July 2012
IMF Country Report No. 12/197

Djibouti: Fifth Review Under the Extended Credit Facility Arrangement, Request for Augmentation of Access and Rephasing, and Request for Waivers of Nonobservance of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Djibouti.

In the context of the Fifth Review Under the Extended Credit Facility Arrangement, Request for Augmentation of Access and Rephasing, and Request for Waivers of Nonobservance of Performance Criteria, , the following documents have been released and are included in this package:

- Staff Report for the Fifth Review Under the Extended Credit Facility Arrangement, Request for Augmentation of Access and Rephasing, and Request for Waivers of Nonobservance of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on October 24, 2011 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 January 26, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive
- A Press Release summarizing the views of the Executive Board as expressed during its February 6, 2012 discussion of the staff report that completed the request and/or review.
- A statement by the Executive Director for Djibouti.

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

Letter of Intent sent to the IMF by the authorities of Djibouti*
Memorandum of Economic and Financial Policies by the authorities of Djibouti*

*Also included in Staff Report

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

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DJIBOUTI

Fifth Review Under the Extended Credit Facility Arrangement, Request for Augmentation of Access and Rephasing, and Request for Waivers of Nonobservance of Performance Criteria,

Prepared by the Middle East and Central Asia Department
(In consultation with other departments)

Approved by Adnan Mazarei and Dhaneshwar Ghura

January 26, 2012

- **Fifth review under the Extended Credit Facility (ECF) arrangement:** Discussions were held in Djibouti during October 11–24, 2011. The staff team comprised Messrs. Sdralevich (head) and Davies, and Ms. Gicquel (all MCD), and Mr. Million (SPR). The mission met with the governor of the Central Bank of Djibouti (CBD), the minister of finance, senior government officials, representatives of public enterprises, the private sector, and the donor community. World Bank staff attended some of the meetings. Mr. Thiam (resident representative) assisted the mission.
- **Fund relations:** The ECF arrangement (September 2008–June 2012) was approved in September 2008 in the amount of SDR 12.72 million (80 percent of quota). The fourth review of the program was completed on July 8, 2011. Program performance was weak, and the authorities are requesting four waivers of nonobservance of end-June performance criteria. Djibouti's outstanding purchases and loans from the Fund were SDR 10.68 million (67.15 percent of quota) as of December 31, 2011.
- **Augmentation:** The authorities are requesting an augmentation of SDR 9.54 million (60 percent of quota) to meet the additional external financing needs created by the international price shock and the drought.
- **Exchange rate regime:** The CBD operates a currency board arrangement pegged to the U.S. dollar at the rate of Djibouti Franc 177.721 per U.S. dollar. Djibouti has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions.
- **Safeguards assessment:** A mission took place in June–July 2008; an update assessment mission took place in November 2011.
- **Financial Sector Assessment Program:** The report (SM/09/137) was discussed by the Board on June 17, 2009.

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EXECUTIVE SUMMARY

Djibouti has been hit by the drought in the Horn of Africa and the increase in global commodity prices. The drought has worsened water scarcity, reduced agricultural production and cattle stock, and accelerated refugee inflows. The higher imports caused by the drought, combined with the strong increase in food and fuel prices in 2011, widened the current account deficit from 6 percent of GDP in 2010 to 12 percent in 2011.

The authorities have requested an augmentation of access under the ECF of 60 percent of quota. As a result of the exogenous shocks, financing needs for 2011–12 are now expected to be higher than previously projected, despite the pledges from the international community to help Djibouti address the impact of the drought. The augmentation, to be disbursed in two tranches, would meet the shortfall that is projected at about $15 million.

Economic activity is picking up, but inflation is rising. The impact of the drought on growth is expected to be limited, as port business and trade are not affected. Activity is estimated to have increased from 3½ percent in 2010 to almost 4½ percent in 2011, mainly due to the recovery of transshipment and of trade to Ethiopia. Despite incomplete transmission of international food and oil prices, inflation is estimated to have risen from 4 percent in 2010 to 5 percent in 2011.

Performance under the ECF program was weak. Due to the exogenous shocks and the weak tax collection during the electoral period and the subsequent government transition, revenues in the first half of 2011 were disappointing. As a result, the end-June performance criteria on net credit to the government and on the government balance were missed. Also, with tight treasury liquidity and high oil prices, the continuous performance criteria on domestic arrears and on external arrears, and the indicative quantitative target on social spending, were missed. Progress on structural benchmarks was, overall, satisfactory.

The authorities' program for 2011 and 2012 focuses on:

- Achieving a deficit of 0.4 percent of GDP in 2011 by stepping up tax collection and maintaining spending discipline, and aiming at a balanced 2012 budget;
- Taking remedial actions for the missed performance criteria, including through strengthened debt management and program monitoring; and
- Continuing reinforcing bank supervision and central bank governance.

Staff supports the authorities' requests. Staff supports the completion of the fifth review under the ECF; the waivers of nonobservance of the end-June performance criteria on the fiscal balance and net credit to the government, and of the continuous performance criteria on the non-accumulation of domestic arrears and non-accumulation of external arrears; and the augmentation of access and the related rephasing.

I. Background

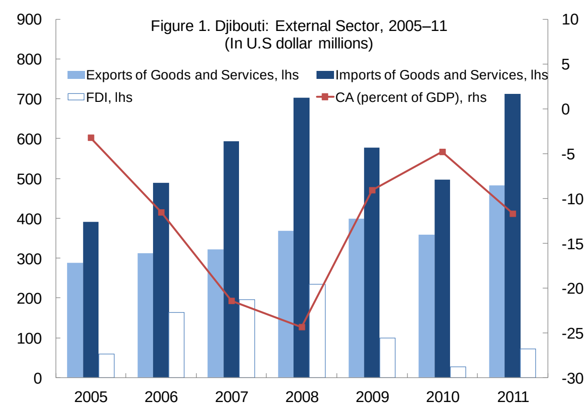
1. **Security risks are increasing with the government's military involvement in Somalia.** In December, the government sent a battalion to Somalia as part of the African Union mission supporting the Transitional Federal Government, challenging the threats made by the insurgent organization Al-Shabaab. The Djibouti military contingent in Somalia will be the third largest after those from Uganda and Burundi.

2. **Djibouti has been severely affected by the double blow of the drought in the Horn of Africa and the global commodity price shock:**

- **Drought**: While most of the damage is concentrated in Somalia, the drought has also affected a large share of the population as well as refugees from the region (Box 1). Although the drought should have a small impact on growth, since the port and trade with Ethiopia are not directly hit, it is having a significant effect on the economy through lower fiscal revenues and higher spending, and increased imports of food and fuel.

- **Commodity price shock:** The spike in the food and oil prices last year has translated into an average effective import price increase estimated at 12 percent in 2011, broadly comparable to the 14 percent increase experienced in 2008. In particular, food prices are now projected to increase by a cumulative 32 percent in 2011–12 from 2010, significantly higher than the 19 percent increase in the Fourth Review Staff Report (CR/12/169). The price shock has boosted the diesel subsidy put in place to limit the cost of transportation for the poor, and has forced the government to increase transfers to the state-owned energy company *Eléctricité de Djibouti* (EDD), squeezed by the high oil prices.

As a result of these shocks, the current account deficit is projected to rise from about 6 percent of GDP in 2010 to about 12 percent in 2011 and 2012.



3. **The authorities have requested an augmentation of access by 60 percent of quota ($15 million) under the ECF to meet the additional financing needs driven by the exogenous shocks.** The international community has pledged $47 million over 2011–13 to help Djibouti address the impact of the drought. Of these, $45 million should be disbursed over 2011–12 in the form of current transfers ($30 million) and capital transfers ($15 million). However, these funds will not be enough to cover the additional balance of payment needs for 2011–12, projected at $18 million more than in the Fourth

Review Staff Report (CR/12/169) due to a higher current account deficit and lower capital account surplus (Text Table 1). The current account deficit is projected to worsen by $14 million compared to the scenario in the Fourth Review Staff Report (CR/12/169), as the increase in imports caused by higher prices and the impact of the drought more than compensates a decline of FDI-related imports, better-than-expected export performance, and drought-related current official transfers. The capital account balance is expected to worsen by about $4 million due to lower-than-expected FDI, despite drought-related official capital transfers. The requested ECF augmentation would cover about $15 million of the 2011–12 financing needs, with the remaining $3 million expected to come from lower accumulation of international reserves.

Text Table 1. Djibouti: Additional Financing Needs Compared to the Program (CR/12/169)

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

	2011–12		
	CR/12/169	Rev. Program	Difference
Current account	-292	-306	-14
Of which : Exports of goods and services	1,001	1,008	7
Imports of goods and services	-1,435	-1,482	-46
Capital account	285	281	-4
Of which: FDI	273	164	-109
Balance	-7	-25	-18
Additional financing needs	…	…	-18
Financing	7	25	18
Of which : Change in CBD reserves	-29	-26	3
Exceptional financing	36	51	15
Of which : ECF	12	26	15
ECF augmentation	…	15	15
Memorandum items:			
Food imports	202	256	54
Due to price increase over 2010	14	24	10
Due to the drought	…	29	29
Due to other effects 1/	…	15	15
Fuel imports	332	356	24
Due to price increase over 2010	42	42	0
Due to the drought	…	12	12
Due to other effects 1/	…	12	12
Additional financing needs excluding drought-related	…	…	-62
Financing	…	…	62
Reserves and Fund disbursements	…	…	18
Drought-related official financing	…	45	45
Current transfers	…	30	30
Capital transfers	…	15	15

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

1/ Includes combined price and volume effects.

Box 1. Impact of the Horn of Africa Drought

Djibouti is being hit hard by the drought. Of a total population of 818,000, about 120,000 citizens, mostly in the rural areas, and about 20,000 refugees from Somalia and Ethiopia are suffering from the food insecurity caused by the drought started in the winter of 2011. The overall impact has been much wider:

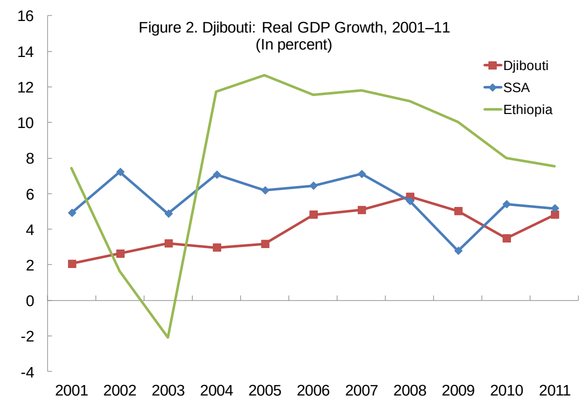
- **Water:** The drought has exacerbated the endemic lack of water, which has damaged or made unusable most of the existing wells. The drought has also reduced the levels of groundwater.
- **Agricultural production:** Domestic agricultural production has fallen by about 40 percent, boosting food imports and increasing the population's dependency on international organizations and NGOs.
- **Cattle:** Adding to the pre-existing dry conditions of the last four years, the drought has led to exceptionally high mortality rate of cattle. More than half of the cattle stock is affected through weight loss or disease. The loss of cattle and fall in its market value are leading to severe income loss for farmers.
- **Energy:** The demand for energy has increased because the fuel is needed to pump water from deeper wells, transport food and water, and meet the higher demand for air conditioning and refrigeration.
- **Refugees:** The drought has accelerated the inflow of refugees from Somalia and Ethiopia to Djibouti, raising their number from about 15,000 before the summer to over 20,000 in September, and increasing the associated spending on food and services, partly borne by the budget.
- **Financial contributions of the population**: Households and businesses have contributed to public initiatives to help the population affected by the drought. Moreover, many families have stepped up transfers to family members in the countryside and abroad (mainly Somalia and Ethiopia).

The international community has responded generously to the authorities' appeal for additional external assistance over the next three years. The government has stepped up spending on wells, water extraction and transport, and food distribution, but alone it is not able to address the needs created by the drought and has therefore launched during the summer an appeal for help to the international community. So far, the government has received pledges for $47 million from bilateral and multilateral donors. The government intends to use the funds for immediate response to urgent needs, but also for medium-term projects for food and water access, agricultural improvement, and disaster prevention.[1]

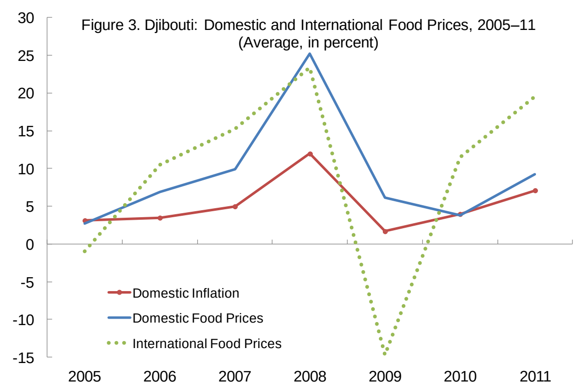
[1/] In evaluating the impact of the drought, staff coordinated with the joint World Bank, European Union, and UNDP needs assessment mission.

II. Recent Economic Developments and Program Performance

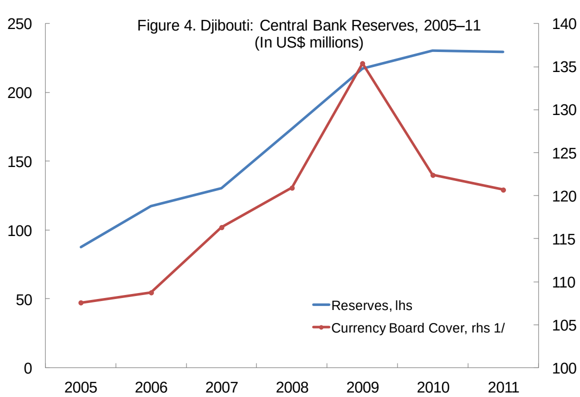
4. **The estimate for economic growth in 2011 has been revised downward due to lower FDI and the exogenous shocks.** GDP growth is still expected to have increased from 3.5 percent in 2010 to 4.4 percent in 2011 (revised from 4.8 percent in the Fourth Review Staff Report CR/12/169) thanks to the recovery of transshipment activity, with two companies starting operations in the Doraleh Container Terminal, and of transit trade to Ethiopia. Due largely to the government's subsidies on food and fuel, transmission of international prices to inflation has been limited; nevertheless, domestic prices are estimated to have risen from 4 percent in 2010 to 5 percent in 2011 and 2012. Gross international reserves fell from $231 million at end-2010 to $224 million in November, because of the large imports and weak fiscal performance. External competitiveness improved in 2011 due to the differential between inflation rates in Djibouti and in Ethiopia, its main trading partner.



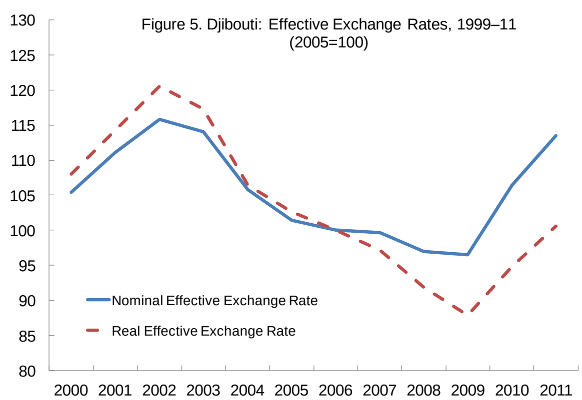
Source: IMF *World Economic Outlook*, Sept. 2011.



Sources: IMF *World Economic Outlook*, Sep. 2011; Djibouti authorities; and Fund staff projections.



1/ Gross foreign assets of the CBD in percent of monetary liabilities (reserve money and government deposits).

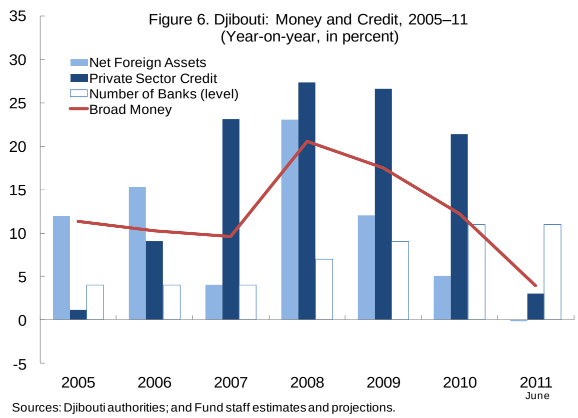


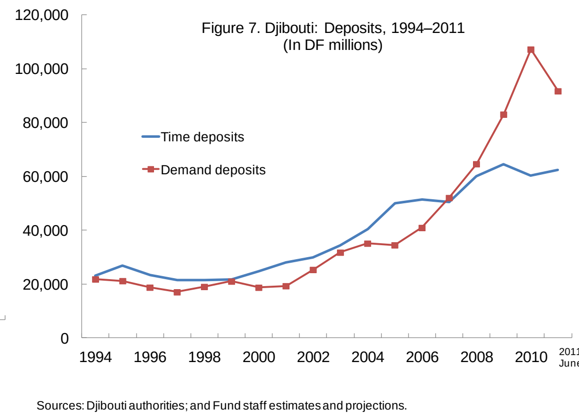
Source: IMF Information Notice System.

Text Table 2. Djibouti: Main Macroeconomic Indicators, 2008–12

	2008	2009	2010 Prel. Act.	2011 Prel. Est.	2012 Proj.
Real GDP growth	5.8	5.0	3.5	4.4	4.7
Inflation, average	12.0	1.7	4.0	5.3	5.0
Current account balance (percent of GDP)	-24.3	-9.1	-5.8	-11.7	-11.8
Gross official reserves 1/	3.6	5.1	3.9	3.6	3.7
Memorandum Item:					
Ethiopia: Real GDP growth	11.2	10.0	8.0	7.5	5.5

Sources: Djibouti authorities; and IMF staff estimates.
1/ In months of following year's imports.





5. **After years of strong growth, money and credit stagnated in the first nine months of 2011.** Broad money fell in the first months of 2011, driven by the fall in domestic currency deposits caused by the uncertainty related to the elections, and to a few large depositors moving their deposits abroad when the *Banque Agricole* group sold *Banque Indosuez-Mer Rouge* (BIS-MR), the second-largest commercial bank in Djibouti, to the Bank of Africa group at the beginning of the year.[1] Concurrently, private-sector credit contracted by 10 percent in the first three months of 2011, before gradually picking up again. By September, as the political situation stabilized and the impact of the one-off factors played out, both money and credit largely recovered and are expected to have posted positive growth by year-end.

[1] BIS-MR, together with the largest bank, the partially French-owned *Banque Commerce et Industrie*, held more than 80 percent of banking system assets at end-2010.

6. **Budget execution in the first semester of 2011 was disappointing because of weak tax collection and the exogenous shocks.** On the revenue side, tax collection faltered due to the elections, the prolonged government transition, and the impact of the drought on taxpayers who in many cases contributed to relief initiatives and supported family members. Furthermore, excise revenue was lower than expected, reflecting the cost of the diesel subsidy implemented to contain the rise in transport costs for the poor, which was 0.8 percent of GDP higher than programmed.[2] On the expenditure side, the government broadly maintained spending discipline but also had to bear unprogrammed drought-related spending of about 0.2 percent of GDP.

7. **Therefore, program performance was weak.** The authorities missed the end-June performance criteria on net credit to the government (by 0.6 percent of GDP) and on the government balance (by 0.2 percent of GDP), as well as the continuous criteria on domestic arrears, due to delays in social contribution payments, and on external arrears, which were accumulated in the second half of 2011 for a total of about $7 million as government liquidity dried up and high oil prices reduced EDD's capacity to pay debt service. Given the shortfall in revenues, the authorities had to cut expenditures heavily, penalizing in particular social spending, and therefore missed the floor on the end-June indicative quantitative target. They met seven out of thirteen structural benchmarks due up to December, and met three more with delay.

