INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/338

DJIBOUTI

December 2015

2014 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR DJIBOUTI

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with Djibouti, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 30, 2015 consideration of the staff report that concluded the Article IV consultation with Djibouti.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 30, 2015, following discussions that ended on November 8, 2014, 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 15, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for Djibouti.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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February 27, 2015

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700 19th Street, NW
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IMF Executive Board Concludes 2014 Article IV Consultation with Djibouti

On January 30, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Djibouti.

Djibouti's fundamental development challenges remain to reduce widespread poverty and unemployment, and diversify its economy to reduce dependence on the ports. Forty two percent of the population lives in extreme poverty and 48 percent of the labor force is unemployed.

Recent Developments and Macroeconomic Outlook

Djibouti is undergoing an investment boom which would accelerate economic growth. Aggregate investment is projected to rise from 26 percent of GDP in 2010-13 to 52 percent in 2014-16. GDP growth is expected to rise from 6 percent in 2014 to about 7 percent in 2015-19. Inflation is projected to pick up from 3 percent in 2014 to 3.3 percent in 2015-19 as the large investment spending fuels demand for housing and basic services.

High debt-financed public investment spending is exerting considerable fiscal and external debt pressures. The fiscal deficit, on a commitment basis, should rise from 5.9 percent in 2013 to 12 percent in 2014, and peak at 13.8 percent in 2015. External public and publicly guaranteed debt is projected to peak at about 81 percent of GDP in 2017-18. Exports, comprising mainly port services, are expected to increase. However, the current account deficit is estimated to widen from 23.3 percent of GDP in 2013 to about 28 percent in 2014-15, due to large capital goods imports financed by loans or Foreign Direct Investments (FDI).

Central bank gross foreign assets are projected to remain strong, permitting full currency board coverage over the period 2015-19. The authorities have indicated that external and domestic arrears are being cleared. The central bank made further progress in strengthening its banking supervision capacity, adopting new instructions on liquidity and the licensing of credit institutions. However, nonperforming loans increased from 11.4 percent of total loans in 2012 to 16.2 percent at end-June 2014—which the authorities attribute to the introduction of stricter loan classification requirements.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors noted that Djibouti is enjoying strong economic growth supported by an ambitious infrastructure program aimed at reducing widespread poverty and unemployment. However, the debt-financed investments have increased fiscal and external debt vulnerabilities. Directors urged the authorities to take steps to ensure a sustainable fiscal and external debt path. They stressed the need to urgently address major structural bottlenecks to promote sustainable strong and inclusive growth and diversify the economy. Steadfast commitment to reforms will be important.

Directors underlined the need for fiscal consolidation. Expanding the tax base and improving tax administration will be crucial in this effort. More broadly, Directors urged the authorities to reexamine the fiscal framework, including rationalizing investment incentives and making them more transparent and efficient. It is also important to contain the wage bill and reform fuel subsidies in conjunction with plans to design targeted social safety nets to protect the poor and vulnerable.

Directors stressed the importance of strengthening the capacity of the central government and public enterprises to select, coordinate, and manage public investment projects. Equally important is enhancing debt management capacity, including the monitoring of contingent liabilities. Directors encouraged the authorities to formulate a debt strategy, with Fund technical assistance, to manage and reduce the external debt burden and improve coordination among government units responsible for contracting, monitoring, and servicing debt. Directors urged the authorities to seek concessional financing to the extent possible and take steps to clear arrears and remain current on Djibouti's debt obligations.

Directors agreed that the fixed exchange rate regime under the currency board arrangement has served Djibouti well. They emphasized that safeguarding its stability, including through adequate levels of reserves, is a top priority. Directors highlighted the importance of strengthening bank supervision to preserve financial stability. Close attention should be given to enhancing credit risk analysis and reinforcing instruments to counter money laundering and terrorist financing. Efforts to deepen the financial sector and promote financial inclusion will be important.

Directors urged the authorities to implement structural reforms to boost competitiveness, achieve inclusive and diversified growth, and reduce poverty. Reforms should aim to improve the business climate, particularly by streamlining business regulation, improving electricity and water supply, and providing appropriate skills training to labor.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Djibouti: Selected Economic and Financial Indicators, 2012–19

