action plan. Assessment of all the recommendations pertaining to banking regulation and, if necessary, their implementation may be accelerated by the WAMU authorities.

30. Reforms in the financial sector will be accelerated to deepen further the financial sector and facilitate access to the financial sector by SMEs and households.

- *Implementation of a regulatory framework conducive to the creation of private credit registers*. The preferred course of action is a regional approach based on the work already begun by Senegal. The BCEAO will prepare a WAEMU-wide draft text to regulate the activities of credit bureaus.
- *Development of financial leasing*. The new general tax code will correct the tax distortions adversely affecting leasing activity in Senegal.
- *Diversification of financial products*. After the reform of financial leasing, the government will pursue its policy of diversifying financing instruments by promoting alternative products, particularly factoring. In this respect, there are plans to conduct a study to identify and overcome all of the obstacles impeding the development of factoring in Senegal.

Other Prerequisites for Improving the Business Climate, Governance, and Competitiveness

31. Stronger growth will require increased private sector competitiveness and further improvement of the business climate. Numerous reforms have been introduced in recent years but have not yet been fully implemented. Efforts will accordingly be made to educate and train the relevant authorities. The simplification of administrative procedures will continue. Emphasis will be placed on: (i) lowering production costs, and in particular on ensuring easier and more affordable access to land; (ii) reforms focusing on the status of the "entrepreneur" specified by the new OHADA Uniform Act, entailing gradual reforms of the informal sector and the emergence of a range of SMEs engaged in the production of goods and services; and (iii) the computerization of the construction permit procedure or TELEDAC in an effort to achieve simplified and more transparent procedures in this area, along with faster processing times. Quantitative targets will be set on the basis of the indicators included in the Doing Business survey, with a view to boosting the score in the years ahead.

III. PROGRAM MONITORING

32. The budget trends described above led to the downward revision of the budget deficit target for 2012 (from 6.4 percent to 5.9 percent of GDP) and we suggest modifying the relevant assessment criterion accordingly. Quantitative assessment criteria for end-June 2013 and indicative targets for end-March 2013, end-September 2013, and end-December 2013 have been proposed. The same applies to the structural benchmarks shown in Table 2 of the MEFP. It is proposed to reschedule the benchmark on the action plan for agency restructuring from end-2012 to end-July 2013. It is proposed to broaden the scope of investment expenditures which could be financed through nonconcessional borrowing to road infrastructure (not only the highway) and urban water and sanitation. The fifth review of the PSI should normally be completed by end-June 2013 and the sixth review by end-December 2013.

Table 1. Quantitative Assessment Criteria and Indicative Targets for 2011–12 [1]

(CFAF billions, unless otherwise specified)

	December 31, 2011			March 31, 2012			June 30, 2012				September 30, 2012			Dec. 31, 2012
	Prog.	Act.	Status	Prog.	Act.	Status	Prog.	Adj.	Act.	Status	Prog.	Prel.	Status	Rev. prog.
Assessment criteria														
Floor on the overall fiscal balance [2] [3]	-427	-455	not met	*-102*	*-70*	met	-213	-181	-102	met	*347*			-425
Ceiling on the contracting or guaranteeing of new nonconcessional external debt by the government (in US$ millions) [4]	500	300	met	500	300	met	500	…	300	met	500			500
Ceiling on spending undertaken outside normal and simplified procedures [4]	0	0	met	0	0	met	0	…	0	met	0			0
Ceiling on government external payment arrears (stock) [4]	0	0	met	*0*	*0*	met	0	…	0	met	*0*			0
Ceiling on the amount of the budgetary float	50	50	met	*50*	*49*	met	50	…	40	met	*50*	*51*	not met	50
Ceiling on nonconcessional debt with a minimum grant element of 15 percent [4]	44	0	met	44	0	met	44	…	0	met	44			44
Indicative targets														
Quarterly ceiling on the share of the value of public sector contracts signed by single tender (percent)	*20*	*16*	met	*20*	*14*	met	*20*	…	*11*	met	*20*			*20*
Floor on social expenditure (percent of total spending)	*35*	*37*	met	…	…	met	*35*	…	*35*	met	…			*35*
Maximum upward adjustment of the overall deficit ceiling due to														
Shortfall in program grants relative to program projections	15	…	…	15	…	…	15	…	-6	…	15			15
Shortfall in concessional loans relative to program projections	50	…	…	50	…	…	50	…	-11	…	50			50
Shortfall in energy sector and autoroute investment relative to program projections	50	…	…	50	…	…	50	…	-27	…	50			50
Memorandum items:														
Program grants	37	37	…	9	…	…	19	…	13	…	28			48
Concessional loans	210	175	…	52	…	…	105	…	94	…	157			328
Investment in the energy sector and the autoroute [5]	66	66	…	*44*	…	…	60	…	*33*	…	*122*			120

[1] Indicative targets for March and September 2012, except for the assessment criteria monitored on a continuous basis. See Technical Memorandum of Understanding for definitions. Indicative targets shown in italics.

[2] Cumulative since the beginning of the year.

[3] The ceiling on the overall fiscal deficit will to be adjusted in line with the TMU definition.

[4] Monitored on a continuous basis.

[5] Investment in the autoroute plus investment under the plan Takkal financed from internal and external concessional resources.

Table 2. Quantitative Assessment Criteria and Indicative Targets for 2012–13 [1]

(CFAF billions, unless otherwise specified)

	December 31, 2012	March 31, 2013	June 30, 2013	September 30, 2013	December 31, 2013
	Prog.	Prog.	Prog.	Proj.	Proj.
Assessment criteria					
Floor on the overall fiscal balance [2] [3]	-425	*-94*	-188	*-283*	-377
Ceiling on the contracting or guaranteeing of new nonconcessional external debt by the government (in US$ millions) [4]	500	500	500	500	500
Ceiling on spending undertaken outside normal and simplified procedures [4]	0	0	0	0	0
Ceiling on government external payment arrears (stock) [4]	0	*0*	0	*0*	0
Ceiling on the amount of the budgetary float	50	*50*	50	*50*	50
Ceiling on nonconcessional debt with a minimum grant element of 15 percent [4]	44	44	44	44	44
Indicative targets					
Quarterly ceiling on the share of the value of public sector contracts signed by single tender (percent)	20	*20*	*20*	*20*	*20*
Floor on social expenditures (percent of total spending)	35	…	*35*	…	*35*
Maximum upward adjustment of the overall deficit ceiling owing to					
Shortfall in program grants relative to program projections	15	15	15	15	15
Excess in concessional loans relative to program projections	50	50	50	50	50
Excess in energy sector and autoroute investment relative to program projections	50	50	50	50	50
Memorandum items:					
Program grants	48	12	24	36	39
Concessional loans	328	82	164	246	254

[1] Indicative targets for March and September, except for the assessment criteria monitored on a continuous basis. See Technical Memorandum of Understanding for definitions. Indicative targets shown in italics.

[2] Cumulative since the beginning of the year.

[3] The ceiling on the overall fiscal deficit will to be adjusted in line with the TMU definition.

[4] Monitored on a continuous basis.

MEFP Table 3: Structural Benchmarks, 2011-2013

Measures	MEFP§	Implementation date	Benchmark for review	Macroeconomic significance	Status
INCREASE TAX REVENUE, IMPROVE THE QUALITY OF EXPENDITURE AND DEBT MANAGEMENT					
Operationalize the new public debt directorate		January 15, 2012	3rd	Improve debt management	Met
Prepare a medium-term debt strategy		September 30, 2012	4th	Improve debt management	Met
Finalize the new general tax code and submit it to parliament		September 30, 2012	4th	Increase government revenue and encourage private sector development	Met with delay in November 2012
Prepare evaluation guide for investment projects	24	December 31, 2012	5th	Improve quality of public expenditure	In progress
Submit the new customs code to parliament	19	June 30, 2013	5th	Increase government revenue and encourage private sector development	New
CONSOLIDATE PROGRESS IN PUBLIC FINANCIAL MANAGEMENT					
Make use of the national registration number for businesses and associations (NINEA) mandatory for customs operations		January 1, 2012	3rd	Modernize tax administration	Met
Launch and complete a comprehensive survey of agencies and their missions		January 31, 2012	3rd	Strengthen public financial management	Met
Adoption by the Council of Ministers of the draft law transposing the directive on the transparency code		June 30, 2012	3rd	Strengthen public financial management	Met
Produce a plan for restructuring all agencies and comparable entities	19	December 31, 2012	5th	Strengthen public financial management	In progress. Reprogrammed to end-July 2013

Finalize the Single Treasury Account	25	February 28, 2013	5th	Strengthen public financial management	In progress
Publish information on transactions pertaining to the government's private property holdings	23	December 31, 2012	5th	Strengthen public financial management	New
Roll out the new payroll management software	14	August 31, 2013	6th	Strengthen public financial management	New
Use cost-benefit assessment for investment projects exceeding CFAF 10 billion to be included in the budget for 2014	24	July 31, 2013	6th	Improve efficiency of government expenditure	New
PROMOTE PRIVATE SECTOR DEVELOPMENT BY IMPROVING THE BUSINESS CLIMATE, STRENGTHENING GOVERNANCE, AND ENHANCING EFFICIENCY OF THE FINANCIAL AND ENERGY SECTORS					
Publish complete information on: (i) the Energy Sector Support Fund (FSE); (ii) projects; (iii) status of planning and execution; (iv) financing details and updated costs of works; and (v) the position of the escrow account, on a monthly basis within two weeks following the end of the month, on a specialized website of the government		July 31, 2011	3rd	Improve the transparency of infrastructure-related investments	Continuous
Finalize a study to analyze the resources allocated to the microfinance sector and their impact, with a view to rationalizing these resources		January 31, 2012	3rd	Streamline the support for the microfinance sector	Met
Adopt an action plan on subsidies to electricity consumers		August 31, 2012	4th	Energy sector development	Met with delay in October 2012
Implement e-filing and e-payment for taxes for large enterprises	18	June 30, 2013	6th	Enhance the efficiency of public policy and improve the business climate	New

ATTACHMENT II: TECHNICAL MEMORANDUM OF UNDERSTANDING

Dakar, November 22, 2012

1. This technical memorandum of understanding (TMU) defines the quantitative assessment criteria, indicative targets, and structural benchmarks on the basis of which the implementation of the Fund-supported program under the Policy Support Instrument (PSI) will be monitored in 2011–2013. The TMU also establishes the terms and time frame for transmitting the data that will enable Fund staff to monitor program implementation.

I. PROGRAM CONDITIONALITY

2. The quantitative assessment criteria for end-December 2012, end-June 2013 and the quantitative targets for end-September 2012 and for end-March, end-September, and end-December 2013, are shown in Tables 1 and 2 of the MEFP, respectively. The prior actions and structural benchmarks established under the program are presented in Table 3.

II. DEFINITIONS, ADJUSTERS, AND DATA REPORTING

A. The Government

3. Unless otherwise indicated, "government" means the central administration of the Republic of Senegal and does not include any local administration, the central bank, or any other public or government-owned entity with autonomous legal personality not included in the government flow-of-funds table (TOFE).

B. Overall Fiscal Balance (Program Definition)

Definition

4. The overall fiscal balance including grants (program definition) is the difference between the government's total revenue (revenue and grants) and total expenditure and net lending. The operations of the Energy Sector Support Fund (FSE) are integrated in the government flow-of-funds table (TOFE). The revenues exclude privatization receipts and sales of mobile phone licenses or of any other state-owned assets. Government expenditure is defined on the basis of payment orders accepted by the Treasury (dépenses ordonnancées prises en charge par le Trésor) and expenditures executed with external resources. This assessment criterion is set as a floor on the overall fiscal balance including grants as of the beginning of the year.

Example

5. The floor on the overall fiscal balance including grants (program definition) as of December 31, 2012, is minus CFAF 425.4 billion. It is calculated as the difference between total government revenue (CFAF 1,723.2 billion) and total expenditure and net lending (CFAF 2,148.7 billion).

Adjustment

6. The overall fiscal balance including grants is adjusted downward by the amount that budget grants fall short of program projections up to a maximum of CFAF 15 billion at current exchange rates (see MEFP Tables 1and 2).

7. The overall fiscal balance including grants is adjusted downward/upward by the amount that concessional loans exceed/fall short of their programmed amount, up to a maximum of CFAF 50 billion at current exchange rates (see MEFP, Tables 1 and 2). For the purposes of this assessment criterion, concessional loans denominated in CFAF and in foreign currency are taken into account.

Reporting requirements

8. During the program period, the authorities will report provisional data on the overall fiscal balance (program definition) and its components monthly to Fund staff with a lag of no more than 30 days. Data on revenues and expenditure that are included in the calculation of the overall fiscal balance, and on expenditure financed with HIPC- and MDRI- related resources, will be drawn from preliminary Treasury account balances. Final data will be provided as soon as the final balances of the Treasury accounts are available, but not later than two months after the reporting of the provisional data.

C. Social Expenditure

Definition

9. Social spending is defined as spending on health, education, the environment, the judicial system, social safety nets, sanitation, and rural water supply. This criterion is set as a floor in percent relative to total spending (including the FSE) excluding capital expenditure related to the extension of the autoroute and the investment projects of the power sector reform plan.

Reporting requirements

10. The authorities will report semiannual data to Fund staff within two months following the end of each period.

D. Budgetary Float

Definition

11. The budgetary float (instances de paiement) is defined as the outstanding stock of government expenditure for which bills have been received and validated but not yet paid by the Treasury (the difference between dépenses liquidées and dépenses payées). The assessment criterion is set as a ceiling on the budgetary float, monitored at the end of the quarter.

Reporting requirements

12. The authorities will transmit to Fund staff on a weekly basis (i.e., at the end of each week), and at the end of each month, a table from the expenditure tracking system (SIGFIP) showing all committed expenditures (dépenses engagées), all certified expenditures that have not yet been cleared for payment (dépenses liquidées non encore ordonnancées), all payment orders (dépenses ordonnancées), all payment orders accepted by the Treasury (dépenses prises en charge par le Trésor), and all payments made by the Treasury (dépenses payées). The SIGFIP table will exclude delegations for regions and embassies. The SIGFIP table will also list any payments that do not have a cash impact on the Treasury accounts.

E. Spending Undertaken Outside Simplified and Normal Procedures

13. This assessment criterion is applied on a continuous basis to any procedure other than the normal and simplified procedures to execute spending. It excludes only spending undertaken on the basis of a supplemental appropriation order (décret d'avance) in cases of absolute urgency and need in the national interest, in application of Article 12 of the Organic Budget Law. Such spending requires the signatures of the President of the Republic and Prime Minister.

14. The authorities will report any such procedure, together with the SIGFIP table defined in paragraph 12, to Fund staff on a monthly basis with a maximum delay of 30 days.

F. Government External Payments Arrears

Definition

15. External payments arrears are defined as the sum of payments owed and not paid on the external debt contracted or guaranteed by the government. The definition of external debt given in paragraph 18 is applicable here. The assessment criterion on external payments arrears will be monitored on a continuous basis.

Reporting requirements

16. The authorities will promptly report any accumulation of external payments arrears to Fund staff.

G. Contracting or Guaranteeing of New Nonconcessional External Debt by the Government

17. Definition of debt. For the purposes of the relevant assessment criteria, the definition of debt is set out in Executive Board Decision No.6230-(79/140), Point 9, as revised on August 31, 2009 (Decision No. 14416-(09/91)).

a) The term "debt" will be understood to mean a direct, i.e., non-contingent, liability created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, according to a given repayment schedule; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

   i. loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

   ii. suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

   iii. leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

b) Under the definition of debt above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

18. **Debt guarantees**. For the purposes of the relevant assessment criteria, the guarantee of a debt arises from any explicit legal obligation of the government to service a debt in the event of nonpayment by the debtor (involving payments in cash or in kind).

19. **Debt concessionality**. For the purposes of the relevant assessment criteria, a debt is considered concessional if it includes a grant element of at least 35 percent;1 the grant element is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt.2 The discount rates used for this purpose are the currency-specific commercial interest reference rates (CIRRs), published by OECD.3 For debt with a maturity of at least 15 years, the ten-year-average CIRR is used to calculate the PV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR is used. The margins for differing repayment periods (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more) are added to the ten-year and six-month CIRR averages.

20. **External debt.** For the purposes of the relevant assessment criteria, external debt is defined as debt borrowed or serviced in a currency other than the CFA franc. This definition also applies to debt among WAEMU countries.

21. **Debt-related assessment criteria.** The relevant assessment criteria apply to the contracting and guaranteeing of new nonconcessional external debt by the government, local governments, SENELEC, the Energy Sector Support Fund (FSE), and any other public or government-owned entity. The criteria apply to debt and commitments contracted or guaranteed for which value has not yet been received. The criteria also apply to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the government. The assessment criteria are measured on a cumulative basis from the time of approval of the PSI by the Executive Board. ACs will be monitored on a continuous basis. No adjuster will be applied to these criteria.

22. **Special provisions**:

a) The assessment criteria do not apply to: (i) debt rescheduling transactions of debt existing at the time of the approval of the PSI; (ii) debt contracted by the airport project company (AIBD) to finance construction of the new Dakar Airport; and (iii) short-term external debt (maturity of less than one year) contracted by SENELEC to finance the purchase of petroleum products.

b) A total ceiling of US$500 million applies over the period 2011–13 for nonconcessional external debt financing to be used for investment projects discussed with

[1] The following reference on the IMF website creates a link to a tool that allows for the calculation of the grant element of a broad range of financing packages: http://www.imf.org/external/np/pdr/conc/calculator.

[2] The calculation of concessionality will take into account all aspects of the debt agreement, including maturity, grace period, payment schedule, upfront commissions, and management fees.

[3] For debts in foreign currencies for which the OECD does not calculate a CIRR, calculation of the grant element should be based on the composite CIRR (weighted average) of the currencies in the SDR basket.

Fund staff in road infrastructure, the energy sector, and urban water and sanitation. The nonconcessional funds obtained in this way will be deposited in a special account. The authorities will report regularly to Fund staff on the balance of this account and the use of funds. Following the issuance of a US$500 million Eurobond in May 2011, with an exchange offer for the outstanding 2009 Eurobond, the remaining ceiling for non-concessional borrowing for 2011–13 is US$ 200 million (equivalent to the amount of the 2009 bonds actually redeemed or exchanged in 2011).

c) A separate ceiling equivalent to CFAF 44 billion in 2011–13 applies for untied nonconcessional external debt financing with a grant element of at least 15 percent. Projects financed in this way would be expected to meet the same economic and social profitability criteria as other capital spending. The government will inform Fund staff in a timely manner before contracting any debt of this type and will provide sufficient information ahead of time to verify the degree of concessionality. It will also provide a brief summary of the projects to be financed and their profitability, including an evaluation by the lender or the government. The government will report the use of funds and project implementation in subsequent MEFPs.

Reporting requirements

23. The government will report any new external borrowing and its terms to Fund staff as soon as external debt is contracted or guaranteed by the government, but no later than within two weeks of such external debt being contracted or guaranteed.

H. Public Sector Contracts Signed by Single Tender

Definition

24. Public sector contracts are administrative contracts, drawn up and entered into by the government or any entity subject to the procurement code, for the procurement of supplies, delivery of services, or execution of work. Public sector contracts are considered "single-tender" contracts when the contracting agent signs the contract with the chosen contractor without competitive tender. The quarterly indicative target will apply to total public sector contracts entered into by the government or any entity subject to the procurement code. The ceiling on contracts executed by single tender will exclude fuel purchases by SENELEC for electricity production. This exclusion reflects new regulation, which requires SENELEC to buy fuel directly from SAR based on the existing price structure.

Reporting requirements

25. The government will report quarterly to Fund staff, with a lag of no more than one month from the end of the observation period, the total value of public sector contracts and the total value of all single-tender public sector contracts.

III. ADDITIONAL INFORMATION FOR PROGRAM MONITORING

26. The authorities will transmit the following to Fund staff, in electronic format if possible, with the maximum time lags indicated:

(a) 3 days after adoption: any decision, circular, edict, supplemental appropriation order, ordinance, or law having economic or financial implications for the current program. This includes in particular all acts that change budget allocations included in the budget law being executed (for instance: supplemental appropriation orders (*décrets d'avance*), cancellation of budget appropriations (*arrêtés d'annulation de crédit budgétaires*) and orders or decisions creating supplemental budget appropriations (*décrets ou arrêtés d'ouverture de crédit budgétaire supplémentaire*).

(b) With a maximum lag of 30 days, preliminary data on:

Tax receipts and tax and customs assessments by categories, accompanied by the corresponding revenue on a monthly basis;

The monthly amount of expenditures committed, certified, and for which payment orders have been issued;

The monthly situation of checks issued by agencies from their deposit accounts at the Treasury but not paid to beneficiaries, with the dates of issuance of the checks.

The quarterly report of the Debt and Investments Directorate (DDI) on the execution of investment programs;

The monthly preliminary government financial operations table (TOFE) based on the Treasury accounts;

The provisional monthly balance of the Treasury accounts; and

Reconciliation tables between the SIGFIP table and the consolidated Treasury accounts, between the consolidated Treasury accounts and the TOFE for "budgetary revenues," between the consolidated Treasury accounts and the TOFE for "total expenditure and net lending," and between the TOFE and the net government position (NGP), on a quarterly basis.

(c) Final data will be provided as soon as the final balances of the Treasury accounts are available, but not later than one month after the reporting of provisional data.

27. During the program period, the authorities will transmit to Fund staff provisional data on current nonwage noninterest expenditures and domestically financed capital expenditures executed through cash advances on a monthly basis with a lag of no more than 30 days. The data will be

drawn from preliminary consolidated Treasury account balances. Final data will be provided as soon as the final balances of the Treasury accounts are available, but no more than one month after the reporting of provisional data.

28. The central bank will transmit to Fund staff:

The monthly balance sheet of the central bank, with a maximum lag of one month;

The consolidated monthly balance sheet of banks with a maximum lag of two months;

The monetary survey, on a monthly basis, with a maximum lag of two months;

The lending and deposit interest rates of commercial banks, on a monthly basis; and

Prudential supervision and financial soundness indicators for bank financial institutions, as reported in the Table entitled *Situation des Etablissements de Crédit vis-à-vis du Dispositif Prudentiel* (Survey of Credit Institution Compliance with the Prudential Framework), on a quarterly basis, within a maximum delay of two months.

29. The government will update on a monthly basis on the website established for this purpose the following information:

a) Preliminary TOFE and transition tables with the delay of 2 months.

b) SIGFIP execution table, the table for the central government and a summary table including regions, with the delay of 2 weeks

c) The amount of the airport tax collected, deposited in the escrow account, and used for the repayment of the loan financing the construction of the new airport, with the delay of 1 month.

d) Full information on: (i) the operations of Energy Sector Support Fund (FSE); (ii) investment projects in the power sector; (iii) planning and execution of these projects; (iv) details of financing and updated costs; and (v) the balance of the escrow account with the resources of the Eurobond issued in 2011 allocated to the Takkal project (within 3 weeks).

e) Full information on: (i) the status of the projects related to the extension of the autoroute to Diamniadio, AIDB, Mbour and Thies; (ii) costs of the projects and their updates; (iii) financing and cost of financing linked to the projects; (iv) the balance of the escrow account with the resources of the Eurobond issued in 2011 and allocated to the extension of the autoroute (with the delay of 3 weeks).

