IMF Country Report No. 17/87

DJIBOUTI

April 2017

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR DJIBOUTI

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 2016 Article IV consultation with Djibouti, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 22, 2017 consideration of the staff report that concluded the Article IV consultation with Djibouti.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 22, 2017, following discussions that ended on November 19, 2016, with the officials of Djibouti on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 7, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- A **Statement by the Executive Director** for Djibouti.

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April 6, 2017

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IMF Executive Board Concludes 2016 Article IV Consultation with Djibouti

On February 22, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Djibouti.

Djibouti is expanding its transportation and utilities infrastructure to leverage its strategic location as a shipping hub and host to military bases. A small state in the arid Horn of Africa, neighboring land-locked Ethiopia, Djibouti largely depends on its deep-water harbor. The authorities' development strategy, *Vision Djibouti 2035*, aims at transforming the country into a middle-income economy and a logistics and commercial hub for the whole of East Africa.

To achieve their development goals, the authorities have launched a large-scale investment program financed by external debt, which has raised public external debt from 50 to 85 percent of GDP in two years. Much of the debt consists of government-guaranteed public enterprise debt. Djibouti continues to be at high risk of debt distress, as all debt sustainability indicators are above their thresholds for a prolonged period.

Growth is estimated to have reached 6.5 percent in 2016, driven by major public sector projects, in particular the railroad to Ethiopia, the construction of several new ports and a water pipeline from Ethiopia. Inflation rose to 3 percent on average in 2016, reflecting mainly increased food and service prices.

Despite remarkable growth, poverty and unemployment remain high and widespread. About 41 percent of the population is poor, 23 percent live in extreme poverty, and the unemployment rate reaches 39 percent. Thus far, the large investment projects have had a limited impact on jobs as they employ high-skilled, often foreign, labor.

[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.

The central government budget—which under the authorities' definition does not include two large investment projects, the water pipeline and railroad, undertaken by public enterprises—aimed at a small deficit of 0.4 percent of GDP in 2016. Including the two projects, the overall fiscal deficit is estimated at 16 percent of GDP, down from 22 percent in 2015. The current account deficit remained large at 29 percent of GDP, financed mainly by borrowing and foreign direct investment. The currency board's coverage is comfortable, with the ratio of reserves-to-base money estimated at 109 percent in 2016 while official international reserves reached 3.4 months of imports.

Performance of the banking sector remained weak and financial inclusion limited despite recent efforts. The financial sector is characterized by a high level of nonperforming loans, high credit concentration, and low profitability, and remains vulnerable to adverse shocks.

Executive Board Assessment[2]

Executive Directors noted that while the ambitious increase in infrastructure investment, mostly debt-financed, contributes to a broadly favorable outlook for Djibouti, it also elevates fiscal and debt vulnerabilities. Directors encouraged the authorities to press ahead with critical reforms aimed at translating this investment into strong, inclusive, and job-creating growth and returning debt to a sustainable trajectory. Key policy priorities include strengthened debt policy and management, tax reform, and structural reforms to improve the efficiency and governance of public enterprises, and to strengthen the business climate.

Directors emphasized the importance of developing a coordinated strategy aimed at establishing debt sustainability, given Djibouti's high risk of debt distress. They encouraged the authorities to adopt a public debt law and set an explicit debt anchor, such as public debt-to-GDP ratio along with a debt path, to ensure sustainability. Directors underscored the need to reduce the pace of government borrowing and avoid borrowing on non-concessional terms, including by public enterprises. They encouraged the authorities to minimize their direct financial participation in PPPs and avoid explicit guarantees and implicit contingent budget liabilities. Directors called for strengthening debt management capacity, coordination of institutions involved in contracting debt, and capacity to evaluate PPP-related fiscal risks, as well as staying current on all debt service obligations.

Directors called for further tax reforms to mobilize revenues and reduce wide-ranging exemptions and special regimes. They urged the authorities to launch a comprehensive review of tax expenditures, exemptions, and special tax regimes with a view to reducing them. This would help broaden the tax base and increase government revenue while generating space for debt service and priority social spending.

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[2] 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.

Directors urged the authorities to accelerate the implementation of structural reforms to support broad-based, inclusive, and private-sector-led growth. Reforms of public enterprises should seek to enhance their efficiency, strengthen governance, improve their capacity to manage investment projects, and open public monopolies to competition. Directors also called for reforms to improve the business climate, strengthen competition, address the distributional dimension of growth, and support private sector development. Investments in human capital and education were also encouraged.

Directors encouraged the authorities to continue focusing monetary and financial policies on banking and external stability as well as financial inclusion. They called on the Central Bank of Djibouti to strengthen risk-based bank supervision, reduce credit concentration, better enforce prudential ratios, introduce a minimum reserve requirement and bank resolution mechanisms, and strengthen the AML-CFT framework.

Directors observed that the currency board arrangement has served Djibouti well, including by instilling confidence and improving predictability in international transactions, and should be maintained at an unchanged parity. They noted that while the exchange rate may be somewhat overvalued in real effective terms, the extent is subject to considerable uncertainty. They called on the authorities to strengthen competitiveness through structural reforms.

Djibouti: Selected Economic and Financial Indicators, 2014–18

	2014	2015	Est. 2016	Proj. 2017	2018
National accounts	(Annual percentage change)				
Real GDP	6.0	6.5	6.5	7.0	7.0
Consumer prices (end of period)	2.8	1.9	3.0	3.0	3.0
Central government	(In percent of GDP)				
Revenues and grants	30.9	37.2	32.5	30.8	29.9
Expenditure	40.5	58.9	48.3	32.4	30.6
Overall balance (commitment basis)	-9.6	-21.7	-15.8	-1.5	-0.6
Change in arrears	-0.5	-0.6	-0.5	-0.5	-0.4
Overall balance (cash basis)	-10.1	-22.2	-16.3	-2.0	-1.1
Memo: Overall balance excluding large projects	-4.0	-0.9	-0.4	0.3	-1.1
Monetary sector	(Annual change in percent of broad money)				
Broad money	6.5	19.0	8.0	8.7	8.3
Currency board cover (in percent)	110	107	109	109	109
External sector	(In millions of US dollars)				
Current account balance	-399	-549	-542	-436	-444
(In percent of GDP)	-25.1	-31.8	-28.6	-20.9	-19.3
External public and publicly guaranteed debt	792	1,197	1,606	1,814	2,008
(In percent of GDP)	49.9	69.3	84.8	86.9	87.3
Gross official reserves	381	355	373	419	435
(In months of next year's imports of goods and services)	3.4	3.1	3.4	3.7	3.6
Exchange rate (DF/US$, end of period)	177.7	177.7	177.7	…	…
Real effective exchange rate (yearly average, 2005=100)	96.4	102.7	103.8	…	…
(Change in percent; depreciation -)	0.5	6.6	1.1	…	…

Sources: Djibouti authorities and IMF staff estimates and projections.

INTERNATIONAL MONETARY FUND

DJIBOUTI

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

February 7, 2017

KEY ISSUES

Context. Djibouti is expanding its infrastructure to leverage its strategic location and foster growth, reduce poverty, and create jobs. The remarkable investments in ports and railways—started in 2015 and mostly debt-financed by financial institutions from China—presents opportunities as well as risks. With public debt rising from 50 to 85 percent of GDP in just two years, the authorities need to advance rapidly with critical reforms. Such reforms would aim at translating the investment boom into strong, inclusive, and job-creating growth to reduce poverty and return to a sustainable debt trajectory given the current high risk of debt distress. While there is strong ownership of such reforms under the authorities' *Vision Djibouti 2035*, close government coordination will be needed to ensure their effective implementation.

Policy discussions. Discussions focused on policies to support the authorities' reform objectives, including (i) public debt policy and management; (ii) revenue mobilization and phasing out exemptions; (iii) public enterprise efficiency and governance; (iv) business environment, inclusiveness, and social policies; (v) financial stability, competitiveness, and safeguards; and (vi) statistics and technical assistance.

Key policy recommendations:

- Slow the pace of borrowing by the public sector and establish a debt management strategy, including a debt law and a public sector debt anchor.
- Continue reforming the tax system by reviewing and reducing tax expenditures, exemptions, and special regimes, such as free zones, to expand the tax base and increase government revenue while fostering economic growth.
- Reform public enterprises to enhance their efficiency and the competitiveness of their services, and improve their capacity to manage large investment projects.
- Improve the business environment and governance to attract investors, develop the private sector, create jobs, and promote sustainable and inclusive growth.
- Focus monetary and financial policy on the stability of the banking system, financial inclusion, and external stability.
- Maintain the currency board with adequate coverage and supportive fiscal policies.
- Finalize the revision of GDP and prepare consolidated financial statements of the public sector and central government.

Approved By
Daniela Gressani and Vitaliy Kramarenko

Discussions took place in Djibouti during November 6–19, 2016. The team comprised Eric Mottu (head), Alexei Kireyev, Hamid-Reza Tabarraei (all MCD), Louis Dicks-Mireaux (SPR), Ms. Cheung Kai Suet (STA), and Joseph Karangwa (Resident Representative). Ms. Daniela Gressani (MCD) joined during the second week. Mohamed Said Seif and Abdourahman Abdi Aden (local economists) and Ms. Nadia Ahmed Yonis (office manager) supported the mission.
The mission met with Prime Minister Abdoulkader Kamil Mohamed, Central Bank Governor Ahmed Osman, Minister of Budget Boheh Ahmed Robleh, Minister of Economy and Finance Ilyas Moussa Dawaleh, Minister of Investment Ali Guelleh Aboubaker, and other senior officials, parliamentarians, bankers, business people, and members of the media and the international community.

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CONTEXT

1. Djibouti is expanding its transportation and utilities infrastructure to leverage its strategic location as a shipping hub and host to military bases. A small state in the arid Horn of Africa, neighboring land-locked Ethiopia, Djibouti largely depends on its deep-water harbor. The authorities' development strategy, *Vision Djibouti 2035*, aims at transforming the country into a logistics and commercial hub for the whole of East Africa and a middle-income economy. The strategy targets medium-term growth of 7.5–10 percent per year, tripling per capita income, and reducing unemployment. It includes five pillars: peace and national unity, good governance, economic diversification, human capital development, and regional integration.

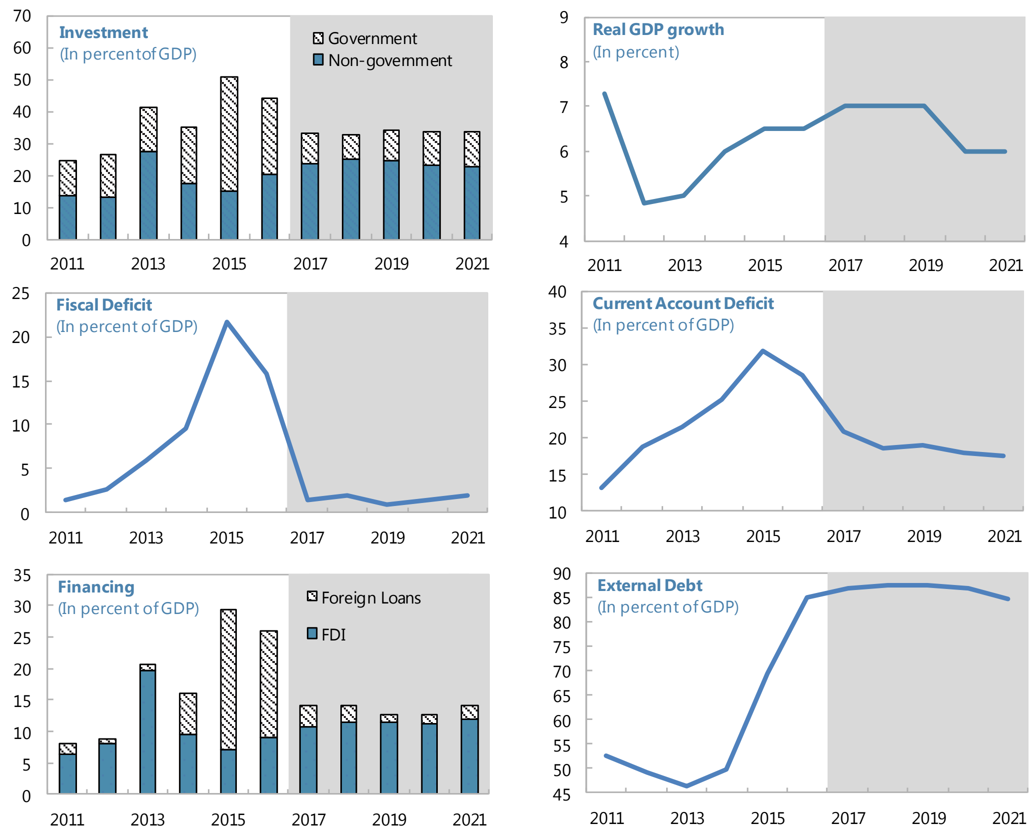
2. To achieve their development goals, the authorities have launched a large-scale investment program financed by external debt, which has raised public external debt from 50 to 85 percent of GDP in two years (Figure 1). At end-2016, 32 percent of the external debt was owed by the central government, while 68 percent consisted of government-guaranteed debt of public enterprises—77 percent of which was owed to China's EximBank. Many of the existing loans are concessional or include near-concessional terms; in 2016, the grant element of new debt was estimated at 36 percent.

3. Despite the investment boom, poverty and unemployment remain very high and widespread. About 41 percent of the population is poor, 23 percent live in extreme poverty, and the unemployment rate is 39 percent. Thus far, the large investment projects have had a limited impact on jobs as they employ high-skilled, often foreign, labor. Sectors with high employment potential, such as fishing, tourism, and telecommunications, remain underdeveloped. Agricultural activity is minimal because of the unfavorable climate.

4. Djibouti faces large humanitarian needs and is negatively affected by regional tensions. Donors and UN agencies estimate that about a quarter of the 1 million population requires assistance. This number includes not only Djiboutians living in extreme poverty, but also about 60,000 refugees, asylum seekers, and migrants, mainly from neighboring countries and Yemen, who put significant additional pressure on limited social services and infrastructure. The direct impact on the budget has been limited as most humanitarian expenditure are covered by donors.

5. Limited progress was made in implementing the recommendations of the 2015 Article IV Consultation (Box 1)**.** This reflects low capacity, the 2016 election cycle, and the overall slow pace of reforms.

Figure 1. Djibouti: Investment Boom, 2011–2021



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

RECENT DEVELOPMENTS

6. Economic activity has remained buoyant, boosted by an investment boom financed primarily by external borrowing. Growth is estimated to have reached 6.5 percent in 2016, driven by major public sector projects, in particular the railroad to Ethiopia, the construction of several new ports[1] and a water pipeline from Ethiopia. Inflation rose to 3.7 percent year-on-year in November, reflecting mainly increased food and service prices.

7. The investment boom continues to exert considerable pressure on public finances. The central government budget—which under the authorities' definition does not include two large investment projects, the water pipeline and railroad, undertaken by public enterprises[2]—aimed at a

[1] Multipurpose port of Doraleh, port of Goubet, port of Tadjourah, and crude oil terminal of Damerjog.

[2] The authorities' definition excludes these two projects on the ground that the government would service these debts only for the next 2-3 years until the projects become profitable. On-lending agreements with a government guarantee for the years thereafter have yet to be signed. In the debt data as reported in the LIC-DSA accompanying

(continued)

small deficit of 0.4 percent of GDP in 2016. Including the two projects, the overall fiscal deficit is estimated at 16 percent of GDP, having declined from 22 percent of GDP in 2015 reflecting the disbursement profile of the railroad project.

8. In 2016, the budget turnout was affected by lower non-tax revenue and grants. While tax revenue slightly exceeded projections, non-tax revenues are estimated to have underperformed by about 1.5 percent of GDP because of lower dividend transfers by the port operator due to an ongoing dispute with the government. Moreover, delays in disbursements led to a significant revenue shortfall in grants (1.8 percent of GDP).

9. To address the revenue shortfall, the authorities cut expenditure in 2016. Domestically-financed capital expenditure and transfers were reduced. The wage bill was contained at 10.2 percent of GDP, with the hiring freeze outside the health and education sectors. Some overruns in spending for goods and services are explained largely by additional security expenses. Interest payments reached 1.4 percent of GDP (compared to 0.6 percent in 2015), mainly due to debt service temporarily assumed by the budget on external loans for the railroad and water pipeline projects.

10. Some domestic and external arrears continue to be incurred. Domestic budget arrears remained steady at 0.5 percent of GDP, reflecting a stock of about one month of the wage bill accumulated over previous years. The authorities' strategy is to absorb this stock gradually over the medium term. Mixed progress was made in clearing external debt arrears in 2016. In May, outstanding arrears to India (0.6 percent of GDP at end-2015) were cleared under a restructuring agreement. However, as of end-November 2016, external debt arrears still amounted to 0.7 percent of GDP. These arrears were owed mainly to Iran (0.3 percent of GDP), and discussions to reschedule them are ongoing. Also, arrears have accumulated since late 2011 with Belgium, Italy, and Spain (0.2 percent of GDP) due to the suspension of payments pending the conclusion of negotiations to convert the related debts into development projects. During 2016, short-term arrears have been periodically incurred and subsequently cleared vis-a-vis several other creditors. As a result, at end-November such short-term arrears amounted to 0.2 percent of GDP, and were owed to Arab Development Funds and India.

11. The current account deficit remains large, fueled mainly by investment-related imports. After rising to 32 percent of GDP in 2015, the current external account deficit is estimated to have declined to 29 percent of GDP in 2016. The large deficit is explained by a major increase in imports of investment goods, despite healthy export growth. Over the medium term, the deficit should gradually decrease as investment-related imports abate and exports of services rise substantially. The deficit has been financed mainly by public sector borrowing (about two thirds) related mainly to infrastructure projects, and net FDI (one third), primarily for free economic zones.

12. The currency board's coverage remains comfortable. In 2016, the ratio of reserves to base money is estimated to have reached 109 percent and official exchange reserves reached

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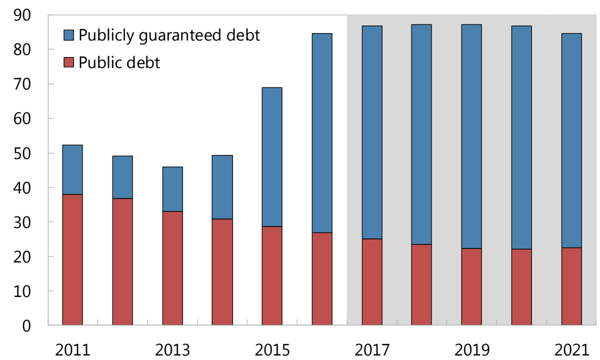
this report they are classified under government-guaranteed debt to be consistent with the government's debt recording and given the intention to sign on-lending agreements with respect to these two loans.

3.4 months of imports. Although the real exchange rate appreciated by about 1.2 percent in August 2016 y-o-y, it stayed close to its 2010 level reflecting favorable inflation differentials with trading partners. While the exchange rate is somewhat overvalued based on the EBA-lite methodology, the currency board arrangement has helped instill confidence and improve predictability in international transactions (the authorities broadly agreed with this assessment, Appendix I). Furthermore, the sensitivity of the current account to changes in the real exchange rate is low. Exports consist mainly of the use of port services by Ethiopia and services and rents related to foreign military bases, and the high dependence on imports for food and fuel results in a low price elasticity of imports.

13. Djibouti continues to be at high risk of debt distress, as all debt sustainability indicators are above their thresholds for a prolonged period.[3] The risk of distress worsened significantly with the large increase in the debt-to-GDP ratio from 50 percent at end-2014 to an estimated 85 percent of GDP at end-2016, primarily reflecting disbursements from newly contracted loans (Figure 2). Much of the debt consists of government-guaranteed public enterprise debt.[4] The DSA indicates that the solvency and liquidity risks are high and have increased since 2015, especially in the short run. Debt service falling due is scheduled to rise significantly over the next few years, and the scope for additional borrowing is low.

Figure 2. Djibouti: Public and Publicly Guaranteed Debt
(In percent of GDP)



Sources: Djibouti authorities; and IMF staff calculations.

14. Commercial banks' loan portfolio deteriorated over the past few years. Non-performing loans (NPLs) increased from 14 percent in 2013 to close to 23 percent in June 2016. This increase was driven mainly by the bankruptcy of two private oil companies and a stricter loan classification required by the Central Bank of Djibouti (CBD). Although provisions declined to 56 percent of NPLs, the authorities confirmed that banks hold collateral on the rest. Bank profitability also dropped over the past few years, and loan concentration is high; in this regard, all banks had to obtain exemptions from single borrower exposure limits. Finally, banks have recently experienced payment difficulties as some international banks have discontinued their correspondent bank relationships.

15. Intensive cooperation with China continues. Chinese investors are involved in many investment projects and are the main source of foreign loans (Table 1). In early 2016, Djibouti signed a cooperation agreement with China on a new free economic zone aimed at establishing an

[3] See the Debt Sustainability Analysis (DSA) supplement to this report.

[4] The guarantee stems from the fact that these debts were contracted by the government but will be on-lent to public enterprises, which bear the responsibility to pay debt service on the debt, when the projects become profitable. However, for the creditor the government remains the payer of last resort in the event of non-payment by the public enterprise.

international transshipment hub, including for Chinese companies, and setting a legal framework for a fast-track entry of Chinese banks in Djibouti.