	Est.			Proj.				
	2012	2013	2014	2015	2016	2017	2018	2019
				(Annual percentage change)				
National accounts								
Real GDP per capita	682.6	697.2	718.9	744.8	775.2	807.6		
Real GDP (annual change in percent)	4.8	5.0	6.0	6.5	7.0	7.1	7.1	7.0
Consumer prices (annual average)	3.7	2.4	3.0	3.0	3.5	3.5	3.5	3.0
				(Percentage of GDP)				
Investment and saving								
Total fixed capital investment	28.1	29.4	48.2	54.9	51.5	35.3	31.7	30.4
Gross national savings	7.8	6.1	20.7	27.1	29.7	21.9	18.5	18.4
Savings/investment balance	-20.3	-23.3	-27.4	-27.8	-21.8	-13.4	-13.2	-12.0
Public finances								
Total revenue and grants	34.5	31.8	35.6	35.4	32.9	31.0	26.9	26.4
Expenditure and net lending	37.2	37.7	47.5	49.4	45.3	34.6	32.7	31.1
Total revenue (excluding grants)	25.9	27.4	28.8	27.1	25.4	24.2	23.3	22.9
Overall balance (commitment basis, incl. grants)	-2.7	-5.9	-12.0	-14.0	-12.4	-3.6	-5.8	-4.7
Change in domestic arrears (decrease -)	-0.6	-1.0	-0.6	-0.5	-0.5	-0.4	-0.4	-0.4
Stock of domestic arrears	5.6	4.1	3.2	2.4	1.6	1.0	0.5	0.1
Overall balance (excluding grants)	-11.3	-10.3	-18.7	-22.3	-19.9	-10.3	-9.4	-8.2
				(Annual percentage change)				
Monetary sector								
Net foreign assets	13.6	27.2	1.0	4.0	7.2	9.7	-0.2	1.0
Net domestic assets	18.2	-36.9	56.8	25.7	18.9	12.3	34.3	24.2
Claims on the private sector	2.2	15.6	15.0	18.0	18.0	18.0	18.0	15.0
Broad money	15.1	6.9	11.4	9.7	10.7	10.6	11.1	10.2
Velocity of broad money (ratio)	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
				(In millions of U.S. dollars)				
External sector								
Exports of goods and services	457	485	589	641	681	730	791	858
Imports of goods and services	-836	-913	-1157	-1302	-1283	-1191	-1227	-1300
Balance of goods and services	-379	-428	-568	-660	-602	-461	-436	-442
Current account balance (in percent of GDP)	-20.3	-23.3	-27.4	-27.8	-21.8	-13.4	-13.2	-12.0
FDI (in percent of GDP)	8.1	19.7	8.1	8.0	8.4	9.6	9.7	10.7
Credit to nongovernment sector (excl. public enterprises)	417.98	471.13	539.17	633.02	743.75	874.38	1028.50	1180.06
Overall balance	-21.5	173.6	-22.8	12.3	41.6	74.4	-37.4	-23.2
Stock of external public and publicly guaranteed debt	666	704	886	1217	1533	1745	1892	1972
Stock of external public and publicly guaranteed debt (in percent of GDP)	49.2	48.4	55.8	69.8	79.4	81.5	79.8	75.4
Gross official reserves	234	411	388	392	431	501	463	440
(in months of next year's imports of goods and services)	3.1	4.3	3.6	3.7	4.3	4.9	4.3	3.8
Private credit to GDP (in percent)	30.9	32.4	33.9	36.3	38.5	40.9	43.4	45.1
Memorandum items:								
Nominal GDP (in millions of Djibouti francs)	240,569	258,658	282,403	309,782	343,068	380,286	421,541	464,581
Currency board cover (in percent)	113.2	107.2	107.8	105.0	105.0	105.0	105.0	105.0

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

DJIBOUTI

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

January 15, 2015

KEY ISSUES

Context: The government of Djibouti has launched an ambitious debt-financed investment program that would spur economic growth but also exacerbate fiscal and external debt vulnerabilities when there is already a high risk of debt distress. The authorities consider that this program is the only path towards reducing widespread poverty and unemployment; Djibouti remains critically dependent on port services and lacks natural resources and a viable agricultural sector. They concur with staff that strong growth and fiscal reform are essential to generate the substantial revenues required to service the public debt and realize the benefits of their investment plans.

Policy priorities

Fiscal consolidation is imperative if the economy is to return to a sustainable fiscal path. A review of the investment incentive system is essential to expanding the tax base and increasing the transparency and efficiency of the tax system. Concomitantly, ongoing efforts to contain the wage bill and reform the fuel subsidy system should be pursued.

Strengthening public investment and debt management: Djibouti needs to improve its institutional capacity to appraise, select, and implement viable investment projects at a pace consistent with its absorptive capacity and resource availability. Public enterprises that will manage the investment projects should be reformed to enable them to manage the projects efficiently. A strategy should be developed to manage and reduce the external debt burden, and debt sustainability considerations should be integrated into the budget process. Non-concessionary public and publicly guaranteed debt—which would lead to additional debt service costs over the medium term—should be avoided.

Promoting economic diversification and structural transformation: For the public investment program to generate growth and jobs in a sustainable manner, the business environment needs to be substantially improved, in particular by: (i) reducing the cost of utilities, especially the high electricity tariffs; (ii) providing training in the skills needed in the labor market; and (iii) reducing corruption, strengthening contract enforcement, and enhancing access to credit for SMEs.

Approved By
Daniela Gressani and Dan Ghura

The team comprised M. El Qorchi (head), Mr. Davies, Mr. Tabarraei, and Mr. Taya (all MCD); and Ms. Novikova (SPR); and was assisted by Mr. Thiam (outgoing Resident Representative). Mr. Joseph Karangwa, the newly appointed Resident Representative to Djibouti, joined the mission for his pre-assignment. The team was supported in the field by Mr. Seif and Mr. Aden (local economists), and Ms. Yonis (office manager); and from headquarters by Ms. Kebet, Mr. Auclair and Mr. Selim (all MCD).

The mission met with the prime minister; the secretary general of the government; the acting central bank governor; and the following ministers: economy and finance responsible for industry; budget; agriculture, water, animal husbandry, and fisheries; higher education and research; equipment and transport; labor with responsibility for public sector reform; the secretary of state with responsibility for national solidarity; and other senior officials. The mission also met with the Djibouti Chamber of Commerce, the chief executives of several banks, and representatives of the UN system and other development partners.