8. **The authorities are committed to paying external debt service regularly**. They have undertaken a range of actions: (i) to help prevent occurrence of new arrears, the debt division of the ministry of finance will report to staff monthly debt obligations and repayments on public and publicly guaranteed debt; (ii) the debt division will be strengthened by additional staff financed by UNDP; (iii) if needed to avoid accumulation of external arrears, the treasury will pay the debt service due on debt contracts which should be serviced by public enterprises under an agreement between these enterprises and the government; and (iv) the ministry of finance will create a macroeconomic unit to help monitor the ECF arrangement (*prior action*), in close coordination with the debt division.

III. Policy Discussions

9. **Discussions focused on the economic situation and the impact of the drought, program performance, and policies for 2011–12.** In the real sector, the authorities' main concern is the impact of the drought and high food and fuel prices on the poor. In the fiscal sector, the challenges are catching up with tax collection and maintaining fiscal discipline despite the s*ubsidy cos*ts, drought-related spending, and transfers to EDD. Public debt issues center on preventing the new accumulation of external arrears and resuming the regular

[2] The only other fuel subsidy, on kerosene, which is used by the poorest households for cooking, has a very small budgetary cost.

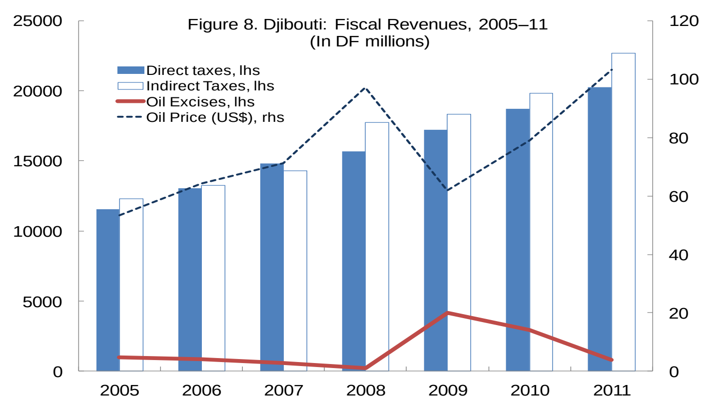
repayment of existing domestic arrears. In the monetary and financial sector, the emphasis is on strengthening bank supervision.

A. Real Sector

10. **Important progress was made in addressing the cost of electricity and the availability of water, key obstacles to development in Djibouti:**

- **Interconnection with the Ethiopian electricity grid:** The interconnection meets about 50 percent of Djibouti's electricity needs at very low cost, which is helping EDD absorb the losses deriving from high oil prices (EDD electricity tariffs are set for a breakeven at 70 dollars per barrel). Later, EDD should be able to lower electricity tariffs for customers, easing one of th*e most serio*us constraints on private sector activity. EDD's plans to build a thermal power station, at an estimated cost of $130 million (about 9 percent of GDP), to replace the existing, ageing facility, have been temporarily suspended while the impact of the interconnection and Djibouti's geothermal potential is evaluated with the help of donors. However, EDD remains in need of reform, and the authorities are working with the World Bank, the European Union, and other donors to streamline the organization, revise the fuel procurement system, and develop a medium-term strategy for the energy sector.

- **Desalinization plant:** A $100 million desalinization project, funded by the European Union and to be completed in 2015, will address Djibouti's medium-term water needs. Aside from the effect of the drought, Djibouti suffers from meager rainfall and a limited, highly salty water table.



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

B. Fiscal Issues

Fiscal policy

11. **The authorities targeted a deficit of 0.4 percent of GDP in 2011.** The revised target realistically takes into account the difficulty of making up fully for the poor tax revenue collection in the first months of the year, the cost of the diesel subsidy (1.2 percent of GDP higher than in the program) and the nonprogrammed spending for the drought (for 0.4 percent of GDP) and transfers to EDD (for 0.2 percent of GDP), which were only partially offset by lower equipment and investment spending. The target implies a weakening by about 0.8 percent of GDP in the fiscal stance for 2011 compared to the program, which envisaged a budget surplus of 0.4 percent of GDP. The additional deficit financing would come from a weaker improvement in the government financial position vis-

à-vis the CBD. The authorities committed to cutting further equipment and investment spending to meet the targeted deficit.

12. **Exceptional revenue measures supported the fiscal effort in (the remainder of) 2011.** The authorities stepped up tax collection by publishing a list of late tax payers and more rigorously enforcing the existing exemptions through the implementation of the ASYCUDA customs software. Despite social and political sensitivities, they also increased diesel prices in October, November, and December by a total of 4 percent (the increase was a *prior action*) to reduce to some extent the subsidy by narrowing the gap between domestic and international prices.

13. **The authorities intend to develop a fuel subsidy reform plan.** Even with the planned price hikes, the diesel subsidy will be very costly. Furthermore, the universal price subsidy is an inefficient social protection tool, especially given that most of the benefit is accrued to the better-off owners of diesel-powered cars and trucks. In the coming months, the authorities therefore plan to develop, with the help of Fund technical assistance, a reform strategy that would allow diesel prices to adjust to international prices based on the automatic smoothing mechanism (which is currently applied for all fuel products except diesel and kerosene) and that would target more efficiently the most vulnerable parts of the population.

14. **The 2012 budget will be balanced.** The authorities agreed to a budget (already approved by the National Assembly) that would maintain debt sustainability, strengthen the financial position with the banking system, and repay the domestic arrears as scheduled. Tax revenues will increase slightly in percent of GDP as a result of the ongoing tax revenue measures. The authorities also committed to continuing tight controls on current spending, including by maintaining the freeze on public-sector hiring (excluding health and education). They will also maintain the existing freeze on public-sector wages, with the exception of the lowest salary level, which will be increased in 2012 as a measure to fight poverty.[3]

Fiscal sector reforms

15. **With the end of the government transition, the authorities are more focused on structural fiscal reform:**

- **Tax revenues**: the authorities have already increased staffing in the VAT unit, and raised the VAT threshold in the 2012 budget (*structural benchmarks for end-*

[3] The cabinet approved an increase from about $96 to $169 a month in the lowest-level public sector salary, representing a potential full-year effect of DF 419 million or about 0.2 percent of GDP. However, the salary increase will be phased in gradually in 2012, and will thus only translate in an additional increase in the wage bill of DF 137 million, or about 0.5 percent of the total wage bill and less than 0.1 percent of GDP.

December 2011). The ministry of finance will enforce the obligation to fill tax returns by companies benefitting from tax exemptions (*new structural benchmark for end-March 2012*). The authorities have introduced the software ASYCUDA to all external trade in 2011 (*structural benchmark for end-December 2011*).

- **Public financial management**: the ministry of finance has resumed the bimonthly treasury planning meetings, after a pause during the ministry's internal reorganization. The authorities have secured financing from the African Development Bank to acquire the software needed for the reclassification of the budget consistent with GFS 2001 (*structural benchmark for end-December 2011)*. They will also keep under review their food subsidy program based on farms in Ethiopia and Sudan.
- **Program monitoring:** throughout the first three quarters of 2011, fiscal reporting to the Fund has been systematically late, and web posting of the fiscal tables has continued to go beyond the agreed two-month lag. To address these delays, the ministry of finance will create a unit charged with coordinating the program measures and reporting, including fiscal tables, and will carry out macroeconomic analysis in support of budget planning (prior action).

C. Public Debt

16. **External public debt should decline slightly from 56 percent of GDP at end-2010 to 55 percent at end-2011, but Djibouti remains at high risk of debt distress (Box 2).** Debt sustainability will be affected by the government's ambitious investment plan, focusing on energy, water, and infrastructure, which is being revised in connection with the new national strategy for poverty reduction (*Initiative Nationale de Développement Social,* INDS).[4]

17. **External arrears were accumulated in the second and third quarter of 2011.** The authorities accumulated external arrears for less than 0.1 percent of GDP to Paris Club creditors in the second quarter, leading to the nonobservance of the related performance criterion, which was waived at the approval of the fourth review (Fourth Review Staff Report CR/12/169). However, starting in May, because of extremely tight treasury liquidity and the difficult financial situation of EDD, the authorities accumulated arrears to the Arab Fund for Economic and Social Development, the Arab Monetary Fund, the Islamic Development Bank, the Kuwait Fund for Arab Economic Development, the OPEC Fund, the World Bank, and Paris Club creditors (Germany, France, and Spain) which reached in the second half of the year a total amount of $7 million, or about 0.6 percent of GDP. Some of these arrears were accumulated on debt service payments taken in charge by public

[4] The World Bank is helping the authorities prepare the strategy, which is intended to replace the 2007 INDS.

companies (including EDD) on behalf of which the government had contracted the loans. All the external arrears were cleared in October-December.

18. **The authorities are committed to avoiding further external arrears**. Following the accumulation of arrears in the first quarter of 2011, the authorities started to more rigorously following the external debt service schedule and strengthening the tracking vis-à-vis creditors of executed debt service payments, including payments on debt contracted to finance public enterprises. In addition, the authorities committed themselves to additional remedial actions: (i) to help prevent recurrence of new arrears, the debt division of the ministry of finance will report to staff monthly debt obligations and repayments on public and publicly guaranteed debt; (ii) the debt division will be strengthened by additional staff financed by UNDP; and (iii) if needed to avoid accumulation of external arrears, the treasury will pay the debt service due on debt contracts which should be serviced by public enterprises under an agreement between these enterprises and the government. The macroeconomic unit will also improve the coordination with the debt division. Finally, a stronger fiscal position will prevent the accumulation of further arrears, and likewise, the interconnection will support EDD's financial position and allow it to resume regular debt service payments.

19. **Debt rescheduling efforts are continuing, and the authorities are making best efforts to reach agreements with the remaining official bilateral creditors.** To comply with the comparability of treatment requirement in the Paris Club agreement, the authorities are seeking similar terms from non-Paris Club creditors. They have already signed agreements with Saudi Arabia and are in negotiation with Kuwait and the United Arab Emirates.

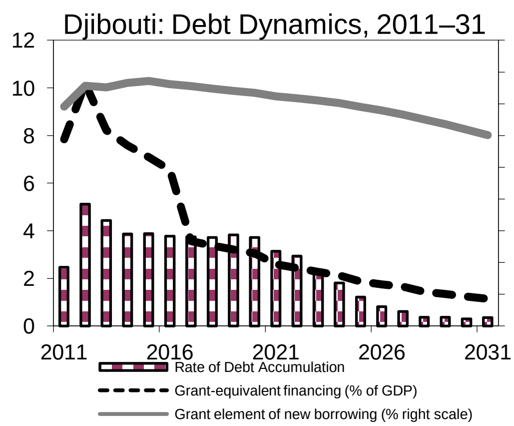
20. **The authorities are repaying domestic arrears.** They committed to repay the arrears scheduled for 2011 (including the arrears accumulated to public utilities in 2009), the remaining domestic arrears previously scheduled for 2010, and the government's 2009 dividend advance from *Banque Commerce et Industrie*. To lay the basis for regular updates of the cross-debt with public enterprises, the authorities concluded stock-taking agreements with EDD and Djibouti Telecom in September, and with the water company ONEAD in November (*structural benchmark for end-September 2011*).

Box 2. Debt Sustainability Analysis

The updated DSA confirms that Djibouti remains at a high risk of debt distress. Under the baseline, the present value (PV) of the debt-to-GDP ratio is projected to decrease from 51 percent in 2011 to 33 percent in 2031, and remains above the threshold of 30 percent until 2013. The PV of the debt-to-exports ratio also breaches its indicative threshold of 100 percent until 2025. However, the PV of the debt-to-revenue ratio and the debt service ratios are below their indicative thresholds.

Stress tests show that external debt sustainability is most vulnerable to a devaluation of the currency. The PVs of the debt-to-GDP ratio and debt -to-revenues ratio are most vulnerable to a one-time devaluation of the currency (Djibouti operates a currency board arrangement pegged to the US dollar). On the other hand, the debt service-to-export ratio and the debt-to-export ratio are most vulnerable to an export shock, highlighting the vulnerability of debt sustainability to port services.

The macroeconomic assumptions for 2011–31 remain broadly the same as in the last DSA. Real GDP growth rate in the long run is projected at 5.8 percent, while inflation is expected to remain at 2.5 percent. The current account deficit is expected to stabilize at about 12 percent of GDP in the next few years, mostly due to large assumed FDI inflows, and then gradually decrease to about 5 percent of GDP in the long run.



The results of the public-sector DSA mirror those of the external DSA. In the baseline scenario, public debt indicators are projected to improve in the medium term. The PV of the debt-to-GDP ratio is projected to decrease from 61 percent in 2011 to 34 percent in 2031. The PV of debt-to-revenue ratio would also decrease from 174 percent to 103 percent in 2031, reflecting Djibouti's relatively high and stable government revenues.

D. Financial Sector Policies

21. **The banking sector, according to end-2010 indicators, remains healthy overall, but there are concerns about credit quality and some governance problems stemming in part from regulatory and prudential weaknesses**. Available indicators show high profitability and nonperforming loans of about 6 percent of total loans. However, rapid credit growth and strong increase in number of banks in recent years, together with rising exposure to the real estate sector, raise concerns about a possible deterioration in credit

quality. Furthermore, the increase in minimum capital envisaged by the new banking law may put many of the smaller banks under severe pressure to find funding. Finally, a banking crisis in Europe might affect the two largest banks which still place a significant share of their liquid assets with counterparts in France. These vulnerabilities may be exacerbated by possible governance problems in the banking sector such as excessive credit concentration, connected lending, and weak internal governance structures, that could arise from remaining weaknesses in the prudential and regulatory framework, the relatively large size of the banking sector in the small Djiboutian economy, and the presence of several small banks.

22. **The authorities are strengthening bank supervision.** The CBD has created a unit dedicated to supervision, including AML/CFT supervision (*structural benchmark for end-June 2011*), and has recruited two additional staff for the unit (*structural benchmark for end-June 2011*). In July, the CBD approved a roadmap for the implementation of the banking law (*new structural benchmark for end-September 2011*), and has started implementing the provisions of the law, including the tightening of licensing procedures. The authorities conducted onsite inspection of five banks and a micro-finance institution in 2011. All banks now submit a detailed monthly statement on credit, liquidity, and foreign exchange operations.

23. **Steps have been taken to improve central bank governance.** In September 2011 the CBD Board of Directors adopted an official timetable for quarterly meetings (*structural benchmark for end-June 2011*). In the context of the ongoing safeguards update, envisaged in the context of the augmentation of access, the CBD agreed to strengthen transparency by publishing the full set of 2010 financial statements, including the opinion letter and disclosure notes (*modified structural benchmark for end-December 2011*), and intends to adopt an audit committee charter. A safeguards assessment update, envisaged in the context of the augmentation of access, is ongoing.

IV. PROGRAM ISSUES AND RISKS

24. **Due to delays in data provision, revised end-December 2011 performance criteria in line with the authorities' revised fiscal objectives for the year could not be proposed to the Board.** The staff report could not be issued before end-December 2011 due to delays in obtaining data on a presidential airplane acquired in 2010.[5] Consequently, the Board can no longer modify the end-December 2011performance criteria on the fiscal balance and net credit to the government. Since the 2011 fiscal balance underlying the

[5] The president of Djibouti was given the airplane as a personal gift at end-2010. Based on the information provided by the authorities, the transaction did not create debt obligations and did not lead to the nonobservance of program conditionality. Following staff inquiries during the October 2011 mission, the authorities revised the 2010 balance of payments to accurately reflect the additional import and the private capital transfer generated by the transaction.

revised macroeconomic framework implies a relaxation of about 0.8 percentage of GDP compared to the target set in the Fourth Review Staff Report (CR/12/169), the two performance criteria in question are likely to be missed (fiscal and financing data for end-December 2011 are not yet available). Since the program is supported by an ECF arrangement, waivers for end-December performance criteria are not needed for the completion of the 5th review, but waivers of nonobservance might be needed on occasion of the completion of the 6th review. However, in line with understandings reached with the authorities on a revised macroeconomic framework and accompanying policies, the staff considers that the broader goals of the program are within reach, provided that the end-December 2011 outcome is in line with the revised targets (Text table 3).

25. **The authorities request a revision of the structural benchmarks set in the Fouth Review Staff Report (CR/12/169).** Given its timeline beyond the end of the ECF arrangement in early June, the authorities request the replacement of the end-June 2012 structural benchmark on the preparation of an estimate of tax expenditure with an end-March 2012 structural benchmark on the preparation of a list of beneficiary companies defaulting on the requirement to file tax returns. This measure is macrocritical since tax returns from companies benefitting from exemptions are essential to calculate total tax expenditures. Following discussions with FIN in the context of the safeguards update, they also clarified the end-December structural benchmark on the publication of the 2010 audited accounts of the CBD. The program envisages prior actions on increasing the diesel price at the pump and creating a macroeconomic unit in charge of program coordination at the ministry of finance.

26. **The authorities are requesting four waivers for the nonobservance of performance criteria.** The waivers for the end-June performance criteria on net credit to the government and on the government balance are justified by the temporary nature of the deviations and the remedial actions on strengthening tax administration and raising diesel prices. The waiver for the continuous criterion on non-accumulation of domestic arrears is justified by the temporary and minor nature of the deviation, since the arrears were accumulated only in three months, for a maximum amount of 0.2 percent of GDP, and were eliminated by the third quarter. The waiver for the continuous criterion on the non-accumulation of external arrears is justified by the temporary nature of the deviation and the remedial measures on improving debt service reporting, debt management, and coordination between the treasury, the debt division, and public enterprises.

27. **With the augmentation of access, the program will be fully financed.** The authorities are expected to mobilize sufficient exceptional financing from multilateral and bilateral creditors on concessional terms, which include financing for drought-related

spending. Donors will continue to support Djibouti mainly through grant and loan project financing, while expected budget support is relatively limited.[6]

Text Table 3: End-December 2011 Quantitative Performance Criteria and Preliminary Estimates

(In millions of Djibouti francs; unless otherwise indicated)

		End-2011 Performance Criteria	
		Program	Prel. Est.
Performance criteria			
	Ceiling on net credit to government from the banking system	-2,600	-779
	Floor on government budget balance (ordonnancement)	883	-938
Indicative target			
	Floor on social spending	14,451	12,829
Memorandum items 1/ :			
Adjuster #1	Projected French, U.S., and Japan military base payments	12,736	12,736
Adjuster #2	External budgetary grants and loans	3,228	3,337
Adjuster #3	Externally financed public investment loans (PIP)	6,815	6,815

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

1/ See the Technical Memorandum of Understanding for definitions and adjustor calculations.

28. **The augmentation will be disbursed at the fifth and sixth reviews.** To balance the need to meet Djibouti's financing requirements with the risks arising from program performance, the augmentation will be disbursed equally following the approval of the fifth and sixth reviews of the ECF arrangement. The augmentation of access is not expected to affect Djibouti's capacity to repay the Fund. With the augmentation, average obligations to the Fund over 2012–22 would rise to 0.5 percent of government revenues (compared to 0.3 percent without augmentation), and to 0.5 percent of exports (compared to 0.3 percent). The remedial actions taken by the authorities to address the weak program performance will strengthen the ECF going forward and support the requested access increase.

29. **The program is vulnerable to a number of risks:**

- ***Wavering political commitment***, resulting from vested interests or a flare-up of domestic social unrest, among other causes;
- ***Administrative capacity constraints***, combined with shortfalls in technical assistance from donors, which could possibly affect the authorities' ability to implement reform;

[6] The donor conference previously planned for early 2011 was tentatively moved to 2012.