OUTLOOK AND RISKS

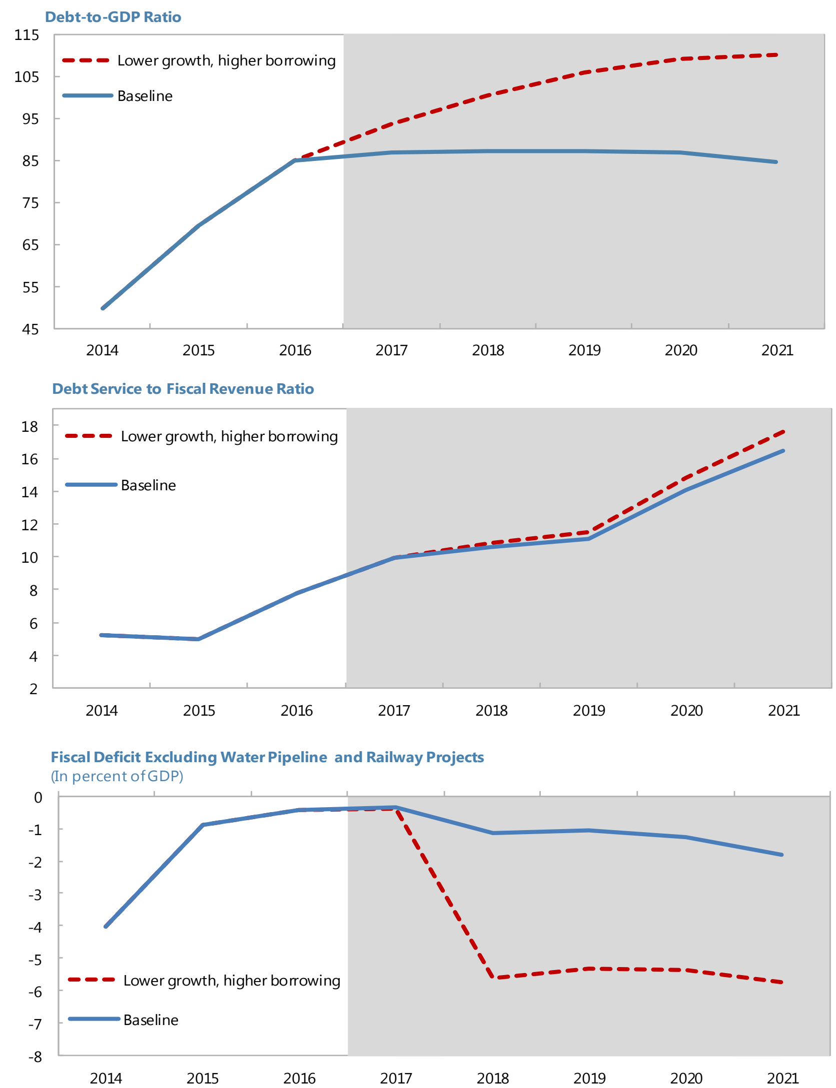
16. Economic growth is expected to remain strong in the medium term, driven by the investment boom. Staff's baseline scenario assumes that current macroeconomic policies will continue in the medium term and planned reforms will be successfully implemented, including comprehensive tax reform, improved business climate, strengthened debt management, and other reforms (discussed in paragraphs 24–28 and 35–38). Growth is projected to increase to 7 percent in 2017–19 supported by large public investments, in particular the railroad and the multipurpose port, which should stimulate private sector activity and FDI. Inflation will remain below 3 percent reflecting moderate world food and commodity prices. The 2017 fiscal deficit is targeted at 2 percent of GDP with the completion of the rail road project. Over the medium term, the fiscal deficit is projected to decline further and stabilize at around 1 percent of GDP under the assumption there will be no new major debt-financed investment projects undertaken by the government, and with the core infrastructure in place, new projects would be financed mainly by FDI. The current account deficit will drop to 21 percent of GDP in 2017 and will decline gradually and stabilize at around 18–20 percent of GDP in the medium term, financed primarily by FDI and public sector borrowing, mainly to complete the ongoing investment projects. International reserves are projected to remain at 3 months of imports. In this scenario, with high and sustained growth of 6-7 percent in 2017-21, the debt-to-GDP ratio reaches a maximum of 87 percent in 2018-19 (Figure 3).

17. The outlook is subject to considerable risks, both on the downside and upside (Table 2). First, if the efficiency of investment is low and expected growth dividends are not realized, fiscal liabilities and the risk of debt distress may increase further. Second, a slowdown of international trade or economic growth in Ethiopia—the main client of Djibouti's ports and the new railroad—would adversely affect growth, fiscal revenues, and the external position. Third, continued regional tensions and refugee/migrant inflows could weaken public finances, investors' confidence, and social cohesion. Finally, a major economic slowdown in China could have a negative effect on financing for major projects, both in Djibouti and Ethiopia. On the upside, a potentially higher impact of economic reforms (see paragraph above) and a favorable external environment would yield strong and inclusive growth more quickly and enable debt ratios to be reduced.

18. An alternative scenario illustrates the potential impact of downside risks. It assumes that growth does not exceed 4.5 percent due to negative shocks if downside risks materialize or reforms are delayed, and public sector external non-concessional borrowing continues at $350 million annually (about 17 percent of GDP) over the next five years to finance future projects. In this scenario, the debt ratio increases further and exceeds 110 percent of GDP by 2021. The budget deficit would increase to 5-6 percent of GDP and debt service would absorb up to 17 percent of budget revenue, putting pressure on social and poverty-reducing spending and becoming a serious constraint for development (Figure 3).

Figure 3. Djibouti: Alternative Scenarios, 2014–21

(In percent)



Source: IMF staff estimates.

POLICY DISCUSSIONS

Discussions focused on recent developments, the medium-term outlook, and policies to support the objectives of authorities' Vision Djibouti 2035. Key themes included (i) public debt policy and management; (ii) revenue mobilization and phasing out exemptions; (iii) public enterprises and governance; (iv) business environment, inclusiveness, and social policies; (v) financial stability, competitiveness, and safeguards; and (vi) statistics and technical assistance.

A. Strengthening Public Debt Management

19. Slowing the pace of government borrowing and avoiding non-concessional loans are urgent priorities. The DSA indicates that further non-concessional borrowing would exacerbate the already high risk of debt distress, while 2017–35 primary balances are projected below debt service requirements. In this situation, it is important to slow the pace of new public sector borrowing, and limit new borrowing, including by public enterprises (PEs), to concessional loans. Furthermore, there is limited space for financial participation in public-private partnerships (PPP).

20. The authorities are encouraged to finalize their debt strategy promptly. Staff encouraged the authorities to hold a national debt conference, similar to the 2015 National Tax Conference, to reach a broad-based consensus on the debt policy, priorities, and management. Moreover, introducing an explicit debt anchor, for example by targeting a specific debt-to-GDP ratio in the medium term, would help benchmark the implementation of a sustainable debt policy. Performing regular DSAs would also help.

21. Debt management should be strengthened. Coordination in contracting new debts remains weak. Line ministries and other government agencies are typically in the lead in negotiating loans and the budget and finance ministries are often involved only at a late stage. To address this issue, the authorities plan to establish a national public debt committee to act as a clearing house for all new public sector loans, thereby ensuring a centralized and coordinated control over new borrowing, including an evaluation of its costs and risks. In light of the risks and costs of debt and contingent liabilities of public enterprises (PE), staff recommended establishing a database to monitor PE debt, government guarantees, and collateral; regularly publish comprehensive public and private sector debt data; and consolidate PE borrowing and debt explicitly in the public sector accounts. Finally, the authorities should avoid the recurrence of debt service arrears, both external and domestic, develop a time-bound plan for clearing existing arrears, and give priority to staying current on all debt service obligations.

22. The authorities broadly agreed with staff's concerns over debt sustainability. They acknowledged that rising external debt, including contingent liabilities of public enterprises, poses risks. While underscoring the importance of their debt-financed investment program, which they saw as critical to economic development, the authorities acknowledged the need to seek alternative means of financing. In this respect, they aim at financing the next wave of projects (e.g., new specialized ports, airport, gas pipeline, toll roads, and business district) mainly through FDI and PPPs.

The authorities also emphasized that they are working at a technical level on a draft debt law and are considering appropriate debt anchor, although setting explicit debt targets would require substantial additional technical work. Given concerns over risks of debt distress, staff called for strengthening and consolidating debt management expeditiously. The authorities expressed interest in working with staff on a macroeconomic framework to ensure debt sustainability and asked for assistance on debt policy and debt management, and the evaluation of PE contingent liabilities. On external arrears, the authorities explained that the recurrence of short-term arrears in 2016 owed to treasury cash-flow pressures, and did not consider them to be indicative of a fundamental payment incapacity. They were also optimistic that appropriate terms would be agreed for the arrears under negotiation.

B. Mobilizing Revenue and Phasing-out Exemptions

23. Greater domestic revenue mobilization is imperative to generate fiscal space and achieve greater budgetary flexibility. Additional revenue from sustainable, fair and non-distortionary taxation is necessary to finance social and growth-enhancing projects, and to service public debt. However, the potential for revenue mobilization under the existing tax regime remains limited because of widespread tax exemptions and special regimes, such as tax free zones.

24. The authorities have made significant efforts to implement some of the recommendations of the 2015 National Tax Conference. The 2016 budget included measures to streamline and simplify the tax structure. Key changes included: exemption of the lowest income earners from income tax; broadening of the capital gains tax on real estate; reduction of import license fees; introduction of a differentiated scale for company registration fees; revision of the stamp duty and licensing fees; elimination of the excise tax on fruit and vegetable juices and carbonated beverages. The authorities also continued to gradually reduce the consumption tax (TIC) by replacing it with the VAT and excise taxes.

25. Further tax policy and tax administration measures are planned in 2017. The authorities plan to install cash registers in businesses subject to the VAT; transfer the management of the business license tax and local real estate taxes to the regional authorities; appoint customs commissioners to enable customs officers to focus on inspection work; expedite customs clearance procedures by introducing a risk analysis system; and adopt a code of ethics for customs personnel and an inspection charter. The authorities plan to assess the impact of these changes to ensure that they improve revenue or at least remain revenue neutral.

26. However, fundamental issues such as tax exemptions and special tax regimes, have yet to be addressed. Tax exemptions and other special tax regimes under the investment code, including the free zone system and the regime for foreign military bases, reduce the tax base, create distortions to competition between economic operators, and lead to sizable revenue losses. In 2017, the authorities plan to establish a tax policy unit and a reform steering committee tasked with devising, promoting, and coordinating tax reforms. In addition, the authorities should take immediate steps to review tax expenditures and exemptions in line with the recommendations of

World Bank technical assistance. The objective of the reforms should be to make tax incentives part of the common law, convert the investment code into an investor charter to level the playing field for investors, and reassess the tax regime for free zones. Furthermore, the distortive consumption tax should be phased out and replaced by the VAT and excise taxes.

27. There is considerable room to improve tax and customs administration. To mobilize revenue and improve efficiency, the authorities should reform the tax directorate, including by strengthening its human resources and control systems, introduce an integrated information and risk analysis systems, gradually expand online tax payments, establish a dispute management system, and improve local tax collection and management. As for customs, priority should be given to strengthening customs valuation, introducing risk analysis, and improving dispute mechanisms.

28. On expenditures, better prioritization and stronger financial management are needed. To contain the wage bill, the hiring freeze outside the health and education sectors should be complemented by functional expenditure reviews to identify over- or under-staffed sectors. Spending on goods and services could also be better prioritized. For the investment boom to lead to strong and inclusive growth, the authorities should preserve and significantly increase targeted social transfers and invest in human capital by providing better access to education and health care. Sufficient resources need be allocated to ensure sound maintenance of the large externally financed infrastructure. While there are currently no fuel subsidies because of the relatively low world oil prices, a mechanism for the automatic adjustment of energy prices should be introduced to avoid a recurrence of fuel subsidies in the future. In the area of public financial management, the efforts to set up a treasury single account and a medium-term budgetary framework should continue.

29. The authorities broadly shared staff's recommendations on revenue mobilization, phasing out exemptions, and energy price adjustment. They realize that the ongoing tax reforms, albeit important, cannot substantially increase revenue unless complemented by a comprehensive review of tax expenditures, and plan to take steps to review tax expenditures and exemptions. They noted, however, that planned reforms will likely face strong opposition from vested interests. The authorities appreciated past technical assistance on tax reforms and have requested additional assistance, including on tax expenditures.

C. Reforming Public Enterprises and Governance

30. Weak governance undermines the operational efficiency and financial soundness of public enterprises (PE) and poses risks for the budget and banks. Insufficient operational independence and constraints on decision making, weak government oversight, and lack of transparency weigh on PE performance. These factors have contributed to high prices for utilities, persistent losses, domestic arrears, and budgetary costs. As part of reforms to address these weaknesses, the authorities approved in April 2016 a Code of Good Governance for PEs to improve their performance.

31. The authorities are strongly encouraged to strengthen the management and supervision of public enterprises. The authorities are taking steps to implement the Code of Good

Governance. In early 2017, they plan to adopt the implementing regulations and a management training guide. They also intend to appoint new executive boards and sign performance contracts—based on organizational and financial audits—with five public enterprises by June 2017. The authorities are advised to put in place a joint supervision and audit framework for PEs, involving both the Ministry of Economy Finance and line ministries; prepare consolidated income statements and balance sheets of PEs every six months and establish a risk management framework to evaluate and mitigate possible budget risks. Other measures include implementing the Code of Good Governance, stepping up anti-corruption efforts, and phasing out tax exemptions for PEs. Fiscal implications and risks of PPP projects should be evaluated and factored into medium-term fiscal projections. Eliminating the monopoly status of PEs and opening key sectors to private operators, in particular in telecommunications, would improve competitiveness.

32. The authorities generally shared staff's view on the urgent need to improve the efficiency of public enterprises and their capacity to manage large projects. In particular, they intend to strengthen supervision of PEs. However, they noted the difficulty of opening public monopolies to private sector competition, and preferred reforming PEs first. Importantly, the authorities have liberalized renewable energy production and are preparing an institutional and legal framework for PPPs.

D. Improving the Business Environment, Inclusiveness, and Social Policies

33. The business environment remains relatively unfavorable for private sector development. The private sector is small, includes only a few registered private enterprises, and much activity is informal. Djibouti is ranked only 171 out of 190 countries in the World Bank's 2017 Doing Business report, with particularly low scores for enforcing contracts and protecting investors, getting bank credit, starting a business, getting electricity, and registering property. Consequently, unless the business environment improves considerably, the impact on growth and employment of large-scale and highly capital-intensive investments will likely be limited.

34. Poverty and inequality remain high in Djibouti, and growth has not been inclusive. An analysis of income distribution features of growth (Appendix II) shows that: (i) while the overall poverty declined, extreme poverty remains high and has changed little in the last decades; (ii) inequality remains high and may be increasing; (iii) in the last decade, growth has not been inclusive and has benefited mostly the upper bracket of the income distribution, while the poorest brackets have become poorer in relative terms.

35. Improving the business environment and strengthening social safety nets will be key to promoting inclusive growth and reducing unemployment and poverty. Policies to support economic diversification to tourism, fishing, transport, and telecommunication sectors offer the potential for substantial untapped growth and employment opportunities. These would require significant sectoral and business environment reforms with the view to advancing a private sector-led growth model, including through greater use of PPPs. Staff encouraged the authorities to address the weak business environment in a decisive and coordinated way, and pointed to recent successes, such as in Mauritania. The development of a regulatory framework for PPPs will also be essential. To strengthen social safety nets, the authorities should provide targeted cash transfers to the most vulnerable. The authorities concurred and are developing sectoral programs in education and healthcare with the help of development partners.

36. The authorities confirmed their intention to improve the business climate. The soon-to-be-established one-stop shop for business registration and the ongoing tax reforms are expected to have a positive impact on the Doing Business ranking. Efforts to rationalize regulations and the introduction on the Code of Good Governance for PEs will also help improve the business climate, and will be complemented by stepping up anti-corruption efforts. On inclusion, the authorities are preparing the 2017 household survey and plan to use its results to inform further policy decisions. The authorities are also establishing a database of beneficiaries of social programs, with a view to rationalizing and improving targeting.

E. Enhancing Financial Stability and Safeguards

37. Performance of the banking sector is weak and financial inclusion remains limited despite recent efforts. The sector is characterized by a high level of nonperforming loans, excessive credit concentration, and insufficient profitability, and remains vulnerable to adverse shocks. The central bank is building up its supervisory capacity. Financial inclusion is limited as only 25 percent of adults possess a bank account and access to credit is difficult. In response, the authorities are setting up a guarantee fund to facilitate access to finance for small companies and established a Sharia Board for Islamic banking. In addition, the CBD has launched projects to promote mobile banking services to facilitate financial inclusion and plans to develop electronic payment procedures and modernize the credit information system

38. Efforts to strengthen the financial sector and enhance financial inclusion should continue. Important reform steps include strengthening risk-based bank supervision and the enforcement of prudential ratios, introducing a CAMELS bank rating system, introducing a minimum reserve requirement, and establishing a bank resolution mechanism. The authorities should take corrective actions to address the problems of banks in difficulty, including improving loan classification, writing off unrecoverable loans, increasing provisions, and establish a strategy for bank recapitalization without the use of public resources. On financial inclusion, the authorities are encouraged to strengthen the credit information system, reduce excessive credit concentration, operationalize the recently approved credit guarantee fund for SMEs, expand mobile banking, and develop further the framework for Islamic banking. The CBD should also strengthen its framework for anti-money laundering and combatting the financing of terrorism (AML-CFT), join the MENA-FATF, and intensify supervision of cross-border activities to reduce the risk of further withdrawal of correspondent bank relations.

39. Implementation of the recommendations of the 2012 safeguards assessment of the CBD should accelerate. The CBD recently published its audited financial statements for 2013–15, thereby addressing a priority recommendation from the 2012 assessment. The authorities have also confirmed that an internal audit function has been established. The CBD has yet to provide management letters on internal controls, in line with the IMF's safeguard's policy.

F. Strengthening Statistics and Technical Assistance

40. Data provided to the Fund are broadly adequate for surveillance but shortcomings remain. While progress is being made on revising the national accounts, inadequate data sources hamper their quality. Fiscal data are reported with delays and there are no aggregated data on the accounts and contingent liabilities of PEs. Staff recommended strengthening national accounts and fiscal statistics based on the recommendations of IMF technical assistance.

41. The Fund stands ready to support reform and capacity building efforts through technical assistance and training. The authorities should continue to seek technical assistance from the IMF, including from the Middle East Technical Assistance Center (METAC), focusing on tax policy (tax expenditure and exemptions); public debt policy and management; consolidation of the public sector accounts; and national accounts.

STAFF APPRAISAL

42. The remarkable boom in infrastructure investment, mostly debt-financed, presents opportunities as well as risks. The authorities should advance rapidly with critical reforms aimed at translating investment into strong, inclusive, and job-creating growth and returning debt to a sustainable trajectory. Key policy priorities include strengthened debt policy and management, tax reform to reduce exemptions and special tax regimes, and reforms of public enterprises, governance and the business climate. Close government coordination is needed to ensure effective implementation.

43. The outlook remains broadly favorable with considerable, although manageable, risks. The DSA indicates a high risk of debt distress. Rising debt service obligations could crowd out priority social spending, even in the near term. A possible slowdown in global trade or in Ethiopia would weigh on growth prospects. Lower growth combined with continued public sector borrowing would put external public debt on an unsustainable trajectory. Withdrawal of correspondent bank relations could strain the currency board arrangement by limiting payment options. On the upside, successful implementation of the authorities' reform agenda, including taxation, public enterprise and business climate reforms, could translate into higher growth and a lower debt burden for the budget.

44. Developing a coordinated debt strategy that aims at establishing debt sustainability is an urgent priority. The authorities are encouraged to adopt a public debt law and to set an explicit debt anchor, such as public debt-to-GDP ratio along with a debt path, to ensure sustainability. The pace of government borrowing should be reduced, borrowing on non-concessional terms avoided, and new borrowing, including by PEs, limited to concessional loans. In addition, direct financial participation in PPPs should be kept to a minimum, and explicit guarantees and implicit contingent budget liabilities avoided. Debt management capacity, coordination of institutions involved in contracting debt, and capacity to evaluate and monitor fiscal risks stemming from PPPs should be strengthened.

45. Further tax reforms, especially to reduce the wide-ranging exemptions and special regimes, should be launched. So far, efforts have focused on important, albeit marginal, changes in the tax system, while widespread tax exemptions—the core issue—remain largely unaddressed. The authorities are strongly urged to launch a comprehensive review of tax expenditure, exemptions, and special tax regimes with a view to phasing them out. This would help broaden the tax base and increase government revenue to generate space, not only for debt service, but also for priority social spending needed to generate broad-based economic opportunities.

46. Reforming public enterprises is another priority. Reforms of PEs should seek to enhance their efficiency, strengthen governance, make their services more competitive, and improve their capacity to manage large investment projects. The authorities are advised to open public monopolies (e.g., in the telecom and energy sectors) to competition.

47. Structural reforms need to be accelerated to help translate the investment boom into broad-based, inclusive, and private sector-led growth. Priorities include improving the business climate, introducing greater competition, addressing the distributional dimension of growth, and supporting private sector development, in particular in areas with substantial employment potential. Improved business environment and governance would attract new investors, create jobs, and promote sustainable and inclusive growth.

48. Monetary and financial policy should continue to focus on the stability of the banking system, financial inclusion, and external stability. The CBD needs to strengthen risk-based bank supervision, introduce a bank rating system, reduce credit concentration, better enforce prudential ratios, introduce a minimum reserve requirement, and put in place bank resolution mechanisms. It should also take corrective actions to address the problems of banks in difficulty. The CBD is also encouraged to place priority on strengthening its AML-CFT framework.

49. The currency board arrangement has served Djibouti well and should be maintained at an unchanged parity. Over the past several decades, the currency board arrangement has helped instill confidence and improve predictability in international transactions. While the staff's analysis suggests that the exchange rate is somewhat overvalued in real effective terms, the extent of the overvaluation is subject to considerable uncertainty. Moreover, as the sensitivity of the current account to changes in the real exchange rate is low, the external competitiveness of the economy should be strengthened through structural reforms.

50. The authorities are strongly encouraged to improve statistics. Key priorities include GDP calculations and consolidated financial statements of the public sector.

51. Staff recommends that the next Article IV consultation with Djibouti be held on the standard 12-month consultation cycle.

Box 1. Response to the 2015 Article IV Consultation Key Recommendations

Fiscal policy

- *Design and implement a comprehensive tax reform based on the proposals from the 2015 tax conference.* Progress has been achieved. A few measures were introduced in the 2016 budget, and additional measures are planned in 2017.
- *Reduce tax exemptions*. Little progress. Committees on fiscal policies to be established in 2017.
- *Strengthen the institutional capacity to manage investment projects*. A new ministry in charge of investments was established in May 2016; however, it is too early to determine its impact.
- *Reform public enterprises to ensure their commercial viability*. Little progress.

Debt policy

- *Improve coordination among entities involved in contracting external debt.* Drafts of a national debt policy and a decree establishing a national public debt committee, which would review loan proposals, have been prepared.
- *Develop a strategy to reduce and manage the external debt burden*. A draft debt law and a medium-term debt strategy are being prepared.
- *Limit non-concessional public or publicly guaranteed borrowing*. Limited progress; a new sizable loan was contracted in 2016 to finance the multi-purpose port and the livestock port.