CONTENTS

TABLES

ANNEXES

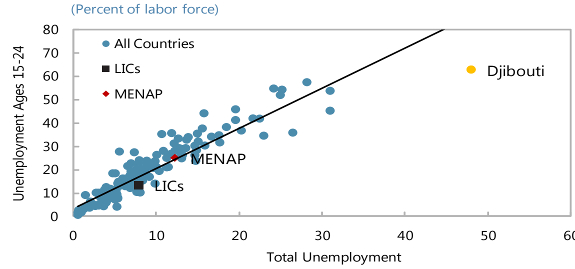
CONTEXT

1. Djibouti is undergoing a debt-financed investment boom. Major investments currently in progress include an extension of facilities at the state-owned ports as well as the building of new ports, financed in part by private investors; and the construction of a railway linking Djibouti and neighboring landlocked Ethiopia, and a pipeline to transport potable water from Ethiopia (Annex II). The government is financing both the railway and water pipeline projects mainly through non-concessionary foreign debt, aggravating medium-term fiscal and external debt vulnerabilities.

2. Poverty and unemployment remain widespread despite economic growth of about 5 percent in 2006–13. The latest poverty profile shows that 41.9 percent of the population lived in extreme poverty in 2012, compared with 42.2 percent in 2002; and the unemployment rate was 48 percent in 2012.[1] Economic growth has been driven by capital-intensive investment in the ports and related activities, with limited trickle-down effects. Many of the jobs created have been taken by expatriates, because of a low domestic skills base. Other activities remain underdeveloped. Agriculture, the primary source of livelihood in most low-income countries, is miniscule because the climate is unfavorable. The business environment is challenging, mainly because of high production costs, weak contract enforcement, red tape, and low access to finance.

Djibouti: Unemployment Rates

Total Unemployment vs. Youth Unemployment, 2012
(Percent of labor force)



Sources: Djibouti authorities, International Labor Organization.
Unemployment data provided by Djibouti authorities may not be perfectly comparable to those ILO due to difference in methodology.
LIC = Low Income Countries; MENAP = Middle East, Afghanistan, and Pakistan

3. Security concerns have risen following the May 2014 terrorist attack. Two suicide bombers attacked a restaurant popular with Westerners in Djibouti-ville, the capital city. One expatriate and the two terrorists were killed. The Al-Shabaab terrorist group, which claimed responsibility for the attack, repeated its threat to conduct similar attacks in retaliation for Djibouti's decision to contribute troops to the African Union Mission in Somalia (AMISOM), which is fighting the group.

4. The government and opposition have signed an agreement to end the deadlock over the disputed February 2013 legislative elections. The opposition won seats in parliament for the first time in the elections, ending a 10-year election boycott. The opposition won 10 seats and the ruling party won the remaining 55 seats. Eight of the 10 elected opposition members of parliament refused to take up their seats, alleging electoral fraud. After violent protests, the government and the opposition opened a political dialogue to end the deadlock. Under the agreement signed in

[1] An update of the 2012 poverty profile is to be released shortly.

December 2014, the opposition will end its parliamentary boycott; and reforms would be introduced to establish a free and independent electoral commission to ensure that the 2016 presidential elections are free and fair.

5. The authorities have reiterated their interest in a new program, but program discussions were suspended owing to concerns about a deterioration of debt vulnerability. An October 2013 program discussion mission was suspended when the authorities informed staff that two loans had been contracted on nonconcessional terms to finance the railway and water pipeline projects with Ethiopia (Annex II). Preliminary analysis showed that the loans would significantly degrade Djibouti's external debt situation, which was already at high risk of distress.

RECENT DEVELOPMENTS AND OUTLOOK

6. The surge of public and private investment is expected to accelerate economic growth. Aggregate investment is projected to rise from 26 percent of GDP in 2010–13 to 52 percent in 2014–16, and public investment from 11 percent to 25 percent of GDP over the same period. Staff projects that GDP growth will rise from 5 percent in 2013, to 6 percent in 2014, and to 6.5 percent in 2015, and will stabilize at about 7 percent in 2016–19. By 2016, when aggregate investment is projected to begin to fall, some of the major investment projects should be operational and supporting growth. Inflation was 2.4 percent in 2013. It is projected at about 3 percent in 2014, and expected to pick up to about 3–3.5 percent in 2015–19 as the large capital spending fuels demand for housing, transport, and other services.