- ***Unsustainable spending pressures*** deriving from: (a) higher transfers to EDD due to continued financial losses, (b) uncontrolled spending on the fuel and food subsidy program, and (c) higher-than-expected cost of the mission to Somalia;

- ***Fall in international reserves to unsustainable levels***—threatening currency board coverage—in case capital inflows and official financing are insufficient to finance the rising current account deficit; and

- ***Terrorist acts*** following the increased involvement in Somalia, which could dent confidence and derail growth.

V. Staff Appraisal

30. **Despite weak performance in the first half of 2011, the program is broadly on track**. Performance has suffered from the commodity price shock and the drought, but also from the authorities' weakening attention around the elections and during the prolonged government transition period. However, the authorities have maintained spending discipline, made sufficient progress on their structural reform program, and committed to adequate policies for 2011 and 2012. Staff expects the 2011 program outcome to deviate from the end-December 2011 performance criteria for the fiscal balance and net credit to the government set in the Fourth Review Staff Report (CR/12/169). However, staff is of the view that, if the 2011 macroeconomic outcome turns out in line with the revised macroeconomic framework, the broad objectives of the program would continue to be met. Staff therefore supports the authorities' request for the completion of the fifth review, the waivers of nonobservance of the end-June performance criteria on the fiscal balance and net credit to the government, and of the continuous performance criteria on the non-accumulation of domestic arrears and non-accumulation of external arrears, in light of the minor deviations from the program objectives and the corrective actions undertaken by the authorities.

31. **The international price increase and the drought had a strong negative impact on the Djiboutian economy.** The spike in commodity prices, especially on food and fuel, has boosted the import bill, reduced fiscal space, and disproportionately affected the poorest households. The drought has put further pressure on the economy, greatly increasing the population's reliance on food and services provided by the government and the international community. Staff supports the request for augmentation of access by 60 percent of quota to meet the additional external financing needs resulting from these exogenous shocks, and the related rephasing of disbursements.

32. **Under the currency board regime, which has served the country well, macroeconomic stability hinges on sound fiscal policy.** Staff welcomes the authorities' commitment to targeting a budget deficit of 0.4 percent of GDP for 2011 and a balanced budget in 2012. To achieve these targets, the authorities must increase their efforts in tax

collection but also remain vigilant about spending pressures. In this regard, the authorities should keep under strict control the financial impact of the increase in the base salary. If spending cuts become necessary in 2012 in the face of lower-than-programmed revenues, they should also focus on the quality of the fiscal adjustment and refrain from disproportionately decreasing capital and social spending, as was the case in 2011.

33. **The success of the program therefore depends crucially on the authorities' immediate implementation of the agreed corrective measures.** They should focus on catching up with tax collection to achieve the ambitious fiscal targets for 2011 and 2012; regularly execute external debt service payments, including those taken in charge by public companies under agreements with the government; maintain spending discipline; and rigorously keep up with fiscal and debt data reporting and publication. The creation of a macroeconomic unit at the ministry of finance will help in this regard.

34. **Furthermore, reform in the fiscal sector is essential for improving fiscal management.** Deepening tax revenue reforms, notably in the VAT administration and the reduction of tax exemptions, is necessary to increase revenue potential. Progress in public financial management is encouraging, but more needs to be done, particularly on strengthening the budget process (including increased transparency of budget planning and execution) and tracking domestic arrears and public-sector cross debt.

35. **The reform of the fuel subsidy will help to contain its budgetary cost and better target the needs of the poor.** Staff welcomes the recent increases in diesel prices and the authorities' intention to develop, with the help of the Fund, a reform strategy to phase out the universal diesel price subsidy and reinstate the automatic smoothing mechanism.

36. **Lowering the cost of energy requires a medium-term strategy centering on the reform of EDD.** The oil price increase heightened EDD's financial difficulties, but problems in the energy sector are long-standing. Only the development of a coherent energy strategy, including the reform of EDD, can prevent further government transfers to EDD and allow for the pass-through to customers of the low cost of the electricity imported from Ethiopia.

37. **The CBD should continue focusing on the implementation of the banking law and possible governance issues in the banking sector.** The CBD should now develop a solid implementation framework and adequately train its staff. The financial system appears sound, but, in light of the high credit growth, the increase in the number of banks in recent years, and possible shocks from a financial crisis in Europe, the authorities should carefully monitor banking sector developments and be vigilant toward the increase in risks, both systemic and to individual banks. The CBD should also pay attention to possible governance issues in the banking sector. The tightening of bank licensing is an important step in this direction.

Table 1. Djibouti: Selected Economic and Financial Indicators, 2008–16

(Quota: SDR 15.9 million)
(Population: 0.818 million; 2009)
(Per-capita nominal GDP: $1,383; 2010)
(Poverty rate: 42 percent; 2002)

	2008	2009	2010	2011	2012	2013	2014	2015	2016
	Act.	Act.	Prel. Act.	Prel. Est.			Rev. Prog.		
	(Annual percent change, unless otherwise indicated)								
National accounts									
Real GDP (annual change in percent)	5.8	5.0	3.5	4.4	4.7	5.0	5.5	5.8	5.8
Consumer prices (annual average)	12.0	1.7	4.0	5.3	5.0	2.5	2.5	2.5	2.5
Consumer prices (end of period)	9.2	2.2	2.8	9.2	0.4	2.4	2.3	2.3	2.3
	(In percent of GDP)								
Investment and saving									
Total fixed capital investment	46.7	35.5	20.8	23.6	26.1	32.6	32.8	33.3	34.8
Private	32.9	18.3	9.0	12.5	14.1	19.7	19.4	19.6	20.7
Public	13.8	17.2	11.7	11.1	12.0	12.9	13.4	13.6	14.1
Gross national savings	22.4	26.4	14.9	11.9	14.3	20.7	21.1	20.8	22.5
Savings/investment balance	-24.3	-9.1	-5.8	-11.7	-11.8	-11.9	-11.7	-12.5	-12.3
Public finances									
Total revenue and grants	41.9	37.0	35.5	35.1	35.6	35.6	35.7	35.8	35.8
Of which: Tax revenue	20.0	20.1	20.2	20.6	20.7	21.9	22.6	23.1	23.3
Expenditure and net lending 1/	40.6	41.6	36.0	35.5	35.6	35.6	35.7	35.7	35.7
Of which: Current expenditure	26.8	24.3	24.3	24.4	23.6	22.7	22.3	22.1	21.7
Investment expenditure	13.8	17.2	11.7	11.1	12.0	12.9	13.4	13.6	14.1
Overall balance (commitment basis, incl. grants) 1/	1.3	-4.6	-0.5	-0.4	0.0	0.0	0.0	0.0	0.0
Domestic financing	-0.6	-0.2	0.1	-0.4	-0.5	-2.1	-1.8	-1.8	-1.6
External financing	2.6	5.9	1.3	2.1	1.4	2.1	1.8	1.8	1.6
Change in domestic arrears (decrease -) 2/	-3.2	-1.2	-0.8	-1.3	-0.9	0.0	0.0	0.0	0.0
	(Annual percent change, unless otherwise indicated)								
Monetary sector									
Net foreign assets	23.1	12.1	5.1	3.1	6.7	6.9	7.0	6.9	7.0
Net domestic assets	10.0	43.1	38.6	6.6	18.9	9.0	10.7	11.9	11.5
Claims on the private sector	27.3	26.6	21.4	4.8	10.3	15.2	14.6	14.7	13.7
Broad money	20.6	17.5	12.2	4.0	9.9	7.5	8.1	8.4	8.4
Velocity of broad money (ratio)	1.2	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Average commercial lending interest rate (in percent)	11.4	11.7	10.1	...	...	...	...	...	...
	(In millions of U.S. dollars, unless otherwise indicated)								
External sector									
Exports of goods and services	369	399	359	483	525	577	616	657	728
Imports of goods and services	-704	-578	-509	-713	-769	-824	-870	-909	-980
Current account balance (in percent of GDP)	-24.3	-9.1	-5.8	-11.7	-11.8	-11.9	-11.7	-12.5	-12.3
FDI in percent of GDP	23.8	9.5	2.4	5.8	6.7	12.3	12.0	12.2	12.3
Stock of external public and publicly guaranteed debt (in percent of GDP)	60.2	59.8	56.1	54.6	53.4	53.1	52.4	51.5	50.8
Gross official reserves 3/	174	218	231	230	254	277	302	329	358
(in months of next year's imports of goods and services)	3.6	5.1	3.9	3.6	3.7	3.8	4.0	4.0	3.8
Memorandum items:									
Nominal GDP (in millions of Djibouti francs)	174,617	186,447	200,578	220,440	242,370	260,628	281,650	305,411	331,119
Currency board cover (in percent) 4/	120.9	135.4	122.4	120.7	114.5	112.8	111.3	109.6	108.9
Exchange rate (DF/US$) end-of-period	177.7	177.7	177.7	…	…	…	…	…	…
Real effective exchange rate (yearly average, 2005=100)	106.5	102.6	100.0	…	…	…	…	…	…
(Change in percent; depreciation -)	-9.3	-3.6	-2.6	…	…	…	…	…	…

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

1/ In 2009 includes externally financed projects of public enterprises guaranteed by the government amounting to 3.7 percent of GDP.

2/ Does not include repayment of arrears to public enterprises accumulated in 2009. Repayment of these arrears is included in current expenditure in 2010–12 .

3/ In 2009, includes special and general allocation of SDR 14 million.

4/ Gross foreign assets of the CBD in percent of monetary liabilities (reserve money and government deposits at CBD).

Table 2. Djibouti: Central Government Fiscal Operations, 2008–12

(In millions of Djibouti francs)

	2008	2009	2010	2011				2012
	Act.	Act.	Prel. Act.	CR/12/169	Prel. Est.	CR/12/169	Prel. Est.	Prog.
				Q2		Q4		
Revenues and grants	73,092	68,953	71,124	32,982	33,329	81,299	77,295	86,251
Tax revenue	35,005	37,449	40,582	20,804	19,840	46,001	45,392	50,143
Direct taxes 1/	15,673	17,229	18,726	9,700	9,485	20,603	20,258	22,211
Indirect and other taxes	19,331	20,220	21,857	11,105	10,355	25,398	25,134	27,932
Indirect taxes	17,721	18,330	19,828	9,984	9,223	22,947	22,683	24,906
Other taxes	1,610	1,890	2,029	1,121	1,132	2,451	2,451	3,026
Nontax domestic revenues	4,618	9,010	8,872	4,819	4,054	9,621	5,817	8,550
Nontax external revenues 2/	10,631	10,546	10,965	4,024	6,373	12,736	12,736	11,692
Grants	22,838	11,948	10,705	3,335	3,062	12,941	13,050	15,866
Development projects	13,105	9,798	9,831	2,830	2,646	9,713	9,713	12,394
Budget support for current expenditures	9,733	2,150	874	504	416	3,228	3,337	3,472
Total expenditure 3/	70,903	77,483	72,140	35,610	33,707	80,416	78,233	86,245
Current expenditure	46,738	45,362	48,649	26,754	24,682	53,864	53,705	57,168
Wages and related expenditure	19,857	24,058	25,464	13,610	13,584	27,231	27,231	29,009
Wages and contributions	19,857	21,634	22,911	12,276	12,239	24,555	24,555	26,178
Housing subsidies	...	2,424	2,553	1,333	1,345	2,676	2,676	2,831
Goods and services	16,467	13,122	14,359	7,900	6,439	15,684	15,384	16,148
Of which : repayment of arrears to public enterprises 4/	0	0	500	0	0	1,300	1,300	1,000
Civil expenditure	12,044	10,700	11,349	6,900	5,896	12,657	12,657	13,416
Of which : extrabudgetary spending		0	0	0	0	0	0	0
Military expenditure 5/	4,424	2,422	3,010	1,000	543	3,027	2,727	2,732
Maintenance	660	650	1,152	574	258	1,354	1,354	1,474
Transfers 6/	5,503	5,528	6,055	3,667	3,600	7,139	7,139	7,556
Interest	558	803	745	499	385	1,005	1,037	1,286
Foreign-financed current spending	1,374	1,201	874	504	416	1,451	1,560	1,695
Investment expenditure	24,164	32,121	23,491	8,856	9,025	26,552	24,528	29,077
Domestically financed	5,709	10,181	10,068	2,798	3,375	10,024	8,000	10,000
Of which : extrabudgetary spending		0	0	0	0	0	0	0
Foreign-financed	18,455	21,940	13,423	6,058	5,650	16,528	16,528	19,077
Grants	13,105	9,798	9,831	2,830	2,646	9,713	9,713	12,394
Loans	5,350	12,142	3,592	3,228	3,004	6,815	6,815	6,683
Overall balance (commitment basis, incl. grants) 3/	2,189	-8,530	-1,016	-2,628	-378	883	-938	6
Overall balance (commitment basis, excl. grants)	-20,649	-20,478	-11,721	-5,963	-3,440	-12,058	-13,988	-15,860
Change in arrears (cash payments = -)	-5,591	-2,154	-1,626	0	-734	-2,800	-2,800	-2,200
Overall balance (cash basis, incl. grants)	-3,402	-10,684	-2,642	-2,628	-1,112	-1,917	-3,738	-2,194
Financing	3,360	10,666	2,698	2,628	1,269	1,917	3,738	2,194
Domestic financing (net)	-1,103	-424	158	440	-597	-2,696	-875	-1,135
Bank financing	-1,007	-328	254	488	-549	-2,600	-779	-1,039
Central bank	-1,267	-1,594	842	488	305	-1,600	75	-655
Commercial banks	260	1,266	-588	0	-854	-1,000	-854	-384
Nonbank financing	-96	-96	-96	-48	-48	-96	-96	-96
External financing (net)	4,463	11,090	2,540	2,188	1,866	4,613	4,613	3,329
Disbursements	5,616	12,142	3,592	3,228	3,004	6,815	6,815	6,683
Amortization payments	-1,153	-1,052	-1,052	-1,040	-1,138	-2,202	-2,202	-3,354
Discrepancy	0	-18	56	0	157	0	0	0
Memorandum items:								
Current expenditure for social purposes 7/	16,058	25,864	4,361	6,541	6,541	14,451	14,451	29,671
Base fiscal balance 8/	-10,451	-7,883	-8,389	-2,449	-2,772	-5,515	-7,636	-5,480
Domestic revenue	39,623	46,459	49,454	25,623	23,894	55,622	51,209	58,693
Domestically financed expenditure	50,073	54,342	57,843	28,072	26,666	61,137	58,845	64,173

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

1/ Includes €7.5 million of ITS personal income taxes from the French military, as per leasing agreement.

2/ Annual leasing fees from French (€30 million) and US (US$30 million) military bases, which include the payment of TIC on behalf of French soldiers. From Q3 2010, includes US$3 million from Japanese military base.

3/ In 2009, includes externally financed projects of public enterprises guaranteed by the government amounting to 3.7 percent of GDP.

4/ In 2010–12 includes the repayment of arrears to public enterprises accumulated in 2009.

5/ Includes €5 million (out of a total of €30 million) of foreign-financed current spending from French military as per leasing agreement. The budget classifies this amount as domestic investment spending.

6/ Excludes housing subsidies.

7/ Revised from 2010 to exclude salaries. In 2011 includes only social spending as defined in TMU.

8/ Defined as domestic revenue minus expenditure financed from domestic sources.

Table 3. Djibouti: Central Government Fiscal Operations, 2008–12

(In percent of GDP)

	2008	2009	2010	2011				2012
	Act.	Act.	Prel. Act.	CR/12/169	Prel. Est.	CR/12/169	Prel. Est.	Rev. Prog.
				Q2		Q4		
Revenues and grants	41.9	37.0	35.5	14.5	15.1	35.6	35.1	35.6
Tax revenue	20.0	20.1	20.2	9.1	9.0	20.2	20.6	20.7
Direct taxes 1/	9.0	9.2	9.3	4.3	4.3	9.0	9.2	9.2
Indirect and other taxes	11.1	10.8	10.9	4.9	4.7	11.1	11.4	11.5
Indirect taxes	10.1	9.8	9.9	4.4	4.2	10.1	10.3	10.3
Other taxes	0.9	1.0	1.0	0.5	0.5	1.1	1.1	1.2
Nontax domestic revenues	2.6	4.8	4.4	2.1	1.8	4.2	2.6	3.5
Nontax external revenues 2/	6.1	5.7	5.5	1.8	2.9	5.6	5.8	4.8
Grants	13.1	6.4	5.3	1.5	1.4	5.7	5.9	6.5
Development projects	7.5	5.3	4.9	1.2	1.2	4.3	4.4	5.1
Budget support for current expenditures	5.6	1.2	0.4	0.2	0.2	1.4	1.5	1.4
Total expenditure	40.6	41.6	36.0	15.6	15.3	35.3	35.5	35.6
Current expenditure	26.8	24.3	24.3	11.7	11.2	23.6	24.4	23.6
Wages and related expenditure	11.4	12.9	12.7	6.0	6.2	11.9	12.4	12.0
Wages and contributions	11.4	11.6	11.4	5.4	5.6	10.8	11.1	10.8
Housing subsidies	0.0	1.3	1.3	0.6	0.6	1.2	1.2	1.2
Goods and services 3/	9.4	7.0	7.2	3.5	2.9	6.9	7.0	6.7
Of which: repayment of arrears to public enterprises 4/	0.0	0.0	0.2	0.0	0.0	0.6	0.6	0.4
Civil expenditure	6.9	5.7	5.7	3.0	2.7	5.5	5.7	5.5
Of which : extrabudgetary spending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Military expenditure 5/	2.5	1.3	1.5	0.4	0.2	1.3	1.2	1.1
Maintenance	0.4	0.3	0.6	0.3	0.1	0.6	0.6	0.6
Transfers 6/	3.2	3.0	3.0	1.6	1.6	3.1	3.2	3.1
Interest	0.3	0.4	0.4	0.2	0.2	0.4	0.5	0.5
Foreign-financed current spending	0.8	0.6	0.4	0.2	0.2	0.6	0.7	0.7
Investment expenditure	13.8	17.2	11.7	3.9	4.1	11.6	11.1	12.0
Domestically financed 5/	3.3	5.5	5.0	1.2	1.5	4.4	3.6	4.1
Of which : extrabudgetary spending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign-financed	10.6	11.8	6.7	2.7	2.6	7.2	7.5	7.9
Grants	7.5	5.3	4.9	1.2	1.2	4.3	4.4	5.1
Loans	3.1	6.5	1.8	1.4	1.4	3.0	3.1	2.8
Overall balance (commitment basis, incl. grants) 3/	1.3	-4.6	-0.5	-1.2	-0.2	0.4	-0.4	0.0
Overall balance (commitment basis, excl. grants) 3/	-11.8	-11.0	-5.8	-2.6	-1.6	-5.3	-6.3	-6.5
Change in arrears (cash payments = -)	-3.2	-1.2	-0.8	0.0	-0.3	-1.2	-1.3	-0.9
Overall balance (cash basis)	-1.9	-5.7	-1.3	-1.2	-0.5	-0.8	-1.7	-0.9
Financing	1.9	5.7	1.3	1.2	0.6	0.8	1.7	0.9
Domestic financing (net)	-0.6	-0.2	0.1	0.2	-0.3	-1.2	-0.4	-0.5
Bank financing	-0.6	-0.2	0.1	0.2	-0.2	-1.1	-0.4	-0.4
Central bank	-0.7	-0.9	0.4	0.2	0.1	-0.7	0.0	-0.3
Commercial banks	0.1	0.7	-0.3	0.0	-0.4	-0.4	-0.4	-0.2
Nonbank financing	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
External financing (net)	2.6	5.9	1.3	1.0	0.8	2.0	2.1	1.4
Disbursements	3.2	6.5	1.8	1.4	1.4	3.0	3.1	2.8
Amortization payments	-0.7	-0.6	-0.5	-0.5	-0.5	-1.0	-1.0	-1.4
Discrepancy	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Memorandum items:								
GDP 7/	174,617	186,447	200,578	228,098	220,440	228,098	220,440	242,370
Base fiscal balance 8/	-6.0	-4.2	-4.2	-1.1	-1.3	-2.4	-3.5	-2.3
Domestic revenue	22.7	24.9	24.7	11.2	10.8	24.4	23.2	24.2
Domestically financed expenditure	28.7	29.1	28.8	12.3	12.1	26.8	26.7	26.5

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

1/ Includes €7.5 million of ITS personal income taxes from the French military, as per leasing agreement.