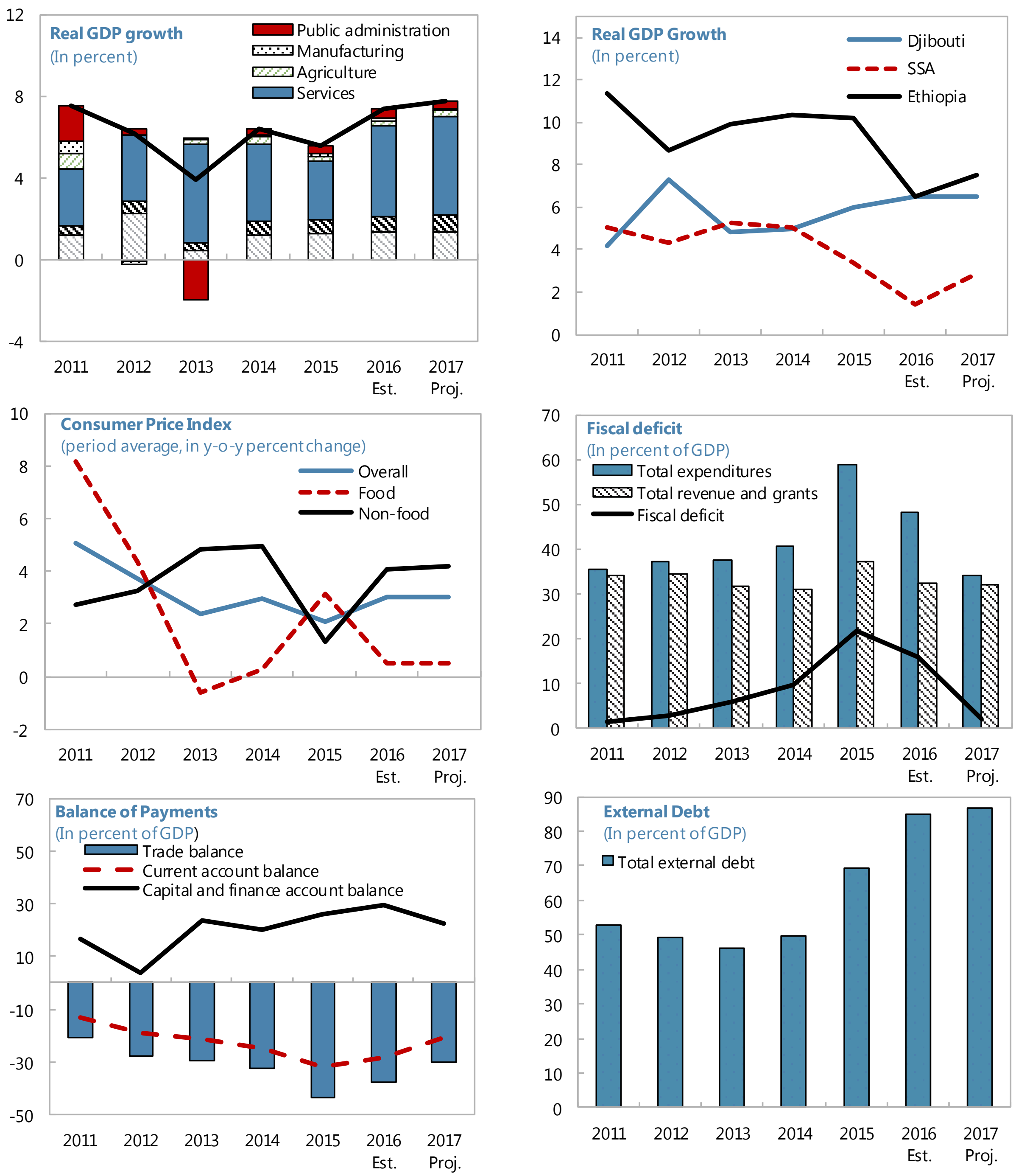
Financial sector policy

- *Address a bank in difficulty.* The bank was recapitalized.
- *Reinforce bank supervision*. With the help of METAC, the most critical areas for strengthening bank supervision have been identified.
- *Establish a bank resolution mechanism*. No progress.
- *Strengthen the income position of the central bank*. No progress yet.
- *Ensure adequate provisioning for nonperforming loans.* No progress; the ratio of provisions to NPL worsened in 2016.
- *Establish a guarantee fund for SMEs.* The fund has been established, but it is not operational yet.

Structural policy

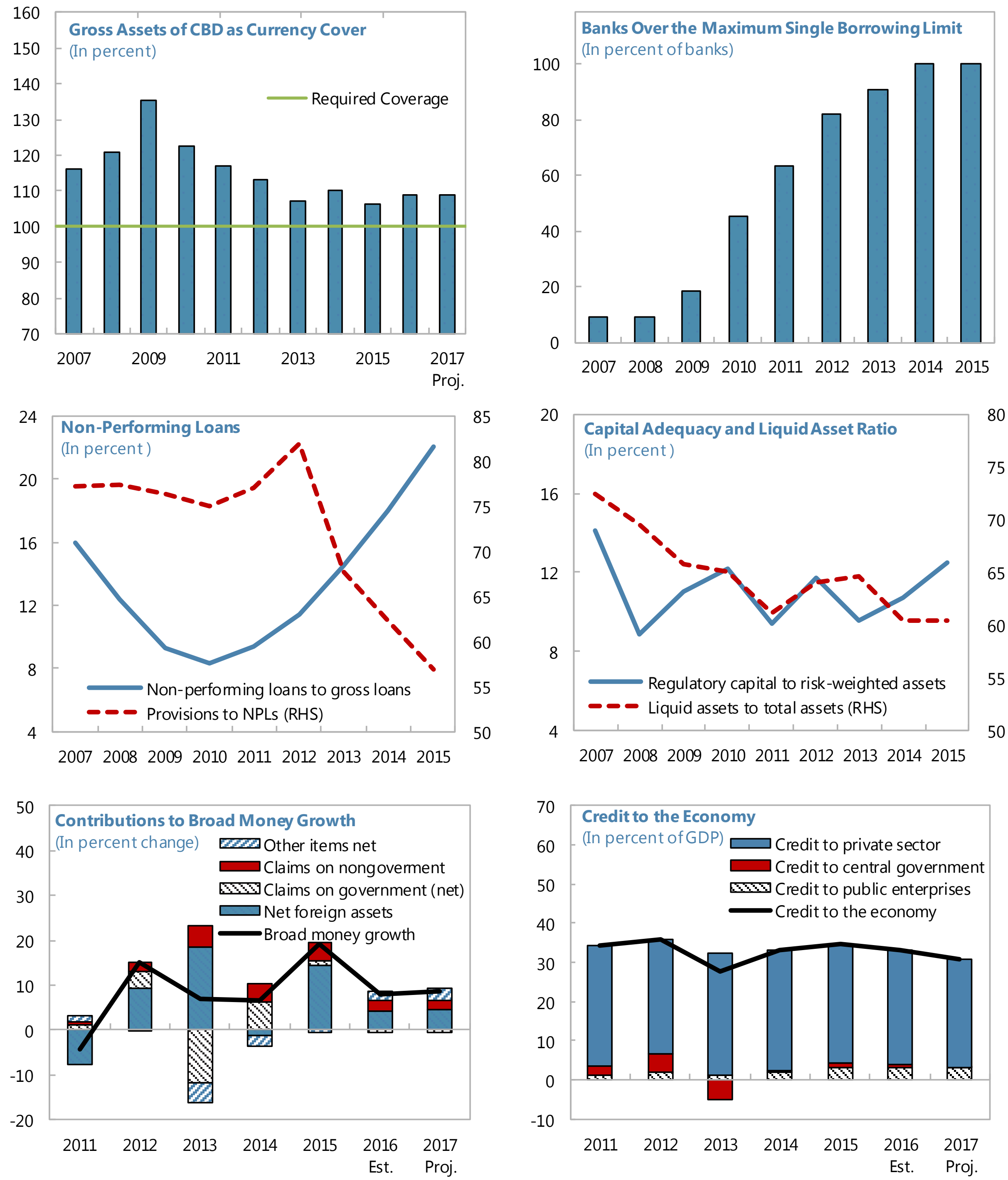
- *Finalize management arrangements for the railway project.* In December 2016, Djiboutian and Ethiopian governments created a joint railway management company.
- *Accelerate reforms of public enterprises*. A law on the code of good governance of PEs was promulgated in April 2016, but has yet to be implemented. Performance contracts with five PEs are expected to be signed by mid-2017.
- *Lower utility costs*. No progress.
- *Improve the business environment.* No progress in Doing Business rankings, although a one-stop-shop is expected to be established shortly.

Figure 4. Djibouti: Selected Economic Indicators, 2011–2017



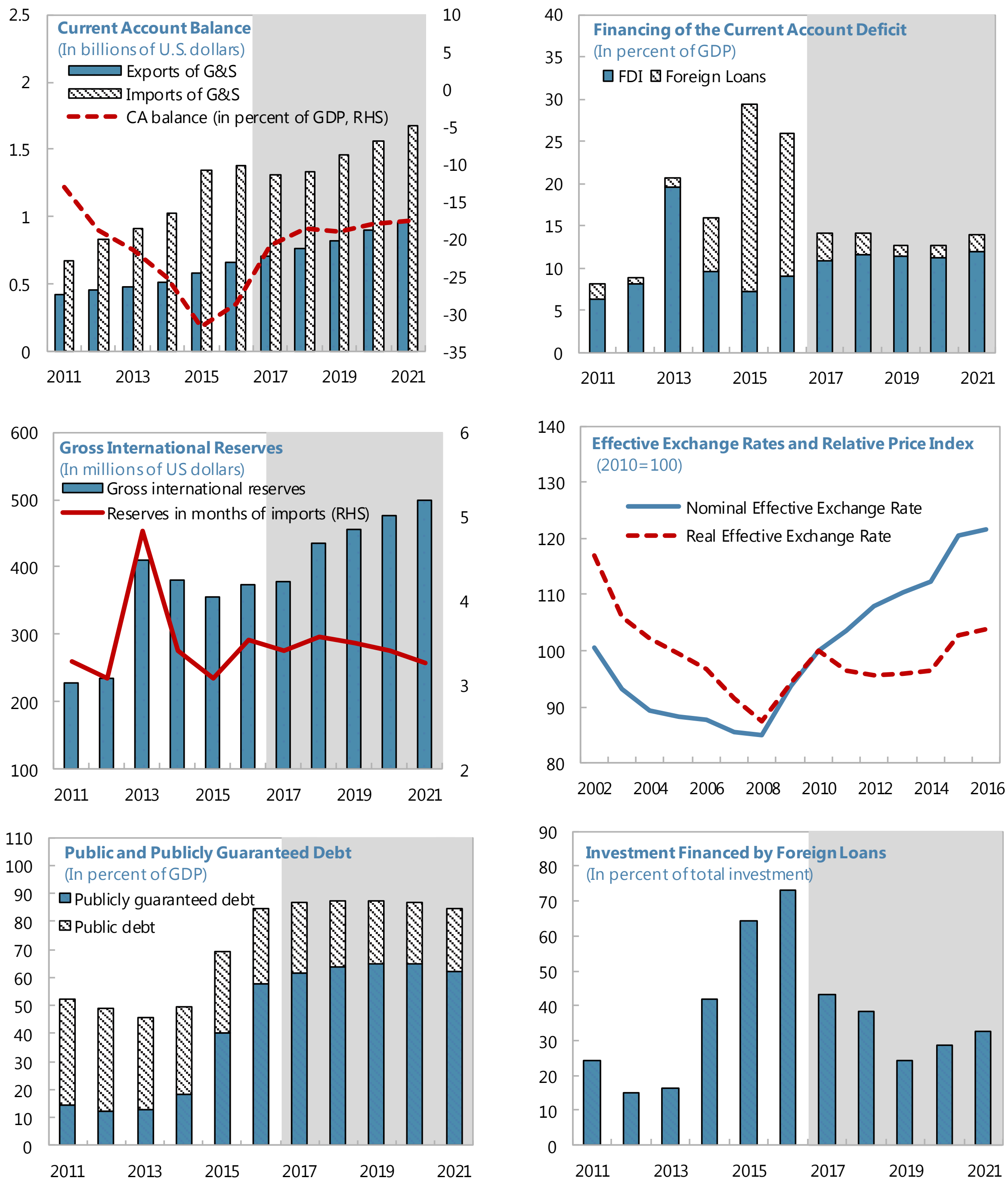
Sources: Djibouti authorities; and IMF staff estimates

Figure 5. Djibouti: Monetary and Financial Indicators, 2007–2017



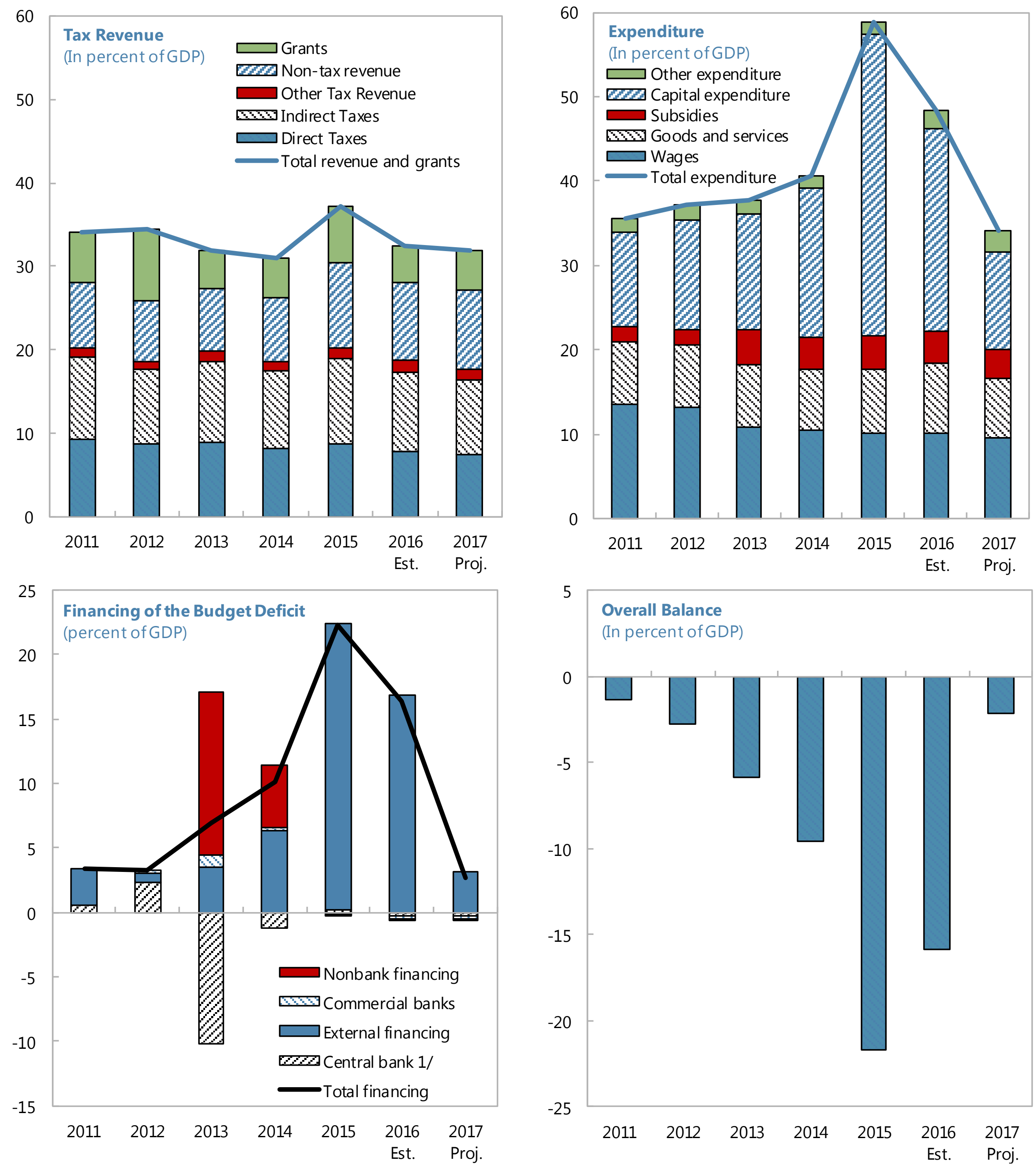
Sources: Djibouti authorities; and IMF staff estimates.

Figure 6. Djibouti: External Sector, 2011–2021



Sources: Djibouti authorities; and IMF staff estimates

Figure 7. Djibouti: Central Government Operations, 2011–2017



Sources: Djibouti authorities; and IMF staff estimates.
1/ Accumulated privatization proceeds.

Table 1. Djibouti: Key Investment Projects, 2016

Project	Total cost (Million USD)	Status	Financing	Financing source
Main investment projects contracted				
Water				
Water pipeline with Ethiopia	322	Ongoing	Publicly guaranteed debt	EXIM-BANK CHINA
Water Desalination plant	63	Pre-initiation	Grants	EU
Water Infrastructure Renovation, phase 2	33	Ongoing	Publicly guaranteed debt	FADES
Energy				
Geothermal Energy	31	Pre-initiation	Public Debt	IDA, FAD, BAD, AFD, FEM, SEFA
Jabanhas's energy network	65	Pre-initiation	Publicly guaranteed debt	FADES, KFAED
Oil pipeline to Ethiopia	1550	Pre-initiation	scheme	US private
Transportation				
Addis Ababa - Djibouti railway	490	Completed	Publicly guaranteed debt	EXIM-BANK CHINA
Port de Goubet	64	Ongoing	Publicly guaranteed debt	EXIM-BANK CHINA
Port de Tadjourah	68	Ongoing	Publicly guaranteed debt	FADES, FSD, OPEC
Road Tadjourah - Balho	80	Initiated	Public Debt	KFAED
Multipurpose Port Doraleh	580	Ongoing	Public Debt	EXIM-BANK CHINA
Other				
Agriculture, Livestock and Fishing	66	Ongoing	Grant / PPG	BAD
Urbanization and Housing	23	Ongoing	Grant / PPG	FADES, FSD
Social Infrastructure	105	Ongoing	Grant / PPG	BAD, IDA, FADES, World Bank
Education and Health	147	Ongoing	Grant / PPG	BAD, BID
Telecommunication / Submarine cable	69	Ongoing	Public guaranteed debt	AFD
Other Sectors	21	Ongoing	Grant / PPG	
Planned investment projects				
Addis Ababa - Djibouti railway electrification	24		Publicly guaranteed debt	EXIM-BANK CHINA
Djibouti new international airport (Bicidley)	450		Publicly guaranteed debt	EXIM-BANK CHINA
Obock international airport (Ras Siyan)	200		FDI	EXIM-BANK CHINA
Road Tadjourh-Galafi	600		Public debt	EXIM INDIA
Road Djibouti-Galileh	580		Public debt	EXIM-BANK CHINA
Liquefied natural gas (LNG) pipeline	3000		FDI	China
Damerjog Port Crude Oil Terminal	200		Publicly guaranteed debt	China

Source: Djibouti authorities.

Table 2. Djibouti: Risk Assessment Matrix 1/

Source of risk	Relative likelihood	Impact if realized	Staff advice on policy response
Global Risks			
Weaker-than-expected global growth, in particular: Significant China slowdown and its spillovers	Low in the short term; Medium thereafter	High: Financing and execution of major investment projects would be affected. Lower port activity would reduce overall economic growth.	Diversify the economy and sources of investment financing.
Heightened risk of fragmentation/security dislocation in part of the Middle East, Africa, and Europe, leading to a sharp rise in migrant flows, with negative global spillovers	High	High: Foreign direct investment and overall economic activity would be negatively affected.	Diversify the economy to better absorb shocks. Seek donor assistance.
Reduced financial services by global/regional banks	High	High: BoP flows would be affected, with negative impact on economic activity and financial intermediation.	Strengthen financial supervision and the implementation of regulatory requirements by financial institutions, including with respect to AML/CFT.
Country-Specific Risks			
Growth slowdown or recession in Ethiopia	Medium	High: Ethiopia is the main client of Djibouti's ports and, given its size, exerts a major influence on Djibouti's economy.	Encourage diversification of economic activity to reduce dependence on the ports. Expand trade networks to new markets in Africa.
The large publicly guaranteed external debt by the public enterprises	High	High: Substantial contingent liabilities for the budget	Set a fiscal risk management function in the MoF to identify and assess fiscal risks arising from the PEs, reform PEs to improve their profitability.
Lower-than-expected efficiency of, and returns on, public investment	Medium-High	High: Lower-than-projected growth, higher fiscal deficit, increased debt distress.	Strengthen project and debt management capacity, improve the business climate.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Table 3. Djibouti: Selected Economic and Financial Indicators, 2014–21

	2014	2015	Est. 2016	Proj. 2017	2018	2019	2020	2021
National accounts			(Annual percentage change)					
Real GDP	6.0	6.5	6.5	7.0	7.0	7.0	6.0	6.0
Consumer prices (annual average)	2.9	2.1	3.0	3.0	3.0	3.0	3.0	3.0
Consumer prices (end of period)	2.8	1.9	3.0	3.0	3.0	3.0	3.0	3.0
Saving and investment			(In percent of GDP)					
Fixed capital investment	34.9	50.8	44.3	33.2	32.9	34.0	33.6	33.9
Non-government	17.3	14.9	20.1	23.5	25.0	24.6	23.3	22.5
Central government	17.7	35.9	24.1	9.7	7.9	9.4	10.4	11.3
Gross national savings	9.8	19.0	15.6	12.3	13.6	15.0	15.7	16.3
Savings/investment balance	-25.1	-31.8	-28.6	-20.9	-19.3	-19.0	-18.0	-17.6
Central government			(In percent of GDP)					
Revenues and grants	30.9	37.2	32.5	30.8	29.9	29.3	28.8	28.4
Tax revenues	18.6	20.1	18.8	17.6	17.8	17.8	17.7	17.7
Nontax revenue	7.6	10.2	9.2	9.5	9.1	8.6	8.2	7.8
Grants	4.7	6.9	4.5	3.7	3.0	3.0	2.9	2.9
Expenditure	40.5	58.9	48.3	32.4	30.6	30.2	30.3	30.4
Current expenditure	22.9	23.0	24.2	22.6	22.8	20.8	19.9	19.1
Capital expenditure	17.7	35.9	24.1	9.7	7.8	9.4	10.4	11.3
Domestically financed	6.9	10.0	4.5	3.6	2.9	4.5	4.7	5.0
Foreign-financed	10.8	25.9	19.6	6.2	4.8	4.9	5.6	6.3
Overall balance (commitment basis)	-9.6	-21.7	-15.8	-1.5	-0.6	-0.9	-1.5	-2.0
Change in arrears	-0.5	-0.6	-0.5	-0.5	-0.4	-0.4	0.0	0.0
Overall balance (cash basis)	-10.1	-22.2	-16.3	-2.0	-1.1	-1.3	-1.5	-2.0
Financing	10.1	22.2	16.3	2.0	1.1	1.3	1.5	2.0
Domestic	3.7	0.1	-0.5	-1.4	-0.2	0.0	0.0	0.0
External	6.4	22.2	16.8	3.4	1.2	1.3	1.5	2.0
Disbursements	7.4	23.1	17.7	4.2	2.2	2.3	3.0	3.7
Amortization	-1.1	-0.9	-0.8	-0.8	-1.0	-1.2	-2.1	-2.8
Other	0.0	0.0	0.0	0.0	0.1	0.2	0.6	1.1
Memo: Overall balance excluding large projects	-4.0	-0.9	-0.4	0.3	-1.1	-1.3	-1.5	-2.0
Monetary sector			(Annual change in percent of broad money)					
Broad money	6.5	19.0	8.0	8.7	8.3	8.3	8.3	8.3
Net foreign assets	-1.3	14.4	4.2	5.8	3.6	3.6	3.5	3.4
Net domestic assets	7.9	4.7	3.8	3.0	4.7	4.7	4.7	4.9
Of which Claims on government (net)	6.2	0.9	-0.6	-1.7	-0.2	0.0	0.0	0.0
Claims on nongovernment sector	4.1	4.3	2.3	1.9	5.1	5.0	5.1	5.2
Credit to non-government (in percent of GDP)	32.9	33.5	32.4	31.0	32.2	33.2	34.4	35.6
Currency board cover (in percent) 1/	110	107	109	109	109	109	109	109
External sector			(In millions of US dollars)					
Current account balance	-399	-549	-542	-436	-444	-483	-497	-531
(In percent of GDP)	-25.1	-31.8	-28.6	-20.9	-19.3	-19.0	-18.0	-17.6
External public and publicly guaranteed debt	792	1,197	1,606	1,814	2,008	2,213	2,402	2,559
(In percent of GDP)	49.9	69.3	84.8	86.9	87.3	87.3	86.8	84.7
Foreign direct investment	153	124	172	226	265	290	310	363
(In percent of GDP)	9.6	7.2	9.1	10.8	11.5	11.4	11.2	12.0
Exports of goods and services	511	588	665	712	766	821	899	963
Imports of goods and services	-1,022	-1,342	-1,381	-1,313	-1,356	-1,461	-1,561	-1,679
Gross official reserves	381	355	373	419	435	455	476	499
(In months of next year's imports of goods and services)	3.4	3.1	3.4	3.7	3.6	3.5	3.4	3.3
Gross foreign assets of commercial banks	903	1,157	1,227	1,300	1,378	1,461	1,549	1,642
(In months of next year's imports of goods and services)	8.1	10.1	11.2	11.5	11.3	11.2	11.1	10.7
Exchange rate (DF/US$, end of period)	177.7	177.7	177.7	…	…	…	…	…
Real effective exchange rate (yearly average, 2005=100)	96.4	102.7	103.8	…	…	…	…	…
(Change in percent; depreciation -)	0.5	6.6	1.1	…	…	…	…	…
Memorandum items								
Nominal GDP (in millions of Djibouti francs)	282,228	306,896	336,649	371,021	408,902	450,651	492,021	537,189
Nominal GDP (in millions of US dollars)	1,588	1,727	1,894	2,088	2,301	2,536	2,769	3,023
Nominal GDP per capita (US dollars)	1,691	1,788	1,908	2,046	2,193	2,351	2,497	2,657
Population (million)	0.939	0.966	0.993	1.020	1.049	1.078	1.109	1.138

Sources: Djibouti authorities; and IMF staff estimates and projections

1/Ratio of central bank gross total assets over liabilities (except the government deposits at the central bank).