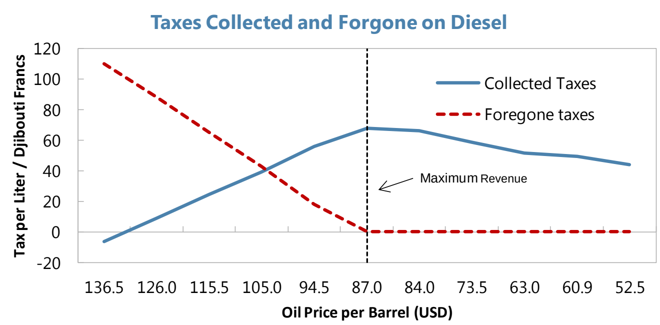
7. High public investment spending is exerting considerable fiscal and external debt pressures. The loans for the railway and the water pipeline projects will be serviced from the central government budget until they can be transferred to the relevant public companies when the projects are operational and generating enough revenues to service the loans. Domestic revenues are expected to fall as a percentage of GDP in 2016–19 compared with 2013–15 for the following reasons. First, the activities driving growth will be mostly tax-exempt, implying that growth will not be accompanied by a concomitant increase in fiscal revenues. Second, rents for the military bases (nontax external revenues) are fixed by bilateral agreement in nominal terms. As a result, over time, they diminish as a percentage of GDP. Third, outstanding tax arrears, which account for the rise in tax revenues in 2013 and 2014, would diminish after 2014 as most arrears are expected to have been collected. Meanwhile, interest payments on outstanding government debt will increase to 1.6 percent of GDP in 2017–19, and by 2019, these will be accompanied by large debt amortization payments. The fiscal deficit, on a commitment basis, should rise from 5.9 percent in 2013 to 12 percent in 2014, and peak at 13.8 percent in 2015, financed mainly by external borrowing. As a result, in 2017–18, external public and publicly guaranteed debt is projected to peak at about 81.5 percent of GDP.

8. The increase in the rent for the U.S. military base and a grant from the Gulf Cooperation Council (GCC) will boost revenues. The rent for the base has increased from US$38 million a year to US$63 million with effect from May 2014. The GCC grant is for US$50 million a year over four years. It will be used to cover debt service vis-à-vis Arab donors and to finance social and investment spending.[2]

9. Of the US$185 million received from the partial privatization of the ports in 2013, about US$79 million was allocated to the 2013 budget, US$73 million to 2014, and the balance of US$33 million to 2015. The allocations covered investment projects, including government contribution to the Djibouti-Ethiopia railway project and the water pipeline project, and current spending items such as support for the newly launched health insurance scheme.

10. The current account deficit is projected to widen from 23.3 percent of GDP in 2013 to about 28 percent of GDP in 2014–15, because of large capital goods imports financed by the project loans or FDI. These high imports will exceed an expected increase in export revenue, mainly from port services. The real effective exchange rate is assessed to be moderately overvalued (Annex III).

11. Declining international oil prices are expected to bode well for the Djibouti economy but would eventually reduce fiscal revenues.[3] All fuel products consumed in Djibouti are imported. Thus, the fall in oil prices would improve the current account. To stabilize domestic prices, the authorities had lowered the applicable taxes on fuel products, forgoing tax revenue. Staff estimates that at an international market oil price of US$87 a barrel, the need to lower the applicable taxes to maintain the current domestic administered price for diesel, the main fuel product, is eliminated. Thus, no fiscal revenue is forgone below this international price. However, as the base for fuel taxes in Djibouti is the international price of oil, declining international oil prices below the US$87 threshold would reduce fiscal revenues. The decline in international oil prices is not expected to have an immediate impact on inflation in Djibouti because prices of fuel products are administered. A lowering of these administered prices would result in a fall in the general price level, due to the large weight of fuel products in the CPI.



[2] Only US$22 million of the US$50 million intended for 2014 has been allocated to the 2014 budget because the full amount is not expected to arrive in time. The remaining US$28 million will be added evenly to the US$50 million intended for 2015–17.

[3] The final impact of a decline in international oil prices on fiscal revenues will depend on whether or not, and the extent to which, domestic administered prices are lowered. Staff estimates that any possible decline in fiscal revenues would be limited.

12. Currency board coverage is being met. Currency board coverage is projected at 110 percent at end-2014, falling to 105 percent in 2015–19, compared with 107 percent in 2013. Central bank gross foreign assets should fall from US$411 million in 2013 to US$388 in 2014, as privatization revenues—kept at the central bank—are drawn down. Gross foreign assets are projected to increase by about 30 percent between 2015 and 2017, boosted by US$200 million in grants from the Gulf Cooperation Council (GCC); and fall in 2018 and 2019, as government deposits at the central bank are drawn down. It is expected that currency board cover will not fall below the 105 percent floor set under the previous ECF. Under the currency board arrangement, the central bank is legally required to provide full cover for base money. Besides performing this basic function, the central bank normally does not intervene in the foreign exchange market. As a result, gross foreign reserves are largely delinked from the domestic foreign exchange market. External arrears have been accumulated. As of end-November 2014, the stock of external arrears (excluding technical arrears) stood at about US$4.7 million or about 0.3percent of GDP. The authorities have indicated that external and domestic arrears are being cleared.