INTERNATIONAL MONETARY FUND

SENEGAL

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION, FOURTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT, AND REQUEST FOR MODIFICATION OF AN ASSESSMENT CRITERION—DEBT SUSTAINABILITY ANALYSIS

November 26, 2012

Approved By
Roger Nord and Peter Allum (IMF) and Marcelo Giugale and Jeffrey Lewis (World Bank)

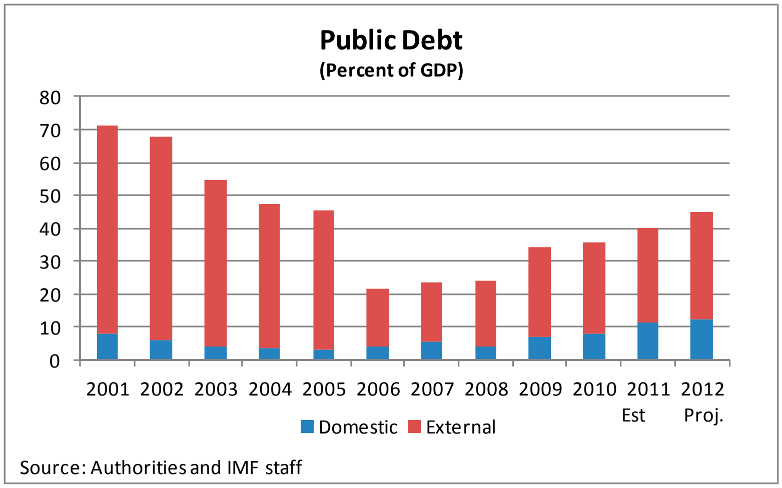
Prepared by the staffs of the International Monetary Fund and the International Development Association

Since the last debt sustainability analysis (DSA) was published in May 2011, Senegal's debt outlook has deteriorated. Growth in 2012 was slower than expected, due to the drought in the Sahel, and fiscal consolidation has been somewhat less than expected, reflecting the impact of exogenous shocks, the higher cost of electricity subsidies, and measures taken by the authorities to stabilize petroleum product prices. On balance, Senegal continues to face a low risk of debt distress, but risks have increased. Overall, the analysis highlights the importance of reducing fiscal deficits, improving debt management, approaching nonconcessional borrowing with caution, and further developing domestic debt markets.[1]

[1] The DSA presented in this document is based on the Debt Sustainability Framework (DSF) for low-income countries (LICs). See "Debt Sustainability in Low-Income Countries—Proposal for an Operational Framework and Policy Implications" and "Debt Sustainability in Low-Income Countries—Further Considerations on an Operational Framework and Policy Implications."

BACKGROUND

1. Senegal's public debt has increased steadily in recent years.[2] The ratio of public debt to GDP is projected to reach 46 percent in 2012, close to levels that prevailed when Senegal benefited from debt relief under the Multilateral Debt Relief Initiative (MDRI) in 2006. The bulk of public debt is external (i.e., owed to non-residents of the West African Economic and Monetary Union, WAEMU), although the share of domestic debt has increased.[3]



2. Most of Senegal's public external debt is on concessional terms. Two-thirds of the debt is owed to multilateral creditors—primarily the World Bank, the IMF, and the African Development Bank. The largest bilateral creditors are France, Kuwait, China, Saudi Arabia, and India.

Total External Debt, Central Government

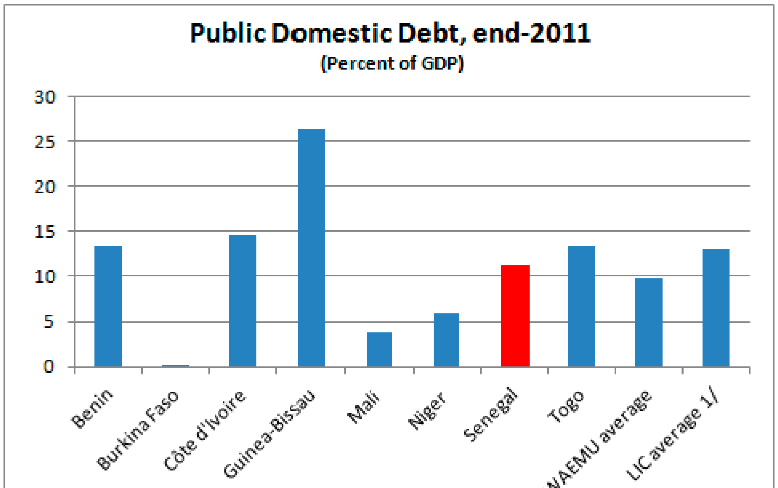
	2008	2009	2010	2011	2011
	(Percent of GDP)				(Share)
Total	19.6	26.9	27.5	28.8	100.0
Multilateral creditors	12.0	17.5	18.2	18.5	64.2
IDA/BIRD	7.0	8.0	8.0	8.8	30.5
AfDB/AfDF	1.5	2.2	2.5	2.8	9.9
IMF	0.5	1.8	3.0	1.5	5.3
OFID/BADEA/IsDB	1.7	3.2	2.8	2.8	9.7
European Investment Bank	0.2	0.3	0.3	0.3	0.9
Other	1.2	2.0	1.8	2.3	7.9
Bilateral creditors	7.6	7.9	7.6	6.6	23.0
OECD countries	2.2	2.8	2.7	2.1	7.3
Arab countries	4.1	3.8	2.8	2.2	7.7
Other	1.2	1.4	2.2	2.3	8.0
Commercial creditors	0.0	1.5	1.6	3.7	12.8
Memorandum Item					
Nominal GDP (CFAF billion)	5994	6029	6369	6818	

Source: Senegalese authorities

[2] Public debt refers to debt of the central government.

[3] Domestic debt includes debt issued in the WAEMU financial market.

3. **Public domestic debt remains relatively low but has grown quickly in recent years.** At end-2011, domestic debt was equal to 11 percent of GDP, slightly above the average in WAEMU countries but below the average across all low-income countries. Domestic debt is denominated in local currency and mostly held by WAEMU banks. Domestic debt as a share of total public debt has increased from 7 percent in 2005 to 28 percent in 2011, reflecting the development of the WAEMU market and external debt relief.



Source: IMF staff
1/ LIC average is based on end-2010 data

4. **Senegal has started relying on nonconcessional borrowing to finance infrastructure projects.** In December 2009, the government issued its first Eurobond. The 5-year, US$200 million bond had a coupon of 8.75 percent and was priced to yield 9.25 percent. The proceeds of the issuance helped finance the Dakar-Diamniadio toll road. In May 2011, the government issued a 10-year, US$500 million Eurobond, with a coupon of 8.75 percent and priced to yield 9.125 percent. Of the US$500 million raised, US$200 million was used to retire the 2009 Eurobond; the remainder has been earmarked for the toll road and for investments in the energy sector.

5. **Private sector exposure is relatively limited, and contingent liabilities contained.** Private external debt has averaged about 20 percent of GDP over the last decade and was equal to 24 percent of GDP at end-2010.[4] Half of this debt was in the form of trade credits and bank deposits; the rest consisted of debt securities, loans, and other liabilities. This exposure was partially offset by private external assets amounting to 8 percent of GDP. Preliminary estimates of contingent liabilities suggest that they amount to less than 10 percent of GDP.[5] There are no explicit government guarantees of enterprises' external and internal debt since the settlement of the ICS chemical company crisis in 2007.

6. **The authorities have taken steps to improve debt management.** A new public debt directorate has been created by combining the two units that had previously managed domestic debt and external debt separately. The new directorate recently prepared Senegal's first medium-term debt strategy, which recommends extending the maturity of debt issued on the regional market and continuing to prioritize concessional external borrowing.

[4] Estimates of private sector external debt are based on BCEAO data on the international investment position.

[5] The fiscal risk posed by these entities is approximated by the standardized stress test that simulates a 10-percent-of-GDP increase in other debt creating flows.

UNDERLYING ASSUMPTIONS

7. **This DSA is consistent with the macroeconomic framework outlined in the staff report for the Fourth Review under the Policy Support Instrument.** The baseline scenario assumes the implementation of sound macroeconomic and structural policies, leading to an increase in economic growth and a narrowing of fiscal deficits over the long term (Box 1). Notable revisions compared to the May 2011 DSA include:

- Real GDP growth is expected to be a bit lower over the next few years and the long term compared to previous projections, partly owing to a less favorable external environment.
- The 2012 fiscal deficit has been revised upward, in line with the program. Projected fiscal deficits over the medium and long term are somewhat lower compared to the previous DSA, to be more in line with the authorities' commitment to meet the key WAEMU convergence criterion on the fiscal deficit.[6]
- The current account deficit in 2012 is expected to be smaller than previously projected following a better-than-expected outturn in 2011. Long-term current account deficit projections have been revised lower in line with the downward revision to long-run fiscal deficits.

Evolution of selected macroeconomic indicators

	2010	2011	2012	2013	2014	Long term 1/
Real GDP growth						
Current DSA	4.1	2.6	3.7	4.3	4.8	5.3
Previous DSA	4.2	4.5	4.8	5.0	5.2	5.8
Overall fiscal deficit (percent of GDP)						
Current DSA	5.2	6.7	5.9	4.9	4.3	2.7
Previous DSA	5.2	6.9	5.6	4.6	4.4	3.7
Current account deficit (percent of GDP)						
Current DSA	4.4	6.1	7.6	7.1	6.7	5.3
Previous DSA	5.9	8.2	8.0	7.5	7.4	7.1

1/ Defined as the last 15 years of the projection period. For the current DSA, the long term covers the years 2018-2032; for the previous DSA, it covers 2017-2031.

[6] The convergence criterion calls for the basic fiscal balance, in percent of GDP, to be greater than or equal to zero. Senegal's basic fiscal balance is assumed to move from a deficit of 3.0 percent of GDP in 2012 to a deficit of 0.5 percent by the end of the projection period. (The basic fiscal balance is defined as total revenue, plus budget support grants, plus the counterpart of HIPC/MDRI-related spending, minus current expenditures and domestically-financed capital expenditure.)

Box 1. Macroeconomic Assumptions for 2012–2031

Real GDP growth: After a substantial slowdown in 2011 because of the drought in the Sahel, real GDP growth is expected to rebound to 3.7 percent in 2012, driven by higher public investment in infrastructure and a recovery in agricultural production. Growth is expected to accelerate over the next few years, reaching 5.2 percent by 2017, as the authorities implement their structural reform agenda, including further investments in the energy sector, comprehensive tax reform, and improvements to the business climate and governance. In the long term, the resolution of energy sector problems is expected to eliminate a major constraint on growth. Real GDP growth is projected to average 5.2 over 2017–2031, compared to an average of 5.1 percent in the five years prior to the outbreak of the global financing crisis.

Public investment: The authorities are expected to maintain public investment at relatively high levels, with the ratio of public capital expenditure to GDP projected to reach 12.1 percent in 2012 before gradually declining to 11.2 percent by the end of the projection period. This compares to levels between 6 and 11 percent over the past decade.

Current account deficit: The current account deficit is projected to widen in 2012 as a result of higher imports of food (related to last year's drought, which led to a poor harvest) and weak export demand (linked to the crisis in Mali). Over the medium and long term, the current account deficit is expected to narrow in line with anticipated fiscal consolidation.

Inflation: Inflation is expected to remain moderate at about 2.5 percent.

Fiscal deficit: The fiscal deficit in 2012 is expected to fall to 5.9 percent of GDP, mostly due to delays in energy investments. In line with the program's objective to reduce the fiscal deficit to maintain debt sustainability, the authorities are targeting a deficit of 4.9 percent of GDP in 2013. Over the medium and long term, the fiscal deficit is projected to narrow gradually to 2.8 percent, reflecting the authorities' commitment to deliver fiscal consolidation consistent with the WAEMU convergence criterion on the basic fiscal balance.

Financing: The authorities are expected to rely increasingly on external nonconcessional borrowing to finance infrastructure projects. In 2013, the authorities are assumed to use the remaining space ($200 million) for nonconcessional borrowing in the program. Thereafter, Senegal is expected to borrow 0.5 percent of GDP per year on nonconcessional terms. The net US$500 million in nonconcessional borrowing in 2011 and 2013 are assumed to be rolled over at maturity. Over the period 2012–2014, the authorities are expected to contract CFAF 42 billion (about US$79 million) in external debt with a grant element between 15 and 35 percent, consistent with the program. The average grant element of new external borrowing is projected to fall from 30 percent to 9 percent over the projection period, as Senegal gradually moves away from concessional borrowing, mainly from multilateral creditors, toward nonconcessional borrowing from bilateral and commercial creditors. Meanwhile, the share of domestic financing is expected to gradually increase over the long term as the WAEMU market develops.

8. Another change compared to the previous DSA is the value of the discount rate in the DSA template used to calculate the present value (PV) of external debt. The discount rate, which follows the long-term U.S. dollar commercial interest reference rate (CIRR), was recently adjusted from 4.0 percent to 3.0 percent.[7] Holding other variables steady, a change in the discount rate from 4 percent to 3 percent raises the present value of debt.

9. Stress tests lead to breaches of three thresholds (Figure 1a, Table 1a, and Table 1b). Three debt burden indicators—the PV of debt to GDP, the PV of debt to exports, and debt service to revenue—breach their indicative thresholds under certain standardized stress tests. Under current DSA guidelines, such breaches could be interpreted to suggest that Senegal's risk of debt distress has increased from low to moderate. The breach of the debt-to-GDP threshold is relatively minor (less than 2 percentage points) but protracted, and occurs under a stress test simulating a one-time 30-percent depreciation of the exchange rate.[8] The debt-to-exports threshold is breached by a wider margin in a scenario where borrowing terms are less favorable than under the baseline scenario, which underscores the importance of approaching further nonconcessional borrowing with caution. The debt service-to-revenue threshold is breached by a very small margin in 2021 under the one-time 30-percent depreciation shock. Under the historical scenario, in which key variables are projected to remain fixed at their 10-year historical average, the PV of debt to GDP and the PV of debt to exports approach, but do not breach, their respective thresholds. The more favorable outcome under the baseline scenario compared to the historical scenario reflects projected improvements in real GDP growth and the current account deficit, as discussed above.

10. Taking remittances into consideration, however, a more favorable assessment emerges. Debt burden indicators remain well below their thresholds in the baseline scenario, while stress tests lead to minor breaches of two thresholds (Figure 1b and Table 3b).[9] The inclusion of remittances in the analysis is justified by the fact that remittances have become an important and reliable source of foreign exchange in Senegal, a pattern that is expected to continue. Remittances have grown every year since 2000, with the exception of 2009, when they fell 6 percent. In 2011, remittances were equal to 13 percent of GDP. The PV of debt to GDP plus remittances peaks at 37 percent, compared to a threshold of 36 percent, under a one-time 30-percent depreciation of the exchange rate, while the ratio of debt service to revenue (which is not affected by remittances) once again breaches its threshold by a very small margin in 2021 under the one-time 30-percent depreciation shock. The PV of debt to exports plus remittances approaches, but does not breach, the threshold in the historical scenario.

[7] The rules of the DSF require the discount rate to be changed when the U.S. dollar CIRR (six-month average) diverges from the discount rate by at least 100 basis points for a continuous period of at least six months. When this occurs, the magnitude of the change in the discount rate is required to be 100 basis points. See "A Review of Some Aspects of the Low-Income Country Debt Sustainability Framework."

[8] The exchange rate shock is arguably overstated in the case of Senegal in light of the peg to the euro, which is guaranteed by the French Treasury. At end-2011, 8 percent of Senegal's public external debt stock was denominated in euro, and another 42 percent was denominated in SDR (which is partially linked to the euro).

[9] The previous DSA did not discuss remittances, since the low risk rating was justified even without including remittances.

PUBLIC DSA

11. Indicators of overall public debt (external plus domestic) and debt service do not point to significant vulnerabilities related to the level of domestic debt (Figure 2 and Table 2a). In the baseline scenario, the PV of total public debt to GDP and the PV of total public debt to revenue remain relatively flat over the projection period, despite the fact that the share of domestic debt is projected to increase over time as the WAEMU market develops. The PV of public debt to GDP peaks at 42 percent, well below the benchmark level of 56 percent associated with heightened public debt vulnerabilities for medium performers. The short average maturity of domestic debt (slightly over one year) is, however, a source of vulnerability, as it exposes the government to significant rollover and interest rate risks. In 2013, public debt service is expected to spike, owing mainly to a sharp increase in amortization payments on domestic debt.

12. Stress tests, however, indicate that the path of public debt would become explosive in the absence of fiscal consolidation (Table 2b). In a scenario that assumes an unchanged primary deficit (as a percent of GDP) over the entire projection period, starting with the level projected in 2012, the PV of public debt to GDP grows rapidly, breaching the 56 percent benchmark level in 2021. The benchmark level is also breached in the "historical" scenario (holding real GDP growth and the primary deficit constant at their historical levels) and in a growth shock scenario. These stress tests, which produce similar results for the PV of public debt-to-revenue indicator, highlight the importance of reducing fiscal deficits and raising potential output growth.

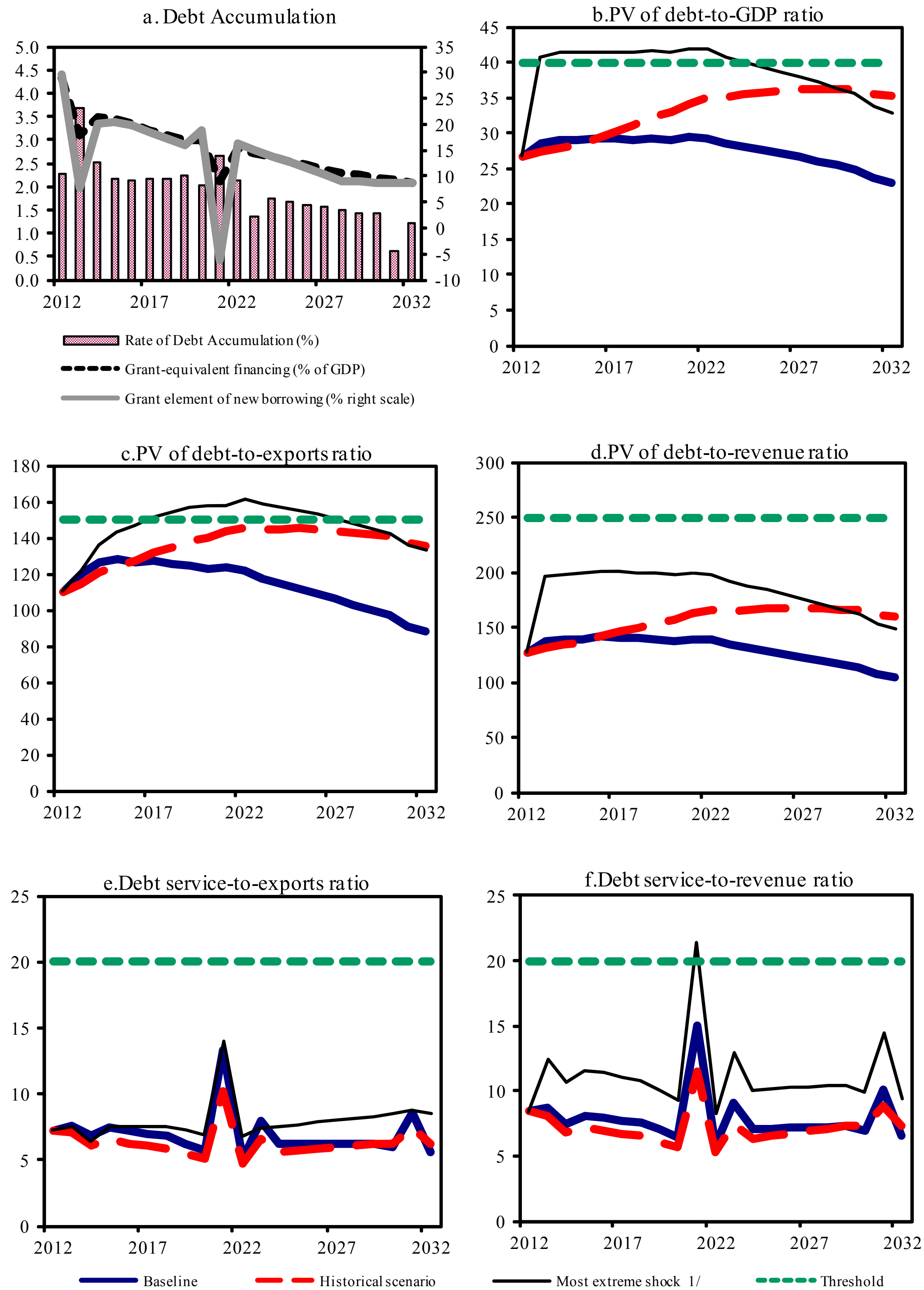
CONCLUSION

13. In staff's view, Senegal continues to face a low risk of debt distress. Stress tests in the external DSA result in breaches of three thresholds, but the inclusion of remittances produces a better picture, with only marginal breaches. This justifies keeping a low risk rating for now under the assumption of fiscal consolidation and strengthened debt management.

14. Vulnerabilities have increased over recent years, and new risks have emerged. Since Senegal benefited from comprehensive debt relief under HIPC and MDRI, public debt has grown steadily. The 2011 Eurobond, while addressing medium-term rollover risks, has exposed Senegal to longer term rollover risk, underscoring the importance of improving debt management. While Senegal is expected to gradually shift to nonconcessional external borrowing as it moves toward emerging market status, it should approach such borrowing with caution given current debt levels and the sensitivity of debt indicators to less favorable borrowing terms. Relatively low levels of domestic debt suggest that there is scope to further develop domestic debt markets to decrease reliance on external financing; reliance on the regional debt market should however increase gradually, taking into account the cost and maturities of such borrowing. At the same time, it will be critical to reduce fiscal deficits from levels seen in recent years to maintain debt sustainability.

15. The authorities generally agreed with the assessment, stressed their fiscal consolidation efforts, and questioned the impact of the change in the discount rate. They acknowledged that fiscal consolidation and a cautious approach to nonconcessional borrowing were critical for safeguarding debt sustainability. They pointed out that they have taken action since taking office to keep the fiscal deficit under control in 2012. Efforts made to reduce the cost of running the government will help keep the 2012 fiscal deficit below 6 percent of GDP, a development bucking earlier trends. The authorities also intend to keep reducing the fiscal deficit in 2013 and the medium term, while addressing the country's social and development needs. Their fiscal objective is to reduce the deficit below 5 percent of GDP in 2013 and below 4 percent by 2015. Reconciling these various objectives will require a significant improvement in public spending efficiency. Efforts to reduce the cost of running the government will continue and produce their full impact in 2013 and beyond. A comprehensive streamlining of agencies in 2013 is also expected to generate substantial savings in the medium term. Finally, the authorities are working on rationalizing expenditure in key sectors such as education and health (with World Bank assistance) and on more cost-effective support to the most vulnerable segments of the population. In this regard, energy subsidies will be substantially reduced next year and in the medium term. The authorities challenged staff to explain why a mechanical change in the discount rate should translate into a deterioration of the debt outlook. Staff explained that the change in the discount rate applied to all countries, not just Senegal, and was consistent with the Fund's longstanding methodology for calculating present values.