Table 4. Djibouti: Central Government Operations, 2014–21

(In millions of Djibouti francs)

			Est.	Proj.				
	2014	2015	2016	2017	2018	2019	2020	2021
Revenues and grants	87,326	114,222	109,424	114,444	122,358	132,089	141,874	152,653
Tax revenues	52,600	61,779	63,349	65,438	72,985	80,038	87,164	95,036
Direct taxes	22,941	26,724	26,541	27,338	30,101	33,013	36,081	39,494
Indirect and other taxes	29,660	35,055	36,808	38,100	42,884	47,025	51,082	55,542
Indirect taxes	26,485	31,280	31,948	33,750	36,980	40,519	43,979	47,787
Other taxes	3,175	3,775	4,860	4,350	5,903	6,506	7,103	7,755
Nontax revenue	21,527	31,323	31,062	35,132	37,069	38,643	40,207	41,918
Domestic	8,684	13,037	11,777	13,227	15,163	16,737	18,302	20,013
External	12,843	18,286	19,285	21,905	21,905	21,905	21,905	21,905
Grants	13,199	21,120	15,013	13,874	12,304	13,409	14,503	15,698
Development projects	9,521	8,474	6,500	7,282	10,819	11,924	13,018	14,213
Budget support	3,678	12,646	8,513	6,592	1,485	1,485	1,485	1,485
Expenditure	114,392	180,805	162,750	120,108	124,958	136,060	149,156	163,411
Current expenditure	64,566	70,685	81,607	83,979	93,266	93,557	98,089	102,488
Wages and related expenditure	29,561	31,023	34,212	35,482	38,247	41,207	43,957	46,866
Wages and contributions	26,432	27,748	30,846	32,016	34,467	37,085	39,505	42,057
Housing subsidies	3,129	3,275	3,366	3,466	3,780	4,122	4,452	4,809
Goods and services	20,245	22,999	27,702	26,148	26,890	27,818	28,885	29,938
Civil expenditure	16,577	19,055	22,789	20,413	21,058	21,857	22,781	23,690
Military expenditure	3,668	3,944	4,913	5,735	5,831	5,961	6,105	6,248
Maintenance	1,456	1,320	1,403	1,403	1,489	1,640	1,791	1,956
Transfers	10,955	12,239	12,767	13,096	13,596	14,096	14,596	15,096
Interest	892	1,747	4,630	7,049	12,165	7,829	7,807	7,487
Loans to central government	892	796	4,630	7,049	7,357	1,441	1,418	1,361
Large projects	0	951	0	0	4,807	6,389	6,389	6,127
Rail road	0	447	0	0	4,807	5,244	5,244	4,982
Water pipeline	0	503	0	0	0	1,145	1,145	1,145
Foreign-financed current spending	1,456	1,357	893	801	880	967	1,052	1,146
Capital expenditure	49,827	110,120	81,143	36,129	31,693	42,503	51,067	60,923
Domestically financed	19,368	30,704	15,188	13,176	12,012	20,279	23,371	26,859
Foreign-financed	30,459	79,416	65,955	22,953	19,681	22,223	27,696	34,063
Grants	9,521	8,474	6,500	7,282	10,819	11,924	13,018	14,213
Loans to central government	3,767	5,377	5,943	7,282	8,862	10,300	14,677	19,850
Large projects	17,171	65,565	53,512	8,389	0	0	0	0
Rail road	0	53,922	33,480	0	0	0	0	0
Water pipeline	17,171	11,643	20,032	8,389	0	0	0	0
Overall balance (commitment basis)	-27,066	-66,582	-53,326	-5,664	-2,601	-3,971	-7,281	-10,758
Change in arrears	-1,416	-1,698	-1,700	-1,700	-1,700	-1,700	0	0
Overall balance (cash basis)	-28,482	-68,280	-55,026	-7,364	-4,301	-5,671	-7,281	-10,758
Financing	28,482	68,280	55,026	7,364	4,301	5,671	7,281	10,758
Domestic	10,524	193	-1,685	-5,337	-724	-187	-187	-156
Bank	-3,024	318	-1,560	-5,212	-599	-62	-62	-31
Central bank	-3,600	682	-1,082	-4,705	-62	-62	-62	-31
Commercial banks	576	-364	-478	-507	-538	0	0	0
Nonbank	13,548	-125	-125	-125	-125	-125	-125	-125
External	17,958	68,087	56,711	12,701	5,025	5,858	7,468	10,914
Disbursements	20,938	70,942	59,455	15,671	8,862	10,300	14,677	19,850
Loans to central government	3,767	5,377	5,943	7,282	8,862	10,300	14,677	19,850
Large projects	17,171	65,565	53,512	8,389	0	0	0	0
Rail road	0	53,922	33,480	0	0	0	0	0
Water pipeline	17,171	11,643	20,032	8,389	0	0	0	0
Amortization	-2,979	-2,854	-2,744	-2,970	-4,286	-5,308	-10,094	-15,104
Loans to central government	-2,979	-2,854	-2,744	-2,970	-4,286	-5,308	-5,724	-6,364
Large projects	0	0	0	0	0	0	-4,370	-8,740
Rail road	0	0	0	0	0	0	-4,370	-8,740
Water pipeline	0	0	0	0	0	0	0	0
Other	0	0	0	0	450	867	2,885	6,168
Memorandum								
Overall balance (excluding large projects)	-11,312	-2,716	-1,513	1,025	-4,301	-5,671	-7,281	-10,758

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

Table 5. Djibouti: Central Government Operations, 2014–21

(In percent of GDP)

			Est.	Proj.				
	2014	2015	2016	2017	2018	2019	2020	2021
Revenues and grants	30.9	37.2	32.5	30.8	29.9	29.3	28.8	28.4
Tax revenues	18.6	20.1	18.8	17.6	17.8	17.8	17.7	17.7
Direct taxes	8.1	8.7	7.9	7.4	7.4	7.3	7.3	7.4
Indirect and other taxes	10.5	11.4	10.9	10.3	10.5	10.4	10.4	10.3
Indirect taxes	9.4	10.2	9.5	9.1	9.0	9.0	8.9	8.9
Other taxes	1.1	1.2	1.4	1.2	1.4	1.4	1.4	1.4
Nontax revenue	7.6	10.2	9.2	9.5	9.1	8.6	8.2	7.8
Domestic	3.1	4.2	3.5	3.6	3.7	3.7	3.7	3.7
External	4.6	6.0	5.7	5.9	5.4	4.9	4.5	4.1
Grants	4.7	6.9	4.5	3.7	3.0	3.0	2.9	2.9
Development projects	3.4	2.8	1.9	2.0	2.6	2.6	2.6	2.6
Budget support	1.3	4.1	2.5	1.8	0.4	0.3	0.3	0.3
Expenditure	40.5	58.9	48.3	32.4	30.6	30.2	30.3	30.4
Current expenditure	22.9	23.0	24.2	22.6	22.8	20.8	19.9	19.1
Wages and related expenditure	10.5	10.1	10.2	9.6	9.4	9.1	8.9	8.7
Wages and contributions	9.4	9.0	9.2	8.6	8.4	8.2	8.0	7.8
Housing subsidies	1.1	1.1	1.0	0.9	0.9	0.9	0.9	0.9
Goods and services	7.2	7.5	8.2	7.0	6.6	6.2	5.9	5.6
Civil expenditure	5.9	6.2	6.8	5.5	5.1	4.9	4.6	4.4
Military expenditure	1.3	1.3	1.5	1.5	1.4	1.3	1.2	1.2
Maintenance	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Transfers	3.9	4.0	3.8	3.5	3.3	3.1	3.0	2.8
Interest	0.3	0.6	1.4	1.9	3.0	1.7	1.6	1.4
Loans to central government	0.3	0.3	1.4	1.9	1.8	0.3	0.3	0.3
Large projects	0.0	0.3	0.0	0.0	1.2	1.4	1.3	1.1
Rail road	0.0	0.1	0.0	0.0	1.2	1.2	1.1	0.9
Water pipeline	0.0	0.2	0.0	0.0	0.0	0.3	0.2	0.2
Foreign-financed current spending	0.5	0.4	0.3	0.2	0.2	0.2	0.2	0.2
Capital expenditure	17.7	35.9	24.1	9.7	7.8	9.4	10.4	11.3
Domestically financed	6.9	10.0	4.5	3.6	2.9	4.5	4.7	5.0
Foreign-financed	10.8	25.9	19.6	6.2	4.8	4.9	5.6	6.3
Grants	3.4	2.8	1.9	2.0	2.6	2.6	2.6	2.6
Loans to central government	1.3	1.8	1.8	2.0	2.2	2.3	3.0	3.7
Large projects	6.1	21.4	15.9	2.3	0.0	0.0	0.0	0.0
Rail road	0.0	17.6	9.9	0.0	0.0	0.0	0.0	0.0
Water pipeline	6.1	3.8	6.0	2.3	0.0	0.0	0.0	0.0
Overall balance (commitment basis)	-9.6	-21.7	-15.8	-1.5	-0.6	-0.9	-1.5	-2.0
Change in arrears	-0.5	-0.6	-0.5	-0.5	-0.4	-0.4	0.0	0.0
Overall balance (cash basis)	-10.1	-22.2	-16.3	-2.0	-1.1	-1.3	-1.5	-2.0
Financing	10.1	22.2	16.3	2.0	1.1	1.3	1.5	2.0
Domestic	3.7	0.1	-0.5	-1.4	-0.2	0.0	0.0	0.0
Bank	-1.1	0.1	-0.5	-1.4	-0.1	0.0	0.0	0.0
Central bank	-1.3	0.2	-0.3	-1.3	0.0	0.0	0.0	0.0
Commercial banks	0.2	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0
Nonbank	4.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	6.4	22.2	16.8	3.4	1.2	1.3	1.5	2.0
Disbursements	7.4	23.1	17.7	4.2	2.2	2.3	3.0	3.7
Loans to central government	1.3	1.8	1.8	2.0	2.2	2.3	3.0	3.7
Large projects	6.1	21.4	15.9	2.3	0.0	0.0	0.0	0.0
Rail road	0.0	17.6	9.9	0.0	0.0	0.0	0.0	0.0
Water pipeline	6.1	3.8	6.0	2.3	0.0	0.0	0.0	0.0
Amortization	-1.1	-0.9	-0.8	-0.8	-1.0	-1.2	-2.1	-2.8
Loans to central government	-1.1	-0.9	-0.8	-0.8	-1.0	-1.2	-1.2	-1.2
Large projects	0.0	0.0	0.0	0.0	0.0	0.0	-0.9	-1.6
Rail road	0.0	0.0	0.0	0.0	0.0	0.0	-0.9	-1.6
Water pipeline	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.1	0.2	0.6	1.1
Memorandum								
Overall balance (excluding large projects)	-4.0	-0.9	-0.4	0.3	-1.1	-1.3	-1.5	-2.0

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

Table 6. Djibouti: Balance of Payments, 2014–21

(In millions of U.S. dollars, unless otherwise indicated)

	2014	2015	Est. 2016	2017	2018	Proj. 2019	2020	2021
Current account	-399	-549	-542	-436	-444	-483	-497	-531
Trade balance	-511	-754	-716	-601	-590	-639	-662	-715
Exports	511	588	665	712	766	821	899	963
Goods	129	134	136	146	156	167	178	190
Services	382	455	529	566	610	655	721	774
Of which: services to foreign military bases	188	222	266	283	301	321	342	364
Imports	-1,022	-1,342	-1,381	-1,313	-1,356	-1,461	-1,561	-1,679
Goods	-803	-1,076	-1,107	-1,049	-1,080	-1,164	-1,244	-1,338
Of which: investment goods	-300	-492	-521	-412	-401	-441	-476	-523
Services	-218	-266	-274	-264	-276	-297	-317	-340
Income	94	133	113	114	123	134	141	160
Of which: income related to military bases	72	103	109	123	123	123	123	123
Current transfers	19	73	61	51	23	23	24	24
Private	-13	15	15	15	15	16	16	17
Official	32	57	47	36	7	7	7	7
Capital and financial account	322	453	562	492	461	503	519	553
Capital transfers	65	94	39	45	65	71	77	84
Foreign direct investment	153	124	172	226	265	290	310	363
Portfolio investment	0	29	0	0	0	0	0	0
Public sector	113	418	414	214	200	210	193	164
Disbursements	165	445	449	243	245	264	278	278
Amortization	-53	-27	-35	-29	-44	-54	-85	-115
Commercial banks	-9	-212	-46	-48	-50	-52	-55	-57
Other investment	0	0	-18	55	-20	-16	-7	0
Errors and omissions	47	77	0	0	0	0	0	0
Overall balance (deficit -)	-30	-19	20	56	17	21	21	22
Financing	30	19	-20	-56	-17	-21	-21	-22
Central bank	25	22	-20	-50	-17	-21	-21	-22
Assets	30	26	-19	-46	-16	-20	-21	-22
Liabilities	-5	-4	-2	-5	0	0	0	0
Exceptional financing	5	-4	0	-6	0	0	0	0
Memorandum items								
Current account (in percent of GDP)	-25.1	-31.8	-28.6	-20.9	-19.3	-19.0	-18.0	-17.6
Central bank gross foreign assets (in millions of US dollars)	381	355	373	419	435	455	476	499
In months of next year's imports of goods and services	3.4	3.1	3.4	3.7	3.6	3.5	3.4	3.3
Currency board cover	110.3	106.5	109.0	109.0	109.0	109.0	109.0	109.0
FDI (in percent of GDP)	9.6	7.2	9.1	10.8	11.5	11.4	11.2	12.0
External public and publicly guaranteed debt								
In millions of US dollars	792	1,197	1,606	1,814	2,008	2,213	2,402	2,559
In percent of GDP	49.9	69.3	84.8	86.9	87.3	87.3	86.8	84.7
In percent of exports of goods and services	155.2	203.4	241.5	254.6	262.1	269.5	267.0	265.6
Debt service								
In millions of US dollars	64	42	68	77	97	111	144	173
In percent of GDP	4.1	2.4	3.6	3.7	4.2	4.4	5.2	5.7
In percent of exports of goods and services	12.6	7.1	10.3	10.8	12.6	13.5	16.0	17.9

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

Table 7. Djibouti: Monetary Survey and Banking Sector Indicators, 2014–21

(End-of-period, in millions of Djibouti francs, unless otherwise indicated)

			Est.	Proj.				
	2014	2015	2016	2017	2018	2019	2020	2021
Broad money	234,774	279,444	301,928	328,337	355,567	385,172	416,967	451,419
Currency in circulation	27,295	30,817	32,167	35,647	37,998	40,610	43,117	45,792
Deposits	207,479	248,627	269,761	292,690	317,569	344,562	373,850	405,627
Demand deposits	143,928	179,167	194,397	210,920	228,849	248,301	269,406	292,306
Djibouti francs	82,773	105,447	114,410	124,135	134,686	146,134	158,556	172,033
Foreign currency	61,155	73,721	79,987	86,786	94,163	102,166	110,851	120,273
Time deposits	63,551	69,460	75,364	81,770	88,720	96,261	104,444	113,321
Djibouti francs	24,292	29,331	31,824	34,529	37,464	40,649	44,104	47,853
Foreign currency	39,259	40,129	43,540	47,240	51,256	55,613	60,340	65,469
Net foreign assets	176,140	209,849	221,593	239,010	250,866	263,844	277,346	291,484
Central bank	57,879	53,907	57,537	66,458	69,424	73,102	76,882	80,861
Assets	67,626	63,022	66,313	74,431	77,334	80,951	84,669	88,616
Liabilities	9,747	9,115	8,775	7,972	7,911	7,849	7,787	7,756
Commercial banks	118,260	155,942	164,056	172,552	181,442	190,741	200,464	210,623
Assets	160,543	205,677	218,018	231,099	244,964	259,662	275,242	291,757
Liabilities	42,283	49,735	53,961	58,547	63,522	68,921	74,778	81,133
Net domestic assets	58,635	69,595	80,334	89,327	104,702	121,328	139,621	159,935
Claims on government (net)	1,238	3,337	1,777	-3,435	-4,035	-4,097	-4,159	-4,190
Central bank	-3,568	-1,104	-2,186	-6,891	-6,953	-7,015	-7,077	-7,108
Commercial banks	4,806	4,441	3,963	3,456	2,918	2,918	2,918	2,918
Claims on nongovernment sector	92,765	102,874	109,235	114,890	131,528	149,403	169,162	190,989
Public enterprises	5,400	9,364	11,050	11,271	11,440	11,554	11,670	11,787
Private sector	87,365	93,510	98,186	103,619	120,088	137,848	157,492	179,202
Of which: in foreign currency	18,367	19,659	20,642	21,784	25,247	28,980	33,110	37,675
Capital accounts	-24,214	-26,641	-29,545	-32,728	-34,231	-35,943	-37,740	-39,627
Other items (net)	-11,155	-9,976	-1,133	10,600	11,440	11,965	12,358	12,763
	(Annual change in percent of broad money)							
Broad money	6.5	19.0	8.0	8.7	8.3	8.3	8.3	8.3
Net foreign assets	-1.3	14.4	4.2	5.8	3.6	3.6	3.5	3.4
Central bank	-2.0	-1.7	1.3	3.0	0.9	1.0	1.0	1.0
Commercial banks	0.7	16.1	2.9	2.8	2.7	2.6	2.5	2.4
Net domestic assets	7.9	4.7	3.8	3.0	4.7	4.7	4.7	4.9
Of which Claims on government (net)	6.2	0.9	-0.6	-1.7	-0.2	0.0	0.0	0.0
Claims on nongovernment sector	4.1	4.3	2.3	1.9	5.1	5.0	5.1	5.2
Memorandum items								
Central bank								
Net international reserves (in U.S. dollars million)	15.4	2.3	11.4	15.2	16.5	18.2	19.9	21.8
Gross foreign assets (in U.S. dollars million)	380.5	354.6	373.1	418.8	435.1	455.5	476.4	498.6
In percent of foreign currency deposits	67.3	55.4	53.7	55.5	53.2	51.3	49.5	47.7
In percent of total deposits	32.6	25.3	24.6	25.4	24.4	23.5	22.6	21.8
Banking system								
Credit to the private sector, 12-month percent change	8.6	7.0	5.0	5.5	15.9	14.8	14.3	13.8
Share of foreign currency deposits/total deposits	48.4	45.8	45.8	45.8	45.8	45.8	45.8	45.8
Commercial banks' foreign assets/liability ratio	1.1	1.3	1.2	1.2	1.2	1.1	1.1	1.1
Money velocity	1.2	1.1	1.1	1.1	1.2	1.2	1.2	1.2

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

Table 8. Djibouti: Financial Soundness Indicators, 2010–16

(In percent, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015				2016	
						Q1	Q2	Q3	Q4	Q1	Q2
Capital adequacy											
Tier I capital to risk-weighted assets	12.2	9.4	11.7	9.6	10.7	10.4	10.6	10.6	12.5	12.7	13.4
Regulatory capital to risk-weighted assets	12.2	9.4	11.7	9.6	10.7	10.4	10.6	10.6	12.5	12.7	13.4
Asset quality											
Nonperforming loans to gross loans	8.3	9.4	11.4	14.5	18.0	20.3	22.5	22.3	22.1	22.9	22.6
Nonperforming loans net of provisions to capital	15.9	17.3	13.3	37.7	48.2	67.7	81.8	73.5	61.2	59.1	59.4
Provisions to nonperforming loans	75.1	77.0	82.0	67.8	62.4	55.4	52.1	53.7	56.9	55.8	55.2
Banks exceeding maximum single borrower limit	5	7	9	10	11	11	11	11	11	10	10.0
Earning and profitability											
Return on assets (ROA)	1.1	1.0	1.3	1.2	0.7	0.2	0.4	0.5	0.6	0.3	0.4
Return on equity (ROE)	26.9	26.6	27.5	28.5	15.7	5.4	8.9	11.4	13.4	5.2	8.3
Interest margin to gross income	75.6	78.6	59.6	67.4	61.2	58.6	58.6	66.0	75.4	50.8	81.9
Noninterest expenditures to gross income	56.8	49.7	37.6	59.1	55.3	69.2	57.2	66.2	70.5	78.0	81.0
Salary expenditures to non-interest expenditures	59.7	56.6	61.0	41.8	48.4	53.9	43.7	61.8	73.4	42.7	42.6
Liquidity											
Liquid assets to total assets	65.1	61.2	64.0	64.6	60.4	61.1	59.5	61.0	60.5	64.6	62.9
Liquid assets to short-term liabilities	120.7	112.3	128.0	110.8	94.5	91.3	92.3	92.2	90.1	97.9	87.7
Liquid assets to demand and saving deposits	211.0	213.2	202.0	251.6	266.9	280.7	253.6	273.7	286.7	299.8	396.6
Liquid assets to total deposits	76.8	73.6	80.0	82.3	79.9	78.6	76.4	77.0	78.1	82.8	80.7

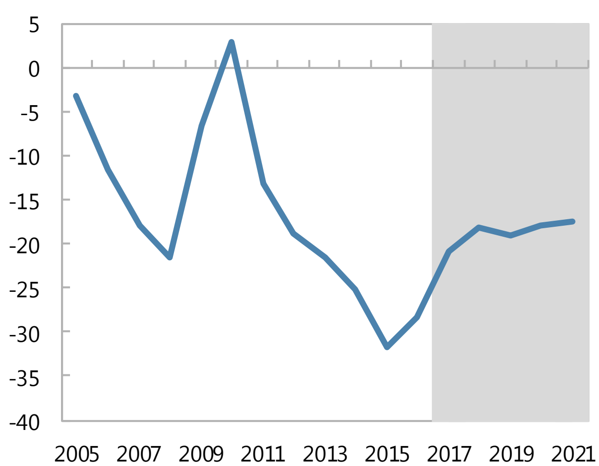
Sources: Central Bank of Djibouti and IMF staff estimates.