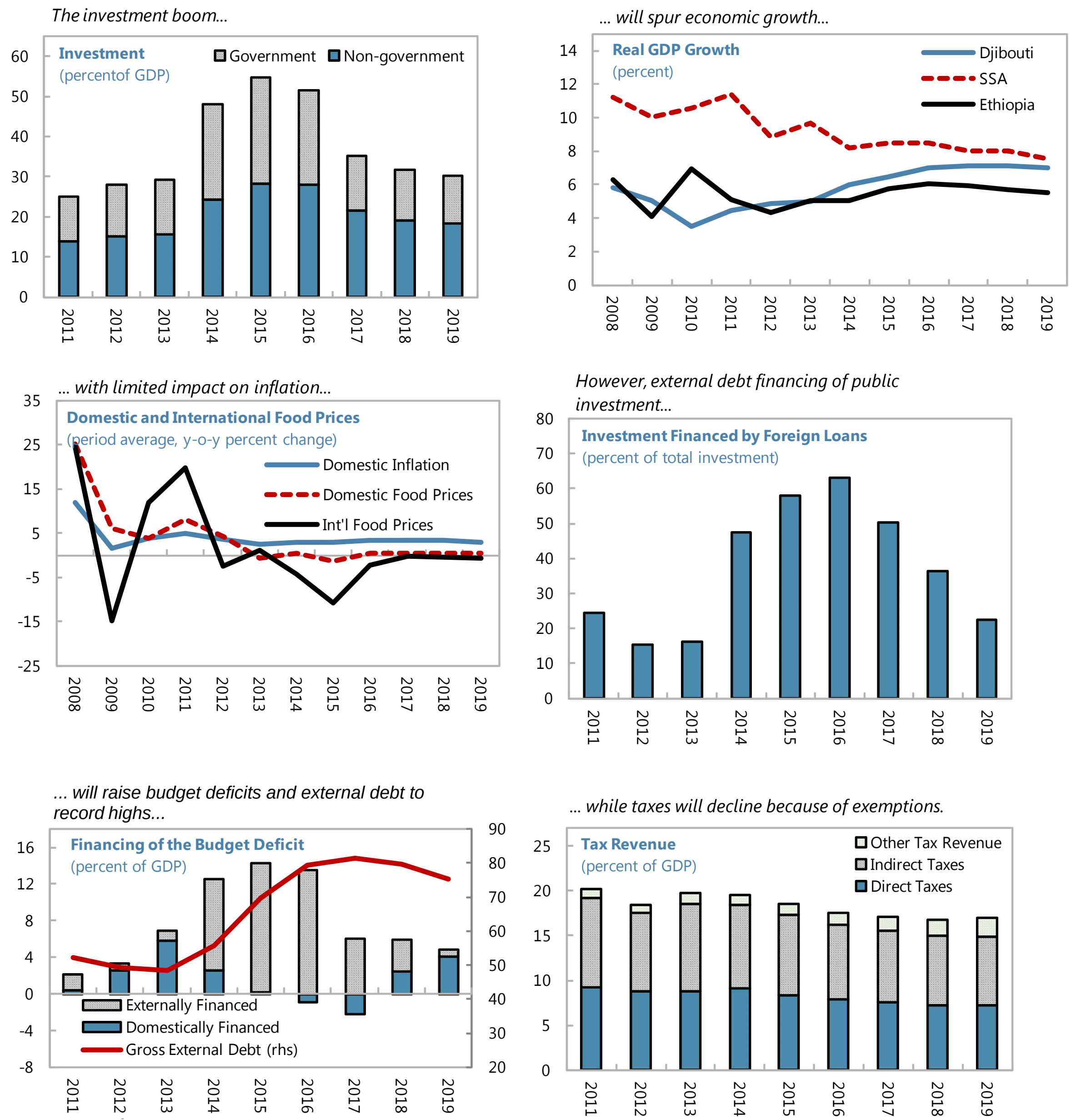
13. The financial sector remains stable but vulnerabilities persist. The central bank (BCD) made further progress in strengthening its overstretched banking supervision capacity, adopting new instructions on liquidity and the licensing of credit institutions. The banking sector is dominated by the two leading banks although their market share—currently 67 percent of assets—has been declining because of competition from the new banks. Eight of the 10 banks in operation, including the two leading banks, have now met the increased minimum capital requirement of one billion FD (US$5.6 million), following the expiration of the end-January 2014 deadline. Neither of the two banks that have failed to meet the minimum capital requirement is likely to pose systemic risks, given their low market share. Another bank, which had been in distress, is under receivership. This is also unlikely to pose systemic risk, because the bank's market share is small. Nevertheless, nonperforming loans increased from 11.4 percent of total loans in 2012, to 16.2 percent at end-June 2014—which the authorities attribute to the introduction of stricter loan classification requirements. The nonperforming loan provisioning rate fell from 82 percent in 2012 to 60 percent in June 2014, and all the banks exceeded the single borrower limit as at end-June 2014.

Djibouti: Investment by Sector

Project	Total cost (Million $)	Status	Source of financing	Public/private
Water/Energy	563			
Water pipeline with Ethiopia	339	Yet to start	China and Djibouti government	Public
Water Desalination Plant	55	Study started in 2013	Mostly grants	Public/Private
Water Infrastructure Renovation	35	Study started in 2014	Secured	Private
Geothermique Energy	31	Study started in 2013	Secured	Private
Transportation	7232			
Liquified natural gas port	3,000	Study started in 2013	Secured.	Private
Tadjourah - Galafi Railway	600	Study started in 2013	Not secured	Private
Djibouti-Galileh Toll Road, 224 kms	570	Study started in 2013	Not secured	Private
Addis Ababa-Djibouti railway	550	Ongoing	China and Djibouti government	Public
Djibouti multipurpose port	525	Study started in 2013	Secured.	Private
Khor Ambado 400 Hects (Phase I)	500	Study started in 2014	Secured.	Private
Chebelleh Airport & Cargo Village (Phase 1)	450	Study started in 2013	Secured.	Private
Ship repair and drydocks	400	Yet to start	Not secured	Private
Doraleh Container Terminal	300	Ongoing	Secured.	Private
Crude oil terminal	200	Study started in 2013	Secured.	Private
Djibouti Shipping company	200	Study started in 2012	Not secured	Private
Agriculture, Livestock and Fish	66		o.w. $51 million are grants	
Urbanization and Housing	23		o.w. $2 million are grants	
Social Infrastructure	105		o.w. $79 million are grants	
Education and Health	147		o.w. $107 million are grants	
Telecommunication	69		FDI	
Other Sectors	21		Grants	