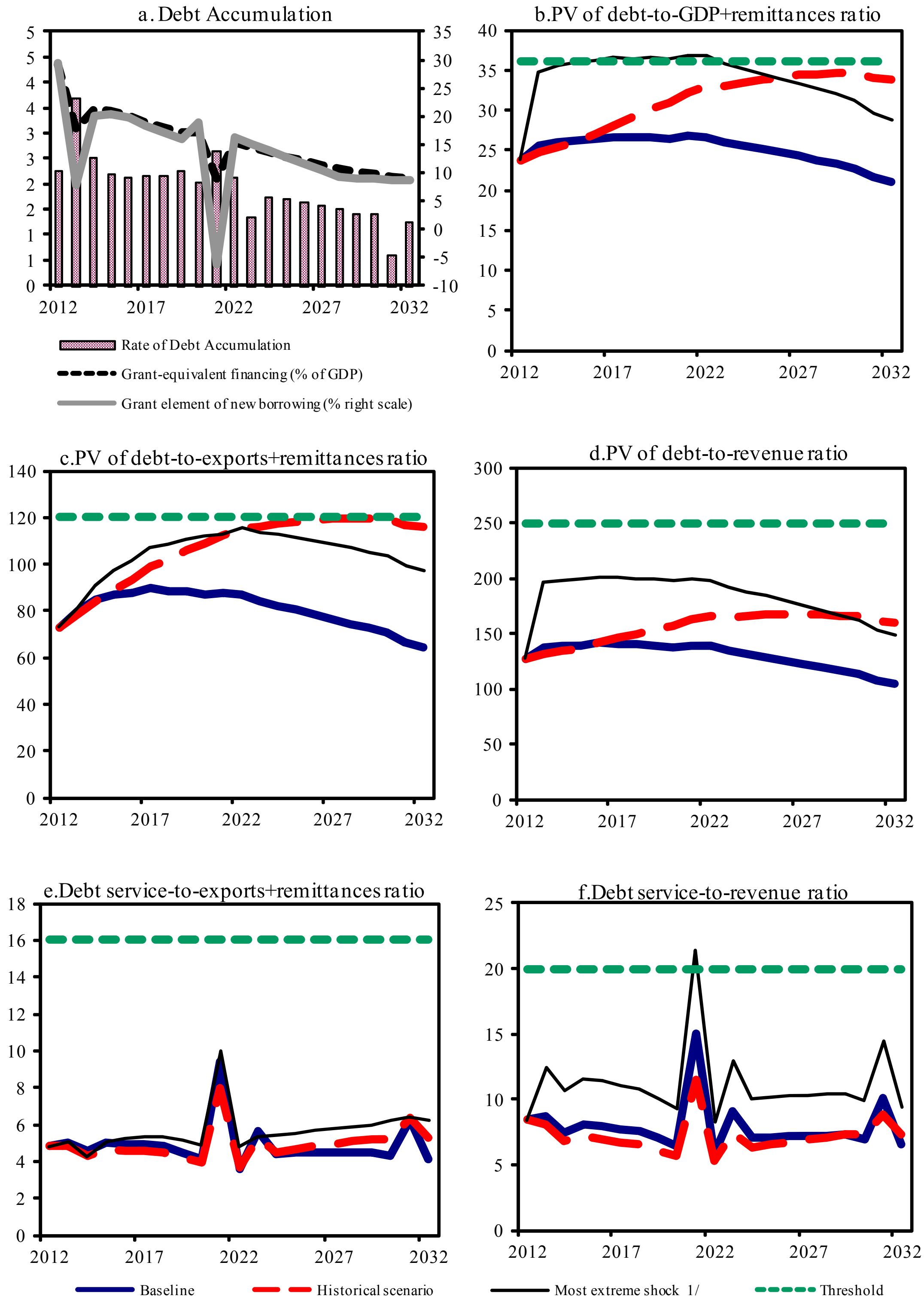
Figure 1a. Senegal: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2012-2031 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022. In figure b. it corresponds to a One-time depreciation shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Terms shock and in figure f. to a One-time depreciation shock

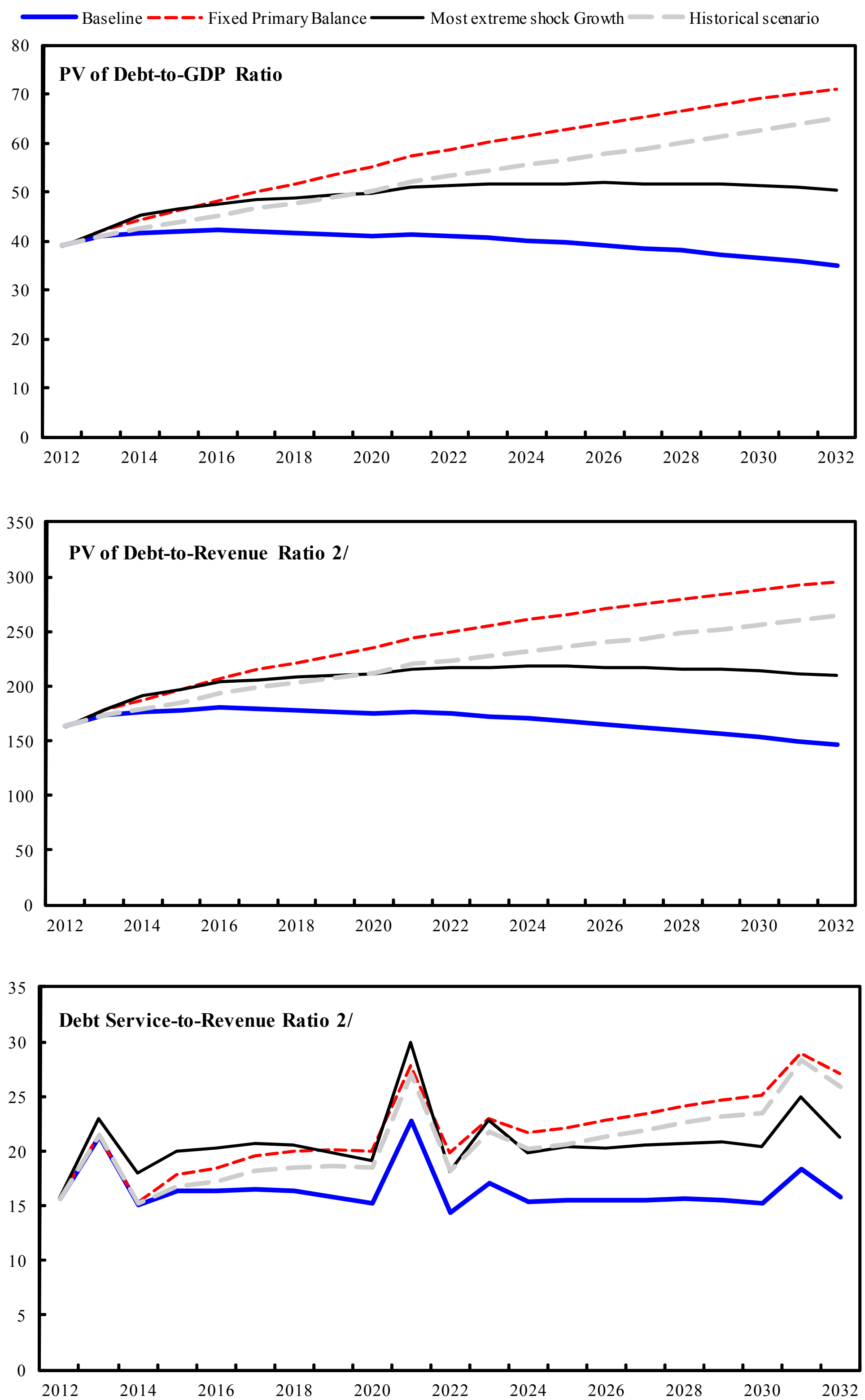
Figure 1b. Senegal: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios (with Remittances), 2012-2032 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022. In figure b. it corresponds to a One-time depreciation shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Terms shock and in figure f. to a One-time depreciation shock

Figure 2. Senegal: Indicators of Public Debt Under Alternative Scenarios, 2012-2031 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2022.
2/ Revenues are defined inclusive of grants.

Table 1a.: External Debt Sustainability Framework, Baseline Scenario, 2012-2032 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 0 Average	Standard 0 Deviation	Projections									
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012-2017 Average	2022	2032	2018-2032 Average
External debt (nominal) 1/	**50.7**	**53.4**	**49.0**			**53.6**	**54.5**	**54.6**	**54.1**	**53.6**	**53.1**		**49.9**	**38.0**	
o/w public and publicly guaranteed (PPG)	26.9	27.5	28.8			32.7	34.6	35.4	35.8	36.1	36.2		35.7	26.9	
Change in external debt	5.6	2.7	-4.4			4.6	0.9	0.0	-0.5	-0.5	-0.6		-0.6	-1.2	
Identified net debt-creating flows	7.0	2.0	-1.7			3.8	3.8	3.2	2.7	2.4	2.1		2.1	2.1	
Non-interest current account deficit	**6.5**	**3.9**	**5.3**	**7.6**	**3.1**	**7.0**	**6.5**	**6.0**	**5.6**	**5.2**	**4.9**		**4.7**	**4.6**	4.6
Deficit in balance of goods and services	16.9	15.5	16.2			17.5	16.6	15.9	15.0	14.1	13.6		13.4	13.2	
Exports	24.4	25.0	24.7			24.2	23.9	23.0	22.8	23.0	22.9		24.0	26.1	
Imports	41.3	40.5	40.9			41.7	40.4	38.9	37.8	37.1	36.5		37.4	39.3	
Net current transfers (negative = inflow)	-11.5	-12.1	-11.4	-9.8	2.2	-11.0	-10.4	-10.0	-9.5	-9.0	-8.6		-8.5	-8.4	-8.5
o/w official	-0.4	-0.5	-0.3			-0.5	-0.3	-0.3	-0.3	-0.3	-0.3		-0.3	-0.2	
Other current account flows (negative = net inflow)	1.2	0.5	0.4			0.5	0.3	0.1	0.1	0.1	-0.2		-0.2	-0.2	
Net FDI (negative = inflow)	**-2.0**	**-2.1**	**-1.9**	**-1.6**	**0.7**	**-1.9**	**-1.1**	**-1.1**	**-1.0**	**-1.0**	**-0.9**		**-0.9**	**-0.9**	-0.9
Endogenous debt dynamics 2/	**2.5**	**0.1**	**-5.0**			**-1.2**	**-1.5**	**-1.8**	**-1.8**	**-1.8**	**-1.9**		**-1.7**	**-1.6**	
Contribution from nominal interest rate	0.2	0.5	0.8			0.6	0.7	0.7	0.7	0.7	0.7		0.7	0.5	
Contribution from real GDP growth	-1.0	-2.1	-1.2			-1.9	-2.2	-2.5	-2.5	-2.6	-2.6		-2.4	-2.0	
Contribution from price and exchange rate changes	3.3	1.8	-4.6			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**-1.4**	**0.7**	**-2.7**			**0.8**	**-2.9**	**-3.1**	**-3.2**	**-2.8**	**-2.7**		**-2.7**	**-3.3**	
o/w exceptional financing	0.1	1.6	-0.9			-1.9	-0.2	-0.2	-0.2	-0.2	-0.2		-0.1	0.0	
PV of external debt 4/	...	...	44.4			47.6	48.5	48.2	47.4	46.7	46.0		43.4	34.1	
In percent of exports	...	...	179.8			196.7	203.0	209.4	208.1	203.0	200.9		180.9	130.9	
PV of PPG external debt	**...**	**...**	**24.2**			**26.7**	**28.6**	**29.0**	**29.1**	**29.1**	**29.1**		**29.3**	**23.0**	
In percent of exports	**...**	**...**	**97.9**			**110.3**	**119.6**	**126.2**	**127.8**	**126.6**	**127.2**		**121.9**	**88.1**	
In percent of government revenues	**...**	**...**	**119.8**			**127.6**	**137.3**	**139.0**	**139.4**	**141.3**	**140.8**		**138.4**	**104.0**	
Debt service-to-exports ratio (in percent)	**19.1**	**19.1**	**27.0**			**19.8**	**19.1**	**19.4**	**19.6**	**18.2**	**17.4**		**15.0**	**14.8**	
PPG debt service-to-exports ratio (in percent)	**5.0**	**5.7**	**14.0**			**7.3**	**7.6**	**6.8**	**7.4**	**7.2**	**7.0**		**5.1**	**5.6**	
PPG debt service-to-revenue ratio (in percent)	**6.5**	**7.4**	**17.2**			**8.4**	**8.7**	**7.5**	**8.1**	**8.0**	**7.7**		**5.8**	**6.6**	
Total gross financing need (Billions of U.S. dollars)	1.2	0.9	1.4			1.4	1.4	1.5	1.5	1.5	1.5		2.1	4.4	
Non-interest current account deficit that stabilizes debt ratio	0.9	1.2	9.7			2.3	5.5	6.0	6.1	5.6	5.5		5.3	5.8	
Key macroeconomic assumptions															
Real GDP growth (in percent)	2.1	4.1	2.6	3.9	1.9	3.7	4.3	4.8	5.0	5.1	5.2	4.7	5.2	5.6	5.3
GDP deflator in US dollar terms (change in percent)	-6.7	-3.4	9.4	7.6	8.4	-7.0	0.1	2.1	2.2	2.0	2.1	0.3	2.3	2.4	2.4
Effective interest rate (percent) 5/	0.4	0.9	1.7	0.8	0.4	1.2	1.3	1.4	1.4	1.5	1.5	1.4	1.5	1.3	1.4
Growth of exports of G&S (US dollar terms, in percent)	-11.1	3.1	10.8	10.3	10.5	-5.4	3.0	3.1	6.2	8.3	6.9	3.7	8.6	8.9	8.7
Growth of imports of G&S (US dollar terms, in percent)	-25.0	-1.4	13.4	13.7	17.2	-1.7	1.3	2.8	4.3	5.2	5.7	2.9	8.4	8.7	8.3
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	29.6	7.8	20.2	20.4	19.7	18.4	19.4	16.4	8.6	11.3
Government revenues (excluding grants, in percent of GDP)	18.6	19.4	20.2			20.9	20.8	20.9	20.9	20.6	20.7		21.2	22.1	21.4
Aid flows (in Billions of US dollars) 6/	0.9	0.7	0.6			0.7	0.7	0.7	0.8	0.8	0.8		0.9	1.1	
o/w Grants	0.4	0.3	0.3			0.4	0.4	0.4	0.5	0.5	0.5		0.6	1.1	
o/w Concessional loans	0.5	0.4	0.2			0.3	0.3	0.3	0.3	0.3	0.3		0.2	0.0	
Grant-equivalent financing (in percent of GDP) 7/	...	...	...			4.3	3.1	3.5	3.4	3.3	3.2		2.8	2.1	2.5
Grant-equivalent financing (in percent of external financing) 7/	...	...	...			56.4	40.2	52.9	54.2	54.2	53.6		54.1	52.0	50.8
Memorandum items:															
Nominal GDP (Billions of US dollars)	12.8	12.9	14.5			13.9	14.6	15.6	16.7	17.9	19.2		27.7	58.9	
Nominal dollar GDP growth	-4.8	0.6	12.3			-3.6	4.3	7.1	7.3	7.2	7.4	5.0	7.6	8.2	7.7
PV of PPG external debt (in Billions of US dollars)			3.3			3.6	4.2	4.5	4.9	5.2	5.6		8.1	13.5	
(PVt-PVt-1)/GDPt-1 (in percent)						2.3	3.7	2.5	2.2	2.1	2.2	2.5	2.1	1.2	1.7
Gross workers' remittances (Billions of US dollars)	1.7	1.8	1.9			1.7	1.7	1.8	1.8	1.8	1.9		2.7	5.7	
PV of PPG external debt (in percent of GDP + remittances)	...	...	21.4			23.7	25.5	26.1	26.3	26.4	26.6		26.7	21.0	
PV of PPG external debt (in percent of exports + remittances)	...	...	64.2			72.9	79.8	84.5	86.8	87.8	89.6		87.0	64.4	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	9.2			4.8	5.0	4.6	5.0	5.0	4.9		3.6	4.1	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Defined as grants, concessional loans, and debt relief.

7/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 1b.Senegal: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012-2032
(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	**2022**	2032
PV of debt-to-GDP ratio								
Baseline	27	29	29	29	29	29	**29**	23
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	27	27	28	28	29	30	**35**	35
A2. New public sector loans on less favorable terms in 2012-2032 2	27	29	31	33	34	35	**39**	35
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	27	29	30	31	31	31	**31**	24
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	27	29	31	31	31	31	**31**	23
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	27	29	30	30	30	30	**30**	24
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	27	31	34	34	34	34	**33**	24
B5. Combination of B1-B4 using one-half standard deviation shocks	27	29	30	30	30	30	**30**	23
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	27	41	41	41	42	42	**42**	33
PV of debt-to-exports ratio								
Baseline	110	120	126	128	127	127	**122**	88
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	110	115	121	125	127	132	**146**	135
A2. New public sector loans on less favorable terms in 2012-2032 2	110	121	136	143	147	152	**162**	133
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	110	119	126	128	126	127	**122**	88
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	110	126	143	145	143	143	**136**	96
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	110	119	126	128	126	127	**122**	88
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	110	132	149	150	148	147	**137**	92
B5. Combination of B1-B4 using one-half standard deviation shocks	110	121	126	127	126	126	**120**	86
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	110	119	126	128	126	127	**122**	88
PV of debt-to-revenue ratio								
Baseline	128	137	139	139	141	141	**138**	104
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	128	132	134	136	142	146	**165**	160
A2. New public sector loans on less favorable terms in 2012-2032 2	128	139	150	156	164	168	**184**	157
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	128	140	146	146	148	148	**145**	109
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	128	140	148	148	150	149	**145**	106
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	128	138	144	144	146	146	**144**	108
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	128	151	164	164	165	163	**156**	109
B5. Combination of B1-B4 using one-half standard deviation shocks	128	139	142	142	144	143	**140**	104
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	128	196	198	199	201	201	**198**	149

Table 1b.Senegal: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012-2032 (concluded)
(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
Debt service-to-exports ratio								
Baseline	7	8	7	7	7	7	**5**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	7	7	6	7	6	6	**5**	6
A2. New public sector loans on less favorable terms in 2012-2032 2	7	8	6	7	7	8	**7**	9
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	7	8	7	7	7	7	**5**	6
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	7	8	7	8	8	8	**6**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	7	8	7	7	7	7	**5**	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	7	8	7	8	8	7	**5**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	7	7	7	7	7	7	**5**	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	7	8	7	7	7	7	**5**	6
Debt service-to-revenue ratio								
Baseline	8	9	7	8	8	8	**6**	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	8	8	7	7	7	7	**5**	7
A2. New public sector loans on less favorable terms in 2012-2032 2	8	9	7	8	8	8	**8**	10
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	8	9	8	9	8	8	**6**	7
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	8	9	8	8	8	8	**6**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	8	9	8	8	8	8	**6**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	8	9	8	9	9	8	**6**	7
B5. Combination of B1-B4 using one-half standard deviation shocks	8	9	7	8	8	8	**6**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	8	12	11	12	11	11	**8**	9
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	8	8	8	8	8	8	**8**	8

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 2a.Senegal: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012-2032
(In percent of GDP, unless otherwise indicated)

	Actual			Average	Standard Deviation	Estimate	Projections								
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012-17 Average	2022	2032	2018-32 Average
Public sector debt 1/	34.2	35.7	40.0			45.0	46.8	48.1	48.7	49.0	49.0		47.4	38.9	
o/w foreign-currency denominated	26.9	27.5	28.8			32.7	34.6	35.4	35.8	36.1	36.2		35.7	26.9	
Change in public sector debt	10.2	1.5	4.3			4.9	1.9	1.3	0.6	0.3	0.0		-0.5	-1.1	
Identified debt-creating flows	3.2	5.7	4.3			4.9	1.9	1.2	0.6	0.4	0.0		-0.3	-1.0	
Primary deficit	4.2	4.2	5.2	3.0	1.9	4.3	3.1	2.7	2.3	2.1	1.9	2.7	1.6	0.6	1.3
Revenue and grants	21.7	22.0	22.4			23.9	23.5	23.6	23.6	23.3	23.3		23.5	24.0	
of which: grants	3.0	2.5	2.2			2.9	2.7	2.7	2.7	2.6	2.6		2.3	1.9	
Primary (noninterest) expenditure	25.9	26.2	27.5			28.1	26.5	26.3	25.9	25.4	25.2		25.1	24.6	
Automatic debt dynamics	-0.7	1.8	-0.7			1.1	-1.0	-1.6	-1.7	-1.8	-1.8		-1.9	-1.6	
Contribution from interest rate/growth differential	0.6	-0.9	-0.8			-0.7	-1.0	-1.7	-1.8	-1.9	-2.0		-1.9	-1.6	
of which: contribution from average real interest rate	1.1	0.4	0.1			0.7	0.8	0.5	0.5	0.5	0.5		0.5	0.6	
of which: contribution from real GDP growth	-0.5	-1.4	-0.9			-1.4	-1.8	-2.2	-2.3	-2.3	-2.4		-2.4	-2.1	
Contribution from real exchange rate depreciation	-1.3	2.7	0.1			1.8	0.1	0.1	0.1	0.1	0.1		...	...	
Other identified debt-creating flows	-0.3	-0.3	-0.2			-0.6	-0.1	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			-0.6	-0.1	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-0.3	-0.3	-0.2			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	7.0	-4.2	0.1			0.1	-0.1	0.1	0.0	0.0	-0.1		-0.1	-0.1	
Other Sustainability Indicators															
PV of public sector debt	...	...	35.4			38.9	40.8	41.7	42.0	42.1	41.9		41.0	35.0	
o/w foreign-currency denominated	...	...	24.2			26.7	28.6	29.0	29.1	29.1	29.1		29.3	23.0	
o/w external	...	...	24.2			26.7	28.6	29.0	29.1	29.1	29.1		29.3	23.0	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	8.0	8.2	12.3			12.1	12.1	10.5	10.5	10.2	9.9		8.1	6.7	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	158.3			163.2	173.6	176.9	178.2	181.0	180.0		174.5	145.9	
PV of public sector debt-to-revenue ratio (in percent)	…	…	175.5			186.1	196.1	199.7	201.2	204.2	202.5		193.8	158.5	
o/w external 3/	…	…	119.8			127.6	137.3	139.0	139.4	141.3	140.8		138.4	104.0	
Debt service-to-revenue and grants ratio (in percent) 4/	9.1	9.8	19.9			15.7	21.4	15.1	16.4	16.3	16.6		14.4	15.8	
Debt service-to-revenue ratio (in percent) 4/	10.6	11.1	22.1			17.9	24.1	17.0	18.5	18.4	18.6		15.9	17.2	
Primary deficit that stabilizes the debt-to-GDP ratio	-6.0	2.7	0.8			-0.7	1.2	1.5	1.7	1.8	1.9		2.0	1.7	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	2.1	4.1	2.6	3.9	1.9	3.7	4.3	4.8	5.0	5.1	5.2	4.7	5.2	5.6	5.3
Average nominal interest rate on forex debt (in percent)	2.0	2.1	3.7	2.3	0.6	2.5	2.5	2.4	2.4	2.4	2.4	2.4	2.3	2.0	2.2
Average real interest rate on domestic debt (in percent)	10.1	3.6	3.6	1.9	3.5	6.2	6.7	4.2	4.2	3.9	3.9	4.8	4.2	5.8	4.3
Real exchange rate depreciation (in percent, + indicates depreciation)	-6.7	10.4	0.3	-3.3	10.4	6.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	-1.4	1.4	4.3	2.7	2.5	2.2	2.4	2.4	2.5	2.4	2.5	2.4	2.3	2.4	2.4
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	29.6	7.8	20.2	20.4	19.7	18.4	19.4	16.4	8.6	...