2/ Annual leasing fees from French (€30 million) and United States (US$30 million) military bases, which include the payment of TIC on behalf of French soldiers. From Q3 2010, includes US$3 million from Japanese military base.

3/ In 2009, includes externally financed projects of public enterprises guaranteed by the government amounting to 3.7 percent of GDP.

4/ In 2010–12 includes the repayment of arrears to public enterprises accumulated in 2009.

5/ Includes €5 million (out of a total of €30 million) of foreign-financed current spending from French military as per leasing agreement. The budget classifies this amount as domestic investment spending.

6/ Excludes housing subsidies.

7/ 2010 GDP was revised compared to program.

8/ Defined as domestic revenue minus expenditure financed from domestic sources.

Table 4. Djibouti: Balance of Payments, 2008–12
(In millions of U.S. dollars, unless otherwise indicated)

	2008	2009	2010	2011		2012
	Act.	Act.	Prel. Act.	Prog	Prel. Est.	Prog.
Current account (including grants)	-239	-95	-66	-133	-145	-161
(In percent of GDP)	-24.3	-9.1	-5.8	-10.4	-11.7	-11.8
Credit	369	399	359	472	483	525
Exports of goods, f.o.b.	69	77	81	120	127	117
Exports of services	300	322	278	353	356	409
Of which: services to foreign military bases	166	180	187	218	216	224
maritime transportation	65	66	35	52	52	67
Debit	-704	-578	-509	-679	-713	-769
Imports of goods, f.o.b. 1/	-574	-451	-376	-520	-554	-597
Of which: investment goods	-284	-198	-75	-95	-94	-112
crude oil and petroleum products	-161	-86	-155	-161	-171	-185
drought-related	…	…	…	…	26	43
Imports of services	-130	-128	-134	-159	-159	-172
Net income from abroad 2/	93	81	84	71	70	59
Of which: income related to the lease of military bases	60	59	62	72	72	66
Net current transfers from abroad	3	3	0	3	15	23
Private (net)	-8	-8	-9	-9	-9	-9
Official (net)	11	11	9	12	24	32
drought-related	…	…	…	…	12	18
Capital and financial account 3/ 4/	314	131	106	121	124	157
Net capital transfers 1/	45	58	98	21	40	65
Foreign direct investment	234	100	27	92	72	92
Public sector (net)	118	30	2	41	42	48
Disbursements	133	49	21	68	70	83
Repayments	-15	-19	-20	-27	-27	-36
Of which: Eligible for Paris Club rescheduling	-60	-7	-5	-2	-2	0
Commercial banks (- = increase in NFA)	-82	-56	-21	-33	-30	-47
SDR allocation	0	21	0	0	0	0
Errors and omissions	-88	-47	-51	0	0	0
Overall balance (deficit -)	-13	9	9	-11	-21	-4
Financing	13	-9	-9	11	21	4
Central bank	-49	-27	-17	-13	0	-26
Assets	-43	-44	-13	-12	1	-24
Liabilities	-6	17	-4	-1	-1	-1
Of which: SDR allocation	…	-21	…	…	…	…
Exceptional financing	14	13	8	23	21	30
Budget support from donors (grants and loans)	0	0	0	10	10	10
Change in overdue obligations (decrease-)	-60	0	0	0	0	0
Expected debt relief	66	9	8	4	4	0
Paris Club	61	7	5	2	2	0
Non-Paris Club	5	3	3	2	2	0
IMF	8	4	0	9	7	20
ECF financing	6	2	0	9	7	20
of which ECF augmentation	…	…	…	…	0	15
Memorandum items:						
Central bank gross foreign assets 4/	173.7	217.5	230.6	242.1	229.7	254
In months of next year's imports of goods and services	3.6	5.1	3.9	3.8	3.6	3.7
Currency board cover	120.9	135.4	122.4	115.6	120.7	114.5
FDI in percent of GDP	23.8	9.5	2.4	7.2	5.8	6.7
Drought-related external assistance	…	…	…	…	19.0	25.6
Official external debt (including public and publicly guaranteed debt)						
In millions of U.S. dollars	591	627	634	680	678	729
In percent of GDP	60.2	59.8	56.1	53.0	54.6	53
In percent of exports of goods and services	160	157	176	144	140	139
Debt service						
In millions of U.S. dollars	26	25	24	34	35	53
In percent of GDP	2.6	2.4	2.1	2.6	2.8	3.9
In percent of exports of goods and services	6.9	6.3	6.6	7.2	7.2	10.1

Sources: Djibouti authorities; and Fund staff estimates and projections.
1/ Revised to reflect the acquisition of the presidential airplane in Q4 2010.
2/ Includes the French and U.S. contributions for the military bases and outflows of interest due on Paris and non-Paris Club debt.
3/ Excludes exceptional financing.
4/ In 2009, includes special and general allocation of SDR 14 million.

Table 5. Djibouti: Monetary Survey and Banking Sector Indicators, 2008–12

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

	2008	2009	2010	2011		2012
	Act.	Act.	Prel. Act.	CR/12/169	Prel. Est.	Prog.
Broad money	142,310	167,191	187,589	201,857	195,079	214,487
Currency in circulation	17,624	19,629	20,084	21,612	19,886	24,314
Deposits	124,686	147,562	167,505	180,245	175,194	190,172
Demand deposits	64,612	83,049	107,207	115,361	112,128	121,715
Djibouti francs	40,296	62,511	72,251	77,746	75,567	82,028
Foreign currency	24,316	20,538	34,956	37,615	36,560	39,686
Time deposits	60,074	64,513	60,298	64,884	63,066	68,458
Djibouti francs	38,238	23,497	18,657	20,076	19,513	21,182
Foreign currency	21,836	41,016	41,641	44,808	43,552	47,276
Net foreign assets	117,498	131,673	138,351	144,778	142,579	152,078
Central bank	27,093	35,182	38,149	34,893	33,089	34,162
Assets 1/	30,873	38,658	40,979	43,034	40,819	45,114
Liabilities 1/	3,780	7,372	6,726	8,141	7,730	10,952
Commercial banks	90,405	100,381	104,092	109,884	109,490	117,916
Assets	102,308	119,169	132,369	140,311	139,064	150,017
Liabilities	11,903	18,788	28,277	30,427	29,574	32,101
Net domestic assets	24,812	35,518	49,238	57,079	52,500	62,409
Claims on government (net)	3,236	2,908	3,161	561	2,382	1,343
Central bank	1,459	-135	706	-894	781	126
Commercial banks	1,777	3,043	2,455	1,455	1,601	1,217
Claims on nongovernment sector	44,730	57,342	69,058	77,294	72,297	79,513
Public enterprises	1,519	2,625	2,646	2,665	2,665	2,683
Private sector	43,211	54,717	66,412	74,629	69,633	76,829
Capital accounts	-9,786	-10,697	14,476	-11,912	15,179	16,747
Other items (net)	-13,368	-14,035	-11,187	-8,864	-11,912	-12,653
	Change from previous year; in percent of broad money					
Broad money	20.6	17.5	12.2	7.6	4.0	9.9
Currency in circulation	1.8	1.4	0.3	0.8	-0.1	2.3
Net foreign assets	18.7	10.0	4.0	3.4	2.3	4.9
Central bank	6.3	5.7	1.8	-1.7	-2.7	0.5
Commercial banks	12.3	7.0	2.2	3.1	2.9	4.3
Net domestic assets	1.9	7.5	8.2	4.2	1.7	5.1
Of which: Claims on government (net)	-0.8	-0.2	0.2	-2.2	-0.4	-0.5
Claims on nongovernment sector	7.7	8.9	7.0	4.4	1.7	3.7
Memorandum items:						
Monetary authorities						
Net international reserves (in U.S. dollars million) 1/	30.0	56.9	42.2	32.7	39.4	32.2
Gross foreign assets (in U.S. dollars million) 1/	173.7	217.5	230.6	242.1	229.7	253.8
In percent of foreign currency deposits	66.9	62.8	53.5	52.2	51.0	51.9
In percent of total deposits	24.8	26.2	24.5	23.9	23.3	23.7
Banking system						
Credit to the private sector, 12-month percent change	27.3	26.6	21.4	12.4	4.8	10.3
Money velocity	1.2	1.1	1.1	1.1	1.1	1.1

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

1/ In 2009, includes special and general allocation of SDR 14 million.

Table 6. Djibouti: Financial Soundness Indicators, 2000–10

(In percent, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Capital adequacy											
Tier I capital to risk-weighted assets	17.3	18.5	21.7	19.1	15.0	15.7	17.4	8.1	8.5	9.5	10.1
Regulatory capital to risk-weighted assets	2.3	2.6	2.5	2.7	2.1	2.0	4.2	3.7	3.5	3.2	3.6
Reported total capital to risk weighted assets (K1-1)	114.2	99.5	96.5	104.5	101.5	106.2	102.7	80.9	85.4	86.4	112.3
Asset quality 1/											
Nonperforming loans to gross loans	19.7	26.9	30.6	29.2	28.8	27.8	15.6	10.9	8.6	6.7	6.1
Nonperforming loans net of provisions to capital	49.6	50.4	59.0	60.5	67.0	73.7	23.5	20.8	17.2	14.9	17.4
Provisions to nonperforming loans	54.7	55.5	52.3	52.5	55.1	56.6	74.9	75.5	77.4	76.6	73.5
Banks exceeding maximum single borrower limit 2/	1	0	0	2	1	0	1	1	1	2	5
Earning and profitability											
Reported return on assets (ROA)	4.8	4.2	2.1	2.8	2.1	1.9	1.8	1.8	1.6	1.4	3.3
Reported return on equity (ROE) 3/	13.1	11.7	7.9	8.5	21.1	28.2	43.9	49.4	53.0	55.1	44.3
Interest margin to gross income	33.5	31.7	26.3	22.3	22.7	40.5	49.9	47.1	43.1	45.7	71.6
Noninterest expenditures to gross income	59.0	60.0	64.7	71.2	72.2	59.1	47.6	51.8	55.7	44.2	51.8
Salary expenditures to non-interest expenditures	60.9	62.9	61.8	60.7	54.0	56.6	56.4	50.4	41.4	53.8	45.2
Liquidity											
Liquid assets to total assets	47.5	58.5	64.9	70.5	74.3	76.6	75.4	72.1	65.7	67.5	64.0
Liquid assets to short-term liabilities	285.6	455.1	494.0	726.0	710.5	736.2	670.3	660.5	626.8	596.4	490.6
Liquid assets to demand and saving deposits	164.0	180.1	188.7	175.8	209.1	226.6	597.9	615.3	491.3	647.0	746.5
Liquid assets to total deposits	61.4	72.0	78.8	81.4	85.4	87.7	87.1	82.9	75.2	78.1	76.6

Source: Central Bank of Djibouti and Fund staff estimates.

1/ Nonperforming loans include three loan classifications: watch, doubtful, and loss. Revised from 2006 to exlcude old NPLs of a liquidated bank.
2/ Maximum single borrower limit is defined as 25 percent of capital (K3-1).
3/ Based on minimum capital.

Table 7. Djibouti : Reviews and Disbursements, 2008–12

Date	Action/Status	Disbursement	In percent of Quota /1
September 2008	Board Approval of ECF arrangement.	3.864 million SDR	24.00
June 2009	First review completed (June 2009) on end-December 2008 performance criteria.	1.476 million SDR	9.28
December 2010	Second and third reviews completed (January 2011) on end-June and end-December 2009 performance criteria.	2.952 million SDR	18.56
June 2011	Fourth review completed (July 2011) on end-December 2010 performance criteria.	1.476 million SDR	9.28
November 2011	Completion of the fifth review on end-June 2011 performance criteria.	6.246 million SDR 2/	39.28
May 2012	Completion of the sixth review on end-December 2011 performance criteria.	6.246 million SDR 2/	39.28
	Total	22.260 million SDR	140.00

Source: Fund staff estimates and projections.

1/ Djibouti's quota is SDR 15.9 million.
2/ Includes the ECF augmentation of SDR 9.54 million or 60 percent of quota.

Table 8. Djibouti: Indicators of Capacity to Repay the Fund, 2007–22

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Projections										
Fund obligations based on existing credit (in millions of SDRs)																
Principal	1.82	2.73	2.73	2.18	1.64	0.91	-	0.92	1.07	1.36	1.95	1.95	1.03	0.89	0.59	-
Charges and interest	0.09	0.08	0.06	0.01	-	0.01	0.01	0.03	0.03	0.02	0.02	0.02	0.01	0.01	0.01	0.01
Fund obligations based on existing and prospective credit (in millions of SDRs)																
Principal	1.82	2.73	2.73	2.18	1.64	0.91	-	0.92	1.07	1.36	3.20	4.45	3.53	3.38	3.09	1.25
Charges and interest	0.09	0.08	0.06	0.01	-	0.01	0.01	0.06	0.06	0.06	0.05	0.04	0.03	0.02	0.01	0.01
Total obligations based on existing and prospective credit																
In millions of SDRs	1.9	2.8	2.8	2.2	1.6	0.9	0.0	1.0	1.1	1.4	3.3	4.5	3.6	3.40	3.10	1.26
In billions of DF	0.5	0.8	0.8	0.6	0.5	0.3	0.0	0.3	0.3	0.4	0.9	1.3	1.0	1.0	0.9	0.4
In percent of government revenue	1.0	1.1	1.1	0.8	0.6	0.3	0.0	0.3	0.3	0.3	0.8	1.0	0.7	0.7	0.6	0.2
In percent of exports of goods and services	0.9	1.2	1.1	0.9	0.5	0.3	0.0	0.3	0.3	0.3	0.7	0.8	0.6	0.5	0.4	0.2
In percent of debt service 1/	10.4	13.8	12.3	10.5	6.7	2.9	0.0	3.0	3.6	4.6	7.9	11.8	9.7	9.6	9.1	3.8
In percent of GDP	0.3	0.5	0.4	0.3	0.2	0.1	0.0	0.1	0.1	0.1	0.3	0.3	0.2	0.2	0.2	0.1
In percent of quota	12.0	17.6	17.5	13.8	10.3	5.8	0.1	6.2	7.1	8.9	20.4	28.2	22.4	21.38	19.50	7.92
Outstanding Fund credit																
In millions of SDRs	10.18	11.32	10.07	7.88	10.68	22.26	22.26	21.34	20.27	18.91	15.71	11.25	7.72	4.34	1.25	0.00
In billions of DF	2.77	3.18	2.76	2.14	3.02	6.30	6.29	6.02	5.70	5.31	4.41	3.16	2.17	1.22	0.35	0.00
In percent of government revenue	5.22	4.35	4.00	3.01	3.90	7.31	6.77	5.98	5.22	4.48	3.65	2.49	1.60	0.84	0.23	0.00
In percent of exports of goods and services	4.85	4.85	3.89	3.35	3.51	6.75	6.13	5.49	4.89	4.11	3.15	2.09	1.32	0.67	0.18	0.00
In percent of debt service 1/	55.23	55.55	44.55	37.89	43.80	71.20	71.19	64.48	63.72	60.84	…	…	…	…	…	…
In percent of GDP	1.84	1.82	1.48	1.07	1.37	2.60	2.41	2.14	1.87	1.60	1.23	0.84	0.54	0.28	0.08	0.00
In percent of quota	64.01	71.16	63.30	49.59	67.17	140.00	140.00	134.21	127.48	118.93	98.81	70.75	48.55	27.30	7.86	0.00
Net use of Fund credit (millions of SDRs)	-1.82	1.14	-1.25	0.77	1.31	13.06	0.00	-0.92	-1.07	-1.36	-3.20	-4.45	-3.53	-3.38	-3.09	-1.25
Disbursements	0.00	3.86	1.48	2.95	2.95	13.97	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-	-	-
Repayments and Repurchases	1.82	2.73	2.73	2.18	1.64	0.91	0.00	0.92	1.07	1.36	3.20	4.45	3.53	3.38	3.09	1.25
Memorandum items:																
Nominal GDP (in billions of DF)	151	175	186	201	220	242	261	282	305	331	359	376	404	432	462	495
Exports of goods and services (in billions of DF)	57	66	71	64	86	93	103	110	117	129	140	151	164	181	199	220
Government revenue (in billions of DF)	53	73	69	71	77	86	93	101	109	118	121	127	136	145	155	166
Debt service (in billions of DF) 1/	5	6	6	6	7	9	9	9	9	9	12	11	10	10	10	9
DF/SDR (period average)	272	281	274	271	282	283	282	282	281	281	281	281	281	281	281	281

Source: Fund staff estimates and projections.

1/ Total debt service includes IMF repurchases and repayments.

Appendix I.
Letter of Intent
Memorandum of Economic and Financial Policies

Djibouti, January 25, 2012

Madame Christine Lagarde
Managing Director
International Monetary Fund
Washington D.C. 20431

Madame Managing Director,

1. This Letter of Intent is to inform you of the progress made by Djibouti in 2011 in the context of the Extended Credit Facility (ECF) arrangement. It also sets out the government's intentions in the area of economic policy and the reforms envisaged for 2012.

2. The objectives of the ECF-supported program approved in 2008 remain unchanged. These objectives are consistent with our determination to make Djibouti a hub of trade, financial services, and logistics and related services. The ECF-supported program will remain aligned with the National Social Development Initiative (INDS), which is a reflection of our national economic development and poverty reduction strategy.

3. Program implementation suffered significant disruption starting in the second quarter of 2011 owing to the exceptional drought conditions. More than 12 million people (11 percent of the population) in the Horn of Africa have been affected by one of the worst droughts in 60 years, resulting in the loss of harvests and cattle. Djibouti is one of the most affected countries, along with Ethiopia, Kenya, and Somalia. The current drought, the fourth consecutive year without rainfall, has severely affected some 120,000 people in rural areas, that is, 50 percent of the rural population, and 15 percent of the total population, and around 20,000 refugees, while herds have been drastically reduced. Further, the drought has exacerbated a structurally critical food security situation, with 14.5 percent of the urban population (Djibouti city and the five regional capitals) living in food insecurity, and with more than 12,000 children under five years old suffering from malnutrition across the country, according to the most recent national nutrition survey of March 2011. Based on available data, around 33 percent of Djiboutians live in high-risk areas, and 35.3 percent of the economy is vulnerable to natural risks.

4. Against this backdrop, we launched an appeal for emergency aid to our partners. In response to the appeal, various partners have committed to providing us with aid amounting

to a total of US$ 47 million, based on confirmed amounts at end-October 2011. We have therefore set up an interministerial drought crisis committee chaired by the Minister of the Interior, assisted by the Ministry of Finance and the solidarity secretariat in coordination with donors, including the IMF. In line with these commitments, since July 2011 there have already been partial payments made and the remainder is expected to be received over the next two years, with the highest concentration of disbursements in 2012. Most of this aid is expected to take the form of in-kind donations channeled mainly through the World Food Program.