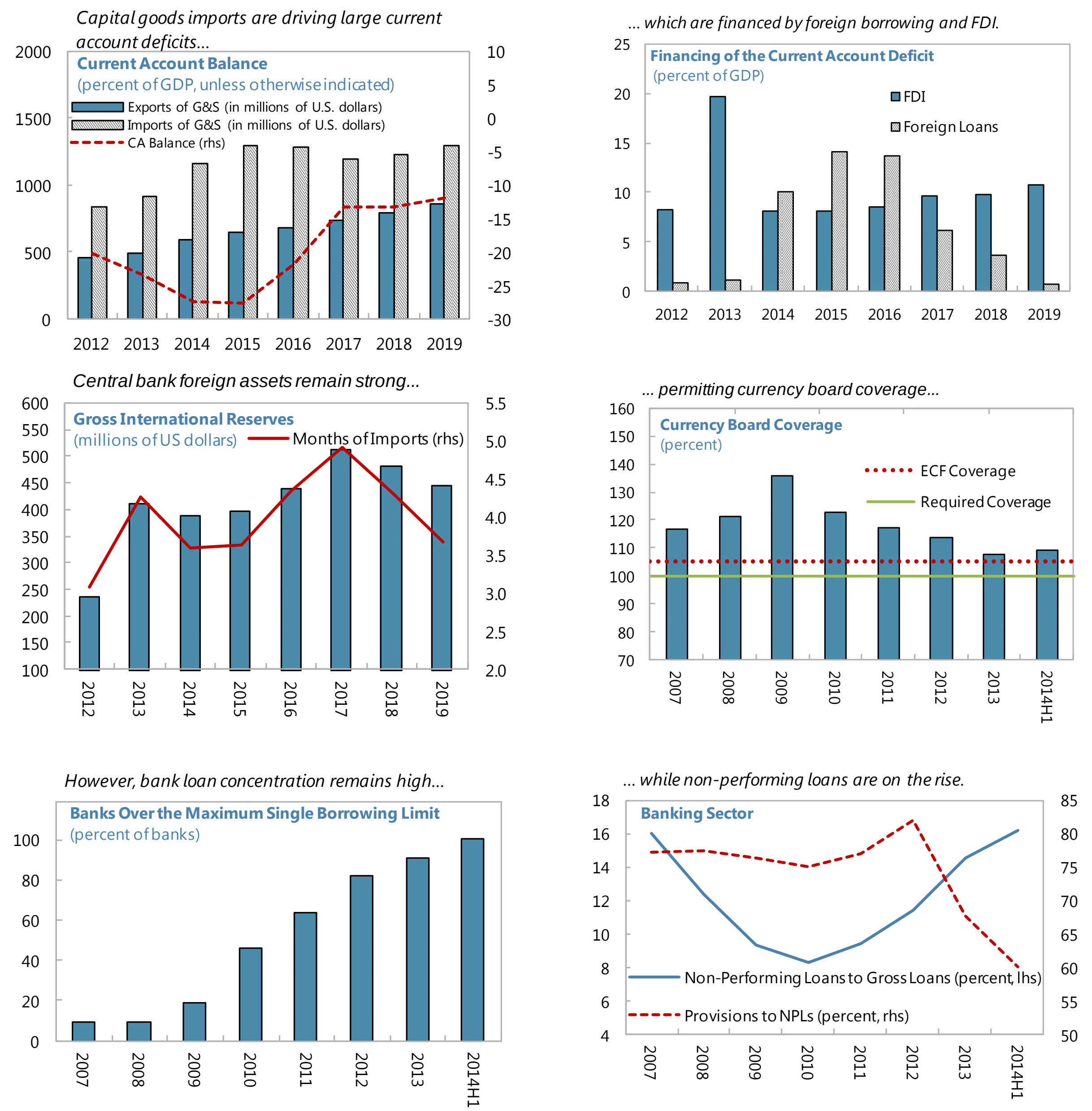
Source: Djibouti authorities.

Figure 1. Djibouti's Investment Boom



Sources: Djibouti authorities; and IMF staff estimates.

Figure 2. Djibouti: External and Financial Sectors During the Investment Boom



Sources: Djibouti authorities; and IMF staff estimates.

POLICY DISCUSSIONS: PROMOTING INCLUSIVE GROWTH ALONG WITH FISCAL AND EXTERNAL SUSTAINABILITY DURING AN INVESTMENT BOOM

A. Job Creation and Poverty Reduction

14. A number of factors account for widespread poverty and unemployment in Djibouti.

- **Investment has been narrowly concentrated.** Although the current development model—which exploits Djibouti's strategic location along one of the world's busiest shipping routes—has transformed Djibouti into a vibrant service economy centered on port activities, it has fostered reliance on a single sector catering mainly to Ethiopia, leaving the economy vulnerable to external shocks. In addition, services—the main driver of growth in recent years—and construction activities account for only about 13 percent of formal employment. Much of the current investment boom is also narrowly concentrated on port and transportation services, reinforcing the need for reform to broaden the base and spread the benefits of growth (See Annex 1: Risk Assessment Matrix).