Sources: Country authorities; and staff estimates and projections.
1/ The public sector refers to the central government.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2b.Senegal: Sensitivity Analysis for Key Indicators of Public Debt 2012-2032

	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
PV of Debt-to-GDP Ratio								
Baseline	39	41	42	42	42	42	41	35
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	39	41	42	44	45	47	53	65
A2. Primary balance is unchanged from 2012	39	42	44	46	48	50	59	71
A3. Permanently lower GDP growth 1/	39	41	42	43	44	44	47	52
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	39	42	45	47	48	48	51	50
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	39	43	46	46	46	45	44	37
B3. Combination of B1-B2 using one half standard deviation shocks	39	42	45	46	46	47	48	45
B4. One-time 30 percent real depreciation in 2013	39	52	52	52	51	51	48	41
B5. 10 percent of GDP increase in other debt-creating flows in 2013	39	50	51	51	50	50	47	39
PV of Debt-to-Revenue Ratio 2/								
Baseline	163	174	177	178	181	180	174	146
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	163	174	180	186	194	199	224	265
A2. Primary balance is unchanged from 2012	163	179	188	196	207	215	250	295
A3. Permanently lower GDP growth 1/	163	175	179	182	187	188	198	214
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	163	179	191	197	204	206	217	209
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	163	181	193	194	196	195	186	153
B3. Combination of B1-B2 using one half standard deviation shocks	163	179	190	194	199	200	204	187
B4. One-time 30 percent real depreciation in 2013	163	221	221	219	220	217	205	171
B5. 10 percent of GDP increase in other debt-creating flows in 2013	163	214	216	215	217	214	202	162
Debt Service-to-Revenue Ratio 2/								
Baseline	16	21	15	16	16	17	14	16
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	16	21	15	17	17	18	18	26
A2. Primary balance is unchanged from 2012	16	21	15	18	18	20	20	27
A3. Permanently lower GDP growth 1/	16	21	15	17	17	17	16	21
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	16	22	16	18	18	19	17	21
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	16	21	15	19	19	18	15	17
B3. Combination of B1-B2 using one half standard deviation shocks	16	22	16	18	18	18	16	19
B4. One-time 30 percent real depreciation in 2013	16	23	18	20	20	21	18	21
B5. 10 percent of GDP increase in other debt-creating flows in 2013	16	21	16	27	18	20	15	18

Sources: Country authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

Table 3b.Senegal: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt (with Remittances), 2012-2032
(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	**2022**	2032
PV of debt-to-GDP+remittances ratio								
Baseline	24	26	26	26	26	27	**27**	21
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	24	25	25	26	27	28	**33**	34
A2. New public sector loans on less favorable terms in 2012-2032 2	24	26	28	29	31	32	**35**	32
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	24	26	27	27	28	28	**28**	22
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	24	26	28	28	28	28	**28**	21
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	24	26	27	27	27	27	**28**	22
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	24	29	32	31	31	31	**30**	22
B5. Combination of B1-B4 using one-half standard deviation shocks	24	26	27	27	27	27	**27**	21
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	24	35	36	36	36	36	**37**	29
PV of debt-to-exports+remittances ratio								
Baseline	73	80	85	87	88	90	**87**	64
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	73	78	84	89	93	99	**116**	116
A2. New public sector loans on less favorable terms in 2012-2032 2	73	81	91	97	102	107	**115**	97
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	73	80	84	87	88	89	**87**	64
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	73	83	94	96	97	99	**95**	69
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	73	80	84	87	88	89	**87**	64
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	73	97	109	102	102	104	**98**	67
B5. Combination of B1-B4 using one-half standard deviation shocks	73	86	89	88	89	90	**87**	63
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	73	80	84	87	88	89	**87**	64
PV of debt-to-revenue ratio								
Baseline	128	137	139	139	141	141	**138**	104
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	128	132	134	136	142	146	**165**	160
A2. New public sector loans on less favorable terms in 2012-2032 2	128	139	150	156	164	168	**184**	157
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	128	140	146	146	148	148	**145**	109
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	128	140	148	148	150	149	**145**	106
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	128	138	144	144	146	146	**144**	108
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	128	151	164	164	165	163	**156**	109
B5. Combination of B1-B4 using one-half standard deviation shocks	128	139	142	142	144	143	**140**	104
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	128	196	198	199	201	201	**198**	149

Table 3b.Senegal: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt (with Remittances), 2012-2032 (concluded)
(In percent)

Debt service-to-exports+remittances ratio								
Baseline	5	5	5	5	5	5	**4**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	5	5	4	5	5	5	**4**	5
A2. New public sector loans on less favorable terms in 2012-2032 2	5	5	4	5	5	5	**5**	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	5	5	5	5	5	5	**4**	4
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	5	5	5	5	5	5	**4**	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	5	5	5	5	5	5	**4**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	5	6	5	5	5	5	**4**	5
B5. Combination of B1-B4 using one-half standard deviation shocks	5	5	5	5	5	5	**4**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	5	5	5	5	5	5	**4**	4
Debt service-to-revenue ratio								
Baseline	8	9	7	8	8	8	**6**	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	8	8	7	7	7	7	**5**	7
A2. New public sector loans on less favorable terms in 2012-2032 2	8	9	7	8	8	8	**8**	10
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	8	9	8	9	8	8	**6**	7
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	8	9	8	8	8	8	**6**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	8	9	8	8	8	8	**6**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	8	9	8	9	9	8	**6**	7
B5. Combination of B1-B4 using one-half standard deviation shocks	8	9	7	8	8	8	**6**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	8	12	11	12	11	11	**8**	9
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	8	8	8	8	8	8	**8**	8

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitl an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

SENEGAL

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION, FOURTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT, AND REQUEST FOR MODIFICATION OF AN ASSESSMENT CRITERION—FINANCIAL DEPTH AND MACRO-STABILITY

November 26, 2012

This enhanced review of Senegal's financial sector is one of several pilot reviews called for by the Executive Board in May 2012. The purpose of the reviews is to go beyond the traditional surveillance focus on banking system soundness and solvency by analyzing in more depth the interplay between financial development, macroeconomic and financial stability, and effectiveness of macroeconomic policies in low-income countries. Senegal is a member of the West African Economic and Monetary Union (WAEMU); a number of key macroeconomic and financial policies are designed and implemented at the union level. This study focuses on Senegal-specific issues. Another pilot study, to be prepared in the context of the next annual consultation on regional policies in early 2013, will focus on union-wide issues.

The financial system in Senegal, like in many other low-income countries (LICs), is dominated by the banking sector, with commercial banks representing about 90 percent of the financial system. A large number of microfinance institutions (MFIs) supply limited financial services targeting lower income households. They help raise overall access to the financial system to about 20 percent of the population. Insurance companies account for most of the remainder of the domestic financial system. The regional securities and equity market is a marginal source of funding, except for the government. The interbank market remains underdeveloped.

The banking system appears to be relatively robust, with lending concentration and asset quality being the main risks. Financial soundness indicators suggest that banks are on average adequately capitalized, profitable, and liquid. Micro-prudential regulation of banks needs to be enhanced and supervision strengthened further. The authorities are encouraged to develop a holistic view of the financial system and systemic risk.

Financial depth has increased in recent years and is broadly in line with the country's structural characteristics. However, a comparison with selected countries suggests substantial scope for further deepening, which would facilitate the conduct of fiscal policy, make it easier for agents to deal with volatility, and foster investment and growth.

There is broad agreement that the main obstacles to further financial development include: large informational asymmetries, a poor business and judicial environment, an inadequate tax regime, regulatory and supervision issues, and inadequate skills. The authorities have a strategy to address a number of these issues, whose implementation they intend to accelerate. The regional authorities are working on the development of the interbank market and the strengthening of the public debt market, which they see as priorities.

Approved By
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TABLES

SENEGAL'S FINANCIAL SYSTEM: STRUCTURE, PERFORMANCE, AND RISKS

A. Overview of the Structure of the Financial System

1. The financial system in Senegal is dominated by the banking sector. It is composed of 19 commercial banks concentrated in the three largest cities. Banks make up about 90 percent of the financial system (Table 1). The five largest banks account for 66 percent of assets and collect 79 percent of deposits. A large number of microfinance institutions (MFIs; 234 establishments) supply limited financial services targeting lower income households. While they cover both urban and rural regions, about half of the sector's activity is concentrated in greater Dakar. Insurance companies (25) account for most of the remainder of the domestic financial system. The regional securities and equity market is a marginal source of funding, except for the government.[1]

Text Table 1. Senegal: Financial System Structure, end-2011

	Total Assets			Deposits		Credits	
	Amount (bn of FCFA)	(% of total)	(% of GDP)	Amount (bn of FCFA)	(% of GDP)	Amount (bn of FCFA)	(% of GDP)
Private Deposit Taking Financial Institutions							
Banks	3,365	88%	53	2,401	38	2,022	32
of which foreign owned banks	1,904	50%	30	1,598	25	1,384	22
Microfinance Institutions	278	7%	4	181	3	214	3
Non-Deposit Taking Financial Institutions							
Insurnace (1)	161	4%	3				
Life	62	2%	1				
Non-Life	99	3%	2				
Securities Firms	N/A						
Dealers	N/A						
Others	N/A						
Public Financial Institutions	N/A						
Total Financial System (excluding BCEAO)	3,804	100%					

(1) End 2010
Source: BCEAO, DRS, Association of Insurers, IMF

2. The banking sector is dominated by subsidiaries of French, Nigerian, Moroccan and pan-African banks (regional banking groups that are originally African). Nonresidents also have stakes in banks majority-owned by residents. The government has minority stakes (ranging from about 10 to 25 percent of equity) in a number of banks. One bank provides Islamic banking services. Only about 7 percent of the population holds a bank account, though this may be overstated as some individuals may hold multiple accounts. Bank deposits amount to about 40 percent of GDP. The interbank market is

[1] In addition, there is a public pension fund ("social security fund"). Employees of the formal sector (but not civil servants) contribute to it. Given Senegal's very young population, the fund is well capitalized. It manages assets of CFAF 175 billion (2.6 percent of GDP) and invests predominantly in long term deposits in banks and in real estate.

underdeveloped, with only a limited amount of liquidity traded among banks. There is no explicit deposit insurance scheme. More detailed analysis on the banking system is available in Section I.B.

3. MFIs represent a small, though rising share of the Senegalese financial sector. MFIs focus on basic services such as savings accounts and micro-credit. More people have accounts at MFIs than at banks, which helps raise overall access to the financial system to about 20 percent of the population. MFIs' loans amount to about 10 percent of bank credit. Most MFIs are operated as mutuals or by NGOs, and have a social mandate, e.g., to lend to farmers in remote regions. The 18 largest MFIs (with assets or deposits above CFAF 2 billion) make up 90 percent of the MFI sector. More detailed analysis on MFIs is available in Section I.C.

4. The insurance industry, while still in its infancy, is growing. Non-life insurance development has been fostered by the growth of credit markets, with banks requesting their clients to take insurance on assets (e.g., houses) purchased through loans, and the development of the formal sector. Life insurance expanded by 20 percent in 2011. Insurance companies are required to hold a minimum of cash deposits (11 percent of their assets) for liquidity purposes. Their assets are invested in term deposits with commercial banks (47 percent); securities, in particular government paper, and equity (18 percent); and real estate (12 percent). Large foreign insurance companies are present, though mostly in the form of domestic partnerships.

5. The regional capital markets remain a marginal source of funding except for the government. [2] The regional stock exchange based in Abidjan (known as BRVM, its French acronym), has only one listed Senegalese company, Sonatel. Sonatel, a telecom company with subsidiaries in three other countries in West Africa is the largest Senegalese company and has the highest capitalization at BRVM. Only very few private and public companies have issued debt in the regional market, unlike WAEMU sovereigns, which have significantly increased their recourse to regional financing. Sovereign debt can be issued either at BRVM or through the central bank on the regional money market. This latter segment has been the most active in recent years. Senegal has been able to tap the regional market for increasingly large amounts, with gross issuance likely to exceed CFAF 500 billion (about 7 percent of GDP) in 2012, but at short maturities (average maturity was 1.2 year at end-2011). The regional government debt market is increasingly integrated, with more than half of the debt issued by the Senegalese government bought by WAEMU investors outside Senegal. In addition, Senegal issued a 5-year eurobond ($200 million) in 2009 and a 10-year eurobond ($500 million) in 2011, which was partly used to retire the 2009 issue. No company has yet issued securities in international security markets.

B. The Banking Sector[3]

6. The banking sector has expanded significantly in recent years. In 2011 bank credit to the economy increased by 19 percent (to 29 percent of GDP), the number of bank branches by 11 percent

[2] There is a growing consensus in the literature that the degree of bank based versus market-based system does not matter much for economic growth. It is less important what the particular institutional arrangements that provide financial services to the economy are; what matters is the overall financial development.

[3] All data on individual banks were obtained from the BCEAO. The labeling of banks 1-19 differs across graphs, and therefore a particular number does not necessarily correspond to the same bank.

and the number of bank accounts by 44 percent.[4] Preliminary numbers for 2012 suggest a similar pace of development, taking overall bank credit to the economy at more than 30 percent of GDP. Credit to the service sector has been particularly buoyant, while credit to households, especially longer-term credit, has also increased (see Figure 1). Most banks' core business consists in collecting deposits, lending to bigger firms including subsidiaries of multinationals, and holding and dealing in government securities. The entry of three new banks (mostly regional African banking groups) combined with growing competition from MFIs have recently pushed existing banks to diversify away from their high-end clients by offering basic, cheaper services to the middle class, including students and young professionals.

7. The banking system appears to be relatively robust, with concentration of lending and credit quality being the main risks. Both the authorities and Fund staff have conducted stress-tests in recent months (with the authorities doing this on a quarterly basis). The stress tests calibrated various large but plausible shocks (applied to individual banks) in line with the economic structure of Senegal. The system was shocked for (i) sectoral risk, including default by the largest individual exposure and a shock to the three largest borrowing industrial sectors; (ii) overall credit risk comprising a downgrade of nonperforming loans (NPLs) by one category and an increase in total NPLs by 50 percent; and (iii) credit risk related to default of a public entity, or default on credit to the government and to public enterprises. The stress-tests found that liquidity risks and interest rate risks could be withstood, given that banks are highly liquid and the maturity mismatch between assets and liabilities is rather small. Only the concentration of lending was found to be a major source of vulnerability, as loans are concentrated in a few sectors and companies, and exposure to the public sector is large.

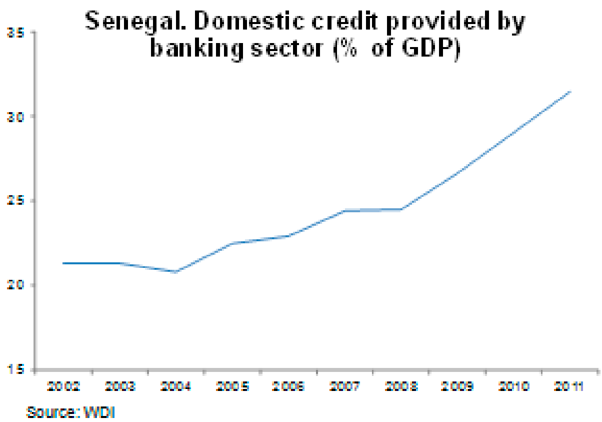
8. The findings of the stress-tests are corroborated by the usual financial soundness indicators (FSIs). With the usual caveat in mind–FSIs are backward looking and procyclical in nature, only provide averages that may hide important variations, and assuming that the data are accurate–Box 1 and Table 1 provide an overview of the soundness of the Senegalese banking system. Based on these indicators, Senegalese banks appear on average well capitalized, profitable, and liquid, with asset quality being the main concern. Also the international financial crisis and the ongoing crisis in Europe did not seem to have large repercussions on Senegalese banks, even though indirect effects may have been significant.[5]

[4] The large increase in the number of bank accounts reflects to a large extent the recent obligation for civil servants to have a bank account to receive their salary by bank transfer, and a similar decision for the payment of monthly grants to university students.

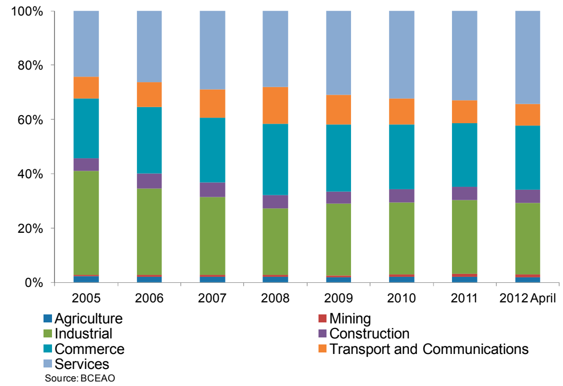
[5] The direct impact has been limited because banks (including subsidiaries of foreign banks) are locally funded. An indirect effect has reportedly been felt through: (i) lower remittances; (ii) some local clients, who export and were paid with delays from overseas, requested extensions of credit lines by local banks; (iii) corresponding banks in Europe imposed tougher restrictions on Senegalese banks, and tightened credit lines; (iv) subsidiaries of international banking groups were requested by their headquarters to tighten their rules on risk-taking. Note that African banking groups appear to have taken the opportunity to expand in the region, counterbalancing some of the negative effect.

Figure 1. Senegal: Evolution of the Bank and Non-Bank Sectors

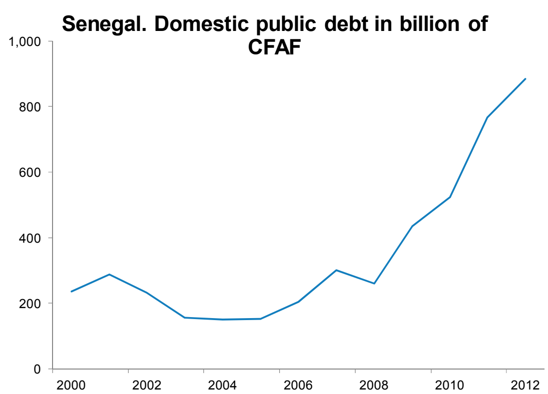
Credit to the economy has grown steadily …



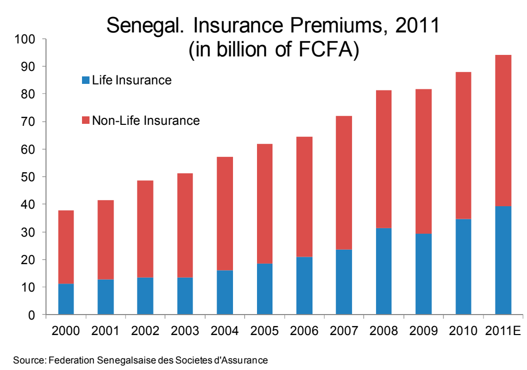
… particularly to the service sector.



Domestic Public Debt has grown in recent years.



Revenues in the insurance market are growing steadily.



Source: BCEAO, Association of Insurers and IFS.

Table 1. Senegal: Financial Soundness Indicators

	2003 Dec.	2004 Dec.	2005 Dec.	2006 Dec.	2007 Dec.	2008 Dec.	2009 Dec.	2010 Dec.	2011 Dec.	2012 June (*)
	(in percent, unless otherwise indicated)									
Capital adequacy										
Capital to risk-weighted assets	11.7	11.5	10.8	12.9	13.5	13.8	16.3	18.0	16.0	16.9
Regulatory capital to risk-weighted assets	12.1	11.9	11.1	13.1	13.6	13.9	16.5	18.2	15.9	16.5
Capital to total assets	7.8	7.7	7.6	8.3	8.3	9.1	9.3	10.0	9.8	12.0
Asset composition and quality										
Total loans to total assets	59.6	57.1	64.0	63.8	58.8	62.8	59.5	57.5	60.6	73.7
Concentration: loans to 5 largest borrowers to capital	141.0	131.4	179.9	103.7	88.5	100.9	71.7	70.6	69.8	58.1
Sectoral distribution of loans										
Industrial	41.1	33.6	35.5	28.9	25.1	19.5	27.5	26.4	22.2	21.5
Retail and wholesale trade	19.9	19.3	17.0	18.9	14.4	18.5	24.5	23.8	19.2	19.1
Services, transportation and communication	17.2	27.4	28.0	30.0	29.6	31.1	34.1	41.9	34.0	34.4
Gross NPLs to total loans 1/	13.3	12.6	11.9	16.8	18.6	17.4	18.7	20.2	16.2	17.5
Of which: without ICS	…	…	…	…	12.7	14.2	15.8	15.8	13.2	15.7
Provisions to NPLs 1/	75.3	75.7	75.4	52.0	53.8	51.5	53.1	54.9	54.0	55.4
Of which: without ICS	…	…	…	…	74.6	65.7	64.7	65.3	68.3	62.8
NPLs net of provisions to total loans 1/	3.3	3.4	3.2	8.8	8.6	9.3	9.7	9.1	8.1	7.8
Of which: without ICS	…	…	…	…	3.6	5.4	6.2	6.1	4.6	5.9
NPLs net of provisions to capital 1/	27.8	25.1	27.2	67.9	60.7	63.9	62.3	52.3	50.4	43.4
Of which: without ICS	…	…	…	…	23.8	35.3	38.4	41.5	35.7	43.3
Earnings and profitability										
Average cost of borrowed funds	1.8	2.0	2.0	2.2	2.3	2.8	3.4	2.2	2.0	
Average interest rate on loans 2/	8.7	11.7	11.8	11.3	11.6	13.9	15.4	8.1	8.4	
Average interest margin 3/	6.7	9.7	9.8	9.2	9.3	11.1	12.0	5.9	6.4	
After-tax return on average assets	1.8	1.8	1.6	1.6	1.6	1.4	1.3	1.6	2.2	
After-tax return on average equity	22.1	17.6	15.8	14.6	15.3	13.0	16.0	15.4	22.6	
Noninterest expenses/net banking income	48.9	48.7	47.9	49.4	50.7	51.3	60.3	56.7	56.0	
Salaries and wages/net banking income	21.8	21.5	21.2	21.7	22.2	21.1	23.0	24.8	23.8	
Liquidity										
Liquid assets to total assets	66.5	66.4	…	…	…	…	74.9		74.9	
Liquid assets to total deposits	81.0	82.0	…	…	…	…				
Total deposits to total liabilities	82.0	79.6	78.3	75.8	73.6	70.3	74.9	76.0	62.8	81.0

(*) Provisional Data

1/ NPL changes in 2006 due to ICS. In 2008, ICS was recapitalized and the government guarantee for its bank loans was lifted. However, the loans in question remain classified as non-performing for the time being, although without the need to provision.
2/ Break in the series in 2010 due to a methodological change.
3/ Excluding the tax on banking operations.

Box 1: Banking System Soundness

Capitalization: FSIs show that the banking sector is overall at an adequate level of capitalization. While the capital adequacy ratio (CAR) decreased to 16 percent at end-2011, it is still largely above the regulatory minimum of 8 percent, and increased further through June 2012. [6] Part of the explanation for this high level is large holdings of sovereign paper, which carries zero risk-weighting. As illustrated during the euro area crisis, this treatment of soverei–gn risk may be problematic. The recent crises in the WAEMU (Côte d'Ivoire and Mali) also suggest that this risk cannot be considered nil; an increase in the risk-weighting of sovereign papers would reduce CARs significantly. Only one bank is currently undercapitalized, but because of small size and limited interconnectedness, it does not raise a systemic risk, and it is being restructured.

Asset Quality: At first glance, the quality of assets appears to be a cause for some concern, and may require further investigation and analysis. The ratio of gross nonperforming loans (NPLs)[7] to total loans was 16.2 percent at end-2011, and increased further in early 2012. However, there are factors qualifying the risk from such high NPL numbers. The latter reflect to a large extent the portfolios of three banks with NPLs in excess of 20 percent, while most other banks have NPLs below 5 percent. In addition, the relatively high level of provisioning for NPLs mitigates risks. A reason for high NPLs reported during discussions with bankers is that NPLs tend to be kept on banks' books longer than is typically the case in other countries, in part because of the long time needed to exercise guarantees through the judicial system. Nonetheless, legacy NPLs do not explain completely the situation, as new NPLs are still relatively high, hinting at limited risk-management capabilities, particularly for some of the smaller banks. In addition, a relatively high concentration risk (below) suggests that the quality of assets can deteriorate rapidly if only a few debtors get into trouble.

Profitability: The profitability of the banking sector is high. The return on assets was 1.8 percent as of mid-2012 for the sector, with the return on equity being above 17 percent. The profitability of banks is boosted by the fact that they have access to ample and cheap deposits from households with which they can purchase government paper. The interest margin on these nominally risk-free operations is substantial.