5. The adverse effects of the drought occur in addition to the strong surge in international prices of petroleum products and, more particularly, foodstuffs, from which the population was already reeling. To meet the additional balance-of-payments financing needs in 2011–12 resulting from the drought and the hike in import prices, we are seeking an augmentation of access to ECF resources of 60 percent of quota (SDR 9.54 million), to be disbursed in two tranches upon approval of the fifth and sixth reviews.

6. The program remains on track, despite temporary deviations from the end-June 2011 targets (Table 1). Notwithstanding strict expenditure control in the first half of 2011, fiscal performance suffered from weak collection of tax and nontax revenues. Collection of direct and indirect taxes slowed due to the election period, the installation of the new government and the reorganization of the revenue administration, but also because of the indirect impact of the drought on households, through transfers to family members often residing in neighboring countries, notably Somalia, and the contribution of private operators to solidarity efforts. In addition, owing to the steep spike in international prices, we incurred losses on diesel excises so as to offset the impact of higher oil prices on the most vulnerable segments of the population.

7. This mixed performance resulted in the nonobservance of the performance criteria on the fiscal balance and on net banking system credit to the government. Furthermore, as a result of the tight cash flow situation, the continuous performance criterion on the non-accumulation of external arrears was not observed in the second semester and the continuous performance criterion on the accumulation of new domestic arrears (related to delays in the payment of salaries and pensions) was not observed in the third quarter. The other performance criteria and quantitative indicative targets for end-June 2011 were observed with the exception of social spending, which was slightly below the target. Further, we did not contract any non-concessional debt either in 2010 or over the course of 2011.

8. Most of the structural benchmarks for 2011 have now been met (Table 2), with the exception of: (i) regular production and publication of the TOFE on the website of the Ministry of Finance (*continuous structural benchmark*) up to August 2011, because of repeated delays in the preparation of the fiscal data; (ii) adoption by Cabinet of a new customs code by end-March 2011 (*structural benchmark for end-March 2011*), which was

completed in June; (iii) adoption of an official timetable of quarterly meetings by the Board of Directors of the Central Bank of Djibouti (CBD) (*structural benchmark for end-June 2011*), which was completed in September; (iv) the conclusion of cross debt agreements, which were finalized in September with the national electricity company (EDD) and Djibouti Telecom, and in November with the national water and sanitation office (ONEAD); (v) the acquisition of software to introduce the budget classification (*structural benchmark for end-December 2011)*, for which however financing has been committed by the African Development Bank; and (vi) the publication of the 2010 audited financial statements of the CBD, including the audit opinion and the disclosure notes (*structural benchmark for end-December 2011*; while the 2010 accounts have been posted on the CBD website, the full audit report will be posted soon).

9. To achieve the objectives of the ECF arrangement, our program for 2011 remains focused on: (i) the pursuit of prudent, coherent fiscal policy, with the safeguarding of social expenditure; (ii) the strengthening of fiscal management; (iii) the maintenance of debt sustainability; (iv) the modernization of the financial sector; and (v) the enhancement of the competitiveness of the economy through the deepening of structural reforms.

I. Economic Developments and Outlook in 2011 and 2012

10. Djibouti's economy is expected to have grown by 4.4 percent in 2011, compared to 3.5 percent the year before, boosted by the resumption of transshipment activity, the stabilization of the situation in Ethiopia and deepening of the services sector, particularly banking and telecommunications (mobile telephony and Internet). In 2011, inflation is estimated to have risen to 5.3 percent, pushed up by the substantial rise in world food and fuel prices. Competitiveness, measured by the effective exchange rate, worsened from 2008 to 2010 as a result of the appreciation of the Djibouti franc against the euro, but the trend was reversed in 2011 because of the positive differential between domestic inflation and inflation rates in Djibouti's main trading partner, Ethiopia.

11. According to our estimations, the current account deficit should have reached 11.7 percent of GDP in 2011, up from 5.8 percent of GDP in 2010, driven by the increase in imports stemming from the impact of the drought and by the surge in food and fuel prices on the world market. International reserves stood at US$231 million at end-2010, but have recently been under strain from higher imports, weak fiscal performance, and a less vigorous than expected resumption of FDI. Reserves are estimated to have remained broadly stable at end-2011, guaranteeing adequate currency board and import coverage. The stock of external debt continued to decline, from 56 percent of GDP at end-2010 to an estimated 55 percent at end-2011.

12. Growth is expected to rise to 4.7 percent in 2012, owing mainly to the speeding up of activity at the port and in the services sector. However, as in 2011, FDI will remain subdued reflecting the dampening effect of the global economic and financial crisis.

Inflation should stabilize at 5 percent in line with the world food price cycle, which we foresee will finally begin to weaken. The current account deficit is set to stabilize at a high level of 11.8 percent of GDP. Despite the modest upturn in exports of goods and services, imports will continue the upward trend we saw in 2011 as a result of the knock-on effects of the drought and the rise in FDI flows.

II. Government Finance

A. Fiscal policy

13. Our fiscal policy remains focused on three key areas, namely: fiscal consolidation to maintain debt sustainability and non-monetary financing of fiscal deficits; the safeguarding of fiscal space for social expenditure; and the strengthening and modernization of fiscal management.

Fiscal policy in 2011

14. In light of spending pressures, we have revised our fiscal balance target for 2011 and expect to close with a deficit of 0.4 percent of GDP for the year. This target should allow catching up with the delays in domestic arrears payments that had already been programmed for 2010. We also focused on making up for the delays in direct and indirect tax revenue collection in the last quarter of 2011 by taking several urgent measures described below. In respect of expenditure, we maintained the freeze on public hiring and wages. New public-sector employment programs will be handled through staff redeployment. Expenditure on goods and services included the settlement, already executed, of domestic arrears accumulated to EDD and ONEAD in 2009. Social and capital expenditure was planned to increase in line with the poverty reduction targets within the INDS framework. However, achieving the deficit target of 0.4 percent of GDP required deferring capital expenditure of an amount equal to around 1 percent of GDP. In 2011, we have not engaged in any extrabudgetary spending, and we commit to not engaging in any such spending in the future.

15. Financing will be provided mainly from external resources, and this will enable the authorities to replenish their deposits with the domestic banking system, in particular the CBD, which dropped significantly in early 2011.

Subsidy policy

16. We relied on a fuel and food price subsidy policy to mitigate the effects of the rise in commodity prices on the most vulnerable population groups. In the energy sector, starting in January 2011, we stabilized the price of diesel by reducing excises, translating into forgone tax revenues of around DF 2,800 million vis-a-vis the budget law. Mindful that, given its budgetary constraints, the government cannot afford to continue absorbing a loss of this magnitude, we plan to undertake a study (with the assistance of the IMF) on the introduction of social protection for vulnerable sectors (such as public transportation, taxis, and

bakeries), while gradually increasing the diesel price at the pump in line with the targeted level of tax revenues included in the price structure of each product. With that in mind, we have already increased the diesel price at the pump by DF 3 in October and by an additional total of DF 8 in November and December (*prior action*) despite a fall in FOB prices. In the event that the social constraints facing the country make it impossible to increase the price of diesel sufficiently to meet the target for petroleum tax revenues of DF 800 million in 2012, we undertake to delay domestically-financed investments for an amount equivalent to the shortfall. We have also fixed the price of kerosene at an affordable level for the most vulnerable segments of the population through a subsidy of around DF 60 million for 2011.

17. Cereal production (of around 8,000 metric tons in 2010 and 9,000 metric tons in 2011) grown in Ethiopia and Sudan and managed by the Djiboutian food security company, is sold on the local market at subsidized prices, with a view to stabilizing local food prices, at a budgetary cost of around DF 103 million. In the interest of increased transparency of the subsidies, we plan to prepare a summary balance sheet of the food security program for FY 2010 by end 2011. We will also regularly disclose the operating accounts of the food security company.

2012 Budget law

18. In December, Cabinet has approved the 2012 budget law in accordance with the conclusions of our discussions. The main thrusts of the budget law remain consistent with the objectives of the INDS, especially the continuation of the programs undertaken in the context of the Millennium Development Goals despite a more somber international environment. With regard to revenues, we intend to maintain the tax revenue to GDP ratio constant at the 2011 level, thanks to reforms of the VAT and exemptions as well as to our tax collection efforts. On the expenditure side, we will seek to raise our capital expenditure in sectors with growth potential, while pursuing the fiscal restraint imposed by the constraints on the revenue side. In that context, we will maintain the hiring freeze in the public service, with the exception of the social sectors, i.e., education and health. We are also committed to maintaining the freeze of wages in the public sector, but we plan to increase the lowest level of the public sector salary scale to fight poverty by catching up with the cumulated loss of purchasing power of the lowest paid public sector employees.

19. One of the major challenges facing us is unemployment, which affects a significant share of our active population, and in particular, young people. With a view to achieving greater alignment between training and employers’ needs, on taking office the new government reorganized the institutional framework, specifically by bringing vocational training under the umbrella of the National Education Ministry. We have also opened a logistics training center to promote training in the skills needed in high-technology sectors like the port, transport, and energy. To facilitate the employment of young graduates outside the civil service, we have established a youth employment promotion fund and, through the national budget, we are financing a loan initiative for business creation. Already seven start-

up projects have been approved and have effectively begun doing business. Further, we have put in place a guarantee fund for loans granted within that framework.

B. Fiscal Reforms

20. In 2011 and 2012, we intend to push forward with fiscal reform measures with the objective of building capacity for tax collection, particularly in view of the gaps recorded in the first two quarters, expenditure control, and fiscal planning and management. Indeed, to deal urgently with the issue of weak fiscal revenues, we have decided to implement the following urgent measures: (i) strengthening of controls by the revenue collection agencies, particularly off-site inspections (for customs and taxes) and sampling, which we plan to continue in 2012, particularly with regard to imports subject to tax exemptions (investment code); (ii) publication of the list of property owners in default of property taxes with, in the case of persistent nonpayment, the possibility of seizure and sale of the property; (iii) issuance of reminders to and application of enforcement measures against companies in payment default: (iv) issuance of regular reminders to taxpayers, seizure of accounts in persistent default ; (v) stepped-up tax audits of companies operating locally, particularly, those that obtained contracts in the context of tax-exempt projects or with foreign military bases; and (vi) recovery of tax claims outstanding from previous years as well as amounts due for the current year from public entities. Lastly, for FY 2012, a commission has been established to initiate and recommend new tax measures to strengthen the level of fiscal revenues and simplify the business environment (facilitation of procedures for setting up a business and simplifying the process of formalization of informal activities).

Direct and indirect taxes

21. In the context of the existing program commitments, in June we adopted the customs code, which was modernized to make it consistent with that of the Common Market for Eastern and Southern Africa (COMESA) (*structural benchmark for end-March 2011*). We have included in the 2012 budget the lowering of the VAT threshold from DF 80 million to DF 50 million (*structural benchmark for end-December 2011*), for which an awareness-building campaign for operators has been launched, and we have already strengthened the VAT unit with competent human resources (*structural benchmark for end-December 2011*). We have introduced the ASYCUDA software for managing customs revenue on all external trade transactions (*structural benchmark for end-December 2011*). We also intend to (i) strengthen coordination between the entities responsible for managing the VAT and direct taxes, based on the extension, already in effect, of the single taxpayer identification number (NIF) to enterprises subject to the declaration of direct taxes and to other taxpayers; and (ii) strengthen the functionality of the tax center opened in 2011 in the commune of Balbala consistent with the proximity policy of equipping each major region of the country with similar centers (the two regional treasuries of Ali Sabieh and Tadjourah will soon be operational) in the context of decentralization. The ASYCUDA system will incorporate the NIF through an interface with the tax directorate, thus improving taxpayer identification.

22. In respect of exemptions, we intend to: (i) resume the work of the commission, including the tax and customs services and the National Investment Promotion Agency (ANPI), tasked with reviewing the conditions for the granting of exemptions for new investments, without, however, modifying the incentives already granted, and producing a list of beneficiaries; (ii) introduce a requirement for all enterprises granted exemptions to file tax returns or face nonrenewal of their exemptions in case of noncompliance (an information campaign has been launched in the press intended for the enterprises concerned), assign the required personnel to estimate the tax expenditure of the government, and draft a report on tax expenditure, which will be annexed to the 2012 supplementary budget. We intend to publish the list of enterprises whose tax-exempt status has been revoked for failure to file their tax returns *(structural benchmark for end-March 2012)*; and (iii) not renew the exemptions of enterprises that fail to comply with the provisions of the code.

Expenditure control and public financial management

23. Given the fiscal slippages at end-2009, we have strengthened expenditure control and public financial management. On the expenditure control side, we have (i) in 2010, improved coordination among the principal structures of the Ministry of Finance by creating a sub-directorate responsible for auditing and monitoring the accounts of public institutions within the Treasury Directorate and a central accounting agency for hospital facilities, and we also enhanced the status of government accounting staff at public institutions; (ii) implemented preventive expenditure control measures such as sustained surprise audits at five ministries in 2011 to update and monitor the single register of civil servants and the physical inventory of government assets. As regards financial management and transparency, we (i) prepared, on a commitment basis, bi-monthly cash programming exercises, expanded to include the Ministries of Education and Health, except for a brief period during the summer; (ii) recently restructured the Treasury Directorate by creating a separate government accounting directorate to improve transparency in the execution of treasury operations; (iii) replaced most of the government accounting staff in the ministries and public enterprises to ensure greater transparency and rigor in the management of public assets; and (iv) annexed the budgets of the Water Fund and Youth Fund to the 2011 budget law.

24. In 2011 and 2012, we plan to continue these efforts by pursuing: (i) a policy of transferring the balances of government accounts and of donor-financed project accounts to the single treasury account; (ii) the preparations for the establishment of a medium-term budget framework (MTBF) for the 2013 budget law by recruiting qualified staff for the Budget Directorate (*structural benchmark for end-June 2011)* and amending, if necessary, the organic and budget laws for the 2013 budget, with support from our partners, in particular the IMF and UNDP; (iii) publication of the monthly fiscal reporting table (TOFE) on the Ministry of Finance website within a maximum of two months (*continuous structural benchmark*); and (iv) efforts to apply the new budget classification, to be introduced in the

context of the 2013 budget, with the help of adequate software, for which financing has been committed by the African Development Bank and which we expect to acquire by June 2012 (*structural benchmark for end-December 2011)*.

Arrears and cross debt

25. We remain determined to reduce the stock of domestic arrears, including those accumulated in 1995–2001, with possible assistance from donors, and to prevent further accumulation. We undertake to: (i) strengthen controls on the public expenditure chain so as not to accumulate further arrears, with the exception of arrears attributable to the one-month lag in the payment of civil servants' wages and the three-month lag in pension fund contributions, which we intend to reduce as resource availability allows; (ii) monitor, on a regular basis, the situation regarding domestic arrears and execution of payments to public utilities (which will be reported to IMF staff on a quarterly basis) in the context of the bi-monthly cash programming exercises; and (iii) continue to exercise prudence in our budget appropriations for current expenditure and social spending, and in external financing for which agreements have not yet been signed.

26. In November 2011, slightly behind the initially programmed schedule, we prepared a summary table on the situation of cross debts among public enterprises and pursued the attendant debt consolidation process with the public enterprises concerned by signing all of the relevant agreements (*structural benchmark for end-September 2011*). We intend to repay over the 2011–2012 period the outstanding payments arrears accumulated in the course of 2009, by drawing on specific budget line items under expenditure on goods and services.

III. External Debt

27. Progress in relations with the Paris Club creditors facilitated the conclusion of bilateral agreements and the entry into force of the second phase of the agreement concluded in October 2008. In accordance with the clause on comparability of treatment under the Paris Club agreement, we have signed bilateral agreements with Saudi Arabia and have contacted the United Arab Emirates and Kuwait to begin negotiations with a view to obtaining treatment comparable to the Paris Club agreement.

28. However, given the strained cash-flow situation in the first half of the year, other external arrears have been accumulated since May 2011, by the government and some public enterprises (EDD and Société Immobilière) vis-à-vis multilateral and bilateral creditors, including Paris Club creditors. These arrears were settled in the course of October, November, and December 2011. We undertake to avoid any future accumulation of external arrears, including those arising from public enterprises, and, to that effect, we intend to strengthen the monitoring of debt service payments, in particular through systematic verification with creditors of the actual execution of such payments, and we will also ensure regular transmission of the monthly debt service reports to the IMF.

29. To preserve debt sustainability, we will continue to contract only concessional loans and prioritize projects to be funded under the INDS. Consequently, under the auspices of the Ministry of Finance, we also plan to improve coordination among the various ministerial departments in the context of the government's financing programs as well as the related policies and actions. We also plan to extend to public enterprises the requirement to refrain from contracting nonconcessional debt, while retaining the option to exclude those enterprises whose operations are managed on a purely commercial basis.

IV. MONETARY AND FINANCIAL POLICIES

30. Our monetary policy continues to be underpinned by the currency board arrangement, which meets the needs of our economy by ensuring price stability. We undertake to continue covering all our foreign currency-denominated liabilities and maintaining a rate of coverage higher than 105 percent of reserve money and government deposits with the CBD. Our external position is bolstered by the absence of encumbrances on our foreign currency reserves, and we are committed to pursuing this prudent policy.

31. Growth of credit and deposits has been high in recent years, fuelled by the arrival of new banks and a sustained demand for credit to the private sector. However, the trend was reversed in the first quarter of 2011 as a result of a reduction in current account overdrafts, which account for 57 percent of loans to the private sector. The reversal derived in part from uncertainty owing to the election period, and from the situation of one bank which was in the process of changing ownership. While credit to the private sector recovered in the second quarter of 2011, deposits continued their decline. Despite strong growth in the banking sector over the past few years, the financial sector remains healthy, with a relatively low level of nonperforming loans and disputed loans, most of which are historical loans. The banking sector has seen a marked expansion in financial products and internet banking activity.

A. Banking Supervision

32. Mindful that banking system growth increases the pressure on bank supervision and regulation, we are implementing our reform program in accordance with the broad guidelines of the Financial System Assessment Program. We have started strengthening supervision by reorganizing the supervisory structure and setting up a dedicated supervision unit, as recommended by the technical assistance missions of the IMF's Monetary and Capital Markets Department and the Banque de France (*structural benchmark for end-June 2011*). We have also recruited two officers (*structural benchmark for end-June 2011),* in addition to the senior official already hired for the unit, and have begun training staff in the core skills for effective off-site and on-site supervision. We also conducted the on-site inspection of five banks and one microfinance institution in 2011 and plan to inspect another bank before the end of the year, and to pursue continuous off-site supervision of banks. We

are currently in the process of revising the charter of foreign exchange bureaus to make it compliant with the new banking law.

33. To address the challenges posed by the implementation of various banking sector laws approved in the first half of 2011, we have developed a road map with a precise timetable for bringing these laws into effect (*structural benchmark for end-September 2011*). In this regard, preparation of the enabling texts of the banking law and supervision instruments has been completed and the new instructions were adopted in December 2011.