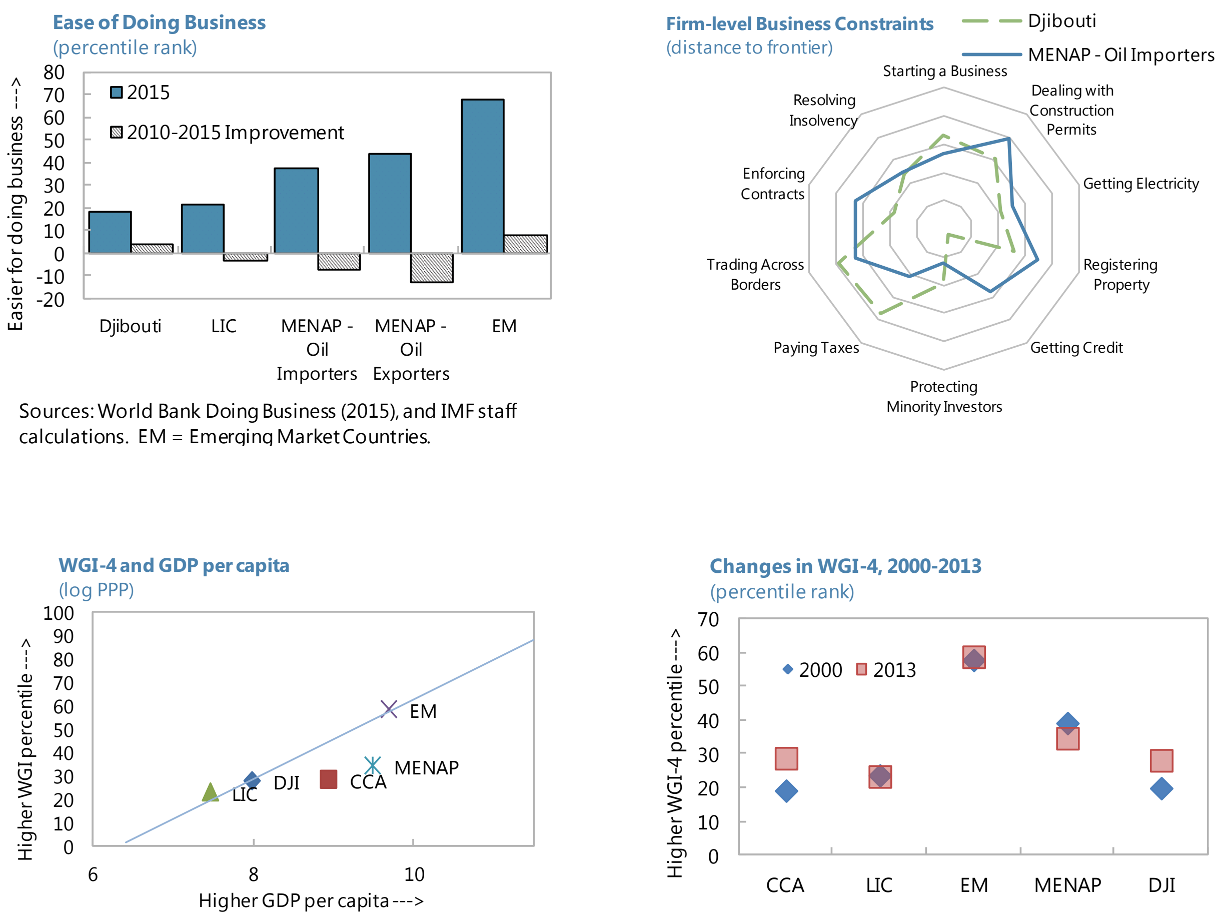
- **The business environment has been challenging.** Djibouti ranked 155th out of 189 countries on the World Bank's Doing Business 2015 Index. The country ranked 171 or lower in getting electricity, getting credit, and enforcing contracts. These are major obstacles, especially for labor-intensive small businesses. On the control of corruption index of the Worldwide Governance Indicators, Djibouti's percentile rank (out of 200 countries and territories) improved steadily to 51.5 in 2008 and then deteriorated to 41.6 in 2013.

- **Djibouti's demographics pose additional challenges.** First, the low labor force participation rate, because of the low female participation rate, increases the dependence on the working population. Second, the population is relatively young—almost 75 percent is less than 35 years old—meaning a large proportion of the labor force are job market entrants who lack the experience (and skills) needed for employment. Youth unemployment standing at about 60 percent is much higher than the overall unemployment rate of 48 percent. Third, large-scale migration, exacerbated by refugees fleeing conflict in neighboring Somalia, is exerting additional pressure on basic social services and on the already tight job market.

- **The domestic skills base is weak.** More than a third of the labor force has no education; those with some education have been trained mainly for white-collar jobs, resulting in a significant skills mismatch.