Appendix I. External Sector Assessment

The currency board arrangement remains appropriate. It has helped underpin confidence in the economy and lends greater predictability in managing international transactions—an important consideration given Djibouti's role as a major transshipment hub. While the EBA-lite methodology indicates a real exchange rate overvaluation, the magnitude is subject to considerable uncertainty. Since Djibouti's foreign trade comprises mainly of basic food and fuel imports and port services exports and services to military bases, it is unlikely to be sensitive to real exchange rate changes. Gains in external competitiveness are therefore best achieved by reducing the high cost of doing business and improving governance and the investment climate. The authorities agreed with the broad thrust of the assessment and policy recommendations, which are in line with their policies aimed at strengthening competitiveness through structural reforms.

1. Djibouti's external current account deficit has deteriorated sharply since 2010, reaching 32 percent of GDP in 2015 on the back of the investment boom. This deterioration was driven by a major increase in investment-related imports fueled by a public sector investment boom and a step-up in FDI. In 2016, the deficit is expected to contract modestly and subsequently decline over the medium term to 18 percent of GDP as the public sector investment boom unwinds. The growth of imports (goods and services) is projected to decelerate to 4 percent per year on average over 2017-21 reflecting the slowdown in investment and soft non-oil world prices, while export growth would average 8 percent per year thanks to an expansion in services related to transport and military bases; the expansion in transport services owes in part to the large-scale port and railway projects that are expected to be operational in the near future. External project-related borrowing and FDI will continue to finance the current account deficit.

Current Account Balance, 2005–2021
(In percent of GDP)



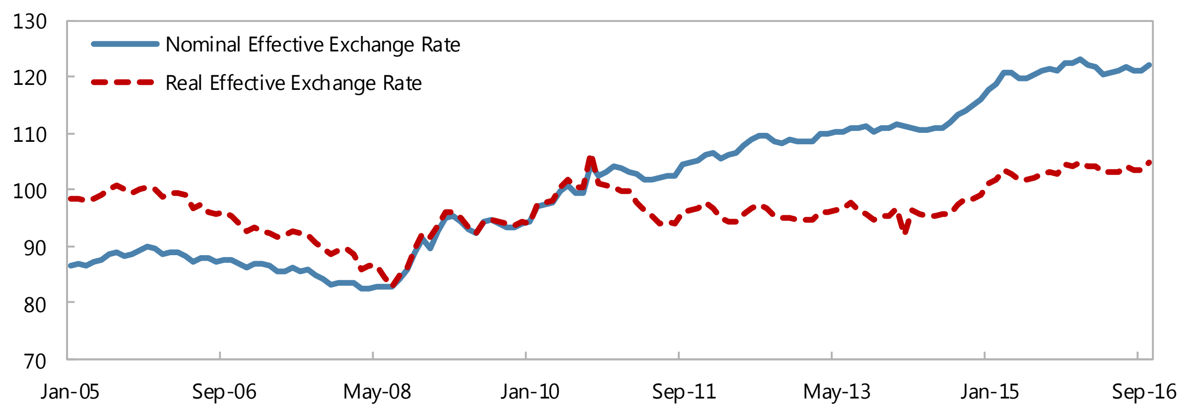
Imports and Exports, 2005–2021
(In percent of GDP)

Source: Djibouti Authorities; and IMF staff calculations.

2. Djibouti's real effective exchange rate (REER) has appreciated by about 7.7 percent since 2014. The appreciation of the REER primarily reflects the rise in the NEER, which in part owes to the strength of the dollar (to which the Djibouti franc is pegged) against major currencies and Djibouti's trading partners.

3. The real exchange rate assessment is based on the IMF's External Balance Assessment (EBA-lite) methodology using the current account and the external sustainability approaches.[1] As foreseen by the EBA-lite model, the present assessment for Djibouti using the current account approach takes into account the temporary nature of the ongoing investment boom and surge in investment related imports, which will unwind as the wave of large-scale projects driving the boom are completed over the next few years. As a result, the variables are adjusted to strip out the temporary surge in investment from the actual current account, the fitted current account through the explanatory variables (imports and fiscal balance) and the policy gap (fiscal) in 2015 (the year on which the assessment is based).[2] The elasticity of the current account to the REER is estimated using the EBA-lite model: import and export elasticities are based on a cross-country panel regression, and the overall elasticity is calculated using Djibouti's import and export shares.

Nominal and Effective Exchange Rates (2005–2016)
(2010=100)



Source: Djibouti Authorities; and IMF staff calculations.

4. The adjusted current account approach suggests that the real exchange rate was overvalued by 24 percent in 2015. The EBA model-based analysis indicates a current account norm of -5.0 percent of GDP for the current account.[3] Applying the estimated elasticity of the

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[1] See Methodological Note on EBA-lite, IMF 2016. http://www.imf.org/external/pp/ppindex.aspx

[2] With respect to the policy variables, because the impact of investment boom on the fiscal deficit is temporary it does not require a change in policy (and therefore does not contribute to the policy gap): the unwinding of the boom will reduce the deficit towards the desired value without any discretionary policy action.

[3] The current account norm is the level of the current account that is in line with fundamentals and desirable policy values. The policy gap is defined as the gap between a country's actual policies and its optimal policies and the 'fitted current account' (a product of the level of economic fundamentals and the coefficients of the EBA regression panel). The regression panel, estimated on a sample of about 146 countries over the period 1995-2012, includes a set of 'traditional fundamentals, 'financial factors', 'cyclical/temporary factors' and policy-related regressors, most of these variables being computed as a country's deviation from the 'world' counterpart.

current account balance with respect to the real exchange rate of -0.20, the real exchange rate adjustment that would be needed to eliminate the gap between the norm and actual current account is estimated at 24 percent (Table 1). This estimate is however subject to uncertainty, in particular because the key parameters (regression coefficients) underlying the EBA-lite model calculation of the exchange rate adjustment are based on pooled estimates that do not take account of country specific effects. In addition, the adjustment made to strip out the temporary effect of the investment surge is an approximation and may not capture in full the effect of the surge because of data limitations, e.g. petroleum imports linked to the investment are not in factored into the adjustment.

External Balance Assessment (EBA-Lite)

(Percent of GDP, unless otherwise stated)

Indicator	CA Approach	ES Approach	
Net IIP		-80.7 1/	-59.6 2/
Current account actual	-9.8 (2015)	-17.5 (2021)	-17.5 (2021)
Policy gap	-0.2		
Current account norm	-5.0	-11.5	-8.5
Current account gap	-4.8	-6.0	-9.1
Real exchange rate gap (percent)	24.1	28.9	43.4

1/ Holding Net IIP at projected end-2016 level

2/ Achieve end-2015 Net IIP level in 2026

Source: Djibouti Authorities; and IMF staff calculations

5. The external sustainability method suggests that the real exchange rate was overvalued by a larger amount.[4] The external sustainability approach method assesses the sustainability of a country's external position by comparing the current account balance (in percent of GDP) expected to prevail in the medium term to the current account that would stabilize the NFA/GDP (external position) at a specified benchmark. Under the assumption of a benchmark equal to the projected external position for 2016, which captures the sharp increase in external borrowing in 2016.[5] Under this scenario the required adjustment in the current account implies an overvaluation of the real exchange rate of 29 percent. However, the high net external liabilities at end-2016 (-81 percent of GDP), and the fact that the country has a high risk of debt distress as measured by the LIC-DSA suggests a reduction in net external liabilities is needed. Under one possible hypothesis of an external position target equal to the end-2015 level (-60 percent of GDP) to be achieved over 10 years, the implied real exchange rate overvaluation would be about 43 percent. While a reduction in net external liabilities would be desirable, the appropriate target

[4] The external sustainability approach is applied using 2016 as the base year.

[5] Under the external stability approach, the current account gap equals the current account forecast five years ahead (2021) minus the current account level (norm) that would stabilize the NFA/GDP position at the chosen benchmark level. The REER gap is the change in the exchange rate required to close the current account gap.

(continued)

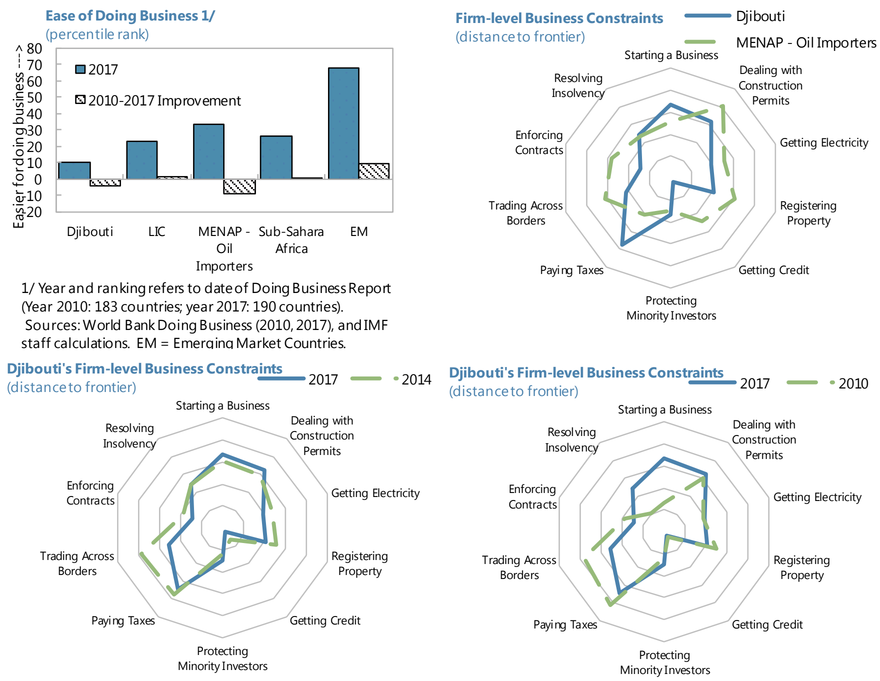
value for the external position and time span over which it should be achieved are a policy choice.[6] The external sustainability approach incorporates the impact of the investment surge because it reflects the impact of the debt financing of the surge. In this respect, the required exchange rate adjustment (or overvaluation) to maintain or reduce the level of the external position is overstated to the extent the investment surge and related borrowing unwinds over the medium term as the government intends.

6. The sensitivity of the current account to real exchange rate movements is likely to be low. Djibouti depends heavily on imports of food and other staples, and the scope for production is very constrained by non-price (climate) factors, and thus imports are not elastic with respect to exchange rate movements. Moreover, the main sources of foreign exchange—port services and rental fees for military bases— are not sensitive to exchange rate changes as they are both set in long-term contracts. For this reason, an improvement in the external competitiveness of the economy should be achieved through structural reforms that aim to lower the cost of services, such as electricity, water and telecommunications, and to improve the business and investment environment, rather than relying solely on the changes in the nominal exchange rate.

7. The economy is burdened with an uncompetitive business environment, and more efforts are needed to converge towards better performers. In the World Bank's survey-based "Doing Business" Djibouti's is ranked at a low level and has achieved very little improvement over the last 5 years. Djibouti's ranking in the 2017 Doing Business Index Report was 171 out of 190 countries. Production costs are high with electricity tariffs at levels among the highest in the world. The rankings are particularly low in several important areas, such as enforcing contracts and protecting investors, getting bank credit, starting a business, getting electricity, and registering property (Figure 3 and Table 2) undermining competitiveness and discouraging private sector investment. The authorities recognize these weaknesses and plan to address them by opening a power plant to improve electricity supply, rationalizing business taxes, and establishing technical and professional training schools, as well as making the recently opened one-stop shop fully operational.

[6] Given, the small impact of the real exchange rate on the current account, a substantial exchange rate overvaluation is implied. Alternatively, given Djibouti's currency board peg to the dollar an adjustment in the fiscal deficit is the implied policy action needed.

Djibouti: Business Environment and Governance Indicators



Doing Business Djibouti 1/

Indicator	Rank in 2014 (189 countries)	Rank in 2017 (190 countries)
Ease of doing business	160	171
Starting a business	127	172
Getting electricity	144	172
Getting credit	180	181
Enforcing contracts	163	184

Source: World Bank Doing Business (2014,2017).

1/ Year and rank refers to date of Doing Business Report.

8. **International reserves are adequate.** Reserve buffers are needed to cope with potential economic shocks, given that the export base lacks diversity, and the elasticity of the current account to changes in the real exchange rate is likely to be small, is concentrated mainly on the use of port services by Ethiopia, and revenues from services provided to, and rents from, foreign military bases. At the same time, the high dependence on imports for food and fuel results in a low price elasticity

of imports. As such, any adjustment to export shocks and significant import price changes through real exchange rate movements is likely to be small. Other potential sources of pressure on the external account stem from the projected rise in debt service, and also could arise if the projected contraction in the large fiscal deficit is not realized. Applying the methodology for assessing reserve adequacy in credit-constrained economies, which compares the marginal benefits and costs of holding reserves, the optimal level of reserves for Djibouti is estimated at 3.1 months of imports at end-2016[7]; the cost of holding reserves (6.15 percent) is proxied by an estimate of the marginal product of capital (the net return on using reserves to invest in real assets) for Djibouti reported in IMF Policy Paper, March 2016, "*Assessing Reserve Adequacy—Specific Proposals*". Given data limitations, the estimate of the marginal product of capital in Djibouti is subject to uncertainty and the optimal level of reserves is relatively sensitive to variations in the marginal product/cost of holding reserves. For example, a cost of holding reserves of 5 percent and 7 percent, rather than 6.15 percent, would give an optimal level of reserves of 4.3 and 2.5 months of imports, respectively. By comparison the actual level of reserves at end-2016 is estimated at 3.4 months of imports. Under the currency board arrangement, Djibouti must maintain at least 100 percent reserve cover, which at end-2016 is estimated at 109 percent.[8]

9. The medium-term outlook for the external sector is mixed given considerable downside risks. In light of the lack of diversification, a slowdown in international trade or a negative growth shock in Ethiopia could put considerable pressure on the balance of payments. Significant increases in world food and oil prices would also be a source of pressure. Moreover, risks of debt distress could rise if the investment boom of the past few years does not unwind and continues to be financed by non-concessional external debt, or if the projects fail to generate an adequate economic rate of return. On the upside, full implementation of economic reforms to improve governance and the investment climate, a favorable external environment, and the unwinding of the investment boom would sustain high growth and a stable external position.

10. The authorities agreed with the broad thrust of the assessment and policy recommendations, which are in line with their policies aimed at strengthening competitiveness through structural reforms.

[7] This is higher than the 2.2 months estimated in the 2015 Article IV Consultation, reflecting the recent widening of the fiscal deficit and a downward revision in the growth of external demand.

[8] The required reserve coverage is defined as the ratio of central bank gross foreign assets to reserve money plus government deposits at the central bank.

Appendix II. Growth Inclusiveness: Distributional and Gender Dimensions

The note examines the poverty-reducing and distributional characteristics of Djibouti's economic growth, and discusses policies that might help make growth more inclusive. It covers the period 2002–13, for which comparable household surveys are available. The main findings are that in the past decade the overall level of poverty in Djibouti declined but there have been no clear signs of improvements in either equality or growth inclusiveness. Inequality remains high and continually increases. Growth has not been inclusive, as it benefitted mainly those in the upper part of the income distribution, while the poorest groups became even poorer in relative terms. Progress in poverty reduction and inclusiveness would require not only sustained high growth but also the creation of opportunities in sectors with high earning potential for the poor. Better-targeted social policies and more attention to the regional distribution of spending would also help reduce poverty and improve inclusiveness.

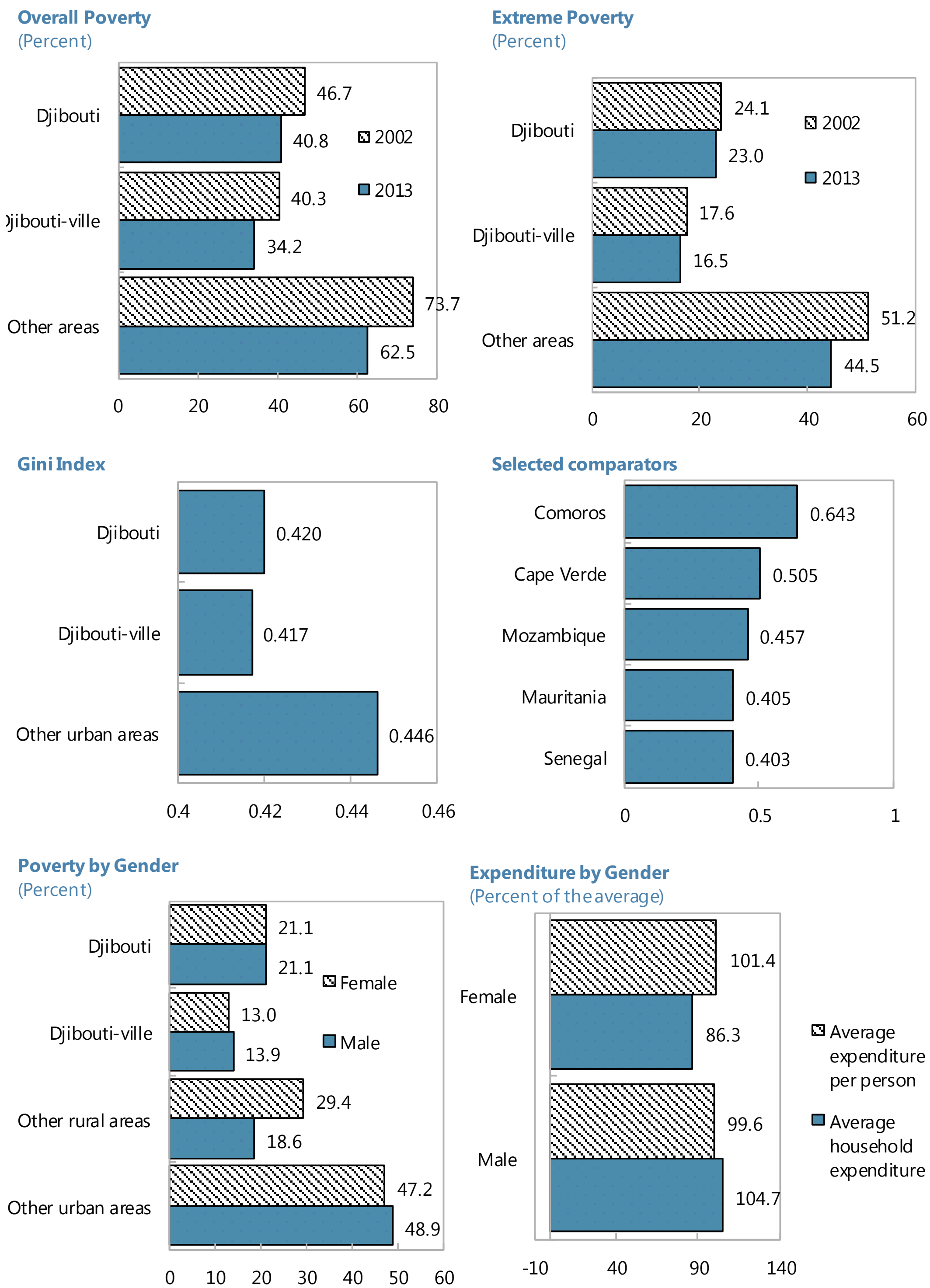
A. Growth and Poverty

1. Djibouti's economic growth in the past decade averaged 4 percent a year but has not led to a visible reduction in poverty. The incidence of poverty in Djibouti remains high despite moderate economic growth over the last decade. After dramatic increases in both absolute and relative poverty during 1996–2002, the overall poverty rate declined during 2003–12 from 47 percent to 41 percent, while extreme poverty dropped only insignificantly from 24 to 23 percent (DISED 2013) (Figure 1).

2. Despite the small size of the country, poverty levels vary widely across regions and are more severe in rural areas than urban centers. In 2013, in Djibouti-ville, the capital of the country, overall poverty stood at 34 percent and extreme poverty at 17 percent, whereas in the rest of the country, mainly in rural regions, about 63 percent of the population lived in poverty and 45 percent in extreme poverty (DISED, 2013). The Ali Sabieh and Obock regions have the highest levels of poverty.

3. Inequality in household consumption is high and increasing. The 2013 government household survey estimates the Gini index at 0.44, an increase from 0.39 in 2002, as zero represents perfect equality, while an index of 100 implies perfect inequality (DISED 2013). Judging by the Gini index, inequality is more pronounced in rural areas and less in the capital, although the differences are not large. In 2002-13, the shares in the overall consumption of the two highest deciles of the population increased, while the shares of all other deciles declined.

Djibouti: Poverty and Inequality



Source: DISED.

4. Gender is not a major factor in poverty. The extreme poverty rate within female-headed households is 21 percent, same as within male-headed households. There are no significant differences in poverty between female and male-headed households in the capital and in rural areas. At the same time, the difference is very significant in other urban areas, where the poverty rate of female-headed households is 29 percent compared to 19 percent for male-headed households. The average expenditure per person is broadly equal in both types of households. .

5. However, gender inequality remains substantial. Only 29 percent of women aged 15 to 64 are active in the labor market compared to 54 percent of men. Low literacy rates and educational attainment depress women labor force participation. Only about 54 percent of women with at least three years of university studies are in the labor market compared to 76 percent of men. While overall female literacy is 53 percent relative to 67 percent for men, the literacy rate of women in rural areas is only 20 percent. Djibouti has the highest ratio of maternal mortality in the region and one of the highest in the world.

6. The unemployment rate is one of the highest in the world. The unemployment rate stood at 39 percent in 2015 based on the latest survey of employment and the informal sector (DISED, 2015). It is much higher among women (49 percent) than men (34 percent), and in rural areas (59 percent) than in urban areas (37 percent). Economic growth has been driven by capital-intensive investment in the ports and related activities, with limited employment creation and trickle-down effects. Many of the jobs created have been filled by expatriates, because of a low domestic skills base. Other activities remain underdeveloped. The agricultural sector, the primary source of livelihood in most low-income countries, is small because of the unfavorable climate. Both services—the main driver of growth in recent years—and construction activities, are potentially labor-intensive but account for only about 13 percent of formal employment. The business environment remains difficult because of high costs, red tape, and low access to finance. The inability of the economy to generate adequate job growth reinforces the need for reforms to spread the benefits of growth.