34. As regards strengthening the banking system regulations, the National Assembly adopted the laws on Islamic finance and financial cooperatives in January 2011. Further, all banks now submit monthly financial statements, allowing for the identification of risks such as those related to credit, liquidity, and exchange operations, as well as their internal audit reports. These data provided regularly by the banks will enable us to compile bi-annual financial stability indicators. We have also tightened the imposition of penalties on banks that fail to meet the requirement for regular disclosure of their financial statements. We have improved regulation of the banking system. In January 2011, the National Assembly adopted the banking law, which provides for an increase in the required minimum capital, which will be tripled to DF 1 billion over a period of up to three years. Moreover, in view of the current banking environment, we have decided to strengthen the conditions for granting new licenses through strict application of the laws recently entered into force. Further, we are preparing for the upcoming introduction of reserve requirements, which will be an important new tool for liquidity management by the CBD. Similarly, in November we introduced a foreign currency cash flow forecasting tool to facilitate efficient monitoring of changes in the Bank's foreign exchange reserves.

B. Financial Sector Development

35. We intend to pursue our efforts to develop the financial sector and access to finance. With the help of our development partners (World Bank, African Development Bank, Islamic Development Bank, and UNDP), we will continue to work to (i) improve access to microfinance for individuals and small and medium-sized enterprises (SMEs) by setting up a dedicated unit at the CBD; (ii) improve the management of existing structures, such as the central credit register, and lay the groundwork for transitioning to a credit bureau; (iii) facilitate mobile banking transactions; and (iv) strengthen the payment system. The provisions of the banking law will be implemented with technical assistance from the IMF.

C. Governance of the CBD

36. To ensure the integrity of CBD operations, we have been implementing the recommendations of the safeguards assessment mission, and hosted another such mission during the month of November in the context of augmentation of access under the ECF. Starting with the 2011 financial year, financial reports will be completed within six months from the end of the exercise, as will the audit opinion. Additionally, the publication of the

full set of financial statements for 2010 on the website of the CBD, including the audit opinion and disclosure notes, is in progress and will soon be completed (*structural benchmark for end-December 2011*). We have strengthened the internal control by updating the procedures in force. In September 2011, the Board of Directors adopted an official timetable of quarterly Board meetings pursuant to our commitments, and expanded the prerogatives of the Board of Directors of the CBD (*structural benchmark for end-June 2011*). With regard to the latter, the Board decided to consider creating an audit committee in the near future to provide oversight, and an audit charter is under preparation.

D. Combating money laundering and financing of terrorism

37. We are currently remedying the weaknesses in the area of combating money laundering and financing of terrorism. In May 2011, the National Assembly adopted an amendment of the law on combating money laundering and two separate draft laws on the prevention of terrorism and the financing of terrorism, respectively, submitted by the CBD in collaboration with the Ministry of Justice. The CBD is currently considering long-term technical assistance in this area, to be financed by donors.

V. COMPETITIVENESS AND STRUCTURAL REFORMS

38. As a result of the currency board arrangement, Djibouti's attractiveness for investment depends crucially on the competitiveness of the economy, which is still hampered by the high costs of the principal factors of production and weaknesses of the business climate. Accordingly, we are strongly committed to pursuing our program of structural reforms, which are aimed especially at reducing energy and water costs, restructuring public enterprises, and improving the legal and regulatory framework.

39. We have made considerable progress on structural reforms, notably with regard to the Investment and Commercial codes and the law on industrial property. The Labor Code is now being enforced, including the collective bargaining arrangements for the various industries and enterprises. The final components of the new Commercial Code, namely the company and bankruptcy laws, were finalized at end-2010. The Commercial Code has been adopted in full by the National Assembly in October 2011.

40. We are pursuing the reforms in the energy and water sectors. Interconnection with Ethiopia's electricity grid is now completed and, on average, covers over 50 percent of current consumption in Djibouti at very favorable negotiated rates, which should enable Djibouti to reduce its energy costs. We will update the energy master plan with donors. With the support of the World Bank, a study, aimed at assessing the various options for developing thermal energy potential, was launched in November 2011. We continue to implement the recommendations validated by the final study on the restructuring and adjustment of human resources for the EDD carried out by IDEA Consulting. Lastly, in the water sector, ONEAD is considering a sizeable seawater desalination investment program to be financed by donors, with significant support from the European Union.

VI. Data

41. The still-low quality of our statistical database continues to hamper our efforts to formulate and monitor economic policies. With the support of our development partners, we are seeking to improve the quality, coverage, and timeliness of economic data, especially in the areas of national accounting, the balance of payments, and government finance. In June 2011, the National Assembly approved the legal framework by ratifying the draft law on the organization of statistical activity and the structure of the National Statistics System. As regards the statistical base, in 2009 we completed the general population census. With support from our development partners, we expect that the survey of economic activities, of which the data are to be included in the estimation of the national accounts, will be completed in 2012. A harmonized consumer price index is being finalized within COMESA and will be applied as of January 2012, following the household consumption-budget survey set to begin in January 2012.

VII. Program Monitoring

42. Due to the delay in concluding program discussions, we will no longer be able to request a modification of the end-December 2011 quantitative performance criteria on the fiscal balance and net credit to the government (related to the sixth review) to reflect changes in the macroeconomic scenario. Therefore, the existing end-December performance criteria remain in place (Table 1 and Technical Memorandum of Understanding below), even though, consistently with the understanding with Fund staff, we expect that fiscal policies will be also considered in relation to the revised fiscal objective of a deficit of 0.4 percent of GDP in 2011. Some of the program reforms will be the subject of structural benchmarks (Tables 2 and 3 below). To compensate for the losses in fuel revenues, the diesel prices have been increased at the pump in October, November, and December (*prior action*). In light of the reorganization of the Ministry of Finance with an expanded scope of activities, and to ensure better coordination of the actions required for implementation of the ECF-supported program, we will establish, under the supervision of the Secretary General, a macroeconomic unit that will take on the functions of the committee responsible for monitoring the program and will be entrusted with macroeconomic analysis. The unit will be tasked with continuing the preparation of the promised documents within the agreed timeframes, monitoring of the targeted program variables, and preparing a reference macroeconomic framework for the Ministry of Finance (*prior action*). For the latter task, each directorate shall designate a contact person who will be responsible for preparing and communicating data on actual and projected revenues and expenditures.

VIII. Conclusion

43. In light of the overall performance of the program and based on the policies set forth in this letter, we request waivers for the nonobservance of the criteria at end-June 2011 relating to net banking system credit to the government, the fiscal balance, and the

continuous criteria on the non-accumulation of new external arrears and on the accumulation of new domestic arrears. On that basis, we request the conclusion of the fifth review of the ECF arrangement, with the disbursement of an amount of SDR 1.476 million and the first tranche of the augmentation of access under the ECF, for the amount of SDR 4.77 million, the augmentation of access of SDR 9.54 million, and the rephasing of disbursements.

44. The government believes that the policies and measures stated in this letter are sufficient to achieve the objectives of the ECF arrangement. We shall quickly take all the additional measures necessary for achievement of the program objectives. We shall consult with IMF staff at our own initiative or that of the IMF staff before adopting such measures or changes to the policies specified in the attached MEFP. We shall provide the IMF with any information it may request regarding progress made in implementation, within the framework of its economic and financial development policies and the achievement of the objectives of the program.

Yours sincerely,

/s/	/s/
Ilyas Moussa Dawaleh	Djama M. Haïd
Minister of the Economy, Finance,	Governor
Responsible for Industry and Planning	Central Bank of Djibouti

Table 1. Djibouti: Quantitative Performance Criteria and Indicative Target, 2011–12 1/

(In millions of Djibouti francs; unless otherwise indicated)

(Cumulative flows)

	2011									2012
	Mar. 31			Jun. 30			Sept. 30		Dec. 31	Mar. 31
	Indicative Targets			Performance Criteria			Indicative Target		PC	IT
	Prog.	Adj. Prog.	Prel. Act.	Prog.	Adj. Prog.	Prel. Act.	Prog.	Prel. Act.	Prog.	
Performance criteria										
I. Ceiling on accumulation of new domestic arrears 2/ 3/	2,079		2,340	2,260		2,629	2,135	…	2,279	2,279
II. Ceiling on accumulation of new external arrears 3/ 4/	0		0	0		176	0	430	0	0
III. Ceiling on net credit to government from the banking system	-3,459	-2,448	-937	488	-1,817	-549	-2,015	…	-2,600	-1,845
IV. Floor on government budget balance (ordonnancement)	1,255	944	-119	-2,628	-99	-378	-1,903	…	883	6
V. Ceiling on new medium- and long-term nonconcessional loans contracted or guaranteed by the government and by the CBD 3/	0		0	0		0	0	0	0	0
VI. Floor on currency board cover 3/ 5/	105		115	105		116	105	147	105	105
Indicative target										
I. Floor on social spending	2,232		3,296	6,541		5,570	10,024	8,210	14,451	…
Memorandum items 1/ :										
Adjuster #1 Projected French, U.S., and Japan military base payments	4,646		3,657	4,024		6,373	7,154	7,154	12,736	5,954
Adjuster #2 External budgetary grants and loans	255		210	504		416	2,548	771	3,228	868
Adjuster #3 Externally financed public investment loans (PIP)	2,111		1,411	3,228		3,004	4,466	5,043	6,815	1,384

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

1/ See the Technical Memorandum of Understanding (EBS/10/235) for definitions and adjustor calculations.

2/ Arrears on the wage bill and to private suppliers, public enterprises, and pension funds.

3/ To be impemented on a continuous basis.

4/ Includes arrears on direct and guaranteed debt, continuous.

5/ Gross foreign assets of the BCD in percent of monetary liabilities (reserve money plus government deposits at BCD).

Table 2. Djibouti: Structural Benchmarks Under the Extended Credit Facility (ECF)

Measures	Date	Motivation	Status
Prior actions			
1. Increase the diesel price at the pump	5 days before the Board meeting	Strengthening of tax revenue	Met. Diesel price at the pump increased by 8 DF.
2. Create a macroeconomic unit in charge of program coordination at the Ministry of Finance	5 days before the Board meeting	Strengthening of program monitoring	
Structural benchmarks			
Budget and revenue management			
1. Strengthening of budget transparency with the monthly publication of the TOFE on the Ministry of Finance website with a maximum lag of two months	Continuous	Fiscal transparency	Not met. The data for December through August 2011 were published with a delay.
2. Adoption by the Cabinet of a customs code consistent with the COMESA zone code	March 2011	Regional trade integration	Not met. The bill was adopted in June 2011.
3. Recruitment of qualified staff in the Budget Department for the preparation of the MTBF.	June 2011	PFM-Budget Process	Met. One jurist and three economists were recruited in June 2011 and started work in July 2011.
4. Sign cross-debt agreements with EDD, ONEAD, Djibouti Telecom	September 2011	Financial management	Not met. The agreements were finalized with EDD and Djibouti Telecom in September, and with ONEAD in November.
5. Acquisition of the software for the introduction of the new budget classification.	December 2011	PFM-Budget Process	Not met. The AfDB has agreed to fund the acquisition of the software. The authorities have started consultations with countries in North Africa for the acquisition of the software.
6. Inclusion in the 2012 budget of the lowering of the VAT basis from 80 to 50 million FD	December 2011	Strengthening of tax revenue	Met. The lowering of the VAT basis was included in the 2012 budget.
7. Increase of human resources in the unit in charge of VAT	December 2011	Strengthening of tax revenue	Met. The required staff have been recruited in June 2011.
8. Set up the customs revenue management software ASYCUDA for all external trade transactions in Djibouti.	December 2011	Strengthening of tax revenue	Met. The software has been installed for all external trade transactions.
9. Prepare a list of enterprises whose tax exempt status has been revoked for failure to file tax returns	March 2012	Strengthening of tax revenue	
10. Prepare a report estimating fiscal expenditures due to exemptions	June 2012	Strengthening of tax revenue	Removed.
Strengthening of supervision and regulation			
11. Creation of a unit dedicated to supervision, including AML/CFT supervision	June 2011	Strengthening bank supervision and AML/CFT	Met. The unit was created in May 2011 as part of the reorganization of the CBD.
12. Recruitment of two staff for the unit dedicated to supervision	June 2011	Strengthening bank supervision and AML/CFT	Met. The two staff were recruited in May 2011 and three other staff have been redeployed to the unit.
13. Develop a roadmap with a precise timetable for the application of the banking laws	September 2011	Strengthening bank supervision	Met.
Strengthening of the Safeguard framework			
14. Adoption of an official timetable for biannual meetings of the Board of Directors and extension of its rights to oversee internal control	June 2011	Strengthening central bank governance	Not met. The timetable was approved with a delay in September 2011.
15. Publication of the full set of 2010 audited financial statements of the CBD on the CBD website, including the audit opinion and disclosure notes (changed from "Approval of audit reports and publishing the audit opinion on the CBD website six months after the end of the fiscal year")	December 2011	Strengthening central bank governance	Not met. The audited 2010 accounts have been published on the CBD website, but with only part of the audit report.

APPENDIX II. TECHNICAL MEMORANDUM OF UNDERSTANDING

I. INTRODUCTION

1. This memorandum defines: (a) the quantitative performance criteria, adjustors, and structural benchmarks for the program supported by the Extended Credit Facility (ECF), which are shown in the Letter of Intent and the related tables; and (b) the scope and frequency of data to be provided for program monitoring purposes.

II. QUANTITATIVE INDICATORS

A. Definitions and Concepts

2. **Test dates**. Quantitative performance criteria are set for June 30, 2011 and December 31, 2011, and must be met at the end of each period, unless otherwise specified.

3. **Government**. For the purposes of the program, "government" is defined as the central government, excluding the social security system.

B. Quantitative Performance Criteria and Indicative Targets

Quantitative Performance Criterion 1: Continuous ceiling on accumulation of new domestic arrears

4. Definition: *New domestic arrears* are defined as payments which are authorized (*ordonnancé*) and are past due date on the wage bill and to private suppliers, public enterprises, and pension funds, incurred as of January 1 of the year and up to the end of the complementary period. The wage bill includes all gross salaries, wages, allowances, benefits, and payments, including housing assistance, that the government agrees to pay to civil servants, to military and security personnel (whether permanent or temporary), and to all other government employees, regardless of the means of payment used (cash, check, or other instrument) or the payment agent (the Treasury or another agency acting on behalf of the government). The ceiling on domestic arrears applies to the total unpaid amount subject to the technical lag (reported in the TOFE as "new arrears"), which must not exceed the sum of one month's wages or three months' pension fund contributions. The ceiling, set for each quarter in Table 1, should be respected on a continuous basis and will be monitored on a monthly basis.

Quantitative Performance Criterion 2: Continuous ceiling on accumulation of new external arrears

5. Definition: *External arrears* are defined as overdue payments (principal and interest) on external debt contracted or guaranteed by the central government or the Central Bank of Djibouti (CBD), excluding debt subject to rescheduling or cancellation. Technical arrears

(as defined in the loan contract) are not considered external arrears for program monitoring purposes. The ceiling should be respected on a continuous basis.

Quantitative Performance Criterion 3: Ceiling on net banking system credit to the government

6. Definition: *Net banking system credit to the government* is defined as the sum of net bank financing, namely, claims on the government minus government deposits with the financial system.

Quantitative Performance Criterion 4: Floor government budget balance on the commitment-basis (*ordonnancement*)

7. Definition: *The government budget balance on a commitment-basis* is defined as the overall balance (on a commitment basis, including grants) shown in the fiscal reporting table (TOFE), representing the difference between total revenue (including grants) and total expenditure, including extra-budgetary expenditure.

Quantitative Performance Criterion 5: Continuous ceiling on contracting or guaranteeing new medium- and long-term nonconcessional external debt by the government, the CBD, and public enterprises

8. Definition: Medium- and long-term nonconcessional external debt contracted or guaranteed by the government, the CBD, and public enterprises, is defined as foreign debt defined by the residency of the creditor, maturing in at least one year, contracted or guaranteed by the government, the CBD, and public enterprises, with a grant component (Net Present Value, NPV, compared with the nominal value) of at least 35 percent, based on the currency- and maturity-specific discount rates announced by the OECD (benchmark commercial interest reference rates - CIRR). The ten-year CIRR is applied to debt maturing in at least 15 years; the six-month CIRR is applied to debt maturing in less than 15 years. For program purposes, the definition of debt is set out in Executive board No. 6230-(79/140), as amended by Decision No. 14416(09/91), including commitments contracted or guaranteed for which value has not been received. The ceiling should be respected on a continuous basis.

Quantitative Performance Criterion 6: Continuous floor on currency board coverage

9. Definition: *Currency board coverage* is defined as the gross foreign assets of the CBD, divided by the sum of government deposits at the CBD and reserve money. The gross foreign assets of the CBD represent the value of the external assets of the CBD, consisting of: (a) monetary gold; (b) SDR holdings; (c) the IMF reserve position; (d) foreign currency holdings; and (e) claims on nonresidents, such as deposits abroad. The foreign assets of the CBD exclude assets that are committed or otherwise encumbered, including but not limited

to assets used as collateral or guarantees for foreign liabilities of third parties (assets not immediately available). The floor should be respected on a continuous basis.

Indicative Target 1: Floor on social spending

10. Definition: *Social spending* is defined as subsidies and transfers to public entities, including health organizations, sports clubs, non-profit entities; and transfers to households in the form of scholarships.

III. PROGRAM ADJUSTORS

11. The quantitative performance criteria can be adjusted as follows:

Adjustor 1: French, U.S. and Japanese payments related to the use of military bases

12. Definition: *The ceiling net banking system credit to the government* will be lowered (raised) by the amount of any excess (shortfall) compared with the projected French , U.S. and Japanese payments for 2011, related to the use of military bases (as reported in Table 1 of LOI). *The floor on the government budget balance on a commitment-basis* will be lowered (raised) by the amount of any shortfall (excess) compared with the expected French, U.S. and Japanese payments for 2011, related to the use of military bases (as reported in Table 1 of LOI).

Adjustor 2: Foreign budgetary grants and loans

13. Definition: *The ceiling on net banking system credit to the government* will be lowered (raised) by one-half of any excess (shortfall) in the total amount of the foreign budgetary grants and loans actually disbursed, compared with the program projections (as reported in Table 1 of LOI). *The floor on the government budget balance on a commitment basis* will be lowered (raised) by one-half of any shortfall (excess) in the total amount of the foreign budgetary grants actually disbursed, compared with the program projections (as reported in Table 1 of LOI).

Adjustor 3: Foreign project loans

14. Definition: *The floor on government budget balance on a commitment basis* will be lowered (raised) by any excess (shortfall) in the total amount of the foreign project loans actually disbursed, compared with the pertinent program projections (as reported in Table 1 of LOI).

IV. REPORTING OBLIGATIONS

15. The authorities will provide the IMF with all data necessary for monitoring economic developments and the results of the program, including but not limited to the

specific information below. Any revision of data reported previously will be quickly forwarded to the staff with appropriate explanations.

Real, monetary, and financial sectors:

16. The balance sheet of the central bank, the consolidated balance sheet of the commercial banks, and the monetary survey, within four weeks of the end of the reporting period (the end of each month).

17. The consumer price index, within four weeks of each month-end.

Fiscal sector, including social spending:

18.

- The monthly TOFE data on operations, revenue, expenditure, and budget financing items, including data on capital budget execution, with details on the externally financed portion and the counterpart funds of the central government for which donor terms apply;
- The extra-budgetary expenditure recorded at least quarterly in the TOFE;
- Execution of FSN expenditure, on, at least, a quarterly basis, shown as a separate line in TOFE;
- Repayment of the domestic arrears accumulated in 2009, on at least quarterly basis, shown as a separate line in TOFE;
- Committed expenditure for which payment authorizations (*ordonnancement*) have not been issued (on a quarterly basis).
- Total payments to the public utilities for services executed in the current year, both in DF and as a percentage of the total budgeted for the year, on a quarterly basis.

These data will be provided within 30 days of each month-end.

Arrears:

19. Data on domestic arrears (*ordonnancement* basis) related to: (1) the current year (monthly flows of new accumulations of arrears in all categories); and (2) the stock at the end of the previous year. Consolidated data for (1) and (2) will be reported monthly, within no more than four weeks.