Liquidity: Liquidity risks are low for the banking sector as a whole, though three smaller banks do not meet the minimum liquidity requirements. Structural factors explaining high liquidity include the limited number of bankable projects, but also regulatory rules that require banks to finance medium and long-term assets to a large extent with medium and long-term resources; as the latter are scarce; banks tend to keep their funds in liquid assets. In addition, subsidiaries of international banking groups are constrained by intra group regulations and treat debt issued by WAEMU sovereigns as risky, and as result limit their exposure to these sovereigns. This restricts the investment universe of banks further, and constraints the amounts of lending activities of these subsidiary banks, thereby keeping liquidity levels higher than they would be otherwise. Finally, the lack of a developed interbank market tends to increase the accumulation of liquidity by the banking system, as liquidity is not significantly traded.

[6] One could admittedly question whether the 8 percent ratio is adequate given the environment of Senegal, but this is beyond the scope of this paper.

[7] The accounting convention followed by the banking system for NPLs and provisioning is not in line with best international practices. For instance, a claim becomes nonperforming after 6 (not 3) months of missed payments.

C. Microfinance

9. After a period of consolidation spearheaded by the authorities, the microfinance sector has continued its rapid expansion. A regulatory reform initiated in 2008-09 led to a reorganization of supervisory responsibilities, with the larger institutions holding assets and/or deposits of more than CFAF 2 billion now supervised by the banking commission, while smaller institutions are supervised by the Ministry of Finance. Following the reform, 118 entities were closed down, though credit (and deposits) continued to rise, from CFAF 81 billion in 2005 to CFAF 219 billion in July 2012 (about 3 percent of GDP). Consolidation has led to the emergence of 18 larger entities which together represent 90 percent of the market, with one institution alone making up 60 percent of the market. Credit is mostly allocated to micro businesses in trade, services such as catering, agriculture, and transportation. Larger MFIs cooperate with various commercial institutions in transferring money and increasingly use banks to finance operations as they do not have access to BCEAO refinancing.

10. The larger MFIs are increasingly competing with banks. In 2012, the asset holdings of the largest MFI make it as big as the seventh largest bank. Four MFIs have been transformed into corporations ("sociétés anonymes") and are capitalized, often with the support of donors; one MFI has even set up its own bank. Larger MFIs enjoy certain advantages that may improve their competitive position relative to commercial banks:

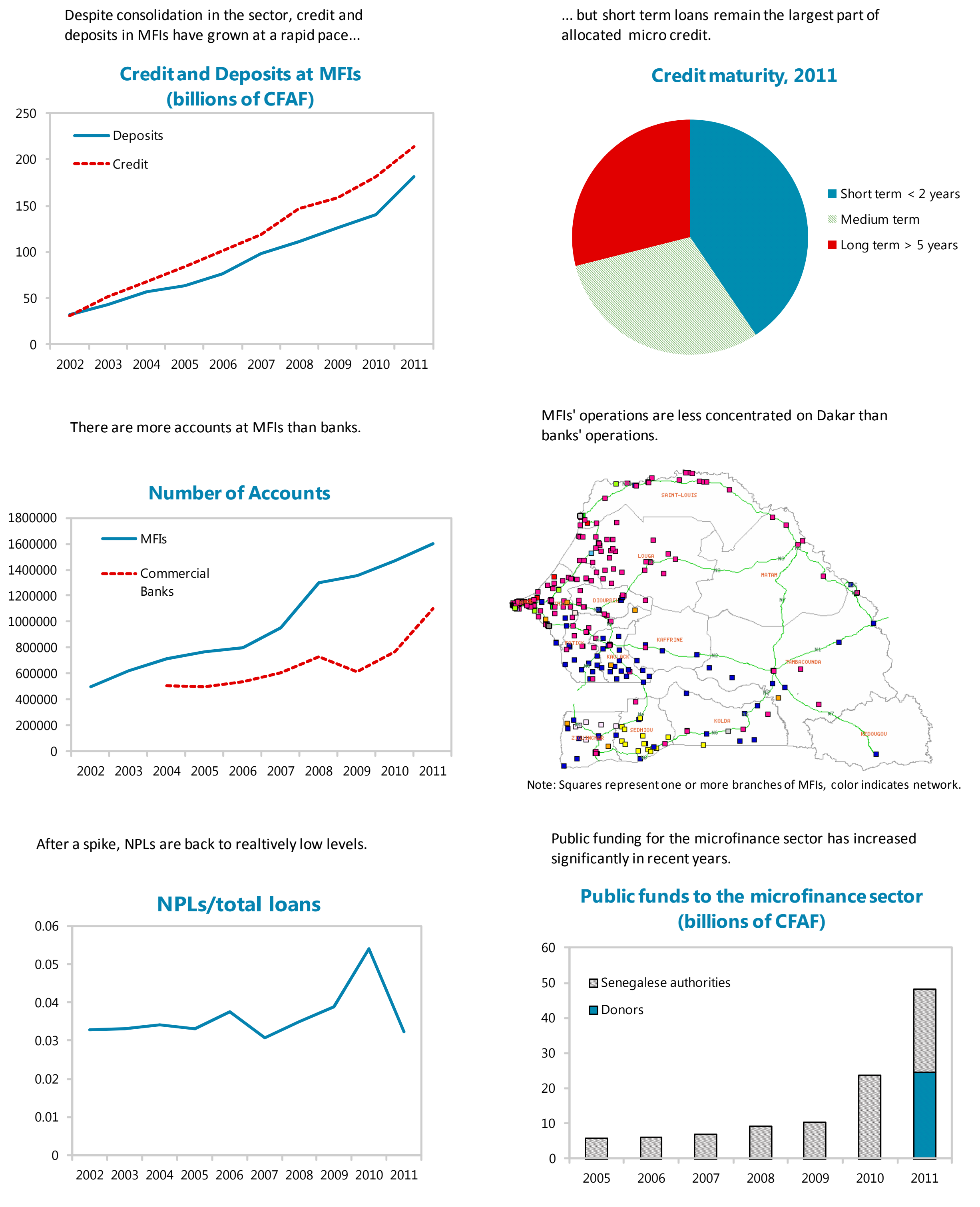
- Most MFIs are structured as cooperatives, benefitting from tax exemptions which were originally justified by their social mandate and not-for-profit motive;

- The cap on interest charged for loans is 27 percent for MFIs but 18 percent for banks;

- MFIs often benefit from public and/or donor support via (i) direct or indirect funds which constitute cheap financing; (ii) guarantees; and (iii) training of staff.

11. Although the MFI sector is profitable overall, the situation varies greatly depending on the size of the institutions. In 2011, the 18 larger entities generated cumulative profits of CFAF 4.5 billion while the other institutions had cumulative losses of about CFAF 0.5 billion. One reason for smaller MFIs' poor profitability might be that the rapid expansion of the sector has shrunk the pool of "lower-risk" clients, and forced MFIs to grant credits to "higher risk" borrowers, while entering new areas or offering new products in which they may lack expertise. Also, smaller networks tend to be in rather remote areas with a high share of credit to agriculture, which is highly volatile and prone to shocks.

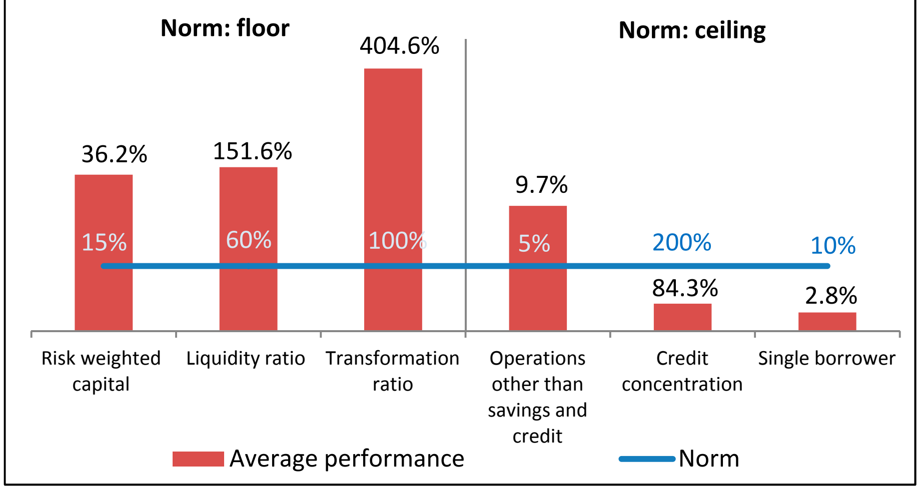
Figure 2. The Microfinance Sector



Source: Ministry of Finance, BCEAO, Staff calculations

12. FSIs for the larger MFIs suggest a relatively sound situation. As of June 2012, only one prudential norm, the cap on operations other than savings and credit (money transfer, for instance) has not been met (Figure 3). However, the sector misses indicative profitability benchmarks.[8] Further, the mutual structure may also raise collective action problems–particularly for institutions with a large number of members–potentially raising governance and accountability issues. Governance problems were indeed experienced by the largest MFI in recent years but were addressed forcefully by the authorities.

Figure 3. Selected Prudential Norms for Microfinance



Source: BCEAO

D. Systemic Risk in Senegal

13. Systemic risk is defined as any threat of disruption to financial services that is caused by an impairment of all or parts of the financial system and that has the potential to have serious negative consequences for the real economy. It is a form of negative externality that occurs when a bank failure, market seizure, or breakdown of the infrastructure can have serious adverse implications for market participants. Systemic risk can be decomposed into time-series and cross sectional risk. In the *time-series dimension*, the build-up of risk over time interacts with the macroeconomic cycle. Financial institutions and borrowers may take on excessive amounts of leverage in the upswing of an economic cycle only to become overly risk-averse in a downswing. This amplifies the boom and bust cycle in the supply of credit and liquidity—and by extension in asset prices—which can be damaging to the real economy. In the *cross-sectional dimension*, the growing size and complexity of the financial system is raising interconnectedness and common exposures which may increase contagion when problems arise. As a result, the failure of one institution—particularly, one of significant size or with strong interconnections—can threaten the system as a whole.

[8] Performance vis-à-vis profitability benchmarks is as follows: return on equity (5 percent vs. a target of 15 percent); return on assets (2 percent vs. a target of 3 percent); profit margin (13 percent vs. a target of 20 percent); and cost income ratio (81 percent vs. a target ranging between 40 and 60 percent).

14. At this juncture systemic risk is likely to be limited in Senegal, as no sector seems highly leveraged (Box 2). Banks in Senegal finance mostly prime borrowers with short-term credit such as trade finance, implying that risks to the financial system, besides from exogenous shocks, are likely to be low.

15. Time-series systemic risk has been low so far. The correlation between credit growth and GDP growth has been very limited so far (at about 0.1). This reflects low financial depth—which means that even a large increase in credit to the economy remains relatively small relative to GDP—and leverage which does not fluctuate much over the business cycle. In addition, Senegal has not been subject to large capital in- and outflows that often constitute the source of time-series volatility in emerging markets (see Figure 4).

Box 2: Leverage in Senegal

Leverage levels in Senegal are low to moderate. The mirror image of a relatively low credit to GDP ratio is low leverage levels in the economy. Government debt, while on a rising trend, remains manageable; corporate, banking and household leverage levels are low to non-existent.

A. The **government** has in recent years accessed the international capital market, but it borrows abroad largely from donors on concessional terms. Domestically, borrowing takes place largely through the regional bond market. Domestic debt has increased rapidly in recent years, but remains at manageable levels (about 10 percent of GDP).

B. **Banks** finance themselves largely out of deposits, with limited debt issuance, keeping leverage in check. In addition, banks generally are highly liquid.

C. As bank lending takes place against guarantees rather than future cash flows, only **households** with significant assets are in a position to borrow, but even they tend to have low gearing ratios. Most other households are credit-constrained, and hence unable to leverage up, at least in the formal market. In rural areas, there may be pockets of households that are overleveraged from having borrowed from MFIs, though no data is available on that.

D. The **corporate sector**, similar to the household sector, is dual in nature. One part is composed of a few, large companies with strong balance sheets that largely borrow short-term to finance working capital, but have low leverage levels; the other part is the SME sector that is largely credit constrained and hence unable to leverage.

16. Most common forms of cross-section systemic risk are not a major concern at the moment, although some developments need to be closely monitored. Interconnection among banks is limited (Figure 4)**.** This reflects, in particular, the underdevelopment of money market. Risks arising from common exposure seem limited too, although there is high lending concentration in most banks.[9] This is because the top borrowers tend to differ across banks. The main exception is the government, as many banks hold government debt. With the planned development of the interbank and government debt market, bank interconnectedness could increase quickly and will need to be monitored.

[9] Related party lending rules, while less stringent than in other jurisdictions, do not seem to be a major factor behind the high lending concentration.

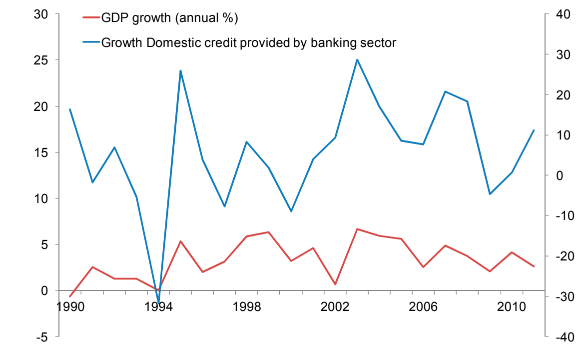
17. Interconnection between banks and the rest of the financial system is significant and needs to be monitored too. Insurance companies use bank deposits as an investment vehicle, rather than simply for liquidity purposes. Insurance companies also buy regional bank bonds and have equity participation in some of the banks. In addition, microfinance institutions also place their money in banks, with one MFI even owning a bank. Lack of detailed data did not allow further analysis of the importance of these linkages, but such a risk mapping warrants further investigation by the authorities.

18. None of the Senegalese banks fits the definition of being too big to fail, suggesting that this form of cross-section systemic risk is contained.[10] A systemically important financial institution (SIFI) is an institution whose eventual demise would create havoc for the rest of the financial system because of its size, interconnectedness, complexity, international linkages and/or the lack of available substitutes for the service it provides. Société Générale and BNP Paribas, which have subsidiaries in Senegal, have been designed as SIFIs by the Financial Stability Board. This is not the case of the parents of other foreign-owned subsidiaries, or any domestically-owned bank.

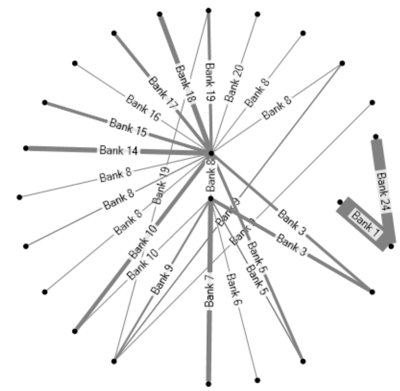
[10] The focus on too big to fail banks does not mean that the failure of a smaller bank is not an important issue; such a failure needs to be handled well to avoid raising concerns about the health of the remaining banks.

Figure 4. Senegal: Time-Series and Cross Sectional Risk/1

Time-series risk is low.

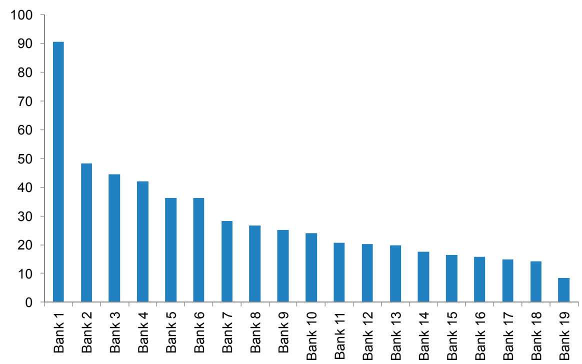


Interconnection through the interbank market is limited (October 2011).

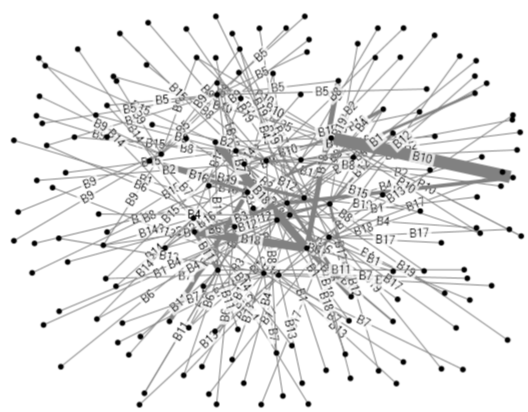


Concentration of lending is high...

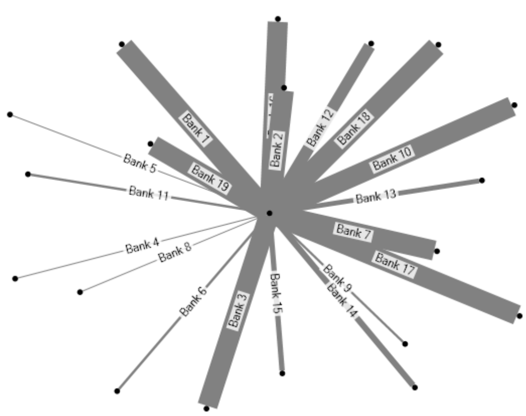
Share of Credit of 5 largest Private Sector Borrowers



... though common exposure through top-10 borrowers is small

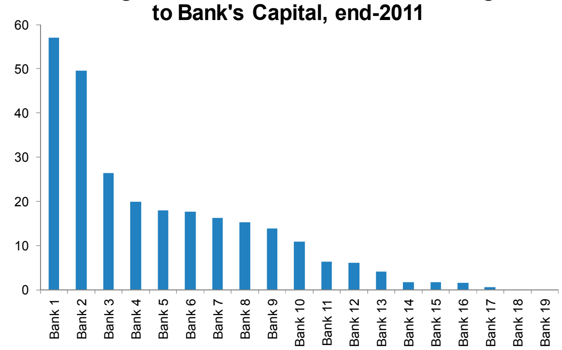


... but common exposure to government is sizable ...



...with concentration risk to the domestic sovereign particularly acute.

Senegal. Government Bond Stock Holdings to Bank's Capital, end-2011

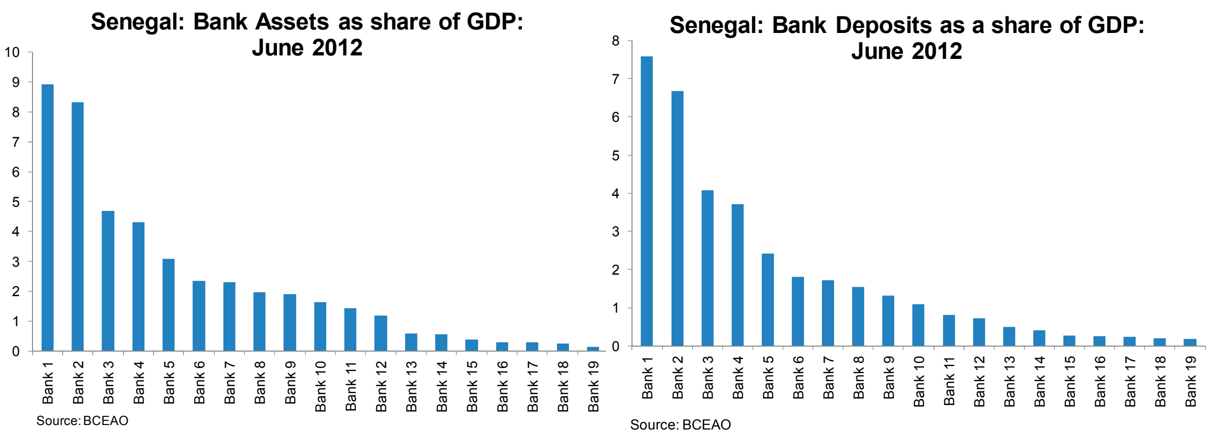


Source: BCEAO

Sources: BCEAO, World Bank, IMF staff estimates

/1 For interconnection charts, both the number of connections and the size of the line matter for the interpretation. More connection to an individual entity means higher interconnection risk, while a thicker line means higher exposure.

Figure 5. Senegal: Bank Assets and Bank Deposits



BENCHMARKING SENEGAL'S FINANCIAL SECTOR: WHAT DO INTERNATIONAL COMPARISONS TELL US?

A. Methodology of the Benchmarking Exercise

19. The benchmarking exercise allows an assessment of Senegal's financial sector performance with respect to depth, breadth, access, and efficiency.[11] For each key financial sector indicator, a structural benchmark is estimated based on the country's economic and structural characteristics.[12] The difference between the observed value and the benchmark then needs to be interpreted. A negative difference suggests scope for policy action, while a positive difference could reflect successful reforms. The analysis was carried out using data from 1995 onwards, where available, and the tool developed by the World Bank for this purpose.

[11] This exercise only considers the banking market, debt and equity markets as well as some non-bank financial institutions. Due to limitations in the dataset, microfinance could not be benchmarked.

[12] The structural benchmarks are calculated based on Al-Hussainy et al. (2010) and FinStats from the World Bank. Using a large dataset of countries, each financial indicator was regressed on a set of structural characteristics, such as GDP per capita and its square, population size and density, the age dependency ratio and country-specific dummies and year fixed effects. These regressions are expected to be updated regularly.

20. Comparisons are also made with a few selected countries, namely Côte d'Ivoire, Kenya, and Morocco. Côte d'Ivoire was chosen because it is a member of the WAEMU and it shares a number of characteristics with Senegal. Kenya is an example of a sub-Saharan African economy with a rapidly developing financial sector. Finally, Morocco is a country that many Senegalese observers view as a potential model for financial development, and is used as an emerging market comparator.

B. A Financial Performance Broadly in Line with Structural Characteristics

Depth. Senegal outperforms the benchmarks for banking and insurance, but underperforms for debt and equity markets (Figure 6):

- Senegal's banking sector has deepened significantly in recent years with the ratios of credit and deposits to GDP now significantly above their benchmarks. Bank intermediation, measured by the credit to deposit ratio, is in line with the structural benchmark.
- Although low in absolute terms, the ratios of insurance sector assets and insurance premiums to GDP are significantly above their benchmarks.
- Debt markets are deepening but they remain below potential, particularly as a source of private sector financing.
- Taking into account its regional nature and the limited recourse to it by the private sector, the equity market looks underdeveloped, at least from a Senegalese perspective.

Breadth. The picture is more mixed with regard to the range of products, markets and providers (Figure 7).

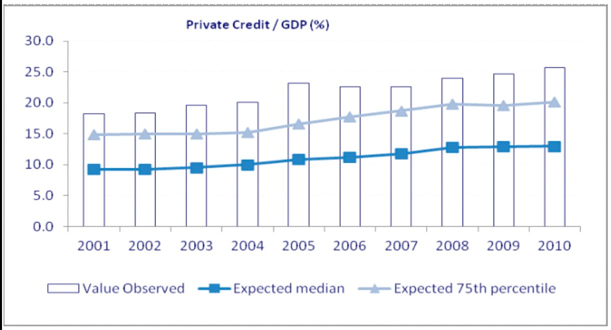
- The level of competition in the banking system—proxied by the asset concentration of the three largest banks or the interest rate margin—is close to the benchmark. More recent data (for 2011 and 2012) suggest that competition may have increased.
- The ratio of credit to the public sector to GDP is in line with its benchmark. This ratio has increased in recent years likely reflecting the development of the government debt market.
- The insurance sector outperforms the benchmark, in particular in life insurance.
- There is underperformance in the area of long-term financing, including from the regional stock market, where only one Senegalese company is listed against a predicted value of 30 companies.

Access. Access to banks is mostly in line the benchmarks, In particular, the number of bank branches relative to the population significantly outperforms the benchmark, and the gap has increased.