7. Djibouti's demographics are challenging. The low labor force participation rate, reflecting among other factors a low female participation rate, increases the dependence on the working population. The population is relatively young—almost 75 percent is younger than 35 years—resulting in a large proportion of the labor force being made up of job market entrants often lacking the skills needed for employment. Youth unemployment is much higher than the overall unemployment rate. In sum, weak job creation and lack of work skills combined lead to the failure to meet the need for jobs. This situation is further exacerbated by migration to Djibouti from neighboring countries, fueled by the regional refugee crisis.

8. The analysis of poverty and growth data in Djibouti continues to be limited due to the lack of data and more representative statistics. In 2013, the authorities updated the 2012 household survey (EDAM-2012) and updated the calculations of key poverty indicators based on new thresholds and methodology (EBC-2013). Also, in 2015 the authorities published the results of a new survey of employment and the informal sector (EESI, 2015). The World Bank is providing support to the Directorate of Statistics and Demographic Studies (DISED) for the 2017 household income and expenditure survey. The goal is to produce reliable indicators, at the national level and disaggregated by region, gender, vulnerability status, etc. The overarching objective is to enhance Djibouti's welfare monitoring systems and the ability to inform policy making.

B. Growth Incidence Curves

9. Growth is considered inclusive when its benefits are widely shared across the population. Although there is no commonly accepted definition, inclusive growth usually refers to growth that provides equal opportunities while social policies redress inequalities in outcomes, so that all segments of society can share in the benefits of growth. Growth is inclusive if it is high, sustained over time, and broad based across sectors; creates productive employment opportunities; and benefits a large part of a country's population. Additional dimensions of inclusive growth regard gender equality, regional diversification, and empowerment of the poor. Inclusive growth requires also inclusive institutions.

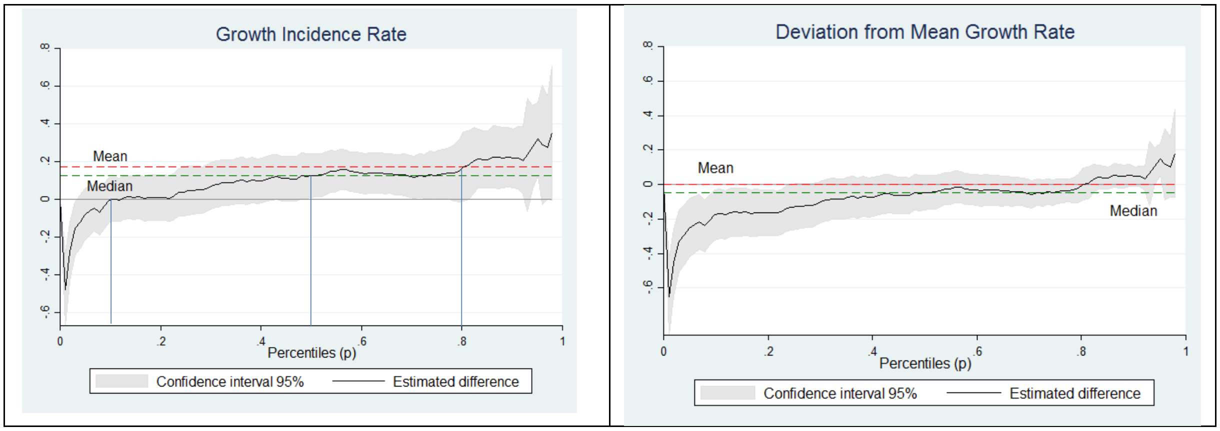
10. A dynamic measure of growth inclusiveness can be derived from growth incidence curves. Growth incidence curves (GIC) help identify the extent to which each decile of the income distribution of households benefits from growth. In plotting GICs, the vertical axis reports the growth rate of consumption expenditure, and the horizontal axis reports consumption expenditure percentiles. The GIC illustrates how consumption at each percentile changes over time. The part of the curve above the zero threshold of consumption growth, shows consumption deciles that benefit from growth, and the part below zero shows the deciles for which consumption was negative despite overall consumption growth. The part of the GIC that is above its mean value shows the consumption deciles of the population that benefit from growth relatively more than the average household. The part of the GIC below the mean, but still above zero, shows the deciles that also benefit from growth but less than an average household.

11. In Djibouti, growth has benefitted most people in the middle and high end of the consumption distribution. In 2003-13, household consumption increased on average. The mean of the GIC is above zero, driven by the middle and upper section of the distribution (from the 3rd to the 10th deciles) (Figure 2). The GIC is positively sloped indicating an increase in inequality during this period. This trend is visible but may not be statistically significant as the 95 percent confidence interval suggests that the growth rate of consumption may not be statistically different from zero. This overall results, however, may mask significant differences between urban and rural areas, as well as men and women-headed households.

12. The GIC indicates that consumption of the poorest parts of the population declined. In 2002-13, the lowest decile of the GIC is located below the zero consumption threshold indicating that the poorest 10 percent of the population experienced a fall in their consumption. As a result, poverty among the poorest increased further in absolute terms. Also, the 95 percent confidence interval around the GIC crosses the horizontal axis several times, in particular the 5th to the

8th deciles, suggesting that the change of consumption even of higher income groups also could have been negative.

Growth Incidence Curve, 2003–13



Source: DISED, 2016.

13. Deviations in the GIC around the consumption growth rate mean growth rate helps better understand the distributional impact of growth in Djibouti. For the lowest 80 percent of the distribution the curve is below the mid-point consumption growth threshold horizontal axis. For them, the consumption growth rate was lower than the mean growth rate. In other words, consumption of 80 percent of households grew more slowly relative to the top 20 percent households. This is an indication that the in relative terms the overall growth in consumption has been accompanied by greater consumption inequality, even though all but 5 percent of households enjoyed positive consumption growth. The GIC also suggests that for the lowest 20 percent (in terms of consumption) of households there is greater certainty that they experienced lower growth of consumption relative to a median Djiboutian as the 95 percent confidence interval is below the mid-point consumption threshold Finally, for the 20th to the 80th consumption percentiles, while the GIC still points at worsening of growth inclusiveness it may not be statistically significant.

14. The analysis of the distributional characteristics of growth in Djibouti leads to the following conclusions: (i) growth and consumption increased in 2002-13; (ii) overall poverty declined but there was no change in extreme poverty; (iii) inequality measured by the Gini index increased; (iv) based on GICs, growth has not been inclusive as it benefitted mainly households in the higher part the consumption distribution. Statistical significance of these results is relatively low.

C. Policies to Improve Inclusiveness

15. 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. In developing countries, growth of average income explains 70 percent of poverty reduction in the short run. Longer growth spells have also been robustly associated with more equality in the income distribution.

16. Special attention should be given to the distributional dimension of growth. An increase in inequality may offset and even exceed the beneficial impact on poverty reduction of a given increase in income. According to recent estimates based on a large set of developing countries, about two-thirds of poverty reduction within a country comes from growth, and greater equality contributes the other third. A one percent increase in incomes in the most unequal countries produces a mere 0.6 percent reduction in poverty, while in the most equal countries, it yields a 4.3 percent cut.

17. Economic diversification can help improve inclusiveness. Diversification is essential for Djibouti to develop sectors with high growth and employment potential such as tourism and fishing, and reduce the risks associated with relying on a single sector (services) catering mainly to one client (Ethiopia). To this end, broad-based reforms aimed at improving the business climate are indispensable.

18. Well-designed public policies are also important for promoting inclusiveness. First, social policies should be used to provide a safety net against extreme poverty and shocks for the poor and vulnerable groups. Second, fiscal reforms will need to generate the level of revenue needed to ensure the affordability of a social safety net. For Djibouti an effective way to increase budget revenues would be a revamp of the investment incentive system to broaden the tax base. Third, poor households could be more effectively protected in the short term by redirecting resources to targeted measures, such as through public works programs.

19. Inclusive institutions have also been found important for growth inclusiveness. Institutions that ensure the rule of law, provide adequate access to public services, and protect property and freedom to contract for the whole population without discrimination have been found to accelerate growth and make it more inclusive.

20. Coherent labor market policies are also needed for increasing inclusiveness. The challenges of growth, job creation, and inclusion are closely linked: creating productive employment opportunities throughout the economy is an important way to generate inclusive growth. In Djibouti, creation of employment opportunities and increasing productivity in rural areas, in particular in fishery, tourism and infrastructure, would prompt higher consumption growth among poorer households. In addition, job and skills training programs would increase the employability of the working age population.

21. Deepening the financial sector through policies that give the poor better access to financial services would increase inclusiveness. Financial development generally increases incomes of the poorest households, whereas unequal access to financial markets can reduce incomes by impeding investments in human and physical capital. In Djibouti, most people lack access to the formal financial system and the scope for reform is considerable. Reforms that significantly expand and widen credit availability would include measures that support and encourage microfinance and other rural finance mechanisms, as well as an expansion in credit information sharing.

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INTERNATIONAL MONETARY FUND

DJIBOUTI

February 7, 2017

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | The Middle East and Central Asia Department (in consultation with other departments and the World Bank)

CONTENTS

RELATIONS WITH THE FUND

(As of December, 2016)

Membership Status

Joined: December 29, 1978; Article VIII.

General Resources Account:

	SDR Million	Percent Quota
Quota	31.80	100.00
Fund holdings of currency	26.70	83.95
Reserve tranche position	5.13	16.15

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	15.16	100.00
Holdings	1.50	9.89

Outstanding Purchases and Loans:

	SDR Million	Percent Quota
ECF Arrangements	18.91	59.46

Latest Financial Arrangements:

Type	Date of arrangement	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
ECF[1/]	Sep. 17, 2008	May 31, 2012	22.26	22.26
ECF[1/]	Oct. 18, 1999	Jan. 17, 2003	19.08	13.63
Stand-By	Apr. 15, 1996	Mar. 31, 1999	8.25	7.27

[1/]Formerly PRGF.

Projected Payments to the Fund[1/]

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

	Forthcoming				
	2017	2018	2019	2020	2021
Principal	3.20	4.45	3.53	3.38	3.09
Charges/interest	0.03	0.03	0.03	0.03	0.03
Total	**3.24**	**4.49**	**3.56**	**3.42**	**3.12**

[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.

Implementation of HIPC Initiative: Not Applicable.

Implementation of Multilateral Debt Relief Initiative (MDRI): Not applicable

Implementation of Post-Catastrophe Debt Relief (PCDR): Not applicable

Safeguards Assessment

The most recent safeguards assessment of the Central Bank of Djibouti (CBD) was completed in 2012. The assessment recommended that the CBD: (i) strengthen independent oversight through a review of the legal framework and establishment of an audit committee; (ii) enhance transparency of its financial reporting practices by timely publication of the financial statements and adoption of International Financial Reporting Standard (IFRS); and (iii) establish an internal audit function to ensure the effectiveness of internal controls. The CBD has made progress in addressing these recommendations. In particular, it recently published its audited financial statements for 2013–15 and the authorities have confirmed that an internal audit function has been established. It has yet to provide the related management letters on internal controls to the IMF as required under the safeguards policy.

Exchange arrangements

Djibouti has a currency board arrangement. The Djibouti franc is pegged to the U.S. dollar at the rate of DF 177.721 = US$1. Djibouti is an Article VIII member and maintains an exchange system that is free of restrictions on payments and transfers for current international transactions.

Article IV Consultation

On December 4, 2015, the Executive Board of the IMF concluded the 2015 Article IV consultation with Djibouti on a lapse of time basis (IMF Country Report No. 16/248).

FSAP Participation

The FSAP, including the assessment of the AML-CFT framework, was approved by the Board in June 2009.

Resident Representative

The IMF has had a resident representative office in Djibouti since 1998. The Fund's Resident Representative is Mr. Joseph Karangwa since February 2015.

Technical Assistance (past two years)

MCM- Review of Islamic Finance Regulatory and Supervisory Framework	November 2014
MCM- Reserve Management	January 2015
MCM- Improving Debt Management Capacity	May 2015
STA- Monetary and Financial Statistics	July 2015

MCM- Reserve Management	September 2015
MCM- Multi-topic MCM mission	October 2015
STA- Consumer Price Index	January 2016
STA- Monetary and Financial Statistics	December 2016
MCM/METAC- Medium term action plan/ Review supervisory Framework	October 2016
STA/METAC- National Accounts	November 2016

BANK-FUND COLLABORATION

Joint Management Action Plan, January–December 2017

(As of December 31, 2016)

Title	Products	Approval date	Expected delivery
A. Mutual Information on Relevant Work Program			
Bank work program for the next 12 months	**Economic policy analysis and advice** • Management of education • Education access and quality projects • Procurement capacity • Strengthening accountability for effective implementation and transparency of public expenditure **Technical assistance** • Djibouti tax reform and national account	 June 2012 May 2014 June 2014 June 2014 May 2016	 Aug 2017 June 2017 April 2017 April 2017 April 2017
Title	**Products**	**Provisional schedule of missions**	**Expected delivery**
Fund work program for the next 12 months	**Macroeconomic policy analysis and advice** • Article IV consultation **Technical assistance** • Reserve management • Islamic banking supervision • Debt management • Public sector consolidation • Government Finance Statistics • Tax reform	 Q4 2017 Q2 2017 Q1 2017 H2 2017 H2 2017 H2 2017 H1 2017	 Jan 2018 Q2 2017 Q2 2017 H2 2017 H2 2017 H2 2017 H1 2017
B. Requests for Work Program Inputs			
Fund requests to Bank	• Periodic update on activities • Reports, macroeconomic and financial data to be shared regularly • Fund staff to participate in review of key analytical work	Ongoing	
Bank requests to Fund	• Periodic update on technical assistance activities • Macroeconomic and financial data to be shared regularly	Ongoing	
C. Agreement on Joint Products and Missions			
Joint products in the next 12 months	• Debt sustainability analysis	Q4 2017	Jan 2018

STATISTICAL ISSUES

General: Data provided to the Fund are broadly adequate for surveillance but some shortcomings remain. While progress is being made on national accounts, inadequate data sources hamper their quality. Shortcomings on the balance of payments and to a lesser extent on external debt persist. Fiscal data are reported with delays and there are no aggregated data on the accounts of, and contingent liabilities from, public enterprises. Djibouti began participating in the General Data Dissemination System (GDDS) in February 2012 but the data is still not reported for the *GFS* Yearbook.

National accounts: Compilation of national accounts statistics has resumed since 2012 with the compilation of GDP estimates for 2008–13. More recently, a new GDP estimate for 2013 was developed within the supply and use table framework using the 2008 SNA as standard and integrating latest data sources. The new estimate is being used as the benchmark for a new series of GDP data which will be published by the end of 2017. A population census was completed in 2009, followed by a household survey on social indicators and consumption expenditure in 2013. A poverty profile was subsequently developed, and the CPI basket revised. A new series of CPI is available since January 2016.

External sector: Progress has been made in improving balance of payments statistics in line with recommendations made by Fund's TA missions over the past few years. Problems were identified in compiling trade statistics, coverage of direct investment transactions in the BOP, and estimating workers' remittances. Efforts to improve coverage are being made, most recently for private transfers and IBS cross border debt data are now being used to estimate other investment of private sector. However, the transition from BPM5 to BPM6 remains to be done, and BOP and debt statistics continue to be provided with a lag.

Government finance: Fiscal data are available on a monthly basis, although with a substantial delay (recently a 6-month lag). Foreign-financed capital expenditure is reported regularly. Additional efforts are needed to improve the compilation and coverage of fiscal data, particularly at the institutional level. The authorities have implemented the GFSM 2001/14 budget classification following the 2009 TA mission from the Fund but do not use it for TOFE compilation and fiscal reporting. There are no consolidated accounts of the public sector beyond the central government, including of debt liabilities of public enterprises.

Monetary accounts: Monetary statistics are generally adequate and cover the central bank and the aggregated balance sheet of all commercial banks. Djibouti received a monetary and financial statistics TA missions in July 2015 on compiling monetary and financial statistics in accordance with the Fund's *Monetary and Financial Statistics Manual (MFSM).* Since then, the central bank has implemented some of the recommendations, in particular those concerning the establishment of a sectorization of the economic entities of Djibouti. However, the majority of the recommendations have not been implemented, mainly because of staffing constraints at the central bank.

Table of Common Indicators Required for Surveillance (As of December 2016)					
	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	n.a.	n.a.	n.a.	n.a.	n.a.
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	September 2016	October 2016	M	M	n.a.
Reserve/Base Money	September 2016	October 2016	M	M	M
Broad Money	September 2016	October 2016	M	M	M
Central Bank Balance Sheet	September 2016	October 2016	M	M	A
Consolidated Balance Sheet of the Banking System	June 2016	September 2016	M	M	A
Interest Rates[2]	June 2015	October 2015	M	M	A
Consumer Price Index	October 2016	November 2016	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	June 2016	October 2016	M	M	n.a.
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	June 2016	October 2016	M	M	n.a.
Stocks of Central Government and Central Government-Guaranteed Debt[5]	June 2016	October 2016	A	A	n.a.
External Current Account Balance	December 2015	September 2016	A	A	A
Exports and Imports of Goods and Services	December 2015	September 2016	Q	Q	A
GDP/GNP	December 2015 [8]	October 2016	A	A	A
Gross External Debt	September 2016	October 2016	A	A	I
International Investment Position[6]	December 2015	June 2016	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 (excluding 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); Bi-monthly (B); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

[8] GDP data estimated by staff on the basis of partial data provided by the authorities.

DJIBOUTI

February 7, 2017

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

Approved By
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Prepared by the staffs of the International Monetary Fund and the International Development Association.

This Debt Sustainability Analysis (DSA) confirms that Djibouti continues to face a high risk of debt distress, and that this risk has increased significantly since the public sector engaged in large, externally-financed infrastructure projects which have driven the external public debt-to-GDP ratio from 50 percent in 2014 to 85 percent in 2016. Baseline projections over the next twenty years suggest significant and prolonged breaches of the present value (PV) of debt-to-GDP and debt-to-exports thresholds. Liquidity ratios are also projected to exceed the relevant thresholds already in 2018, as amortization on recent large loans starts falling due, suggesting potential liquidity strains in the near term.[1]

In the DSA, external debt ratios are most sensitive to the exchange rate, non-debt flows, and exports shocks. Since Djibouti operates one of the oldest currency board arrangements in the world, an exchange rate depreciation should be considered a tail risk. Nevertheless, a sharp depreciation of the U.S. dollar vis-à-vis other currencies in which Djibouti is indebted, namely the euro and the Kuwaiti dinar, could contribute to sizeable valuation effects. Moreover, an increase in global interest rates could pose important risks, given the significant share of debt with variable interest rates.

The DSA suggests that the public sector's borrowing space is very limited and, hence, the pace of external borrowing should be reduced and borrowing on non-concessional terms avoided. In particular, any new borrowing resulting in significant additional short-term debt service should be avoided. Going forward, the authorities should develop a national strategy to manage the external debt burden aimed at restoring debt sustainability and strengthen coordination among the different government entities in charge of contracting external loans.

[1] Under the joint Fund-Bank Low-Income Country (LIC) Debt Sustainability Framework, Djibouti is rated as having weak policy performance, given its Country Policy and Institutional Assessment (CPIA) average rating of 3.04 in 2013–15. The 2015 DSA can be found in IMF Country Report No. 16/248.

BACKGROUND

1. **Total public and publicly guaranteed (PPG) debt increased from 50 percent of GDP at end-2014 to 69 percent of GDP at end-2015, and is projected to increase further to 85 percent of GDP at end-2016.**[2] This increase was mainly due to loan disbursements related to three large-scale projects (see below). Government-guaranteed public enterprise debt accounted for 58 percent of external debt at end-2015, and the share is expected to rise further to 68 percent of external debt by end-2016.[3] The share of domestic debt in total public debt is small and has been declining.

Table 1. Djibouti: Composition of External Public and Publicly-Guaranteed Debt, 2015–16

	2015			2016 (Proj.) 1/		
	Millions of US$	Percent of GDP	Percent of external debt	Millions of US$	Percent of GDP	Percent of external debt
Total (External + Domestic)	1,211	64	…	1,621	86	…
External Debt 1/	1,197	63	100	1,610	85	100
Public debt	495	26	41	508	27	32
Multilateral	323	17	27	322	17	20
IMF	28	1	2	26	1	2
IDA	131	7	11	131	7	8
Other Multilateral	164	9	14	165	9	10
Official Bilateral	172	9	14	186	10	12
Paris Club	47	2	4	47	2	3
Non-Paris Club	125	7	10	139	7	9
Publicly-guaranteed debt	696	37	58	1,096	58	68
Stock of external arrears 2/ 3/	6	0.3	0.5	…	…	…
Domestic Debt 4/	14	1	…	10	1	…

Sources: Djibouti authorities; IMF staff calculations.

1/ Based on information available as of end-November 2016

2/ Excluding arrears under negotiation to Iran and India.

3/ In the DSA projections all external arrears are assumed to be cleared by 2018.

4/ Excluding budgetary arrears equivalent to approximately 0.5 percent of GDP. In the DSA projection these arrears are included and assumed to be paid off by 2019.

[2] Figures for 2016 are based on data available through mid-November 2016.

[3] The government's contingent liabilities or guarantees on public enterprise external debt stem from loans contracted by the government that have been on-lent (under loan agreements, *accords de rétrocession*) to public enterprises. Under the lending agreement, the public enterprise assumes responsibility to pay the debt service falling due on the loan, but is treated in this DSA as being guaranteed by the government because the latter remains the borrower of record and would be the payer of last resort to the creditor in the event of a default by the public enterprise. Two large loans that were contracted by the government for projects being implemented by public enterprises for which on-lending agreements have yet to be signed are however classified under government-guaranteed debt to be consistent with the government's debt recording and given the intention to sign on-lending agreements with respect to these two loans.

2. The pace of debt accumulation accelerated sharply during 2014–16 along with loan disbursements to finance three large projects, but is now expected to moderate. In 2013, the government contracted two large loans to finance the building of the Addis Ababa–Djibouti railway and a water pipeline from Ethiopia for the amount of US$860 million. In addition, in 2016 another government-guaranteed loan to finance the construction of a multipurpose port was signed for an amount of US$340 million. These three loans were extended by China EximBank, and during 2014-16 alone, disbursements reached a cumulative US$1.1 billion (over 90 percent of the loans contracted). The average grant element on new external borrowing (disbursements) is expected to reach 36 percent in 2016, reflecting low international interest rates and generous terms, in particular on the large water pipeline project, but is expected to gradually decline to 12 percent by 2023 in line with the assumption of tightening financing terms for Djibouti in the longer term.

3. The rapid accumulation of external PPG debt since 2014 will contribute to an elevated debt service burden in the coming years. Based on the existing stock of debt and pipeline of disbursements and new project borrowing, the external PPG debt-to-GDP ratio is projected to peak at 87.3 percent in 2018, almost double its 2013 level. At the same time, external debt service will also increase rapidly, in large part reflecting borrowing for the three large projects. The grace period for the railway, water pipeline, and multipurpose port projects will end in 2019, 2021, and 2023 respectively, and total external PPG debt service will increase to about US$350–400 million per year by 2024 and thereafter (peaking in terms of GDP at 9.1 percent in 2024).