20. External arrears data related to: (1) the current year, and (2) the stock at the end of the pr*evious year; c*onsolidated data for (1) and (2) will be reported monthly, within no more than four weeks.

External sector, external assistance and debt:

21. The quarterly balance of payments statistics, end of each quarter with a two quarter lag.

22. The monthly data on foreign grants and loans received by the government and by public enterprises, by creditor and by disbursement currency, within four weeks of each month-end.

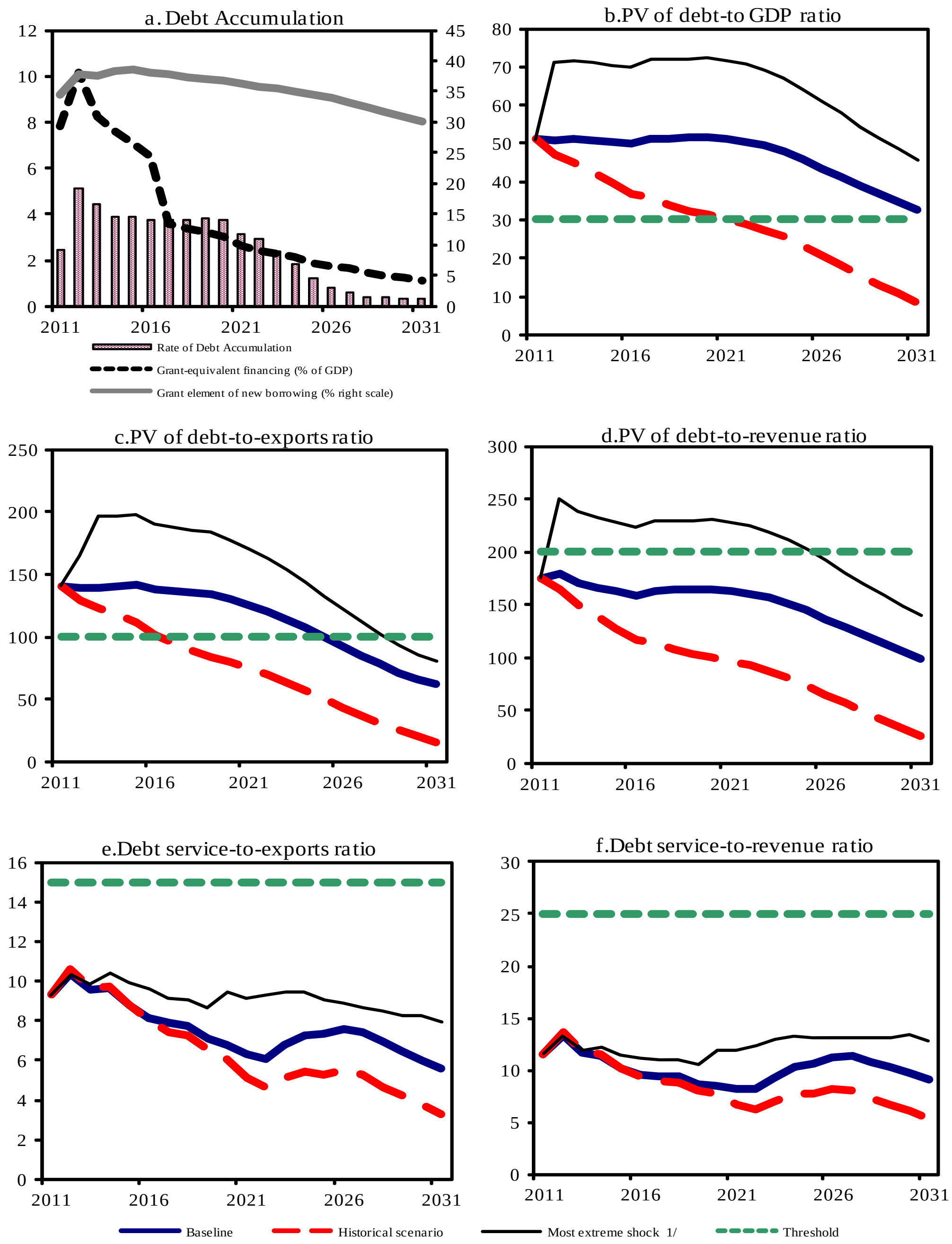
23. The monthly data on the evolution of external debt, including arrears and rescheduling operations, within six weeks of each month-end.

24. The monthly list of medium- and long-term external loans contracted and guaranteed by the government for each month, with the following details on each loan: the creditor, the borrower, the amount, the currency, the maturity, the grace period, and the interest rate arrangements. These data will be reported within four weeks of each month-end.

25. The quarterly data on the balance of the external debt stock, by creditor, debtor, and currency, within six weeks of the end of each quarter.

APPENDIX III. DEBT SUSTAINABILITY ANALYSIS CHARTS AND TABLES

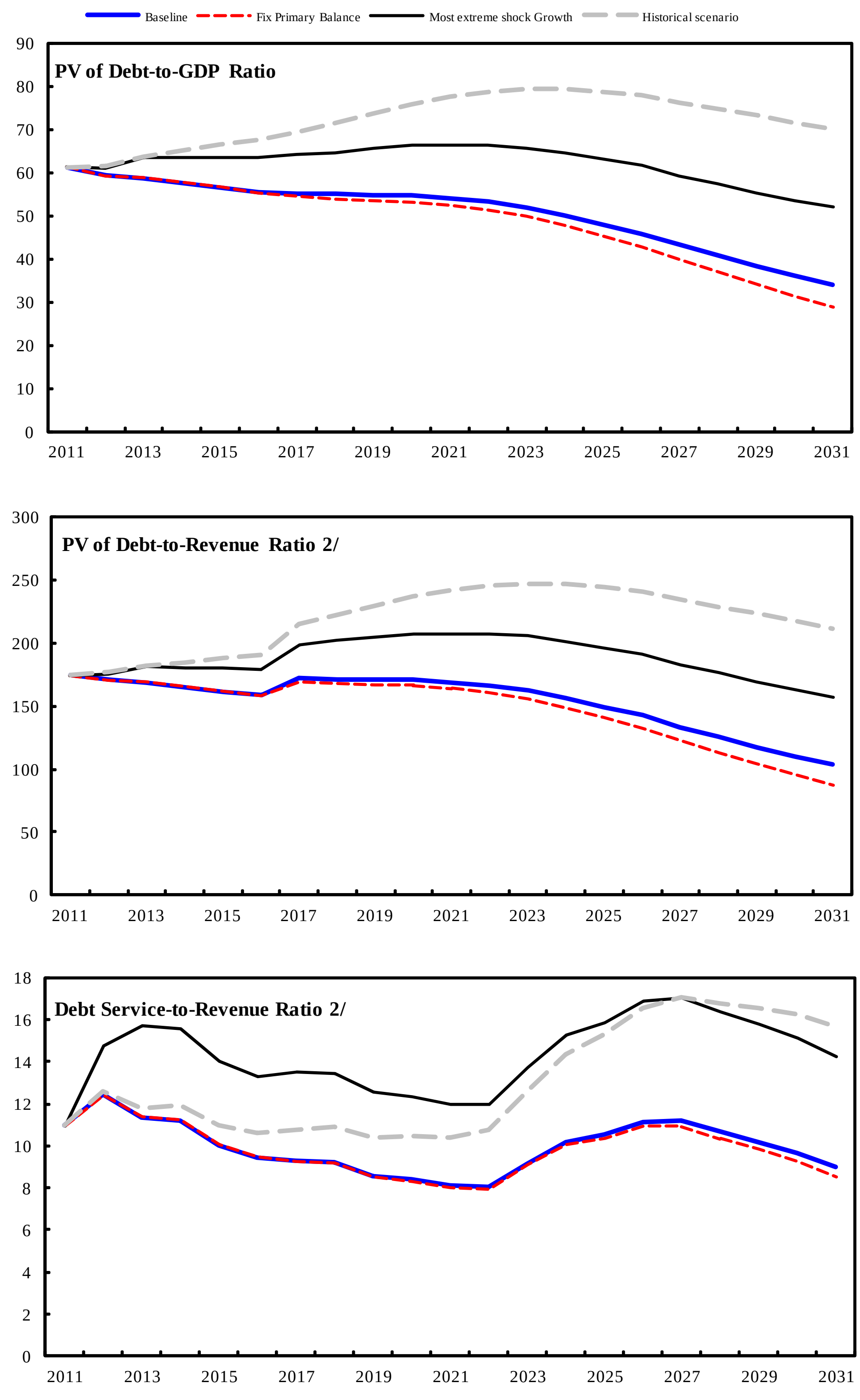
Figure 1. Djibouti: Indicators of Public and Publicly Guaranteed External Debt
under Alternatives Scenarios, 2011-2031 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2021. In figure b. it corresponds to a One-time depreciationshock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Terms shock and in figure f. to a Terms shock.

Figure 2. Djibouti: Indicators of Public Debt Under Alternative Scenarios, 2011-2031 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2021.
2/ Revenues are defined inclusive of grants.

Table 1a.Djibouti: Public Sector Debt Sustainability Framework, Baseline Scenario, 2008-2031
(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2008	2009	2010	Average 5/	Standard Deviation 5/	2011	2012	2013	2014	2015	2016	2011-16 Average	2021	2031	2017-31 Average
Public sector debt 1/	76.5	73.7	68.8			64.9	65.9	67.6	68.4	68.8	68.7		71.0	46.6	
o/w foreign-currency denominated	60.2	59.8	56.1			54.9	57.7	60.2	61.6	62.5	63.0		68.1	45.2	
Change in public sector debt	-9.4	-2.8	-5.0			-3.9	1.0	1.7	0.8	0.3	-0.1		-0.5	-2.8	
Identified debt-creating flows	-13.0	-0.3	-4.7			-5.8	-6.1	-5.1	-5.2	-5.3	-5.3		-4.7	-3.3	
Primary deficit	-2.4	3.3	-0.6	0.7	1.7	-1.6	-1.7	-1.8	-1.6	-1.4	-1.3	-1.6	-1.2	-0.6	-1.0
Revenue and grants	41.9	37.0	35.5			35.1	34.6	34.8	34.9	35.0	35.1		31.9	33.0	
of which: grants	13.1	6.4	5.3			5.9	6.2	4.8	4.4	4.0	3.7		0.6	0.3	
Primary (noninterest) expenditure	39.5	40.3	34.9			33.4	32.9	33.1	33.3	33.6	33.8		30.7	32.5	
Automatic debt dynamics	-10.6	-3.6	-4.1			-4.1	-4.4	-3.3	-3.6	-3.9	-4.1		-3.5	-2.7	
Contribution from interest rate/growth differential	-7.3	-4.4	-3.3			-2.2	-2.8	-3.0	-3.3	-3.6	-3.7		-4.0	-3.0	
of which: contribution from average real interest rate	-2.5	-0.8	-0.9			0.7	0.3	0.6	0.4	0.2	0.0		0.0	-0.3	
of which: contribution from real GDP growth	-4.7	-3.7	-2.5			-2.9	-3.2	-3.6	-3.7	-3.8	-3.8		-3.9	-2.7	
Contribution from real exchange rate depreciation	-3.4	0.8	-0.8			-1.9	-1.6	-0.3	-0.3	-0.3	-0.3		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	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	3.6	-2.5	-0.3			1.9	7.1	6.8	6.1	5.7	5.2		4.2	0.4	
Other Sustainability Indicators															
PV of public sector debt	...	...	66.3			61.2	59.1	58.5	57.6	56.6	55.5		54.0	34.1	
o/w foreign-currency denominated	...	...	53.7			51.1	50.9	51.1	50.7	50.3	49.9		51.1	32.6	
o/w external	...	...	53.7			51.1	50.9	51.1	50.7	50.3	49.9		51.1	32.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	0.3	6.4	2.3			2.2	2.6	2.2	2.3	2.1	2.1		1.4	2.4	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	187.1			174.4	170.7	168.1	164.8	161.5	158.4		169.1	103.1	
PV of public sector debt-to-revenue ratio (in percent)	…	…	220.2			209.9	207.7	194.9	188.5	182.6	177.2		172.1	104.0	
o/w external 3/	…	…	178.3			175.4	179.0	170.1	166.0	162.5	159.2		162.9	99.6	
Debt service-to-revenue and grants ratio (in percent) 4/	6.4	8.3	8.0			11.0	12.4	11.4	11.2	10.1	9.5		8.1	9.0	
Debt service-to-revenue ratio (in percent) 4/	9.3	10.0	9.5			13.2	15.1	13.2	12.8	11.4	10.6		8.3	9.1	
Primary deficit that stabilizes the debt-to-GDP ratio	7.1	6.1	4.4			2.2	-2.7	-3.5	-2.4	-1.7	-1.2		-0.8	2.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	5.8	5.0	3.5	3.8	1.3	4.4	5.1	5.8	5.8	5.8	5.8	5.5	5.8	5.8	5.8
Average nominal interest rate on forex debt (in percent)	1.5	1.4	1.3	1.4	0.1	3.1	2.4	2.4	2.1	1.8	1.6	2.2	1.9	1.2	1.7
Average real interest rate on domestic debt (in percent)	-7.2	1.1	-1.0	-1.6	2.3	-1.1	0.7	3.7	3.8	3.7	3.5	2.4	-0.6	-0.3	-0.4
Real exchange rate depreciation (in percent, + indicates depreciation)	-5.7	1.5	-1.3	-1.1	2.0	-3.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	9.5	1.7	4.0	3.4	2.5	5.3	5.0	2.5	2.5	2.5	2.5	3.4	1.2	1.2	1.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	0.1	-0.1	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	34.5	37.8	37.6	38.3	38.6	38.1	37.5	36.2	30.0	...

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 2a.Djibouti: Sensitivity Analysis for Key Indicators of Public Debt 2011-2031

	Projections							
	2011	2012	2013	2014	2015	2016	2021	2031
PV of Debt-to-GDP Ratio								
Baseline	61	59	59	58	57	56	54	34
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	61	61	63	65	66	68	77	70
A2. Primary balance is unchanged from 2011	61	59	59	58	57	55	52	29
A3. Permanently lower GDP growth 1/	61	59	59	58	58	57	58	45
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2012-2013	61	61	63	63	63	63	66	52
B2. Primary balance is at historical average minus one standard deviations in 2012-2013	61	62	64	63	61	60	58	36
B3. Combination of B1-B2 using one half standard deviation shocks	61	62	65	65	65	64	66	49
B4. One-time 30 percent real depreciation in 2012	61	78	75	72	69	66	59	36
B5. 10 percent of GDP increase in other debt-creating flows in 2012	61	66	65	63	62	61	59	37
PV of Debt-to-Revenue Ratio 2/								
Baseline	174	171	168	165	162	158	169	103
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	174	177	181	185	188	191	241	211
A2. Primary balance is unchanged from 2011	174	171	168	165	161	158	164	87
A3. Permanently lower GDP growth 1/	174	171	169	167	164	162	182	136
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2012-2013	174	175	181	180	180	179	207	157
B2. Primary balance is at historical average minus one standard deviations in 2012-2013	174	178	183	179	175	171	181	110
B3. Combination of B1-B2 using one half standard deviation shocks	174	179	186	185	183	182	206	149
B4. One-time 30 percent real depreciation in 2012	174	225	215	205	196	188	186	109
B5. 10 percent of GDP increase in other debt-creating flows in 2012	174	189	186	181	177	173	183	111
Debt Service-to-Revenue Ratio 2/								
Baseline	11	12	11	11	10	9	8	9
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	11	13	12	12	11	11	10	16
A2. Primary balance is unchanged from 2011	11	12	11	11	10	9	8	9
A3. Permanently lower GDP growth 1/	11	12	11	11	10	10	8	10
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2012-2013	11	13	12	12	11	10	9	11
B2. Primary balance is at historical average minus one standard deviations in 2012-2013	11	12	12	12	10	10	8	10
B3. Combination of B1-B2 using one half standard deviation shocks	11	13	12	12	11	10	9	11
B4. One-time 30 percent real depreciation in 2012	11	15	16	16	14	13	12	14
B5. 10 percent of GDP increase in other debt-creating flows in 2012	11	12	12	12	10	10	8	10