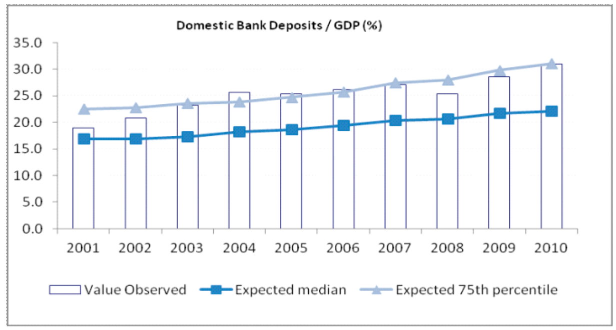
Efficiency and profitability. These are both broadly in line with structural characteristics for the banking sector. One exception is NPLs, which are significantly higher (and provisioning lower) than their benchmark.

Figure 6. Selected Indicators on Financial Sector Depth in Senegal

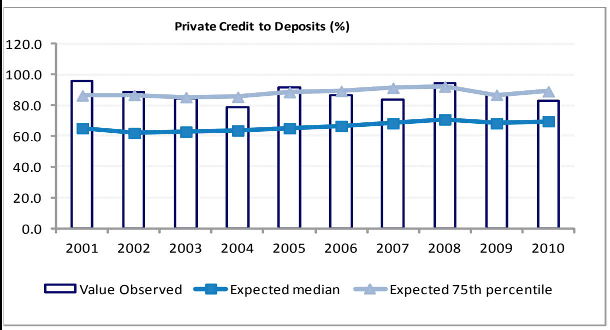
Credit to GDP significantly outperforms the median structural benchmark…



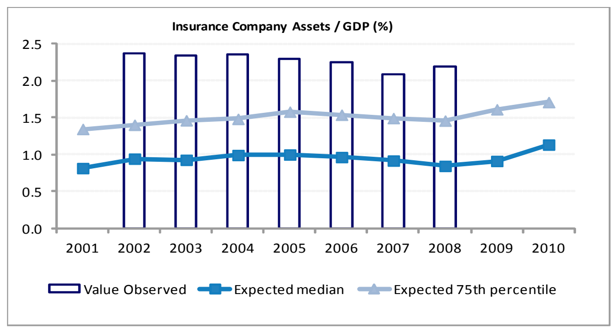
…the same holds for deposits to GDP…



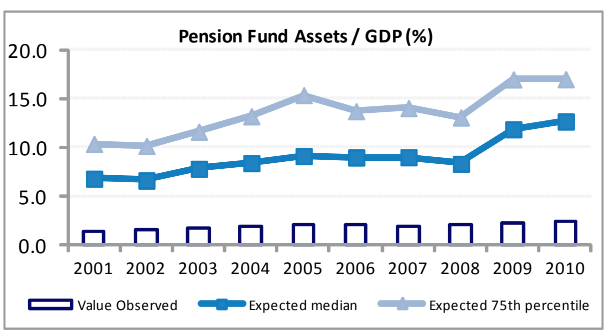
…and credit to deposits.



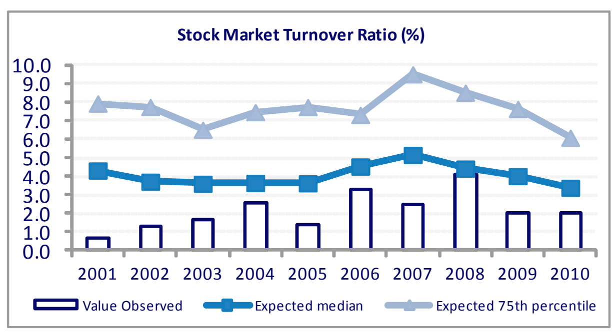
The insurance sector's depth is also higher than suggested by the benchmark.



..unlike the pension fund…



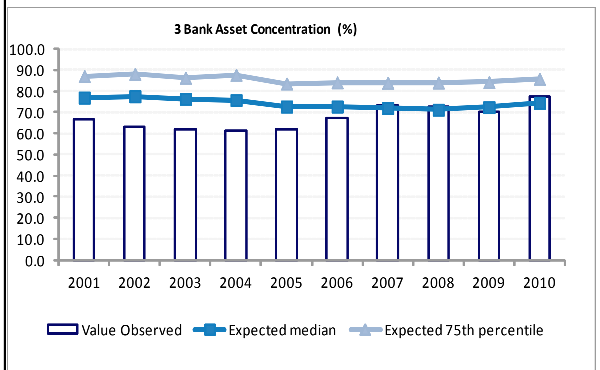
… and equity markets.



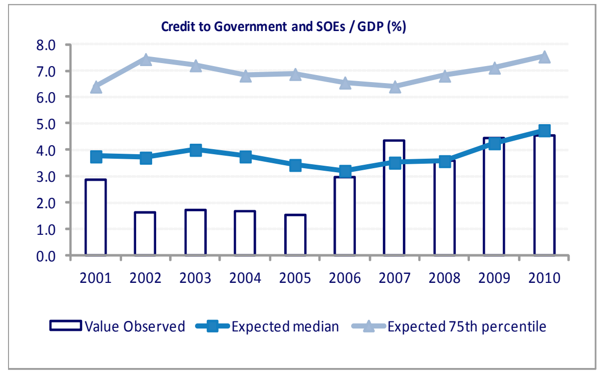
Source: FinStats Database

Figure 7. Selected Indicators on Breadth and Access in Senegal

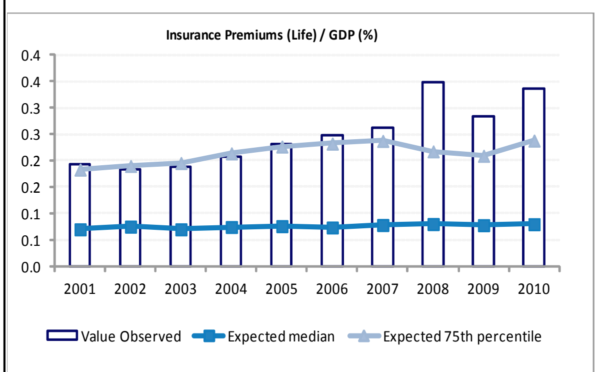
Asset concentration of banks operating in Senegal is in line with structural characterstics...



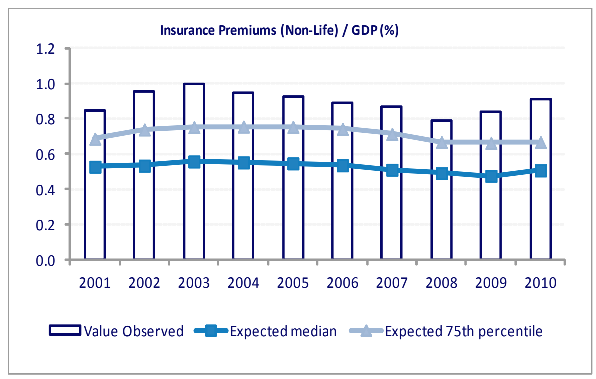
...and so is bank credit to the public sector.



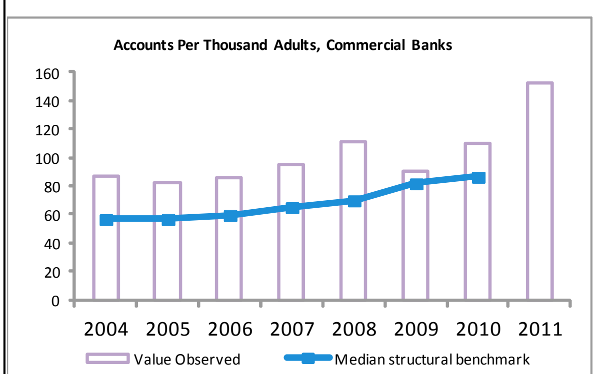
Life insurance premiums to GDP clearly outperform the benchmark...



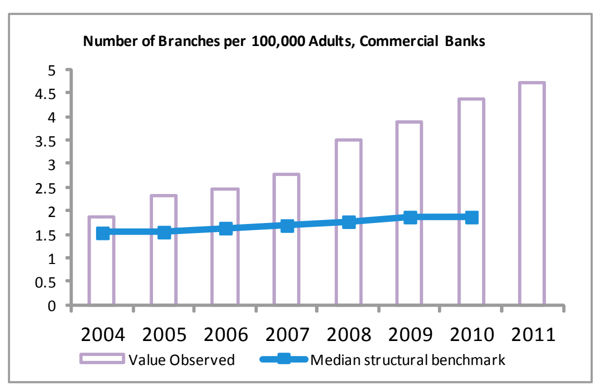
...as well as non-life insurance premiums to GDP.



The number of bank accounts has been slightly above the benchmark...



... and the number of branches way above its benchmark.



Source: FinStats Database, Ministry of Finance

C. But with Still Substantial Scope for Deepening

21. While statistical benchmarking shows that Senegal is not lagging in terms of financial sector development, direct comparison to selected peer countries suggests substantial scope for further deepening. Even for indicators for which Senegal outperforms the benchmarks, there is still some distance to peer countries. Policy action may be warranted to catch up with them, in particular Kenya which has overtaken Senegal on various indicators over the past five years, despite having started at similar levels.

- **Depth**. Kenya's deposits and credit to GDP ratios are about 10 percentage points higher than Senegal's while Morocco's are more than twice as high. Even though Senegal's insurance market performs very well compared to the structural benchmarks, the share of insurers' assets to GDP in Côte d'Ivoire, Kenya and Morocco is significantly larger. Stock market capitalization to GDP has picked up markedly in Kenya since 2002.

- **Breadth**. Kenya has been able to reduce bank asset concentration since 2003, starting from the same level as Senegal then. Life insurance premiums have increased much faster in both Kenya and Côte d'Ivoire than in Senegal throughout the past decade. Also, there is a big difference in the development of the equity market, with 50 listed companies in Kenya and more than 70 in Morocco, but only one in Senegal.

- **Access**. Although broadly in line with other peers including Kenya, access is significantly lower than in Morocco for firms as well as for households. However, the indicators may not reflect the impact of mobile banking on access. Mobile banking has developed very quickly in Kenya, but not in Senegal.

GAINS FROM FURTHER FINANCIAL DEEPENING [13]

A. Impact on the Private Sector: Dealing with Volatility and Financing Growth

22. Shallow financial markets make it more difficult for firms and households to access financial services, leading to:

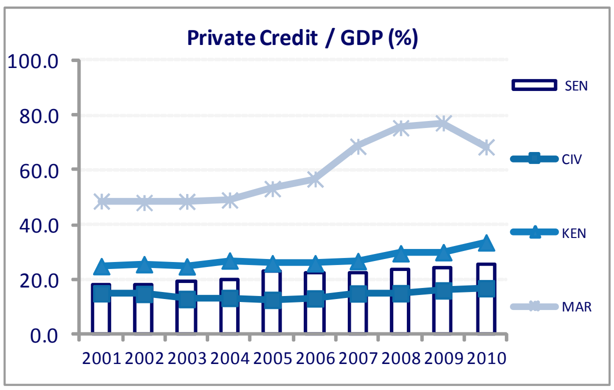
- **Higher volatility:** One of the key functions of banks—to enable agents, including households, to smooth consumption over time—is not performed by an underdeveloped banking system. Shocks have to be fully absorbed by a household's existing assets, and should they be insufficient, adjustment has to be instantaneous, leading in extreme cases to destitution or worse. Shallow banking systems tend to create pro-cyclical financing conditions, providing the private sector with credit in good times, but cutting it back in bad times, accentuating volatility. Financial sector development can help alleviate these liquidity constraints, thereby ultimately reducing volatility.

[13] The Article IV consultation with Senegal only focused on the fiscal implications of a shallow financial system, as monetary policy is set at the regional level. The consequences on the latter one will be analyzed during the regional consultation to be held in early 2013.

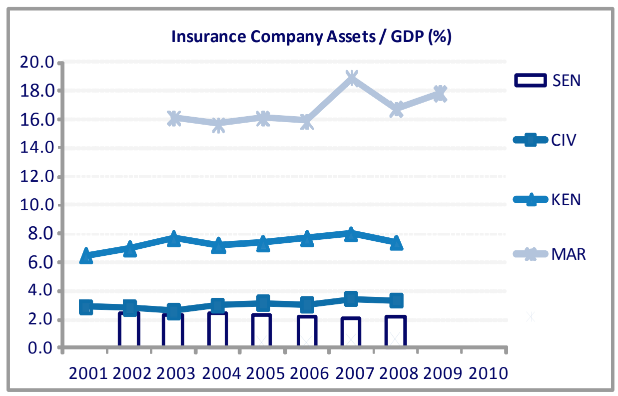
- **Lower growth**: Financial development affects economic growth by facilitating the mobilization of savings to finance investment and by contributing to a better allocation of resources. Rioja and Valev (2004a) find that finance boosts growth in rich countries primarily by raising productivity growth, while finance encourages growth in poorer countries primarily by increasing capital accumulation. Furthermore, Rioja and Valev (2004b) find that the impact may be nonlinear: Countries with very low levels of financial development experience little growth acceleration from a marginal increase in financial development, while the effect is larger for rich countries and particularly large for middle-income countries.

Figure 8. Comparing Senegal to Selected Peer Countries

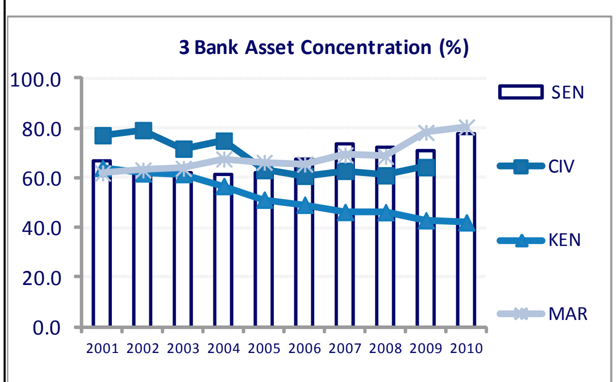
Morocco and Kenya outperform Senegal in terms of credit to GDP...



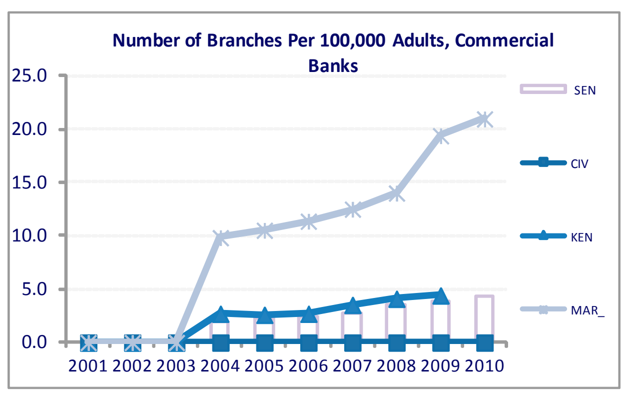
...and development of the insurance sector.



Kenya has managed to reduce asset concentration substantially...



...while Morocco has increased access dramatically.



Source: FinStats Database, IMF staff calculations, BCEAO

B. Impact on the Public sector: Removing Constraints on Fiscal Policy

23. The constraints on fiscal policy stemming from a shallow financial system are multiple, though not always visible:

- **Liquidity (and interest rate) risk**: With a large part of domestic debt issued at relatively short maturities, liquidity risks faced by the government are significant. Should regional liquidity dry up, the government would be in a difficult position to roll over its debt, and may have to finance itself through undesirable means such as arrears, turning a fiscal issue into a financial stability risk (if arrears to banks) or a risk to private sector development (if arrears to suppliers). This situation was experienced to some extent by Senegal in early 2012. Difficulties in raising financing ahead of the presidential election led to significant payments delays to suppliers. Short maturities also expose to significant interest rate risks.

- **Fiscal cost**: A deeper financial market, by creating more liquidity and allowing for economies of scale—reducing average cost of issuance by utilizing the same infrastructure— in debt issuance, may reduce the marginal cost of borrowing to the sovereign. These costs tend to be high presently in Senegal, particularly for longer maturities. For instance, the yield at issuance for bonds with maturities of three to five years was in the 7-9 percent range in the first half of 2012, while average inflation was around 2 percent.

- **Scope for counter-cyclical policy:** Senegal's economy is susceptible to shocks. This puts a premium on fiscal flexibility, particularly since monetary policy is set at the regional level and therefore cannot address the impact of asymmetric shocks. A deeper financial system would give the government more scope to run counter-cyclical policies in the event of a shock, potentially reducing the need for large fiscal adjustment which would particularly affect the part of the population that lives close to the subsistence level and has itself limited access to credit. It would also help keeping the pace of execution of investment projects, which if delayed would generally results in higher fiscal costs (beyond lost output in the medium term).

- **Diversified investor base**. An investor base that is homogenous and narrow, by carrying similar risk preference and time-horizons, is a concern. It creates a market that may be easily disrupted. In the case of Senegal, the liquidity of the debt market is highly dependent on the liquidity situation of banks, which are the main investors.

- **Financing public investment**. A shallow financial system limits the ability of the government to finance long-term investment with large economic and/or social rates of return. This is particularly pertinent for Senegal, given the need for timely infrastructure investments in energy and transportation.

FURTHER DEEPENING WITH STABILITY: OBSTACLES AND RECOMMENDATIONS

24. The development of the financial system should be pursued forcefully in a way that preserves financial stability. Financial systems play a crucial role in facilitating growth and helping reduce vulnerability and poverty. From this perspective, there is no doubt that further financial development is highly desirable in a low-income country like Senegal. However, financial system can also be a source of volatility and crisis, particularly when they become large and/or highly interconnected. There is large body of evidence that financial crises are usually preceded by rapid growth in financial aggregates. As discussed earlier, Senegal's financial system remains relatively small and interconnectedness is limited, and therefore these risks are presently lower than in more developed countries. While this suggests that further development should be the priority in Senegal when designing a strategy for the financial sector, the implications for financial stability should also be analyzed and addressed. Section IV.A analyzes the main obstacles to financial development, while Section IV.B discusses ways to improve the present and future stability of the financial system. The main recommendations are summarized in Table 2.

A. Obstacles to Further Financial Development

25. There is a broad agreement between the authorities and the Fund on the main obstacles to further financial development.[14] Many of these obstacles which have been well identified in the past few years are commonly found in low-income countries. They include:

- **Informational asymmetries**. Lack of information on borrowers, including due to the limited size of the formal sector, the limited availability of audited company statements and the absence of credit bureaus (and limited use of existing databases at the central bank), increases adverse selection and moral hazard issues, and ultimately leads to credit rationing (Figure 9). This problem also affects the larger MFIs, which tend to lend to some of the banks' customers too. Information asymmetries are also an issue for the development of the interbank market.

- **Business and judicial environment.** A key issue is the absence of formalized property rights in large parts of the country, which increases the difficulty of using land as collateral in lending. Moreover, the judicial process tends to be costly and slow, with some recent judgments viewed by lenders as motivated by social considerations rather than legal merit. This inability to recoup losses at a reasonable cost, through collateral initially pledged, discourages lending further, particular to new segments.

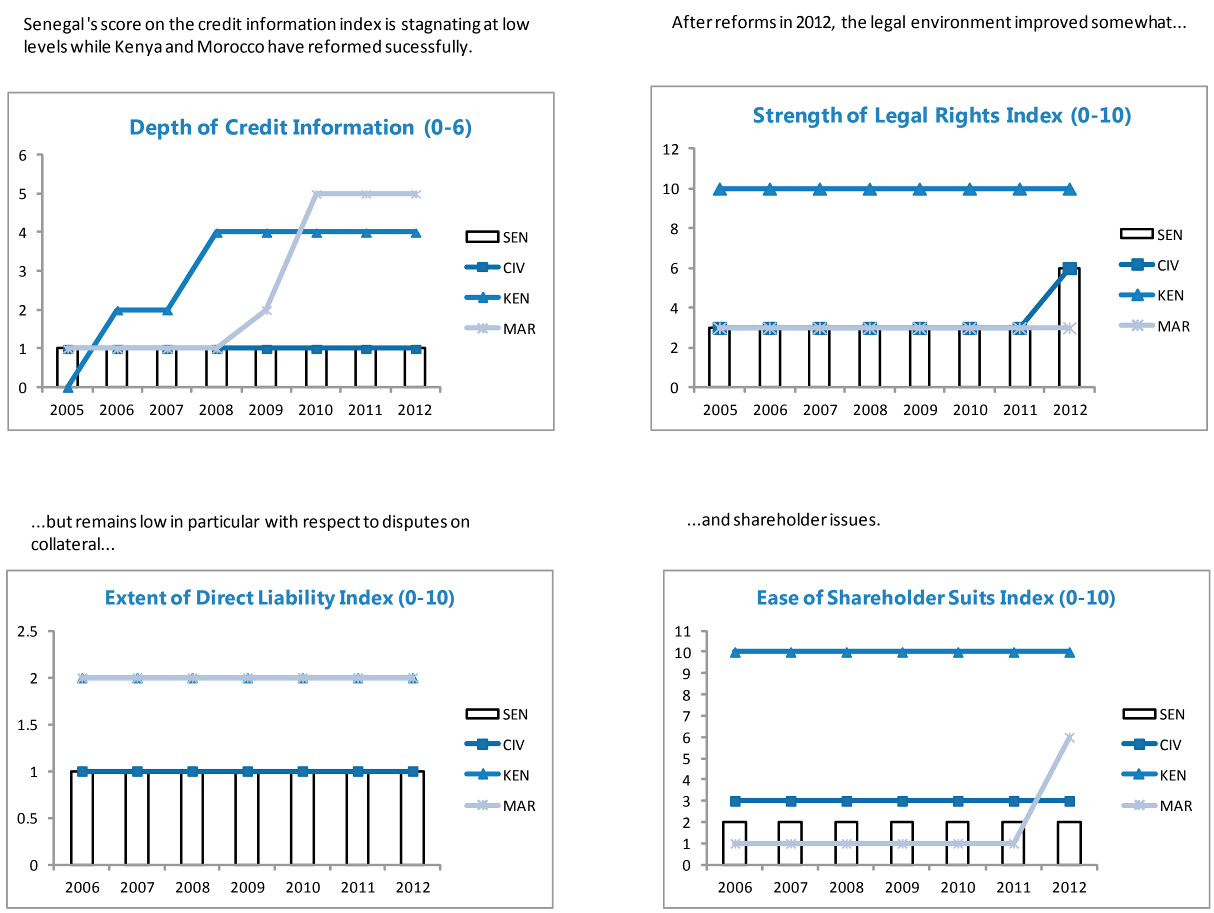
- **Tax regime.** Taxes and fees on banking and stock exchange operations are relatively high. This raises the cost of financial services and reduce demand for them.

- **Regulatory and supervision issues.** Some regulatory ratios, such as the transformation ratio, are perceived as excessively constraining and curbing the development of medium and long-term credit. This ratio, as well as a few others (see below), are not observed by a number of banks. This situation can affect the credibility of the banking system regulatory and supervisory framework and exacerbates the informational problems mentioned above. Another issue is whether the prudential framework is sufficiently responsive to new needs that are likely to emerge first at the national level, but will eventually need to be regulated at the regional level. When a country is at the forefront of financial sector reform, which seems the case of Senegal on certain issues (e.g., credit bureaus, Islamic banking), the need to develop or amend regulations at the regional level may slow the reform process. It should however be recognized that by pushing for reforms to develop their national financial sectors, countries closer to the reform frontier create positive spillovers for the entire region.

[14] These issues were discussed in the Senegal FSAP (2004) and the WAEMU FSAP (2008), and many analyses and recommendations made at the time remain valid.

- **Skills.** The quality of human capital is critical for banks and MFIs, as it provides the necessary risk-management expertise and the ability to design and sell the products that customers need. The lack of appropriate skills may explain why in recent years some MFIs that moved from dealing with micro-enterprises to dealing with SMEs saw their profitability decrease. Banks may face similar challenges moving from larger enterprises to SMEs. The lack of financial culture is also often blamed for the very limited recourse to the stock exchange.