4. Disbursements under the three large loans also increased the share of U.S. dollar-denominated debt in total external debt. In 2014, Djibouti's external debt was mainly denominated in Kuwaiti dinar (22 percent), U.S. dollar (20 percent), and euro (10 percent). However, the disbursements related to the three large projects will increase the dollar-denominated debt share to 60 percent in 2021. Under Djibouti's currency board,[4] a larger share of U.S. dollar-denominated debt would lower valuation risks associated with movements in the U.S. dollar exchange rate.

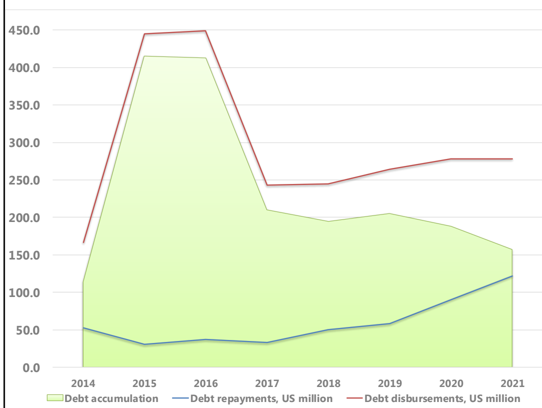
5. Mixed progress was made in clearing external debt arrears in 2016. In May, outstanding arrears to India ($10.9 million or 0.6 percent of GDP at end-2015) were cleared under a restructuring agreement (and are no longer considered arrears). However, as of end-November 2016, external debt arrears on PPG external debt still amounted to 0.7 percent of GDP. These were owed mainly to Iran (0.3 percent of GDP); discussions to reschedule these arrears are ongoing. Also, arrears have accumulated since late 2011 with Belgium, Italy, and Spain ($4.6 million or 0.2 percent of GDP) due to the suspension of payments pending the conclusion of negotiations to convert the related debts into development projects. During 2016, short-term arrears have been periodically incurred and subsequently cleared vis-a-vis several other creditors. As a result, at end-November such short-term arrears amounted to 0.2 percent of GDP, and were owed to Arab Development Funds and India. The authorities explained that the recurrence of short-term arrears in 2016 owed to treasury cash-flow pressures, and did not consider them to be indicative of a

[4] Under the currency board arrangement, the Djibouti franc is pegged to the U.S. dollar.

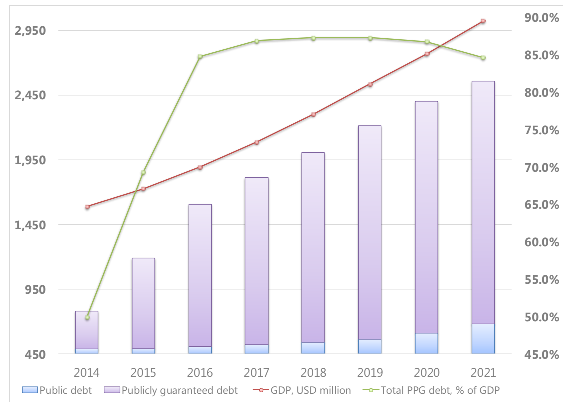
fundamental payments incapacity. They were also optimistic that generous terms would be granted for the arrears under negotiation.

Figure 1. Djibouti: External PPG debt ratios

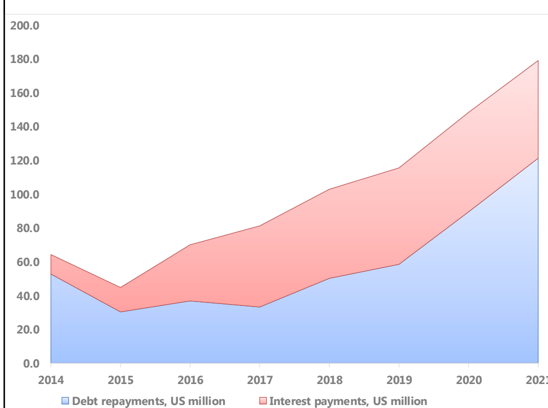
The investment boom led to rapid debt accumulation in recent years …



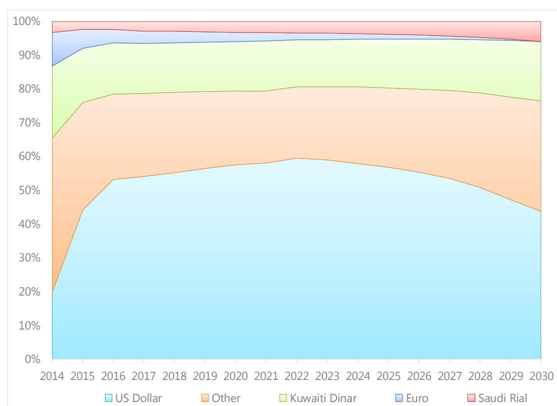
The debt-to-GDP ratio increased by 35 percentage points since 2014, reaching 85 percent of GDP in 2016 …



Consequently, debt service is increasing and will reach 6 percent of GDP in 2021.



The share of debt denominated in U.S. dollar has increased sharply over the past few years.



Source: Staff and authorities' Calculation

MACROECONOMIC ASSUMPTIONS

6. Since the start of the investment boom, economic activity has been strong, but was accompanied by a sizeable widening of the fiscal and current account deficits through 2016. Looking ahead:

- GDP growth is projected to reach 6.5 percent in 2016 and to accelerate to 7 percent in the medium term on the back of the major investments in port facilities, railways and energy.

Growth is assumed to stabilize at 6 percent in the long term once the major investment projects start to bear fruit.

- The current account deficit peaked at 32 percent of GDP in 2015 due to large investment goods imports. Thereafter the deficit is expected to decline in 2016 (28 percent of GDP) and 2017 (21 percent of GDP) as the investment boom begins to unwind, and subsequently to stabilize at around 13 percent of GDP in the long run. The non-interest current account deficit is projected at 11 percent in the long run.

- Net FDI inflows, mainly driven by the development of port-related activities, are projected to fluctuate around 11 percent of GDP per annum, covering the non-interest current account deficit beyond 2022, based on the authorities' investment agenda which relies on FDI inflows, including through PPPs, to finance future investments and avoid further increases in public debt.

- Inflation is projected to stabilize at 3 percent in the medium and long run.

- While the fiscal deficit reached about 16 percent of GDP on average during 2014–16 on account of spending on large public investment projects, the deficit is projected to drop to about 1 percent of GDP from 2018 once the water pipeline project is completed.

- The average effective interest rate on external debt is projected at 2.4 percent in 2016. However, in line with the assumption of gradual tightening of financing terms, the cost of external financing is expected to pick up in the long run with the effective interest rate exceeding 4 percent in the medium term.

- The average grant element of new external PPG borrowing would drop to 28 percent in 2017 (from 36 percent in 2016) after the completion of the highly concessional water project, and would decline gradually to 20 percent in the medium term, before falling to 12 percent thereafter.

Table 2. Djibouti: Evolution of Selected Macroeconomic Indicators

	2016	2017	2018	2019	2020	Average 2020–2036
Real GDP growth						
Current DSA	6.5	7	7	7	6	6
Previous DSA, September 2015	6.5	7	7	7	6	6
Overall fiscal balance (cash basis, percent of GDP)						
Current DSA	-16.3	-2.6	-1.1	-1.1	-1.3	-1.4
Previous DSA, September 2015	-11.9	-1.6	-3.4	-1.1	-0.1	-0.1
Current account deficit (percent of GDP)						
Current DSA	-28.4	-20.8	-18.2	-19	-17.9	-12.2
Previous DSA, September 2015	-25.8	-14.8	-14.5	-12.6	-13.1	-14
External PPG debt (nominal, percent of GDP)						
Current DSA	84.9	86.9	87.3	87.2	86.6	63.1
Previous DSA, September 2015	78.7	79.6	78.3	73.5	68.6	54.1

Source: IMF Staff.

EXTERNAL DSA

7. **The results of the external DSA confirm that Djibouti remains at a high risk of debt distress (as in the previous 2015 DSA).** Furthermore, the risk of debt distress has increased significantly with the debt burden indicators breaching their respective policy-dependent thresholds by larger amounts, and in the case of the liquidity thresholds for longer periods.

8. **Under the baseline, total nominal public and publicly guaranteed (PPG) debt is projected to reach 85 percent of GDP in 2016 and 87 percent of GDP in 2017–19 before steadily declining over the long run. The PV of debt-to-GDP ratio is projected to reach 82-83 percent in 2016–18.**[5] This DSA confirms that, as in the 2015 DSA, all debt solvency indicators breach their corresponding thresholds, but by a larger margin (Figure 2). The PV of external debt-to-GDP and debt–to-exports ratios remain above their policy-dependent thresholds for the entire projection period and the PV of debt-to-revenues ratio remains above its threshold until 2026. This indicates the presence of significant solvency risks during the projection period. In addition, compared to the 2015 DSA, the liquidity indicators reveal greater stress on Djibouti’s debt servicing capacity. The debt service-to-exports and debt service-to-revenue ratios now rapidly approach and exceed their respective thresholds in 2019, somewhat sooner than in the 2015 DSA, and remain above the threshold for almost the whole projection horizon. During 2020-30, the debt service will

[5] Sufficient data on stocks and flows of private external debt are not available to make it possible to incorporate the evolution of the private external debt in the DSA.

on average reach about one-quarter of total export revenues and one-third of fiscal revenues, implying high liquidity risks in the long term.

9. Under this DSA, shocks to exchange rates, non-debt creating flows, and exports are likely to have the most significant impact on debt ratios. The bound tests indicate that a one-time 30 percent nominal depreciation in 2017 would raise the PV of the external debt-to-GDP ratio above 117 percent and cause sizeable and prolonged breaches of the respective thresholds by all the debt burden indicators. However, given the Djibouti franc's exceptional stability vis-à-vis the dollar under the currency board, the DSA exchange rate stress scenario should be considered a tail risk event. While a bilateral movement of the U.S. dollar exchange rate vis-à-vis other major currencies could contribute to a sizeable valuation effect, with the recently increasing share of U.S. dollar-denominated debt, this effect should be limited (Figure 1). However, given that the debt related to the railway project is linked to LIBOR, an increase in global interest rates could pose important risks. In addition, a slowdown in economic growth in Ethiopia or China and a slowdown in international trade would have a major impact on export revenues and could potentially worsen debt indicators.

PUBLIC DSA

10. The dynamics of total public debt reflect the large share of external debt in total public debt, as the share of domestic debt is small and declining (Table 2). Under the baseline, reflecting the sharp rise in external debt, overall public debt is projected to increase from 54 percent of GDP in 2014 to 88 percent in 2017 and the PV of debt-to-GDP remains above the 38 percent benchmark until 2029. Simulations shows that under the fixed primary balance and historical scenarios, public debt dynamics worsen. This owes to the fact that under the baseline, projected economic growth is higher and the primary fiscal deficit lower than their historical values. According to stress tests, public debt indicators are most vulnerable to an exchange rate depreciation: a one-time 30 percent depreciation in 2017 would lead to major increases in all key ratios and would impact significantly the debt service-to-revenue ratio over the medium term.

CONCLUSION

11. Djibouti remains at a high risk of debt distress. This is unchanged from the 2015 DSA, but risks have increased. Under the baseline scenario, solvency and liquidity risks are significant over the projection horizon, and all the debt burden indicators breach their respective policy-dependent thresholds by sizeable margins that are larger than in the 2015 DSA. All the solvency debt burden indicators exhibit protracted breaches of their respective thresholds. In addition, liquidity risks have increased significantly compared with the 2015 DSA, particularly in the near term, and the liquidity thresholds are breached for longer periods. The DSA also shows that Djibouti's debt dynamics and risk of debt distress are particularly vulnerable to adverse exchange rate and export shocks, as well as to costlier borrowing costs and shocks to non-debt creating inflows (FDI).

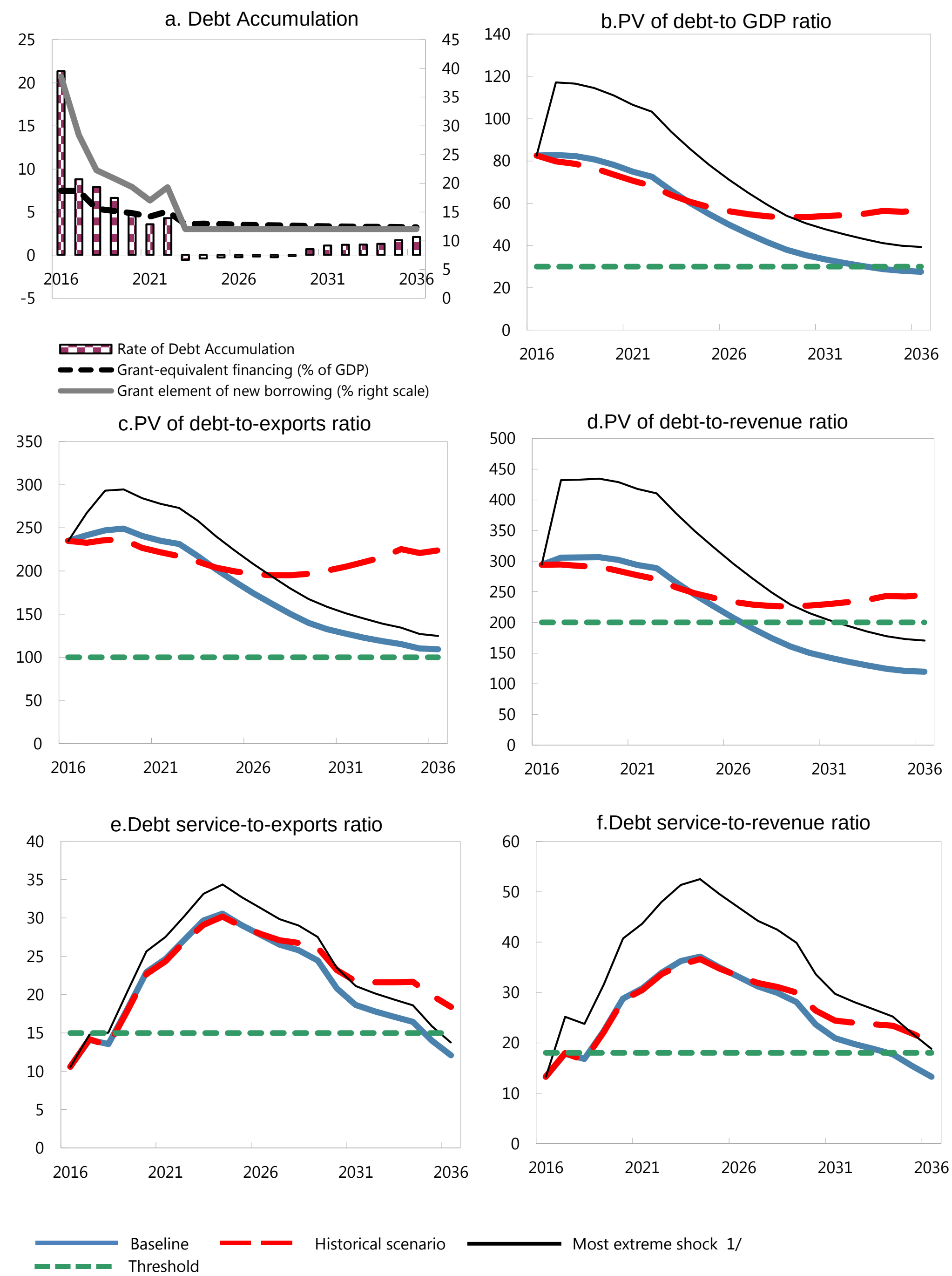
12. Under the existing institutional framework, debt management suffers from weak coordination. Coordination of new borrowing consistent with an overall policy remains a problem as most debt agreements are signed by line ministries and other government agencies while the Ministry of Economy and Finance (and the Public Debt Department) are often involved only at a late stage. The authorities' capacity to monitor and evaluate debt flows and stocks, and the associated budget risks, including through periodic DSAs, would benefit from being strengthened. Given the large role of public enterprises in ensuring the sustainability of PPG debt, it would be important to increase transparency on the risks and costs of the contingent budget liabilities from public enterprise debt liabilities. In this respect, it would be useful for the authorities to establish a database to monitor public enterprise debt, government guarantees, and related collateral.

13. In light of the sharp run-up in external debt and worsening of an already high risk of debt distress, the pace of PPG external borrowing should be reduced and borrowing on non-concessional terms should be avoided. The DSA suggests that any further non-concessional borrowing will exacerbate the already high risk of debt distress, while both the external and fiscal primary balances are below debt service requirements, and for the most part are negative, over the long run. In this situation, it is important to slow the pace of new loans contracted or guaranteed by the government. In addition, all new borrowing, in particular to finance projects managed by public enterprises, should be limited to the projects that generate sufficient revenues to meet debt service requirements. Complementary reforms to strengthen the governance and efficiency of public enterprises would help in this respect. To the extent that the authorities, as planned, turn to public-private partnerships (PPP) to finance and manage future projects, they should also strengthen their capacity to evaluate and monitor PPP-related contingent liabilities for the budget. They should also minimize their financial participation in PPPs and avoid providing explicit guarantees or taking on implicit contingent budget liabilities related to the financial performance of PPP projects.

14. To strengthen debt management, the authorities should press ahead with the finalization and adoption of their debt strategy. The government is currently preparing a national debt policy and plans to establish a national public debt committee. It will be important that the committee, as expected, serve as a clearing house for the approval of all new public sector loans, thereby ensuring a centralized and coordinated control over new borrowing, and an ex ante evaluation of borrowing costs and risks. With respect to a national debt policy, the introduction of an explicit debt anchor, for example, through a target for the medium-term debt-to-GDP ratio, would benchmark and guide a sustainable debt policy. The sizeable increase in debt service over the medium term underscores the importance of consolidating and strengthening debt management expeditiously. Finally, the authorities should give priority to staying current on all debt service obligations.

15. The authorities acknowledge the high risk to debt sustainability attached to the current financing strategy as demonstrated by the DSA. However, they believe that the debt-financed investment projects are critical for Djibouti's development and that their strategy will be viable if it generates the sustained strong economic growth and crowds-in sufficient FDI, which would serve as an alternative financing source for future development. In this regard, the authorities underscored the high priority given to strengthening the governance and efficiency of public enterprises as well to improving the business climate. The authorities also aim at relying more on financing projects through PPPs involving only a small financial participation, if any, by the government. PPPs would be selected only if they were considered to be profitable, and in this respect the authorities did not expect to provide government guarantees. However, in the absence of alternative financing options, they felt that it would be necessary to use external borrowing to finance the projects that they consider important for the country's development and cost effective. The authorities also acknowledged the need to press ahead with establishing a national debt policy and strengthening public debt management; they underscored the importance of technical assistance in this regard.

Figure 2. Djibouti: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2016-2036 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2026. In figure b. it corresponds to a One-time depreciation shock; in c. to a Non-debt flows shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 3. Djibouti: Indicators of Public Debt Under Alternative Scenarios, 2016-2036 1/

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2026.

2/ Revenues are defined inclusive of grants.

Table 3. Djibouti: External Debt Sustainability Framework, Baseline Scenario, 2013-2036 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/	Standard 6/	Projections									
				Average	Deviation							2016-2021			2022-2036
	2013	2014	2015			2016	2017	2018	2019	2020	2021	Average	2026	2036	Average
External debt (nominal) 1/	**46.2**	**49.9**	**69.3**			**84.8**	**87.1**	**87.1**	**87.1**	**85.8**	**83.0**		**58.9**	**30.6**	
of which: public and publicly guaranteed (PPG)	46.2	49.9	69.3			84.8	87.1	87.1	87.1	85.8	83.0		58.9	30.6	
Change in external debt	-3.0	3.7	19.4			15.4	2.3	0.1	-0.1	-1.3	-2.7		-4.9	-1.2	
Identified net debt-creating flows	-1.6	11.6	20.6			15.0	4.5	1.0	1.9	1.8	0.7		-1.8	-1.9	
Non-interest current account deficit	**20.9**	**24.4**	**30.9**	**15.7**	**9.9**	**26.6**	**17.6**	**15.9**	**15.4**	**14.4**	**14.3**		**10.3**	**10.9**	10.5
Deficit in balance of goods and services	29.4	32.2	43.7			37.8	30.1	25.7	25.2	23.9	23.6		20.1	15.1	
Exports	33.4	32.2	34.1			35.1	34.3	33.3	32.4	32.5	31.9		28.6	25.2	
Imports	62.7	64.3	77.7			72.9	64.3	59.0	57.6	56.4	55.5		48.7	40.4	
Net current transfers (negative = inflow)	-0.6	-1.2	-4.2	-0.8	1.3	-3.2	-3.8	-1.0	-0.9	-0.9	-0.8		-0.6	-0.7	-0.5
of which: official	-1.5	-2.0	-3.3			-2.5	-3.0	-0.3	-0.3	-0.3	-0.2		-0.2	-0.9	
Other current account flows (negative = net inflow)	-7.9	-6.6	-8.5			-7.9	-8.7	-8.8	-8.8	-8.6	-8.5		-9.2	-3.6	
Net FDI (negative = inflow)	**-19.7**	**-9.6**	**-7.2**	**-13.2**	**7.8**	**-9.1**	**-10.8**	**-11.5**	**-11.4**	**-11.2**	**-12.0**		**-11.1**	**-11.3**	-11.2
Endogenous debt dynamics 2/	**-2.8**	**-3.1**	**-3.2**			**-2.6**	**-2.3**	**-3.3**	**-2.1**	**-1.4**	**-1.6**		**-1.1**	**-1.4**	
Contribution from nominal interest rate	0.6	0.7	0.9			1.5	3.0	2.2	3.4	3.4	3.1		2.4	0.3	
Contribution from real GDP growth	-2.3	-2.5	-3.0			-4.1	-5.4	-5.5	-5.5	-4.8	-4.7		-3.5	-1.7	
Contribution from price and exchange rate changes	-1.2	-1.3	-1.0			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-1.4**	**-8.0**	**-1.2**			**0.5**	**-2.1**	**-0.9**	**-1.9**	**-3.1**	**-3.5**		**-3.1**	**0.7**	
of which: exceptional financing	-0.2	-0.3	0.2			-0.1	0.4	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	69.2			82.5	82.8	82.3	80.7	78.2	74.9		49.9	27.6	
In percent of exports	...	...	202.9			235.0	241.6	247.2	249.3	240.8	235.1		174.5	109.3	
PV of PPG external debt	**...**	**...**	**69.2**			**82.5**	**82.8**	**82.3**	**80.7**	**78.2**	**74.9**		**49.9**	**27.6**	
In percent of exports	**...**	**...**	**202.9**			**235.0**	**241.6**	**247.2**	**249.3**	**240.8**	**235.1**		**174.5**	**109.3**	
In percent of government revenues	**...**	**...**	**228.0**			**294.2**	**305.6**	**305.9**	**306.5**	**302.1**	**293.8**		**207.6**	**119.6**	
Debt service-to-exports ratio (in percent)	**8.3**	**12.9**	**7.4**			**10.6**	**14.1**	**13.6**	**18.1**	**22.9**	**24.7**		**27.8**	**12.1**	
PPG debt service-to-exports ratio (in percent)	**8.3**	**12.9**	**7.4**			**10.6**	**14.1**	**13.6**	**18.1**	**22.9**	**24.7**		**27.8**	**12.1**	
PPG debt service-to-revenue ratio (in percent)	**10.1**	**15.9**	**8.3**			**13.3**	**17.8**	**16.8**	**22.3**	**28.8**	**30.8**		**33.1**	**13.2**	
Total gross financing need (Billions of U.S. dollars)	0.1	0.3	0.5			0.4	0.2	0.2	0.3	0.3	0.3		0.3	0.3	
Non-interest current account deficit that stabilizes debt ratio	23.9	20.7	11.5			11.2	15.3	15.8	15.5	15.7	17.1		15.2	12.1	
Key macroeconomic assumptions															
Real GDP growth (in percent)	5.0	6.0	6.5	5.1	1.5	6.5	7.0	7.0	7.0	6.0	6.0	6.6	6.0	6.0	6.0
GDP deflator in US dollar terms (change in percent)	2.4	2.9	2.1	4.0	2.3	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Effective interest rate (percent) 5/	1.4	1.8	1.9	1.5	0.2	2.4	4.0	2.8	4.3	4.3	4.0	3.6	4.2	1.1	3.0
Growth of exports of G&S (US dollar terms, in percent)	6.1	5.2	15.2	7.5	4.9	13.0	7.6	7.0	7.2	9.5	7.1	8.6	7.2	8.6	7.5
Growth of imports of G&S (US dollar terms, in percent)	9.2	11.9	31.4	14.6	18.2	2.9	-2.8	1.0	7.6	6.9	7.5	3.9	7.3	8.5	6.9
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	38.6	28.4	22.3	20.9	19.3	17.0	24.4	12.0	12.0	12.5
Government revenues (excluding grants, in percent of GDP)	27.4	26.3	30.3			28.0	27.1	26.9	26.3	25.9	25.5		24.0	23.1	23.8
Aid flows (in Billions of US dollars) 7/	0.1	0.1	0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.1	0.3	
of which: Grants	0.1	0.1	0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.1	0.3	
of which: Concessional loans	...	...	...			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			7.5	7.5	5.4	5.1	4.9	4.5		3.5	3.2	3.5
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			60.9	52.6	39.4	38.6	37.8	37.2		40.4	46.5	42.3
Memorandum items:															
Nominal GDP (Billions of US dollars)	1.5	1.6	1.7			1.9	2.1	2.3	2.5	2.8	3.0		4.7	11.3	
Nominal dollar GDP growth	7.5	9.1	8.7			9.7	10.2	10.2	10.2	9.2	9.2	9.8	9.2	9.2	9.2
PV of PPG external debt (in Billions of US dollars)			1.2			1.6	1.7	1.9	2.0	2.2	2.3		2.3	3.1	
(PVt-PVt-1)/GDPt-1 (in percent)						21.4	8.8	7.9	6.6	4.7	3.6	8.8	-0.2	2.1	0.8
Gross workers' remittances (Billions of US dollars)	...	...	...			...	...	...	...	...	...		...	...	
PV of PPG external debt (in percent of GDP + remittances)	...	...	69.2			82.5	82.8	82.3	80.7	78.2	74.9		49.9	27.6	
PV of PPG external debt (in percent of exports + remittances)	...	...	202.9			235.0	241.6	247.2	249.3	240.8	235.1		174.5	109.3	
Debt service of PPG external debt (in percent of exports + remitta	...	...	7.4			10.6	14.1	13.6	18.1	22.9	24.7		27.8	12.1	