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

Table 3a.: External Debt Sustainability Framework, Baseline Scenario, 2008-2031 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2008	2009	2010			2011	2012	2013	2014	2015	2016	2011-2016 Average	2021	2031	2017-2031 Average
External debt (nominal) 1/	**60.2**	**59.8**	**56.2**			**54.9**	**57.7**	**60.2**	**61.6**	**62.5**	**63.0**		**68.1**	**45.2**	
o/w public and publicly guaranteed (PPG)	60.2	59.8	56.1			54.9	57.7	60.2	61.6	62.5	63.0		68.1	45.2	
Change in external debt	-3.5	-0.4	-3.6			-1.3	2.8	2.5	1.4	0.9	0.5		-0.3	-2.7	
Identified net debt-creating flows	-8.2	-4.3	-1.8			3.4	3.1	-1.0	-1.6	-1.0	-1.3		-3.9	-2.9	
Non-interest current account deficit	**23.5**	**8.3**	**4.1**	**6.1**	**9.7**	**9.8**	**11.1**	**12.9**	**12.2**	**13.3**	**13.3**		**3.4**	**4.2**	4.1
Deficit in balance of goods and services	34.1	17.1	12.2			18.8	20.6	19.3	17.7	16.5	15.5		17.2	5.2	
Exports	37.6	38.1	31.8			36.3	36.5	36.6	36.0	35.5	36.3		40.7	52.7	
Imports	71.6	55.1	44.1			55.0	57.2	55.8	53.7	52.0	51.8		57.9	57.9	
Net current transfers (negative = inflow)	-0.3	-0.3	0.0	-2.1	2.4	-1.7	-4.0	-1.1	-0.7	-0.6	-0.5		-0.3	-0.1	-0.3
o/w official	-1.1	-1.0	-0.8			-2.0	-3.3	-1.6	-1.3	-1.2	-1.1		-0.9	-0.5	
Other current account flows (negative = net inflow)	-10.2	-8.5	-8.2			-7.2	-5.5	-5.3	-4.8	-2.6	-1.6		-13.4	-0.9	
Net FDI (negative = inflow)	**-23.8**	**-9.5**	**-2.4**	**-9.8**	**9.5**	**-5.8**	**-6.7**	**-12.1**	**-11.8**	**-12.0**	**-12.2**		**-4.9**	**-5.1**	-5.1
Endogenous debt dynamics 2/	**-7.9**	**-3.0**	**-3.5**			**-0.7**	**-1.3**	**-1.8**	**-2.0**	**-2.3**	**-2.4**		**-2.5**	**-2.1**	
Contribution from nominal interest rate	0.8	0.8	0.7			1.6	1.2	1.3	1.2	1.0	0.9		1.2	0.5	
Contribution from real GDP growth	-3.2	-2.8	-1.9			-2.3	-2.5	-3.1	-3.2	-3.3	-3.3		-3.7	-2.6	
Contribution from price and exchange rate changes	-5.5	-1.0	-2.3			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**4.7**	**3.9**	**-1.8**			**-4.7**	**-0.2**	**3.5**	**3.0**	**2.0**	**1.8**		**3.7**	**0.2**	
o/w exceptional financing	-6.3	-1.8	-0.7			-2.5	-1.4	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	53.7			51.1	50.9	51.1	50.7	50.3	49.9		51.1	32.6	
In percent of exports	...	...	168.8			141.0	139.5	139.7	140.8	141.8	137.3		125.6	61.9	
PV of PPG external debt	**...**	**...**	**53.7**			**51.1**	**50.9**	**51.1**	**50.7**	**50.3**	**49.9**		**51.1**	**32.6**	
In percent of exports	**...**	**...**	**168.8**			**141.0**	**139.5**	**139.7**	**140.8**	**141.8**	**137.3**		**125.6**	**61.9**	
In percent of government revenues	**...**	**...**	**178.3**			**175.4**	**179.0**	**170.1**	**166.0**	**162.5**	**159.2**		**162.9**	**99.6**	
Debt service-to-exports ratio (in percent)	**6.3**	**6.9**	**7.8**			**9.3**	**10.3**	**9.5**	**9.7**	**8.8**	**8.2**		**6.3**	**5.6**	
PPG debt service-to-exports ratio (in percent)	**6.3**	**6.9**	**7.8**			**9.3**	**10.3**	**9.5**	**9.7**	**8.8**	**8.2**		**6.3**	**5.6**	
PPG debt service-to-revenue ratio (in percent)	**8.2**	**8.6**	**8.2**			**11.6**	**13.3**	**11.6**	**11.4**	**10.1**	**9.5**		**8.2**	**9.0**	
Total gross financing need (Millions of U.S. dollars)	20.4	14.6	47.1			91.7	111.9	62.7	62.7	77.2	78.2		30.3	106.9	
Non-interest current account deficit that stabilizes debt ratio	27.0	8.7	7.7			11.1	8.3	10.4	10.8	12.4	12.8		3.7	6.9	
Key macroeconomic assumptions															
Real GDP growth (in percent)	5.8	5.0	3.5	3.8	1.3	4.4	5.1	5.8	5.8	5.8	5.8	5.5	5.8	5.8	5.8
GDP deflator in US dollar terms (change in percent)	9.5	1.7	4.0	3.4	2.5	5.3	5.0	2.5	2.5	2.5	2.5	3.4	1.2	1.2	1.0
Effective interest rate (percent) 5/	1.5	1.4	1.3	1.4	0.1	3.1	2.4	2.4	2.1	1.8	1.6	2.2	1.9	1.2	1.7
Growth of exports of G&S (US dollar terms, in percent)	14.9	8.2	-10.1	6.7	7.8	25.2	11.2	8.5	6.8	6.9	11.0	11.6	10.3	7.0	9.6
Growth of imports of G&S (US dollar terms, in percent)	18.5	-17.8	-14.0	7.2	15.7	37.2	14.7	5.9	4.2	5.0	8.1	12.5	6.9	6.6	7.7
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	34.5	37.8	37.6	38.3	38.6	38.1	37.5	36.2	30.0	34.6
Government revenues (excluding grants, in percent of GDP)	28.8	30.6	30.1			29.1	28.5	30.0	30.5	31.0	31.3		31.4	32.8	31.8
Aid flows (in Millions of US dollars) 7/	246.4	116.4	81.7			99.4	156.5	137.5	141.2	145.0	144.5		86.0	69.3	
o/w Grants	128.5	67.2	60.2			73.4	84.7	71.2	70.6	70.6	70.6		14.6	14.6	
o/w Concessional loans	117.9	49.2	21.5			26.0	71.8	66.4	70.6	74.4	73.9		71.4	54.7	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			7.8	10.2	8.2	7.6	7.1	6.6		2.6	1.1	2.2
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			68.3	60.8	59.1	59.5	59.5	58.8		42.0	36.4	40.4
Memorandum items:															
Nominal GDP (Millions of US dollars)	982.5	1049.1	1128.6			1240.4	1369.4	1484.3	1608.8	1744.9	1891.3		2601.5	5136.5	
Nominal dollar GDP growth	15.9	6.8	7.6			9.9	10.4	8.4	8.4	8.5	8.4	9.0	7.0	7.0	6.9
PV of PPG external debt (in Millions of US dollars)			606.2			634.1	697.6	758.2	815.6	878.0	943.8		1330.0	1675.2	
(PVt-PVt-1)/GDPt-1 (in percent)						2.5	5.1	4.4	3.9	3.9	3.8	3.9	3.1	0.3	2.0
Gross workers' remittances (Millions of US dollars)	-6.0	-6.0	-6.6			-6.9	-7.1	-7.4	-7.7	-8.0	-8.4		-10.2	-15.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	54.0			51.4	51.2	51.3	50.9	50.6	50.1		51.3	32.7	
PV of PPG external debt (in percent of exports + remittances)	...	...	171.9			143.2	141.5	141.7	142.7	143.7	139.0		126.8	62.2	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	7.9			9.4	10.5	9.7	9.8	8.9	8.3		6.4	5.6	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that PV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ 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 3b.Djibouti: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2011-2031
(In percent)

	Projections							
	2011	2012	2013	2014	2015	2016	**2021**	2031
PV of debt-to GDP ratio								
Baseline	51	51	51	51	50	50	**51**	33
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	51	47	45	42	40	37	**30**	9
A2. New public sector loans on less favorable terms in 2011-2031 2	51	54	56	58	59	60	**68**	54
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	51	52	54	54	53	53	**54**	34
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	51	54	58	57	57	56	**56**	34
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	51	53	54	54	53	53	**54**	34
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	51	58	66	65	64	63	**62**	36
B5. Combination of B1-B4 using one-half standard deviation shocks	51	59	69	68	67	66	**65**	39
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	51	71	72	71	70	70	**72**	46
PV of debt-to-exports ratio								
Baseline	141	139	140	141	142	137	**126**	62
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	141	129	123	118	112	101	**74**	16
A2. New public sector loans on less favorable terms in 2011-2031 2	141	147	153	160	167	166	**168**	102
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	141	139	140	141	142	137	**126**	62
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	141	165	196	197	197	190	**171**	80
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	141	139	140	141	142	137	**126**	62
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	141	159	182	181	181	174	**153**	69
B5. Combination of B1-B4 using one-half standard deviation shocks	141	166	200	200	200	192	**170**	78
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	141	139	140	141	142	137	**126**	62
PV of debt-to-revenue ratio								
Baseline	175	179	170	166	162	159	**163**	100
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	175	165	149	139	128	117	**97**	26
A2. New public sector loans on less favorable terms in 2011-2031 2	175	189	187	189	191	192	**217**	164
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	175	183	180	175	172	168	**172**	105
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	175	188	194	188	183	179	**179**	105
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	175	186	180	175	172	168	**172**	105
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	175	203	221	214	207	201	**198**	111
B5. Combination of B1-B4 using one-half standard deviation shocks	175	206	229	222	215	210	**207**	118
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	175	251	238	232	227	223	**228**	139

Table 3b.Djibouti: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2011-2031 (continued)
(In percent)

	2011	2012	2013	2014	2015	2016	**2021**	2031
Debt service-to-exports ratio								
Baseline	9	10	10	10	9	8	**6**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	9	11	10	10	9	8	**5**	3
A2. New public sector loans on less favorable terms in 2011-2031 2	9	10	10	10	10	10	**9**	8
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	9	10	10	10	9	8	**6**	6
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	9	12	12	12	11	10	**8**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	9	10	10	10	9	8	**6**	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	9	10	10	10	10	9	**7**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	9	11	11	12	11	10	**8**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	9	10	10	10	9	8	**6**	6
Debt service-to-revenue ratio								
Baseline	12	13	12	11	10	9	**8**	9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	12	14	12	11	10	9	**7**	5
A2. New public sector loans on less favorable terms in 2011-2031 2	12	13	12	12	11	11	**12**	13
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	12	14	12	12	11	10	**9**	10
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	12	13	12	12	10	10	**9**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	12	14	12	12	11	10	**9**	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	12	13	12	12	11	10	**10**	10
B5. Combination of B1-B4 using one-half standard deviation shocks	12	14	13	13	12	11	**10**	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	12	19	16	16	14	13	**12**	13
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	35	35	35	35	35	35	**35**	35

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.

Press Release No.12/38
FOR IMMEDIATE RELEASE
February 6, 2012

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fifth Review Under Djibouti's Extended Credit Facility Arrangement and Approves Request for Augmentation of Access and US$ 9.7 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) completed today the fifth review of Djibouti's economic performance under the Extended Credit Facility[7] arrangement (ECF) and approved the authorities' request for an augmentation of access of SDR 9.54 million (US$14.7 million, 60 percent of quota) to meet the additional external financing needs created by the increase in global commodity prices and the drought in the Horn of Africa. The augmentation will be disbursed in equal parts upon completion of the fifth and sixth reviews.

The Board's decision enables the immediate disbursement of SDR 6.246 million (about US$9.7 million), bringing total disbursements under the program to SDR 16.014 million (US$24.75 million).

The Board also approved the authorities' request for two waivers of nonobservance of the end-June 2011 performance criteria on the fiscal balance and on net banking system credit to the government. Furthermore, the Board granted waivers of nonobservance on the continuous performance criteria on the non-accumulation of external arrears and the accumulation of new domestic arrears (related to delays in the payment of salaries and pensions), which were not observed in the second semester as a result of the tight cash flow situation. These waivers were granted on the grounds of temporary or minor deviations from the program objectives

[7] The Extended Credit Facility (ECF) has replaced the Poverty Reduction and Growth Facility (PRGF) as the Fund's main tool for medium-term financial support to low-income countries by providing a higher level of access to financing, more concessional terms, enhanced flexibility in program design features, and more focused streamlined conditionality. Financing under the ECF currently carries a zero interest rate, with a grace period of 5½ years, and a final maturity of 10 years (http://www.imf.org/external/np/exr/facts/ecf.htm). The Fund reviews the level of interest rates for all concessional facilities every two years.

or the corrective measures undertaken by the authorities. The Board also granted a waiver for the non-observance of the external payments arrears performance criterion following minor data revision after the completion of the fourth review under the ECF arrangement.

The ECF arrangement for Djibouti was approved in September 17, 2008 (see Press Release No. 08/211) for an amount to SDR 12.72 million (about US$19.66 million, or 80 percent of the country's quota in the Fund). On January 7, 2011, the ECF arrangement was extended by 9 months, through June 16, 2012 (see Press Release No. 11/3).

After the Executive Board's discussion, Ms. Nemat Shafik, Deputy Managing Director and Acting Chair, said:

"Djibouti has been hit hard by the spike in commodity prices and the Horn of Africa drought, which have affected particularly the poorest households. These shocks have hiked imports, especially on food and fuel, thus increasing the current account and external financing needs, and have put pressure on fiscal space through lower tax revenues and higher fuel subsidies. The augmentation of access of 60 percent of quota under the ECF will help Djibouti meet the additional financing needs stemming from the two exogenous shocks.

"Looking ahead, strong commitment to the ECF-supported program is necessary to maintain macroeconomic stability and reduce poverty. Fiscal policy should focus on increasing revenues and controlling expenditure, while protecting priority social expenditure and capital investment. Further progress on public financial management will strengthen the budget process. Pursuing prudent debt policies, including avoiding non-concessional borrowing remain critical for maintaining debt sustainability.

"Strengthening bank supervision and regulation will help address the challenges posed by the rapid development of the financial sector. Structural reforms should aim at improving competitiveness and fostering private sector development. Reforming the state-owned energy company will lower energy costs and reduce government transfers."

Statement by Kossi Assimaidou, Executive Director for Djibouti
February 6, 2012

Introduction

1. On behalf of my Djiboutian authorities, I thank management and staff for the continued support to their efforts to implement the economic and financial program under the ECF arrangement. At this juncture, Djibouti is facing tremendous challenges stemming from capacity constraints and a difficult environment characterized by elevated commodity prices, insecurity in the Horn of Africa, and a severe drought that heavily affected the region. These shocks have affected the implementation of the program—notably on the fiscal front—and widened the financing needs for 2011-12 despite the pledges from the international community to support the country in responding to the impact of the drought. Nevertheless, the authorities' commitment to prudent policies and the implementation of adjustment measures, helped to maintain the program on track, although some performance criteria, quantitative indicative targets and structural benchmarks were missed for end-June 2011.

2. Despite the challenges Djibouti is facing, the authorities remain committed to the objectives of the program. They intend to pursue their efforts to strengthen the implementation of the adjustment program under the ECF, which is aligned with the National Social Development Initiative (INDS).

3. Based on their commitment to sound policies under the program, my authorities request Directors' support for the completion of the fifth review under the ECF-supported arrangement. They also request Directors' support for the waivers of the nonobservance of the end-June 2011-performance criteria on the fiscal balance and net credit to the government, and of the continuous performance criteria on the non-accumulation of domestic arrears and external arrears. Moreover, to complement the financing committed by multilateral and bilateral donors in meeting the financing needs generated by the exogenous shocks, the authorities request an augmentation of access and the related rephasing.

Recent economic developments: impact of the drought

4. The population and economy of Djibouti have been heavily hit by the severe drought in the Horn of Africa, insecurity in the region and the increase in global commodity prices. In this context, the authorities' prudent policies and the recovery of transshipment and of trade to Ethiopia have led to an increase in economic activity in 2011. As a result, real GDP is estimated to have grown by 4.4 percent against 3.5 percent in 2010. However, due to higher imports to address the drought's effects as well as substantial rise in world food and fuel prices, inflation rose to 5.3 percent in 2011 from 4.0 percent in 2010. The current account deficit widened significantly. As for the gross international reserves, they stood at US$231 million, at end-2010 and despite heavy strains from higher imports and less vigorous than expected resumptions of FDI, they remained broadly stable at end-2011.

5. The fiscal performance notably in the first semester of 2011 reflected the adverse effects of the exogenous shocks. On the revenue side, tax collection was lower than expected due mainly to the drought. On the expenditure side, the authorities maintained discipline while addressing the adverse impact of the drought and instability in neighboring countries. In view of the shortfall in revenues, the authorities had to reduce expenditures heavily, including social spending. Diesel prices were also increased in October, November and December 2011 by a cumulative total of 4 percent, thus helping to reduce the subsidy, and the impact on the budget.

6. The Djiboutian authorities have made important progress in their efforts to further boost economic growth and alleviate poverty. In this regard, the cost of electricity and availability of water, defined as key obstacles to development in Djibouti, are being addressed. On the electricity front, the interconnection with the Ethiopian grid should help to meet about 50 percent of Djibouti's electricity needs at a lower cost and help EDD absorb the losses incurred from high oil prices. As for water, a desalination plant funded by the European Union will be completed in 2015 and will contribute to address Djibouti's medium-term water needs.

7. As regards the drought in the Horn of Africa, Djibouti is one of the most affected countries in the region. Indeed, 50 percent of the rural population or 15 percent of the total population were hit. With around 20,000 refugees, the drought has exacerbated a structurally critical food security situation with 14.5 percent of the urban population living in food insecurity. To alleviate this hardship, the authorities launched an appeal for emergency aid to their partners. In the same vein, an inter-ministerial drought committee, including representatives of donors, was set up to follow up this emergency aid. My authorities welcome the positive response received so far from their development partners. However, the drought occurred at a time when there was also a strong surge in world food and fuel prices. In order to meet the additional balance of payments financing needs in 2011-12, my Djiboutian authorities are requesting an augmentation of access to ECF resources of 60 percent of quota.

Macroeconomic Policies and Structural reforms for 2012

Fiscal policy

8. My Djiboutian authorities will pursue their efforts focused on fiscal consolidation to maintain debt sustainability and non-monetary financing of fiscal deficit, safeguarding fiscal space for social expenditure and modernizing fiscal management. In this respect, the 2012 Budget law approved in December 2011 is in accordance with the objectives of the ECF-arrangement and the INDS framework. In particular, the authorities aim at maintaining the tax revenue-to-GDP ratio constant at the 2011 level with reforms of the VAT and exemptions, as well as further tax collection efforts. They will also raise capital expenditure in sectors with growth potential while pursuing the fiscal restraint given the constraints on the revenue side. Furthermore, my authorities are committed to maintain the hiring freeze in the public sector with the exception of health and education sectors.

9. Efforts to push forward with fiscal reforms will be intensified to enhance capacities for tax collection, expenditure control, and fiscal management. In the context of FY 2012, a commission was established with a mandate to initiate and recommend new tax measures to strengthen the level of fiscal revenues and simplify the business environment. The coordination between the entities managing the VAT and direct tax will be strengthened based on the single taxpayer identification number.

Debt management and sustainability

10. The authorities will continue their efforts to enhance the debt management. They aim at reducing the stock of domestic arrears with possible assistance from donors, and preventing further accumulation. To this effect, controls on the expenditure chain will be strengthened so as not to accumulate further arrears. Prudence in budget appropriations for current expenditure and social spending will also be pursued.

11. With regard to the external debt, the authorities are committed to avoid any future accumulation of arrears including those arising from public enterprises. They will also strengthen capacities in monitoring debt service payments in collaboration with external partners, including the IMF. To preserve Djibouti's debt sustainability, the authorities will contract only concessional loans and prioritize projects to be funded under the INDS. Public enterprises are required to refrain from contracting non-concessional debt excluding those enterprises managed on a purely commercial basis. In addition, progress has been made on debt rescheduling efforts, with agreements signed on the Paris Club agreement with the remaining official bilateral creditors.

Monetary and financial issues

12. My authorities' monetary policy will continue to be underpinned by the currency board arrangement to meet the needs of the economy and ensure price stability. They remain strongly committed to maintain a rate of coverage higher than 105 percent of reserve money and government deposits with the Central Bank of Djibouti.

13. In the wake of the banking sector's expansion, efforts to reform the banking supervision have been undertaken and will continue in accordance with the guidelines of the Financial System Assessment Program and in collaboration with the Fund and other partners. In addition, the charter of foreign exchange bureaus will be reviewed to comply with the new banking law. Moreover, efforts to develop the financial sector and access to finance will be intensified with the support of Djibouti's development partners including the World Bank and UNDP.

14. The authorities remain committed to implementing the recommendations of the safeguards assessment to enhance the governance of the Central Bank and ensure the integrity of its operations. Starting with the 2011 financial year, financial reports will be completed and published within six months from the end of the exercise. The creation of an audit committee is underway with a view to provide oversight and prepare an audit charter. After amending the laws on combating money laundering and financing terrorism, the authorities are seeking long-term technical assistance from their development partners.

Structural reforms and competitiveness

15. My Djiboutian authorities have made important progress with regard to structural reforms in order to increase Djibouti's attractiveness for investment. In this regard, they have introduced attractive investment and commercial codes and have approved the law on industrial property. Efforts to address the high costs of factors of production notably electricity, water and labor have been pursued. Inter-connection with Ethiopian's electricity grid is now completed and covers over 50 percent of current consumption at favorable rates. As for water, donors with a significant support from the European Union will fund a sizeable seawater desalination project.

16. Regarding the labor force, a center to provide training in the skills needed in high-technology sectors was opened. To facilitate the employment of young graduates outside the civil service, the authorities have established an employment promotion fund for the youth as well as a loan initiative for business creation together with its guarantee fund. Efforts focused on restructuring public enterprises and improving the legal and regulatory framework will be pursued with the technical assistance from development partners.

17. The authorities are committed to continue the reform of fuel subsidy with a view to containing its budgetary cost, reinstating the automatic smoothing mechanism and better targeting the needs of the vulnerable segment of population. In this regard, they will seek Fund technical assistance.

Conclusion

18. The authorities' strong commitment to prudent policies and reforms under the program have helped the Djiboutian economy to weather well the drought and other exogenous shocks experienced in 2011. They are determined to ensure that the program's objectives will be achieved, in particular sustaining fiscal and debt stability, enhancing resource mobilization, increasing the economy's competitiveness and growth to fight poverty and youth unemployment. Based on the continued good policy performance in a challenging environment, I would appreciate Directors' support for my authorities' request for the completion of this fifth review and the proposed decisions.