Figure 9. Senegal's Performance in Selected Doing Business Indicators



Source: World Bank, Doing Business Report 2012

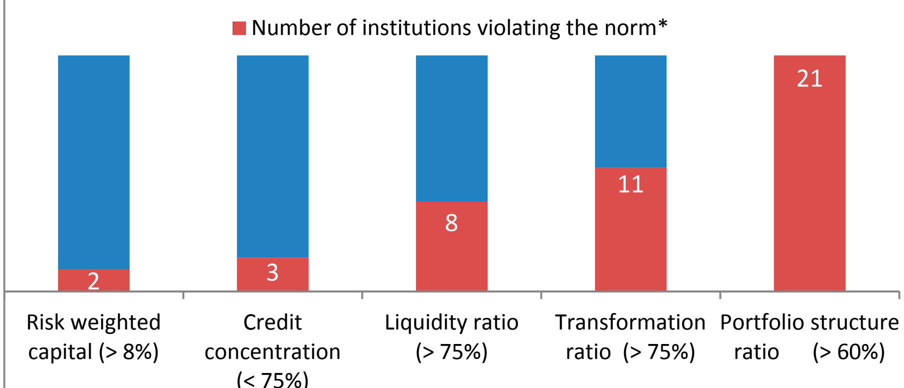
26. The authorities have a strategy to address a number of these issues whose implementation needs to be accelerated. The national consultation on credit took place in 2010. It identified clearly the main obstacles and led to an action plan with specific measures to improve access to credit for both households and firms, particularly SMEs. These measures are grouped in 11 different categories, including among others: facilitating the use of guarantees; SME debt and equity financing and general support to SMEs; availability of information; cost of credit; financial intermediation and the judicial environment. Progress was made in some areas, such as registering land titles and information provision (although the introduction of credit bureaus, for instance, was delayed to allow for a regional approach to the issue). While measures on the mobilization of resources are generally behind schedule, the study to determine the share of stable resources among bank deposits has been completed by the Senegalese banking association. This study is a pre-requisite for the regional regulator to the reconsideration of the transformation ratio which banks view an impediment to the availability of longer-term credit. Actions to improve the efficiency of the judicial process, such as the training of judges in economic affairs, are generally behind schedule, and so are measures aiming at streamlining and improving public support in favor of SMEs. Staff is of the view that this action plan remains largely relevant and that its implementation should be accelerated.

27. A number of obstacles will however need to be addressed at the regional level. As mentioned above, prudential regulation is a regional responsibility and so is the development of regional financial markets. As detailed in the latest report on WAEMU policies, the regional authorities are working on the development of the interbank market and the strengthening of the public debt market, which they see as priorities. They also intend to review certain prudential rules. These issues will be discussed in more details during the next regional consultation in early 2013.

B. Enhancing Financial Stability

28. Micro-prudential regulation of banks could be enhanced and supervision strengthened. As discussed in the 2012 report on regional policies, some prudential ratios and rules are not in line with international best practices. Banks' compliance with prudential rules will also need to improve (Figure 10). For instance, the transformation ratio is met by only 11 Senegalese banks, while no bank meets the portfolio structure ratio, which requires that at least 60 percent of a bank's credit portfolio be composed of rated assets. In these specific cases, low compliance may reflect the perception by banks that certain rules are inadequate. Low compliance, however, also suggests a need to strengthen bank supervision and the enforcement of corrective measures.[15] New challenges, such as the need to monitor the rapid development of banking groups in Senegal and more generally the region, also call for strengthened supervision. These issues will be discussed during the next regional consultation in early 2013.

Figure 10: Selected Prudential Norms for Banks and Non-bank Financial Institutions



* 21 institutions, of which 19 banks and 2 non-bank financial institutions

Source: BCEAO

[15] The portfolio structure ratio, which requires that at least 60 percent of a bank's credit portfolio be composed of rated assets, is problematic in an environment where few rated entities exist with the requisite characteristics.

29. With the financial system growing and getting more interconnected, systemic risk issues will be more likely to arise in the future and will need to be mitigated. Financial regulation in the WAEMU region, like in many countries or regions abroad, is mostly based on the microprudential paradigm that assumes that by making each financial institution safe, the system as a whole is safer. A macroprudential approach to regulation instead considers the systemic implications of the collective behavior of financial institutions—e.g., what would happen in the WAEMU if suddenly all banks decided to stop buying sovereign debt? The recently established Financial Stability Council, which comprises all the key regulators at the regional level, is there to monitor the emergence and limit the consequences of systemic risk. Its activity and effectiveness will be discussed in the context of the next regional mission.

30. With the increasing interconnectedness and breadth of its financial system, Senegal may need to develop a more holistic view of the system and of systemic risk at the national level. At present, it seems that no single entity within Senegal has a detailed view of the whole financial system, the interconnection of its various components, and where the potential pockets of systemic risk may lie. Such a function should be developed in Senegal, preferably under the purview of the Ministry of Finance, and in close collaboration with the other regulators and supervisors, particularly the BCEAO. The institution responsible for this function would also be well placed to reflect on the scope for national macroprudential regulation to address country specific systemic risk.[16] Such a reflection should obviously be conducted in concerted fashion with the regional authorities and regulators.

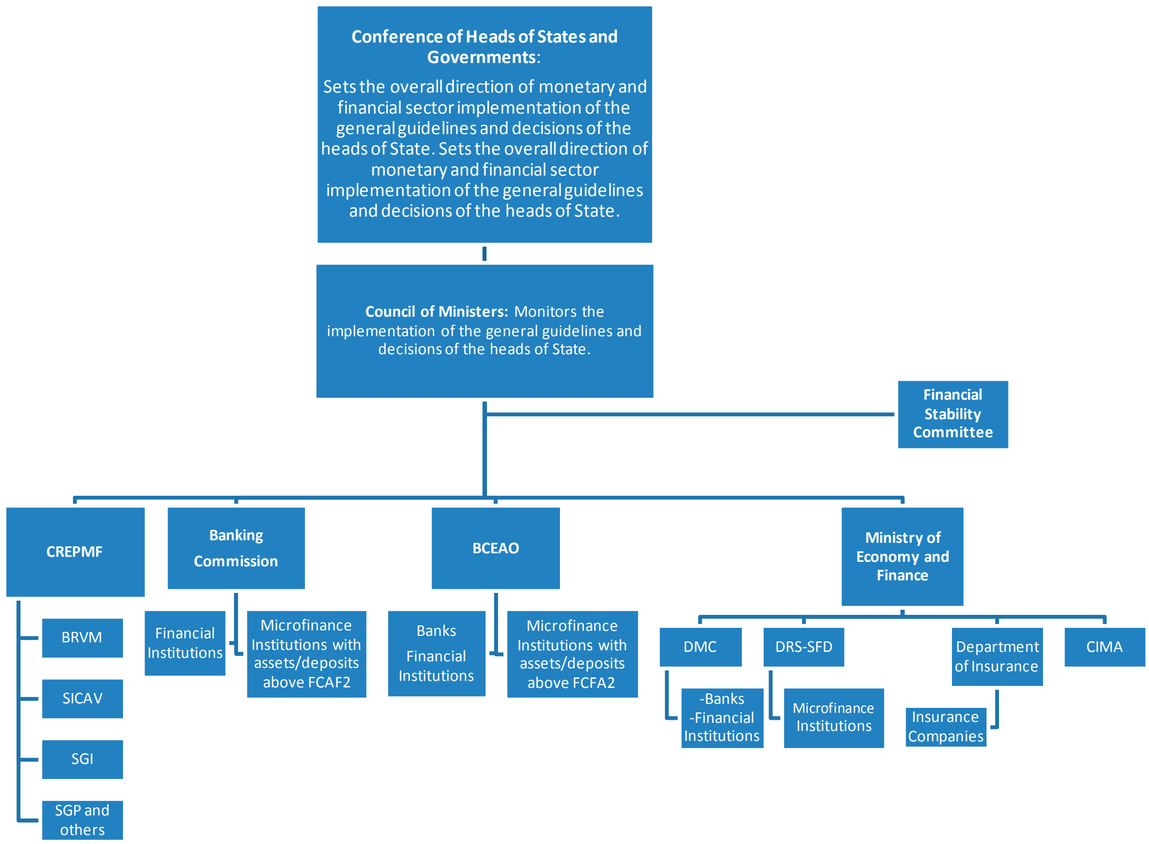
[16] This approach has been followed in the Euro area. European Systemic Risk Board (ESRB) was established in December 2010, charged with providing macro-prudential oversight of the EU the financial system as a whole. In addition, in January 2011, the Committee of European Banking Supervisors (CEBS), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Committee of European Securities Regulators (CESR) were replaced by European Supervisory Authorities (ESAs) to create a new European System of Financial Supervision (ESFS). The ESRB, tasked with monitoring, identifying, and predicting potential systemic risks and issuing recommendations. At the same time, the ESRB collaborates with ESAs, providing them with the necessary macro-prudential input to assist them in carrying out their supervisory functions. One of the ESRB's first decisions was to recommend the establishment of an efficient macro-prudential policy framework in each EU Member States. The recommendation was for each member state to designate an authority in national legislation to conduct macro-prudential policy. Cooperation between the national macro-prudential authorities and the ESRB would be warranted, particularly to enable the timely identification and subsequent discussion of relevant cross-border issues.

Box 3: Bank Supervision and Resolution in Senegal: Division of Labor Between the National and the Regional Authorities

The architecture of the supervisory system is based on a clear division of labor between the national and regional level (see Figure 11). Banks and other large deposit-taking institutions (including MFIs) are supervised at the regional level by the BCEAO and the WAEMU Banking Commission. Smaller microfinance operators are supervised at the national level by the Ministry of Finance. Capital market activity is supervised regionally under the supervision of the Regional Council for Public Savings and Financial Markets (CREPMF, as per its french acronym). The Ministry of Finance, in conjunction with the supra-regional insurance sector regulator CIMA ("Conférence Interafricaine des Marchés d' Assurances"), supervises insurance companies. The 2010 cenral bank reform created the Financial Stability Council, charged with macroprudential supervision and guaranteeing the stability of the overall financial system at the regional level.

The resolution framework similarly depends on a sharing of responsibilities between national and regional bodies. The national directorate of the BCEAO – which is regularly collecting data on various financial indicators and carries out offsite supervision–is typically the first body to detect difficulties at a financial institution. It flags potential operational and stability concerns to the banking commission, with the concerned national authority kept informed. The banking commission is reponsible for on-site supervision. When concerns arise, joint inspections comprising members of both the banking commission and the BCEAO national directorate intensify the supervision of the institution. Evidence from on-site and off-site inspections guides the banking commission's decision on possible prompt corrective actions or possible sanctions. In case of solvency concerns, the banking commission can recommend the closing of an institution. The banking commission informs the Ministry of Finance, which is the body that has to formally rescind the banking license. The Minister of Finance, however, has the possibility of appealing to the council of ministers, where a simple majority could overrule the banking commission's decision.

Figure 11: Organigram of the Supervisory System in Senegal



Source: Ministry of Finance

31. Another area for further work is the financial crisis prevention and resolution framework. The fact that technically insolvent banks have been allowed to continue operations in some WAEMU countries may reflect weaknesses in the bank resolution framework (Box 3). As shown by the euro-area experience, having a good framework in place will be increasingly important with the deepening of the financial system and further regional integration. Developing the financial crisis prevention system is also an important task. Work is ongoing in this area, for instance on the creation of a regional financial stability fund and the establishment of a deposit insurance scheme. These are areas that will require close cooperation between the national and the regional authorities.

Table 2: Summary of Recommendations on Financial Sector Development and Stability

Recommendations	Responsible authorities
Development	
Accelerate implementation of the action plan that followed the National Consultation on Access to Credit, particularly with regard to: • Increasing the availability of information on borrowers. This could cover banks and larger MFIs • Facilitating the use of guarantees. • Reduce cost of using the legal system, including by increasing resources	National
Develop the interbank market	Regional/National
Develop the government debt market by broadening the range of investors and fostering the development of a secondary market	Regional/National
Level the playing field between banks and larger MFIs, for instance by facilitating the transformation of the latter into banks	National/Regional
Review financial activity taxation, after the new tax code has been implemented and revenue concerns have decreased	National
Development and stability	
Review bank regulations to facilitate further deepening while preserving stability. Priority should be to address the regulatory ratios which are systematically breached by most banks. Ultimately, bring regulations to international standards.	Regional/National
Stability	
Strengthen bank supervision	Regional
Have a unit in the ministry of finance that has a holistic view of the financial system and systemic risks in Senegal	National
Enhance further the national/regional coordination to ensure high responsiveness of the prudential framework to new needs	National/Regional
Review and strengthen the financial crisis prevention and resolution framework to ensure that it remains adequate to address new risks (e.g., development of cross-country banking).	Regional/National

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INTERNATIONAL MONETARY FUND

SENEGAL

November 26, 2012

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION, FOURTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT, AND REQUEST FOR MODIFICATION OF AN ASSESSMENT CRITERION—INFORMATIONAL ANNEX

Prepared By

The Staff of the International Monetary Fund in Consultation with the World Bank.

CONTENTS

RELATIONS WITH THE FUND

(As of September 30, 2012)

I. Membership Status: Joined: August 31, 1962; Article VIII

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	161.80	100.00
Fund holdings of currency (Exchange Rate)	159.97	98.87
Reserve Tranche Position	1.85	1.14

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	154.80	100.00
Holdings	130.20	84.11

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ESF Arrangements	121.35	75.00
ECF Arrangements	11.44	7.07

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ESF	Dec 19, 2008	Jun 10, 2010	121.35	121.35
ECF 1/	Apr 28, 2003	Apr 27, 2006	24.27	24.27
ECF 1/	Apr 20, 1998	Apr 19, 2002	107.01	96.47

1/ Formerly PRGF.

VI. Projected Payments to Fund 1/

(SDR Million; based on existing use of resources and present holdings of SDRs):

		Forthcoming			
	2012	**2013**	**2014**	**2015**	**2016**
Principal		3.47	11.56	24.15	25.66
Charges/Interest	0.00	0.32	0.34	0.30	0.24
Total	0.00	3.79	11.89	24.45	25.89

1/ When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. Implementation of HIPC Initiative:

	Enhanced Framework
I. Commitment of HIPC assistance	
Decision point date	Jun 2000
Assistance committed by all creditors (US$ Million) 1/	488.30

Of which: IMF assistance (US$ million)	42.30
(SDR equivalent in millions)	33.80
Completion point date	Apr 2004
II. Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	33.80
Interim assistance	14.31
Completion point balance	19.49
Additional disbursement of interest income 2/	4.60
Total disbursements	38.40

1/ Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts cannot be added.

2/ Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI):

I. MDRI-eligible debt (SDR Million)1/	100.32
Financed by: MDRI Trust	94.76
Remaining HIPC resources	5.56
II. Debt Relief by Facility (SDR Million)	

	Eligible Debt		
Delivery Date	**GRA**	**PRGT**	**Total**
January 2006	N/A	100.32	100.32

1/ The MDRI provides 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

IX. Safeguards Assessments:

The Central Bank of West African States (BCEAO) is a common central bank of the countries of the West African Economic and Monetary Union (WAMU). The most recent safeguards assessment of the BCEAO was completed on March 1, 2010. The 2010 update assessment found that the BCEAO continues to have controls in place at the operational level. The overall governance framework needed nonetheless to be strengthened by the addition of an audit committee to ensure that the Board of Directors exercises appropriate oversight over the control structure, including the audit mechanisms and financial statements. Such committee was established after the completion of the assessment following the Institutional Reform of the WAMU and the BCEAO. Efforts to implement fully the International Financial Reporting Standards reporting framework should also be pursued.

X. Exchange System:

Senegal is a member of the West African Economic and Monetary Union (WAEMU). The exchange system, common to all members of the union, is free of restrictions on the making of payments and transfers for current international transactions. The union's common currency, the CFA franc, had been pegged to the French franc at the rate of CFAF 1 = F 0.02. Effective January 12, 1994, the CFA franc was devalued and the new parity set at CFAF 1 = F 0.01. Effective December 31, 1998, the parity was switched to the euro at a rate of CFAF 655.96 = €1.

The authorities confirmed that Senegal had not imposed measures that could give rise to exchange restrictions subject to Fund jurisdiction. They will inform the Fund, if any such measure is introduced.

Aspects of the exchange system were also discussed in the report “WAEMU: Common Policies of Member Countries" (Country Report No. 12/59 of March 12, 2012).

XI. Article IV Consultations:

The latest Article IV consultation was completed by the Executive Board on May 24, 2010 (Country Report No.10/165). In concluding the 2010 Article IV consultation, Executive Directors welcomed the broadly satisfactory implementation of the Senegalese authorities’ economic program supported under the PSI and the ESF. While Senegal’s risk of debt distress is low, Directors underscored the need to gradually withdraw the temporary fiscal stimulus and reduce the budget deficit to a level consistent with debt sustainability. They welcomed the authorities’ plans to further strengthen revenue collection and stressed that spending pressures had to be contained to preserve macroeconomic stability and debt sustainability and meet the WAEMU convergence criteria, while safeguarding priority spending. Directors supported efforts to reform public financial management and emphasized the need to maintain the reform momentum. They encouraged the authorities to improve their liquidity and debt management to complement the increasing integrity of their budget framework and expressed concern about program slippages that indicate that closer attention needs to be paid to spending procedures and control mechanism. Directors saw room for further strengthening the authorities’ investment planning and evaluation with a view to ensuring high productivity of government spending. They underscored the need to overcome the weak export performance and to improve competitiveness through a more supportive business climate and better governance that would stimulate private-sector growth. Directors underlined that other complementary policies need to be put in place to regain Senegal’s growth momentum and return to previous growth trajectories. Sustained efforts are required to enhance the financial sector’s contribution to the economy. Directors also encouraged the authorities to implement their energy sector reform plan to limit supply bottlenecks and fiscal risks.

XII. Financial Sector Assessment Program (FSAP) and Report on the Observance of Standards and Codes (ROSC) Participation:

A joint team of the World Bank and the International Monetary Fund conducted a mission under the FSAP program in 2000 and 2001. The Financial System Stability Assessment (FSSA) was issued in 2001 (IMF Country Report No. 01/189). An FSAP update was undertaken in 2004, focusing on development issues (in particular nationwide supply of basic financial services and access of SMEs to credit), in line with the priorities defined in the PRSP (IMF Country Report No. 05/126). A regional FSAP for the WAEMU was undertaken in 2007. A ROSC on the data module was published in 2002. An FAD mission conducted a ROSC on the fiscal transparency module in 2005.

XIII. Technical Assistance (2008–12):

A. AFRITAC West

Year	Area	Focus
2008	Debt management and financial markets National accounts Microfinance	DSA workshop Institutional sector and quarterly national accounts Supervision and organization
2009	National accounts Tax administration Debt management Microfinance Macroeconomic and financial statistics	Quarterly national accounts (QNA) Status of the reform and scope for further TA Strengthening public debt management Strengthening microfinance supervision Enhancing production and dissemination of public finances statistics
2010	Debt management National accounts Customs administration Tax administration Customs administration	Strengthening public debt management Quarterly national accounts (QNA) Risk analysis and audit Tax administration modernization Follow-up mission
2011	National accounts Customs administration Public Expenditure Management Debt management Tax administration	Quarterly national accounts (QNA) Risk analysis and audit Strengthening of PFM information systems Strengthening public debt management Establishment of medium-sized enterprise tax center
2012	Tax administration National accounts	Identification and registration of tax payers Quarterly national accounts (QNA)

Year	Area	Focus
	Customs administration Public Expenditure Management	Risk analysis and audit Public accounting system

B. Headquarters

Department	Date	Form	Purpose
Fiscal Affairs	Jan. 2008	Staff	Public - Private Partnerships
	Feb.2008	Staff	PSIA - Poverty and Social Impact Analysis
	Oct. 2008	Staff/AFRITAC	Public financial management
	April 2009	FAD Expert	Public financial management
	Nov. 2009	Staff/AFRITAC	Revenue administration
	Jan. 2010	FAD Expert	Review of the expenditure chain
	Feb. 2010	Staff/AFRITAC	Public financial management
	July 2010	FAD Expert	PFM (Treasury Single Account and cash forecasts)
	Oct. 2010	Staff/Expert/AFRITAC	Revenue administration
	Nov. 2010	Staff/Expert	Review of tax policy and tax expenditures
	Dec. 2010	Staff	Public financial management and accounting (state, PEs, agencies)
	May 2011	FAD Expert	Public financial management
	June 2011	AFRITAC	Tax administration
	Sept. 2011	Staff /Expert	Revenue administration

Department	Date	Form	Purpose
	Nov. 2011	FAD expert	Decentralization of budget authority
	Dec. 2011	FAD expert	Consolidation of accounts
	Jan. 2012	FAD Experts	VAT Credit Reimbursement System, Tax Exemptions and Reform Process
	March 2012	FAD Experts	PIT and Taxation of the Banking and Telecoms Sectors
Monetary and Capital Markets	Sept. 2010	Staff	Needs assessment
	Jan.-Feb. 2011	Staff/World Bank	Medium-Term Debt Strategy (MDTS)
Statistics	Nov. 2008	Staff	SDDS assessment
	April 2009	Staff	Government finance statistics
	Aug. 2011	Staff	National accounts
	Nov. 2011	Staff	Monetary and financial statistics
Legal	Jan-Feb 2012	Staff	Tax law

XIV. Resident Representative

Stationed in Dakar since July 24, 1984; the position has been held by Ms. Valeria Fichera since September 2009.

XV. Anti Money Laundering / Combating the Financing of Terrorism

The onsite visit for Senegal's AML/CFT evaluation took place in July/August 2007 in the context of ECOWAS's Inter-Governmental Action Group Against Money Laundering in West Africa (GIABA). The report was adopted in early May 2008 by the GIABA Plenary held in Accra, Ghana. The report highlighted several areas of weaknesses in the AML/CFT system, confirmed by a score of 12 non-compliant and 16 partially compliant ratings out of the 40+9 FATF AML/CFT recommendations. In May 2009 Senegal joined the Egmont Group of Financial Intelligence Units (FIUs). The FIU publishes on its website statistics on suspicious transaction reports received, the number of cases transmitted to the judiciary, and the number of convictions. Senegal's Fourth Follow-Up Report was discussed at GIABA's May 2012 Plenary. It acknowledged the progress achieved and encouraged Senegal to continue making improvements. At the same time, it was agreed that Senegal will submit its Fifth Follow-Up Report to the May 2013 Plenary.