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 ra

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/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

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

8/ 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 4a. Djibouti: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2016–2036

(In Percent)

	Projections							
	2016	2017	2018	2019	2020	2021	**2026**	2036
PV of debt-to GDP ratio								
Baseline	83	83	82	81	78	75	**50**	28
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	83	80	79	77	74	71	**56**	57
A2. New public sector loans on less favorable terms in 2016-2036 2	83	84	85	86	85	83	**64**	47
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	83	86	88	87	84	81	**54**	30
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	83	84	86	85	82	79	**53**	29
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	83	84	85	83	81	77	**52**	29
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	83	92	98	95	92	89	**60**	31
B5. Combination of B1-B4 using one-half standard deviation shocks	83	91	97	95	92	88	**59**	32
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	83	117	117	114	111	106	**71**	39
PV of debt-to-exports ratio								
Baseline	235	242	247	249	241	235	**175**	109
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	235	233	236	236	227	222	**196**	224
A2. New public sector loans on less favorable terms in 2016-2036 2	235	244	256	265	262	262	**224**	185
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	235	242	248	251	242	237	**176**	110
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	235	258	284	286	277	270	**202**	125
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	235	242	248	251	242	237	**176**	110
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	235	267	293	295	284	278	**208**	125
B5. Combination of B1-B4 using one-half standard deviation shocks	235	264	289	291	281	275	**205**	125
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	235	242	248	251	242	237	**176**	110
PV of debt-to-revenue ratio								
Baseline	294	306	306	307	302	294	**208**	120
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	294	295	292	291	284	277	**234**	245
A2. New public sector loans on less favorable terms in 2016-2036 2	294	309	317	326	329	327	**266**	202
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	294	316	328	329	325	316	**224**	129
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	294	311	321	322	318	309	**220**	125
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	294	310	315	316	312	303	**215**	124
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	294	338	363	362	357	347	**248**	136
B5. Combination of B1-B4 using one-half standard deviation shocks	294	335	361	361	356	347	**247**	138
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	294	432	433	435	429	418	**296**	170

Table 4b. Djibouti: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2016–2036

(In Percent)

Debt service-to-exports ratio								
Baseline	11	14	14	18	23	25	**28**	12
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	11	14	13	18	23	24	**28**	18
A2. New public sector loans on less favorable terms in 2016-2036 2	11	14	12	17	20	23	**27**	15
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	11	14	14	18	23	25	**28**	12
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	11	15	15	20	26	28	**31**	14
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	11	14	14	18	23	25	**28**	12
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	11	14	15	20	25	26	**31**	14
B5. Combination of B1-B4 using one-half standard deviation shocks	11	14	15	20	25	27	**31**	14
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	11	14	14	18	23	25	**28**	12
Debt service-to-revenue ratio								
Baseline	13	18	17	22	29	31	**33**	13
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	13	18	17	22	28	30	**33**	20
A2. New public sector loans on less favorable terms in 2016-2036 2	13	18	15	21	26	29	**32**	16
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	13	18	18	24	31	33	**35**	14
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	13	18	17	23	29	31	**34**	14
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	13	18	17	23	30	32	**34**	14
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	13	18	18	25	31	33	**36**	15
B5. Combination of B1-B4 using one-half standard deviation shocks	13	18	19	25	32	34	**37**	15
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	13	25	24	32	41	44	**47**	19
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	11	11	11	11	11	11	**11**	11

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 assuming 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 5. Djibouti: Public Sector Debt Sustainability Framework, Baseline Scenario, 2013-2036

(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2013	2014	2015			2016	2017	2018	2019	2020	2021	2016-21 Average	2026	2036	2022-36 Average
Public sector debt 1/	51.3	53.7	72.1			86.6	88.1	87.5	87.2	85.8	83.1		58.9	30.6	
of which: foreign-currency denominated	46.2	49.9	69.3			84.8	87.1	87.1	87.1	85.8	83.0		58.9	30.6	
Change in public sector debt	-3.6	2.5	18.4			14.5	1.5	-0.6	-0.4	-1.3	-2.8		-4.9	-1.2	
Identified debt-creating flows	2.8	5.7	17.4			9.5	-5.9	-7.5	-7.4	-6.0	-5.4		-4.5	-0.6	
Primary deficit	5.2	8.8	20.8	4.0	6.7	14.1	-1.1	-1.6	-2.9	-2.3	-1.4	0.8	-1.6	1.8	-0.4
Revenue and grants	31.8	30.9	37.2			32.5	31.9	29.9	29.3	28.8	28.4		26.9	25.8	
of which: grants	4.4	4.7	6.9			4.5	4.8	3.0	3.0	2.9	2.9		2.8	2.7	
Primary (noninterest) expenditure	37.0	39.8	58.1			46.6	30.8	28.3	26.4	26.6	27.0		25.3	27.6	
Automatic debt dynamics	-3.2	-3.5	-3.5			-4.6	-4.8	-5.8	-4.5	-3.8	-4.0		-2.9	-2.4	
Contribution from interest rate/growth differential	-2.7	-3.0	-3.3			-3.9	-4.0	-5.2	-3.7	-3.0	-3.2		-2.3	-2.1	
of which: contribution from average real interest rate	-0.1	-0.1	0.0			0.5	1.7	0.6	2.0	2.0	1.7		1.3	-0.3	
of which: contribution from real GDP growth	-2.6	-2.9	-3.3			-4.4	-5.7	-5.8	-5.7	-4.9	-4.9		-3.6	-1.8	
Contribution from real exchange rate depreciation	-0.5	-0.6	-0.2			-0.7	-0.8	-0.6	-0.8	-0.8	-0.8		...	...	
Other identified debt-creating flows	0.8	0.4	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.8	0.4	0.0			0.0	0.0	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)	0.0	0.0	0.0			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	-6.4	-3.2	1.0			5.0	7.4	6.8	7.1	4.7	2.6		-0.4	-0.6	
Other Sustainability Indicators															
PV of public sector debt	...	...	71.9			84.4	83.9	82.7	80.8	78.3	74.9		49.9	27.6	
of which: foreign-currency denominated	...	...	69.2			82.5	82.8	82.3	80.7	78.2	74.9		49.9	27.6	
of which: external	...	...	69.2			82.5	82.8	82.3	80.7	78.2	74.9		49.9	27.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	8.3	13.1	23.4			17.8	3.8	2.9	3.0	5.2	6.5		6.4	4.8	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	193.3			259.6	263.1	276.4	275.7	271.4	263.7		185.8	107.0	
PV of public sector debt-to-revenue ratio (in percent)	...	...	237.2			300.8	309.5	307.3	306.9	302.3	293.9		207.6	119.6	
of which: external 3/	...	...	228.0			294.2	305.6	305.9	306.5	302.1	293.8		207.6	119.6	
Debt service-to-revenue and grants ratio (in percent) 4/	9.5	13.7	6.9			11.6	15.3	15.2	20.1	25.9	27.7		29.6	11.8	
Debt service-to-revenue ratio (in percent) 4/	11.0	16.1	8.5			13.4	18.0	16.9	22.4	28.9	30.9		33.1	13.2	
Primary deficit that stabilizes the debt-to-GDP ratio	8.8	6.4	2.4			-0.4	-2.6	-1.0	-2.5	-0.9	1.4		3.3	2.9	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	5.0	6.0	6.5	5.1	1.5	6.5	7.0	7.0	7.0	6.0	6.0	6.6	6.0	6.0	6.0
Average nominal interest rate on forex debt (in percent)	1.4	1.8	1.9	1.5	0.2	2.8	4.2	2.9	4.5	4.4	4.1	3.8	4.2	1.1	3.1
Average real interest rate on domestic debt (in percent)	-2.3	...	...	-3.4	0.9	...	...	...	...	...	...		...	...	
Real exchange rate depreciation (in percent, + indicates depreciation)	-1.0	-1.3	-0.3	-2.0	1.9	-1.1	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.4	2.9	2.1	4.0	2.3	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Growth of real primary spending (deflated by GDP deflator, in percent)	6.6	13.8	55.4	7.6	17.4	-14.6	-29.2	-1.7	-0.1	6.6	7.7	-5.2	6.6	6.3	6.2
Grant element of new external borrowing (in percent)	...	...	...	...	...	38.6	28.4	22.3	20.9	19.3	17.0	24.4	12.0	12.0	...

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

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 6. Djibouti: Sensitivity Analysis for Key Indicators of Public Debt 2016–2036

	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
PV of Debt-to-GDP Ratio								
Baseline	84	84	83	81	78	75	50	28
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	84	90	95	101	104	105	102	92
A2. Primary balance is unchanged from 2016	84	97	109	121	132	140	167	202
A3. Permanently lower GDP growth 1/	84	84	83	82	80	77	55	41
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-20	84	87	91	90	89	87	65	49
B2. Primary balance is at historical average minus one standard deviations in 2017-201	84	94	104	101	97	93	65	37
B3. Combination of B1-B2 using one half standard deviation shocks	84	94	102	101	99	96	71	50
B4. One-time 30 percent real depreciation in 2017	84	117	113	109	105	100	71	46
B5. 10 percent of GDP increase in other debt-creating flows in 2017	84	93	91	89	86	82	56	31
PV of Debt-to-Revenue Ratio 2/								
Baseline	260	263	276	276	271	264	186	107
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	260	281	317	342	358	368	373	348
A2. Primary balance is unchanged from 2016	260	305	366	414	457	492	621	782
A3. Permanently lower GDP growth 1/	260	264	279	280	277	271	204	156
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-20	260	273	301	305	306	302	241	187
B2. Primary balance is at historical average minus one standard deviations in 2017-201	260	296	347	344	338	328	240	142
B3. Combination of B1-B2 using one half standard deviation shocks	260	292	341	343	341	335	264	192
B4. One-time 30 percent real depreciation in 2017	260	368	379	373	364	352	264	177
B5. 10 percent of GDP increase in other debt-creating flows in 2017	260	291	305	303	298	290	208	121
Debt Service-to-Revenue Ratio 2/								
Baseline	12	15	15	20	26	28	30	12
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	12	15	16	23	30	34	43	31
A2. Primary balance is unchanged from 2016	12	15	17	25	34	39	55	59
A3. Permanently lower GDP growth 1/	12	15	15	20	26	28	31	15
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-20	12	16	16	22	28	30	34	18
B2. Primary balance is at historical average minus one standard deviations in 2017-201	12	15	17	24	30	32	34	15
B3. Combination of B1-B2 using one half standard deviation shocks	12	16	17	24	31	33	36	18
B4. One-time 30 percent real depreciation in 2017	12	19	22	29	38	41	47	25
B5. 10 percent of GDP increase in other debt-creating flows in 2017	12	15	17	22	28	29	31	13

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.

Statement by Daouda Sembene, Executive Director of Djibouti
Abdulrahman Olhaye, Advisor to Executive Director
February 22, 2017

Our Djiboutian authorities attach high value to Fund's continuous support over the past years. They particularly appreciate the constructive and open policy discussions they held with Fund staff in the context of the 2016 Article IV consultation.

As noted by staff, the authorities have embarked on an ambitious strategy for transforming and modernizing Djibouti into a regional logistics and commercial hub. As part of this strategy, major transformative infrastructure projects are underway, with significant contribution to the high rate of economic growth that took place in recent years and is expected to continue over the medium term. Under *Vision Djibouti 2035*, the authorities are also taking a number of policy measures that aim to enhance the tax regime, reform public enterprises, improve the business environment, elevate public debt management reforms and increase job creation to place Djibouti on a sustainable and inclusive growth path in the medium-term.

The 2016 Article IV consultation was a welcome opportunity to review their policy package with staff and to consider refining them, as appropriate to support their development agenda. The authorities broadly concur with the analysis and conclusions formulated in the staff report. In their view, staff's advice will play a valuable role in helping them address the challenges and risks to the outlook faced by the Djiboutian economy amid the implement of *Vision Djibouti 2035*.

Recent Developments and Outlook

As noted in the staff report, the strong pace of economic growth has been driven in recent years by major infrastructure investment projects. The authorities expect that these transformative development projects will help to transform Djibouti into a premier logistics and commercial hub in East Africa and middle-income economy, reduce unemployment, and deepen regional and global integration. Key among them is the electric transnational cargo and passenger railway connecting Djibouti and Ethiopia, and the Doraleh Multipurpose Port (DMP). In addition, the authorities have launched a cross-border water supply project that will be essential to addressing the country's chronic water shortages and developing the agricultural sector.

This ambitious infrastructure development agenda has had an impact on the country's fiscal and external positions, as illustrated by the significant increase in the twin deficits and debt ratios experienced by the country in recent years. However, it is also worth noting that the overall fiscal balance, excluding the large investment projects, has remained quite low. On the revenue front, tax revenue increased slightly and was above projections in 2016, while non-tax revenues slightly underperformed in 2016, due to lower than expected dividend earnings from Doraleh Container Terminals (DCT) and lower base lease income due to a weaker euro. On the expenditure front, additional pressures emanated from security outlays, inflows of refugees, and higher interest payments. In response, the authorities took steps to reduce outlays in view of the shortfall in overall revenue in 2016 including a hiring freeze in the civil service, except for health and education sectors, and domestically-financed capital expenditure and transfers were reduced.

In the monetary and financial sector, the currency board arrangement continues to serve the economy well. Reserve coverage remains comfortable but inflation has moderately increased in recent months, reflecting increased food and services prices. While the banking sector remains liquid, non-performing loans (NPLs) have increased, largely as a result of the bankruptcy of two private oil companies and the stricter loan classification introduced by the central bank. The suspension of correspondent bank relationships by some international banks has also caused payment difficulties in the banking sector.

Our authorities have taken active steps to enhance banking supervision and they thank the Fund for the recent TA. Similarly, with the publication of audited financial statements on the *Banque Centrale de Djibouti* (BCD) website and the creation and operationalization of an audit committee, BCD has accelerated compliance with respect to the recommendations of the safeguards assessment. Positive steps are also being made to implement the recommendations of the safeguards assessments and our authorities agree with staff that this should be accelerated. The *Banque Centrale de Djibouti* (BCD), continues to roll out a number of initiatives, such as the launch of mobile banking services to provide access to banking services to the rural area.

On anti-money laundering and combatting the financing of terrorism (AML-CFT), the authorities have made significant progress with the ratification universal instruments on combating terrorism through its financing and money laundering that has been fully incorporated into national financial sector regulation and supervisory systems. In addition, the BCD's Department of Financial Intelligence has been strengthened with the recruitment of an experienced consultant to accelerate the authorities' membership to the Middle East and North Africa – Financial Action Task Force (MENA -FATF).

As regards structural reforms, in April 2016, our authorities began to implement the code of good governance for public enterprises, which also include, beginning preparing performance contracts for at least five public enterprises (Djibouti Telecom, Electricité de Djibouti, Fonds de l'Habitat, ONEAD and SID) with the aim to have these contracts formalized by June 2017.

The authorities have begun the process to liberalize the production of renewable energy sector and are developing a legislative and institutional framework to better place PPPs for infrastructure development. Improving the business environment remains on the forefront of the authorities' agenda, as evident by steps taken to create a "one stop shop" for business registration.

Reform and Policy Agenda

The economy of Djibouti has undergone important progress in the past few years. As noted above, under their development plan, *Vision Djibouti 2035,* the authorities intend to strengthen their efforts to raise economic growth and make it more inclusive, while taking steps to secure macroeconomic stabilization, reduce public debt and improve the business environment.

Strengthening Debt and Fiscal Sustainability

While taking note of the heightened risk of debt distress concluded by the DSA, the authorities underscore the importance of implementing their *Djibouti Vision 2035* with a view to leveraging the country's strategic location to accelerate economic development and improve living standards of the population. In this context, the authorities have completed a series of capacity building activities aimed at enhancing the planning, programming, budgeting, and monitoring and evaluation of public investments. The result of these efforts was the recent adoption of a set of guidelines at the ministerial level, to increase the evaluation, coordination and management of all public sector loans with a focus on cost and risk mitigation. This process is expected to culminate with the establishment of a national debt committee.

In parallel, progress continues to be made in clearing of outstanding external debt arrears. In this connection, negotiations are underway and the authorities are hopeful that a mutually agreeable solution will be found soon with creditors.

The authorities are cognizant that revenue mobilization should be increased and are broadly in agreement with the recommendations formulated by staff in this area. The tax structure has been improved last year, building on the proceedings of the 2015 National Tax Meetings. Looking ahead, the authorities plan to implement a number of additional measures aimed notably at improving VAT implementation, supporting real estate developers, and strengthening customs administration.

The authorities have taken note of the staff's recommendation regarding tax exemptions and special tax regimes under the investment code. They have recently requested TA to advance necessary reforms in these areas. In this context, they intend to establish this year a tax policy unit and a reform steering committee whose objective will be to address these issues and to make appropriate recommendations.

On the expenditure side the authorities are considering ways to best prioritize social spending, investments in human capital, access to education, and health.

The authorities also share staff's recommendations on the need to improve the efficiency of public enterprises, and intend to take steps to strengthen the supervision of public enterprises, and to review the institutional and legal framework for PPPs.

Pursuing Financial Sector Reforms

The authorities will pursue their efforts to strengthen the financial sector. The higher level of non-performing loans and large credit concentration are issues ranking high on their agenda. In this regard, technical assistance from the Middle East Technical Assistance Center will continue to be valuable. The central bank continues to make strides to increase financial inclusion by launching some key initiatives: (a.) a facility for the financing of small enterprises; (b.) the establishment of a Sharia Committee to develop Islamic finance that aims to increase the rate of banked citizens and to further reinforce the efforts to become a regional center for Islamic finance; (c.) the launch of a mobile banking services project to facilitate financial inclusion for people in rural areas.

Fostering Job Creation and Poverty Reduction

The authorities broadly share staff's assessment and recommendation on creating more jobs and reducing poverty hence their impetus to launch the *"Accelerated Growth and Employment Promotion Strategy*," (SCAPE) last year, aims to address the challenges of accelerated growth and employment growth as the first phase of the national *Djibouti Vision 2035* framework. To date the authorities guided by SCAPE have implemented a number of measures, notably: reduction of factor costs, strengthened the capacities of SMEs supervisory institutions and become more responsive to the private sector concerns through improved dialogue. SCAPE will also place a particular emphasis on economic and financial governance.

Improving the business environment is critical to the development of the private sector and to job creation. On September 2016, a decision-making body, Economic Development Council of Djibouti (*Conseil de Développement Economique de Djibouti, CDED*) was established to bolster economic institutional development. CDED, working with the World Bank as part of the Bank financed project, "*Governance for Private Sector Development and Finance Project"* will be in charge of (a) coordinating between the various ministries in the planning, execution and implementation of economic development policies; and (b) formulating sound investment promotion policies.

Economic diversification is also a main objective of the reforms underway. A special focus will be put on the fishing sector, with the aim of increasing fishing exports. The authorities are also making efforts to expand the tourism sector through the National Tourism Office of Djibouti (*Office National du Tourisme de Djibouti*, ONTD) that will be key to poverty reduction and job creation by focusing on the establishment of ecotourism centers around nationally protected areas such as the development of the Obock region in the interior.

The authorities acknowledge the importance of expanding the social safety net. To this end steps are being taken to establish a database of social program beneficiaries, with the aim to effectively target social spending to the most vulnerable in the society.

Conclusion

Over the past few years, Djibouti has put in place an important development strategy aimed at transforming the economy by driving infrastructure development, boosting regional integration and upscaling logistical capacities. Against the backdrop of the related increase in debt levels, the authorities are confident that the associated increasing revenue streams will foster Djibouti's economic development and reduce significantly the debt service burden. Fund engagement will be instrumental throughout this process. To conclude we appreciate Fund's continued support for Djibouti, as the authorities endeavor to overcome the challenges facing the country, including the regional refugee crisis.