JOINT MANAGEMENT ACTION PLAN IMPLEMENTATION WORLD BANK AND IMF COLLABORATION

Title	Products	Provisional timing of missions	Expected delivery date
A. Mutual information on relevant work programs			
World Bank	Public finance management technical assistance	Investment project appraisal manual, evaluation of agencies, budget management information systems, internal and external audit, debt management (next mission – Dec. 2012)	
	Development policy operation	Governance, education and health reform, energy sector	December 2012 (Board)
	Policy notes for the new government	18 notes covering the full range of World Bank programs	January 2013
	Energy sector dialogue	Continuous	
	Social protection policy notes	December 2012	December 2012
	Poverty and gender policy notes	Continuous	January 2013
	Statistics for Results' project	Continuous	January 2013
	Debt management workshop and TA	MTDS and public debt management	November 2012
IMF	**IMF-supported program**		
	Fourth PSI Review and Article IV consultations mission, Sept. 6-19, 2012		December 2012 (Board)
	Fifth PSI Review mission (March 2013)		July 2013 (Board)

	Technical Assistance		
	Revenue administration	Six short-term expert visits	FY 2013
	PFM	A resident advisor at the Treasury	Until Sept. 2013
		FAD expert visits: Decentralization of budget authority	Feb. 2013
		Central government accounting	Jan 2013
		Financial regime of autonomous agencies	Jan. 2013
		Wage bill budgeting forecasting	March 2013
		Capital expenditure forecasting	March 2013
	Tax policy	Mining and tax exemptions	Feb. 2013
		VAT documents and exemptions	March 2013
	Debt management	MTDS and public debt management	November 2012
	Statistics	Data Work: SRFs Data Development	December 2012
		National accounts	Feb. 2013
B. Requests for work program inputs			
Fund request to Bank	Analysis on poverty and inclusive growth	Processed data on the 2011 household survey	November 2012
Bank request to Fund	Analysis on tax reform	Ongoing	
C. Agreement on joint products and missions			
Joint products	JSAN	National Strategy for Economic and Social Development (NSESD)	Dec. 2012
	Joint DSA	2012 Article IV Consultation and 4th PSI Review	Nov. 2012

STATISTICAL ISSUES

Senegal – Statistical Issues Appendix As of October 2012
I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance and program monitoring. There are weaknesses in data on national accounts, production, and social indicators. The authorities are committed to improving the quality and availability of economic, financial, and social indicators, partially relying on technical assistance from the Fund and other international organizations and donors.
National accounts: The compilation of the national accounts generally follows the *System of National Accounts, 1993*. Despite staff's professionalism, the lack of adequate financial resources has constrained efforts to collect and process data. Data sources are deficient in some areas, particularly the informal sector. Because of financial constraints, surveys of business and households are not conducted regularly. However, efforts continue to be made to improve data collection procedures, strengthen the coordination among statistical agencies, and reduce delays in data dissemination. The Regional Technical Assistance Center for West Africa (West AFRITAC) has been assisting Senegal with the improvement of their real sector statistics, in particular annual and quarterly national accounts (QNA).
Government finance statistics (GFS): GFS are compiled by the Ministry of Economy and Finance from customs, tax, and treasury directorate sources, and quarterly disseminated as government financial operations tables (TOFE) in the ministry's publications. Following Fund's TA, TOFE presentations were improved and aligned with the extended WAEMU TOFE. Remaining step is to implement the recent WAEMU fiscal directives. A regional advisor in GFS has been conducting technical assistance missions aimed at improving the consistency of fiscal reporting and migrating to the methodologies of the *Government Finance Statistics Manual 2001*. The regional advisor also supported efforts to resume reporting of annual and higher frequency data for publication in *International Financial Statistics (IFS)* and electronic dissemination of the *GFS Yearbook*.
Monetary and financial statistics: Preliminary monetary data are compiled by the national agency of the Central Bank of West African States (BCEAO) and officially released (including to the IMF) by BCEAO headquarters. The authorities report monetary data to STA on a regular basis, with a lag of about three months. There has been an improvement in the timeliness of reporting interest rate and main depository corporation data (central bank and commercial). An area-wide page for the WAEMU zone was introduced in the January 2003 issue of *IFS*. As part of the continuing efforts to help the authorities implement the statistical methodology recommended in the *Monetary and Financial Statistics Manual*, a STA TA mission visited Dakar in 2011 to assist the BCEAO National agency in the

migration of MFS to the standardized report form (SRF) framework. The mission was undertaken as a pilot within the context of a multi-annual project for improving the relevance and timeliness of MFS compiled by the BCEAO.
External sector statistics: Balance of payments statistics are compiled by the Senegalese national agency of the BCEAO. With STA support, several steps have been taken to address certain shortcomings, including: (i) implementation of the *Balance of Payments Manual, fifth edition*; (ii) modification and simplification of related surveys for companies and banks; (iii) improvement in the computerization of procedures; and (iv) significant strengthening of training. Nevertheless, further steps could be taken to enhance the quality and coverage of the balance of payments statistics. Although definitive balance of payments statistics can now be provided with a delay of less than one year, there are significant delays in reporting the data to STA.
II. Data Standards and Quality
The country has begun the process of regional harmonization of statistical methodologies within the framework of the WAEMU. It participates in the General Data Dissemination System (GDDS), and its metadata were posted on the Fund's Dissemination Standards Bulletin Board in 2001. In 2006, the authorities expressed their commitment to work toward subscription to the Special Data Dissemination Standard (SDDS) and appointed a national SDDS coordinator. The 2008 SDDS assessment mission evaluated dissemination practices against SDDS requirements for coverage, periodicity and timeliness and, in cooperation with the authorities, developed an action plan to address identified gaps. A Data ROSC was published on the IMF website in 2002.

Senegal: Table of Common Indicators Required for Surveillance

(As of September 2012)

	Latest observation	Date received	Frequency of data[7]	Frequency of reporting[7]	Frequency of publication[7]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality Accuracy and reliability[9]
Exchange Rates	Current	Current	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	6/2012	9/2012	M	M	M		
Reserve/Base Money	6/2012	9/2012	M	M	M		
Broad Money	6/2012	9/2012	M	M	M		
Central Bank Balance Sheet	6/2012	9/2012	M	M	M	LO, LO, O, O	LO, O, O, LO
Consolidated Balance Sheet of the Banking System	6/2012	9/2012	M	M	M		
Interest Rates[2]	6/2012	9/2012	M	M	M		
Consumer Price Index	6/2012	9/2012	M	M	M	O, LO, O, O	LO, O, O, NA
speeRevenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA	NA					
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	6/2012	9/2012	M	M	M	O, LNO, LO, O	LO, LO, O, LO
Stocks of Central Government and Central Government-Guaranteed Debt[5/11]	2011	9/2012					
External Current Account Balance [10/11]	2011	9/2012	A	A	A		
Exports and Imports of Goods and Services [10/11]	2011	9/2012	A	A	A	O, O, O, O	O, O, O, O
GDP/GNP [10/11]	2011	9/2012	A	I	A	LO, LO, LO, LNO	LNO, LNO, LNO, LNO
Gross External Debt [11]	2011	9/2012	A	I	A		
International Investment Position [6/]	2011	9/2012	A	A	A		

1 Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
2 Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
3 Foreign, domestic bank,, and domestic nonbank financing.
4 The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
5 Including currency and maturity composition.
6 Includes external gross financial asset and liability positions vis-à-vis nonresidents.
7 Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
8 Reflects the assessment provided in the data ROSC published in 2002 and based on the findings of the mission that took place in 2001 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), not observed (NO), or not available (NA).
9 Same as footnote 8, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, and revision studies.
10 Estimate.
11 Reported to staff during mission.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 12/142
FOR IMMEDIATE RELEASE
December 14, 2012

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2012 Article IV Consultation with Senegal

On December 10, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Senegal.[1]

Background

Senegal's growth has been sluggish in recent years, with implications for poverty reduction. Average growth was relatively strong in 1995–2005 (4.5 percent) and accompanied by a large drop in poverty incidence (from 68 to 48 percent). Due partly to a series of exogenous shocks (i.e., food and fuel global prices, global financial and economic crisis, and more recently, the

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

electricity sector crisis and drought in the Sahel), growth decreased to an average of 3.3 percent in 2006–2011. As a result, poverty incidence barely decreased during this period and still stood at 47 percent in 2011. Wide disparities exist between rural areas, where poverty incidence is higher than the national average (at 57 percent), and urban areas (at 33 percent).

Fiscal deficits and debt ratios have increased in recent years. The fiscal deficit, which was below 4 percent of GDP in 2007, stood at 6.7 percent of GDP in 2011. Higher deficits were justified to a large extent by the response to successive shocks. Meanwhile, the public debt-to-GDP ratio has increased continuously and is expected to exceed 45 percent in 2012.

After a tense campaign, President Sall was elected by a large majority and the governing coalition secured a broad majority at the legislative elections in July 2012. With a strong popular mandate, the government is now facing the challenge of accelerating reforms and meeting people's high expectations.

The authorities are addressing Senegal's macroeconomic challenges in the context of an economic program supported by the IMF's Policy Support Instrument (PSI) approved in December 2010 (see Press Release No. 10/469). The key objectives of the program are: (i) pursuing a prudent fiscal and debt policy and improving expenditure quality so as to maintain macroeconomic stability and lay the groundwork for higher, sustainab;e growth; (ii) raising revenue to create more fiscal space for priority spending, including additional infrastructure investment; (iii) further strengthening public financial management and governance to enhance fiscal transparency, budget planning and execution, improve the productivity of public expenditure, and reduce budgetary risks; and (iv) stimulating private sector development through structural reforms, particularly in the energy and financial sectors, and other reforms related to the business climate.

Executive Board Assessment

They commended Senegal's satisfactory program implementation despite the challenging internal and external environments. Although a moderate pickup in growth is expected in the near term, the economy remains exposed to substantial risks. Directors welcomed the authorities' continued commitment to their program to ensure macroeconomic stability, strengthen the economy's resilience to shocks, foster higher and sustainable growth, and reduce poverty.

Directors noted that, while Senegal still faces a low risk of debt distress, high fiscal deficits and rising debt ratios need to be addressed. They welcomed the authorities' commitment to keep the deficit under 6 percent in 2012 and their determination to reduce the deficit further in the medium term to levels that are consistent with fiscal and debt sustainability. Directors also highlighted the importance of stronger debt management. They welcomed the recently finalized medium-term debt strategy, and encouraged the authorities to rely primarily on concessional financing.

Directors underscored the need to improve public financial management and government spending efficiency and transparency. They commended ongoing efforts to reduce the cost of running government, streamline public agencies, and rationalize expenditure in key sectors. Directors stressed that phasing out the costly and poorly targeted energy price subsidies while strengthening social safety nets is a priority. Sustained progress in all these areas will be necessary to meet the country's fiscal objectives and make room for critical social and development needs.

Directors noted that the financial sector is generally robust. However, the rising level of NPLs and concentration of lending need to be closely monitored.

To move Senegal to a path of higher, sustainable, and inclusive growth, Directors stressed the need to address infrastructure gaps, remove inefficiencies in government operations, and improve the business climate. They welcomed the tax and customs reforms that are underway and called for timely implementation of the new energy investments and restructuring of SENELEC, the national power utility. Directors also encouraged the authorities to deepen and strengthen the financial system to support their growth strategy.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Table 1. Senegal: Selected Economic and Financial Indicators, 2011–17

	2011	2012	2012	2013	2014	2015	2016	2017
		EBS/ 12/85	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Annual percentage change)							
National income and prices								
GDP at constant prices	2.6	3.9	3.7	4.3	4.8	5.0	5.1	5.2
Of which: nonagriculture GDP	4.8	3.2	2.9	4.0	4.8	5.1	5.2	5.3
GDP deflator	4.3	2.2	2.2	2.4	2.4	2.5	2.4	2.5
Consumer prices								
Annual average	3.4	2.5	1.5	1.6	1.8	1.8	1.8	1.8
End of period	2.7	2.2	1.6	1.8	1.8	1.8	1.8	1.8
External sector								
Exports, f.o.b. (CFA francs)	7.1	3.2	4.4	6.9	3.6	5.4	8.4	9.2
Imports, f.o.b. (CFA francs)	8.9	9.0	9.5	4.2	3.4	3.3	6.1	7.0
Export volume	-2.7	0.4	-1.0	4.4	4.9	5.5	6.1	6.4
Import volume	4.3	4.7	3.4	3.2	4.2	4.4	4.5	4.8
Terms of trade ("–" = deterioration)	5.6	-0.4	-0.4	1.7	-0.7	0.7	0.6	0.5
Nominal effective exchange rate	1.4	…	…	…	…	…	…	…
Real effective exchange rate	1.1	…	…	…	…	…	…	…
	(Changes in percent of beginning-of-year broad money, unless otherwise indicated)							
Broad money	6.7	7.5	6.0	7.4				
Net domestic assets	9.0	7.6	10.4	7.4	…	…	…	…
Domestic credit	10.2	7.0	9.5	7.0	…	…	…	…
Credit to the government (net)	-2.0	1.7	1.8	1.3	…	…	…	…
Credit to the economy (percentage growth)	18.8	5.6	10.6	7.6	…	…	…	…
	(Percent of GDP, unless otherwise indicated)							
Revenue	20.2	*20.7*	*20.9*	*20.8*	*20.9*	*20.9*	*20.6*	*20.7*
Grants	2.2	*2.7*	*2.9*	*2.7*	*2.7*	*2.7*	*2.6*	*2.6*
Total expenditure and net lending	29.0	*29.8*	*29.7*	*28.4*	*27.9*	*27.5*	*26.9*	*26.7*
Overall fiscal surplus (+) or deficit (–)								
Payment order basis, excluding grants	-8.9	*-9.1*	*-8.8*	*-7.6*	*-7.0*	*-6.6*	*-6.3*	*-6.0*
Payment order basis, including grants	-6.7	*-6.4*	*-5.9*	*-4.9*	*-4.3*	*-3.9*	*-3.7*	*-3.5*
Primary fiscal balance [1]	-5.2	*-4.9*	*-4.3*	*-3.1*	*-2.7*	*-2.4*	*-2.1*	*-1.9*
Gross domestic investment	28.7	*30.8*	*30.3*	*30.1*	*30.2*	*30.5*	*30.5*	*30.5*
Government	10.5	*12.6*	*12.1*	*11.8*	*11.8*	*11.9*	*11.7*	*11.6*
Nongovernment	18.2	*18.2*	*18.2*	*18.3*	*18.4*	*18.6*	*18.7*	*18.9*
Gross domestic savings	12.5	*12.8*	*12.8*	*13.5*	*14.3*	*15.5*	*16.4*	*16.9*
Government	5.4	*7.7*	*7.9*	*8.8*	*9.1*	*9.5*	*9.6*	*9.8*
Nongovernment	7.1	*5.1*	*4.9*	*4.7*	*5.3*	*5.9*	*6.7*	*7.1*
Gross national savings	22.6	*22.5*	*22.7*	*23.0*	*23.5*	*24.2*	*24.5*	*24.9*
External current account balance								
Including current official transfers	-6.1	*-8.3*	*-7.6*	*-7.1*	*-6.7*	*-6.3*	*-5.9*	*-5.7*
Excluding current official transfers	-6.8	*-8.9*	*-8.4*	*-7.8*	*-7.4*	*-7.0*	*-6.5*	*-6.3*
Total public debt	40.0	*44.9*	*45.0*	*46.8*	*48.1*	*48.7*	*49.0*	*49.0*
Central government domestic debt	11.3	*12.2*	*12.3*	*12.2*	*12.7*	*12.9*	*13.0*	*12.8*
External public debt	28.8	*32.6*	*32.7*	*34.6*	*35.4*	*35.8*	*36.1*	*36.2*
External public debt service								
Percent of exports	14.0	*7.4*	*7.3*	*7.6*	*6.8*	*7.4*	*7.2*	*7.0*
Percent of government revenue	17.2	*8.7*	*8.4*	*8.7*	*7.5*	*8.1*	*8.0*	*7.7*
Gross domestic product (CFAF billions)	6,818	7,243	7,225	7,718	8,286	8,921	9,600	10,351

Sources: Senegalese authorities; and IMF staff estimates and projections.

[1] Total revenue and grants minus total expenditure and net lending, excluding interest expenditure.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 12/477
FOR IMMEDIATE RELEASE
December 10, 2012

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth Review Under Policy Support Instrument for Senegal

The Executive Board of the International Monetary Fund (IMF) today completed the fourth review of Senegal's performance under the Policy Support Instrument (PSI). The program is on track and all end-June 2012 assessment criteria were met. The Board also concluded the 2012 Article IV consultation with Senegal. A Public Information Notice will be issued in due course.

The PSI was approved by the Executive Board on December 3, 2010 (see Press Release No. 10/469). The IMF's framework for PSIs is designed for low-income countries that may not need, or want, IMF financial assistance, but still seek IMF advice, monitoring and endorsement of their policies. PSIs are voluntary and demand driven (see Public Information Notice No. 05/145).

Following the Executive Board's decision, Mr. Min Zhu, Deputy Managing Director and Acting Chair, issued the following statement:

" Senegal's economic growth has been sluggish in recent years, with implication for poverty reduction. Despite the still challenging external environment, a moderate growth pick up is projected in 2012 and 2013, owing to a rebound in agriculture and the completion of a number of large infrastructure and mining projects. With full implementation of the authorities' ambitious reform program, supported under the Fund's Policy Support Instrument, growth should gradually return in the medium term to the level recorded before the global financial crisis. Inflation would remain moderate.

"The authorities' plan to further reduce the fiscal deficit below 6 percent of GDP in 2012 and 5 percent of GDP in 2013 will help maintain debt sustainability. At the same time, they need to make space for growth-supporting public investments and other priority spending. To achieve this objective, they are committed to reducing the cost of running the government, streamlining public agencies, rationalizing expenditure in key sectors, and phasing out the costly and poorly targeted subsidies while strengthening social safety nets. It will be critical to sustain these efforts over the medium term to achieve a lasting improvement of public spending efficiency and reduction of the fiscal deficit.

"The main medium-term challenge for Senegal is to move to higher, sustainable, and inclusive growth. The authorities' new development strategy and its focus on inclusiveness are therefore welcome. The government has an important role to play in raising the growth potential, for instance through the provision of critical infrastructure and reforms to improve the business environment. Accelerating the implementation of the new energy investments and the restructuring of SENELEC, the national power utility, is a priority in the short term," Mr. Zhu added.

Statement by Kossi Assimaidou, Executive Director for Senegal

December 10, 2012

1. My Senegalese authorities are appreciative of the close collaboration between Senegal and the Fund. They consider the recent Management visit in Dakar as a testimony of this productive working relationship and they highly value the fruitful policy dialogue they had with Management on that occasion.

2. The authorities also attach high importance to the policy advice provided by staff during the 2012 Article IV consultation; key among which is the need to ensure stricter control over the fiscal deficits in the near term and foster stronger and more inclusive growth over the medium term. Consistent with this advice, a strong focus is already being placed by the authorities on lower deficits and stronger growth, as reflected in the 2013 budget which was approved by the parliament and the recently-validated National Strategy for Economic and Social Development spanning the period 2013–17. Moreover, the main recommendations set forth in the comprehensive set of informative staff papers—for which we are thankful—are generally in line with the authorities' policy and reform agenda and key commitments under the Policy Support Instrument (PSI). These include the need to preserve fiscal sustainability, further improve public financial and debt management, fiscal transparency and governance, and promote further financial deepening.

Preserving fiscal sustainability

3. The authorities put a high premium on maintaining fiscal deficits at levels that are consistent with fiscal and debt sustainability. Reflecting this policy stance, the government took several actions in recent months, including the streamlining of public agencies, the downsizing of the Cabinet, the elimination of some high-level political positions and institutions, and measures aimed at generating efficiency gains and savings in government spending. As a result of these consolidation efforts and the delayed execution of some energy projects, the deficit for 2012 is expected to be contained below 6 percent of GDP—well below the original program target.

4. Going forward, the authorities have restated their commitment to further reduce the deficit. For 2013 in particular, the approved budget is in line with the authorities' fiscal objective of bringing the deficit below 5 percent of GDP. Over the medium term, the downward trend in fiscal deficit is expected to continue. Achievement of fiscal targets will be facilitated by the implementation of the new tax code which is scheduled to begin early next year. Subsequently, the new customs code which is expected to be finalized and submitted to the parliament during the first half of 2013 will add a significant contribution once it takes effect. Along with these decisive steps, the continuation of ongoing efforts to modernize tax administration will enable timely progress toward fiscal objectives.

5. Concomitant to their work on boosting revenue, the authorities will continue to strengthen their efforts to contain public spending. A key element of their plans to keep

expenditure under control will consist in capping electricity consumption subsidies to CFAF 80 billion in 2013. In order to generate the potentially large savings required by the introduction of this cap, all possible options are under consideration. These include, among others, taking cost-cutting initiatives for the electricity company *SENELEC* and making electricity tariff adjustments while sparing vulnerable households.

Further Improving Public Financial and Debt Management, Fiscal Transparency and Governance

6. The authorities are mindful of the importance of making inroads in further strengthening public financial management and fiscal transparency and governance. In this regard steps were recently taken, that include the signing of the decree on the transposition of the WAEMU's directive on budget classification and the submission to parliament of a draft law on fiscal transparency. Moreover, opportunities for further improvements in governance will be provided by ongoing comprehensive audits of the civil service and agencies and efforts to establish the single treasury account. Similarly, public governance will benefit from the work underway to ensure greater transparency in land transactions involving the State, notably through the publication of these transactions.

7. The authorities value their fruitful collaboration with staff in the process of assessing the implications of higher debt-financed public investment for growth and debt sustainability yin Senegal. The results of this exercise generally confirm the view that increased public investment typically fosters growth in the country but it may undermine debt sustainability if exclusively financed by nonconcessional resources. Beyond the high sensitivity of the latter result to the model assumption of exclusive reliance on nonconcessional external borrowing to finance investment scaling-up, it is noteworthy that the baseline scenario, which reflects more realistically the composition of financing in Senegal, implies a more positive debt outlook over the long run.

8. Nevertheless, I would like to reiterate that my Senegalese authorities take long-term fiscal and debt sustainability very seriously. Their unfailing determination to preserve it will be served by the renewed emphasis they have put on improving public debt management. Indeed, implementation of their recently-finalized medium-term debt strategy (MTDS) will not only help improve the debt outlook, but also contribute to improved prospects for deficit reduction. This positive outcome will also be helped by the increased reliance on longer maturity bond issuance, and preferential recourse to concessional financing, as recommended by the MTDS. Moreover, the project evaluation guide which is being finalized will help conduct systematically cost-benefit analyses for large investment projects, thereby ensuring that only those with adequate rates of return are retained.

Promoting Further Financial Development in a Stable Macro-financial Environment

9. Financial sector soundness indicators remain strong in Senegal. The latest stress-test exercises conducted by the authorities and staff have reconfirmed that the banking system remains sound with adequate levels of liquidity, profitability, and capitalization although a

few banks may need to improve their asset quality and credit continues to be highly concentrated.

10. The in-depth focus of Article IV consultation on the financial sector was a welcome opportunity for the staff to explore avenues for further enhancing financial stability and overcoming impediments to further financial development. We thus view the paper on financial depth and macro-stability in Senegal as an appropriate follow-up of the Executive Board's recent call for better integrating the interaction between financial deepening and macro-financial stability into financial sector surveillance in low-income countries. The paper provides evidence about the limited systemic risk facing Senegal's financial sector. It also reveals a number of areas in which the country outperforms or underperforms selected peer countries in terms of financial sector depth and breadth and access to banking services.

11. However, the staff paper identifies some impediments to further financial development and maintain financial stability and formulates a number of useful recommendations to overcome them. The recommendations include in particular, the need to strengthen micro-prudential regulation, enhance banking supervision, and develop the interbank market. On issues related to financial sector development and stability, it is worth noting that a number of responsibilities fall outside the purview of the country authorities and belong to regional authorities, as Senegal belongs to a monetary union with a common regional central bank, as explained by staff. Still, the competent country and regional authorities have endeavored to establish a continuous dialogue with a view to addressing such issues. In other areas under their sole responsibility, the Senegalese authorities are determined to pursue their reform efforts, notably by improving the business and judicial environment, and strengthen the tax regime. In this endeavor, they will be guided by the action plan they have previously developed on the basis of previous consultations with domestic and external stakeholders.

12. In conclusion, the PSI program is on track and performance under the program continues to be strong. On the quantitative front, all end-June 2012 assessment criteria and indicative targets were met, reflecting notably the authorities' efforts to keep the deficit under control and further strengthen public finance and debt management. At the same time, implementation of the structural reform agenda proceeded satisfactorily. More specifically, steps were taken in line with program commitments to finalize an operational and financial restructuring plan for *SENELEC*, a medium-term debt management strategy, a draft law on fiscal transparency, an action plan for the reduction of electricity consumption subsidies, and a new tax code.

13. In light of Senegal's satisfactory program performance and continued commitment to the program objectives, I would appreciate Directors' support for the completion of the fourth PSI review and the authorities' request for modification of the assessment criterion on the fiscal deficit.