- **Financial inclusion remains low.** Despite a relatively high bank deposit-to-GDP ratio of 80 percent, and private credit-to-GDP ratio of 30 percent, the bulk of the population and most small and medium size enterprises lack access to banking services. These are still concentrated on a few enterprises and individuals. Only about 14 percent of the adult population has a bank account. Interest rate spreads are high, with the average deposit and lending rates at about 2 and 12 percent respectively. The high lending rate reflects banks risk aversion. Absent reliable credit and financial status information to support loan applications, banks impose a high lending rate or demand large collateral. Micro-finance remains underdeveloped. The Djibouti Savings and Credit Fund, the main micro-finance institution, has, since 2012, been under conservatorship by the central bank due to management problems.

Figure 3. Djibouti: Business Environment and Governance Indicators



Sources: World Bank Doing Business (2015), and IMF staff calculations. EM = Emerging Market Countries.

Sources: Worldwide Governance Indicators 2013 (government effectiveness, regulatory quality, rule of law, and control of corruption); the line is the OLS trend for all countries.

CCA = Caucus and Central Asian Countries

15. The authorities have articulated their overarching framework for addressing the country's development challenges in Vision Djibouti 2035. Vision Djibouti 2035 envisions Djibouti as Africa's commercial and logistics hub. It aims to triple per capita income, and reduce the unemployment rate from 48 percent to 10 percent, by 2035. The vision consists of five pillars: (i) peace and national unity, (ii) good governance, (iii) economic diversification, (iv) human capital development, and (v) regional integration. A rolling five-year Accelerated Growth Strategy for Promoting Employment (SCAPE) and a National Employment Policy 2014-19 have been developed to realize the vision. The employment policy emphasizes youth and female employment, and the development of small and medium enterprises.

16. The authorities are pursuing several initiatives to improve electricity and water supply. High electricity costs and limited water supply are regarded as major constraints to investing in Djibouti.

Electricity:

- Geothermal project, sponsored by a consortium of seven donors. The recruitment process for the consultant to oversee the project is underway. The project is expected to be completed in 2018.
- A second power interconnection with the Ethiopian electricity grid (which now supplies about 65 percent of Djibouti's electricity consumption).
- A second thermal plant in Djibouti-ville, the capital city.
- Wind-generated electricity project: A joint venture is being considered. The first phase is expected to be completed in 2017.
- A solar project.

To avoid possible duplication and inefficient use of scarce resources in these initiatives, the EU is undertaking a study to develop a strategic vision for the energy sector.

Water supply: Two major initiatives are being launched. The first is the water pipeline that will be constructed between Djibouti and Ethiopia, permitting the importation of 100,000 cubic meters of water a day free of charge from Ethiopia (Annex 2 contains more details). The second initiative is a €45 million water desalination plant which will be built with a €40.5 million grant from the EU. The remaining €4.5 million will be provided by the Djibouti government or other donors. The project is expected to generate 45,000 cubic meters of water a day and to be completed in 2018.

17. A number of poverty alleviation and social welfare initiatives have been launched. First, compulsory health insurance will be introduced for all government employees starting in 2015. The cost is being covered from the government budget and with additional funding from the African Development Bank. Health insurance will be extended subsequently to other beneficiaries. Second, the government has announced the construction of 5,000 social housing units. Third, connection fees and consumption tariffs for water supplied by the state-owned water company have been lowered for poor neighborhoods. Fourth, a stone cutting project that employs 2,800 unskilled workers has been launched. Last, the authorities are developing a social register (database) to identify the poor and facilitate coordination of poverty alleviation initiatives.

Reform priorities

18. Rationalizing development initiatives and improving donor coordination. To ensure efficient resource allocation, development initiatives should be pursued within a well-defined global or sectoral strategy, especially in sectors with multiple initiatives such as electricity. Staff welcomes the authorities' plans to improve coordination of donors and government institutions.

19. Improving the business environment and competitiveness. Reducing red tape, stepping up anti-corruption efforts, and improving contract enforcement through administrative and judicial reforms should help create a more business friendly environment. Moreover, improving the supply of basic utilities and reducing the cost of electricity would boost competitiveness.

20. Reform of educational curricula and training programs. The emphasis should be on ensuring that the labor force is trained for the needs of the job market, and that Djibouti nationals—rather than expatriates—take the jobs created during the investment boom.

21. Economic diversification. Diversification is essential to exploit opportunities in sectors with high growth and employment potential such as tourism and fishing, and reduce the risks associated with relying on a single sector (services) catering mainly to one client (Ethiopia). To this end, improving the business climate is indispensable.

22. Promoting financial inclusion and stability. Given the importance of financial stability for financial inclusion, staff stressed the need to strengthen banking supervision, reduce credit concentration, and monitor non-performing loans. Staff urged the authorities to increase the number of onsite bank inspections, focusing on internal risks and controls. Furthermore, staff reiterated the importance of strengthening the AML/CFT framework, particularly elements related to the financing of terrorism, the supervision of cross-border activities, and the detection of cross-border transportation of currency. Staff strongly encouraged the authorities to adopt the following measures to facilitate access to credit for individuals, and small and medium enterprises (SMEs):

- Accelerate the implementation of the national strategy for modernization of payments and credit reporting systems (project document has been completed with World Bank assistance).
- Set up a framework for mobile payments to make financial services accessible to low-income groups.
- Operationalize the SME Partial Credit Guarantee Fund (project study has been completed with World Bank assistance).

- Diversify sources of SME financing by establishing an appropriate regulatory framework for specialized financial institutions such as leasing and Islamic financing institutions. (The authorities have requested Fund technical assistance to improve the regulatory framework for Islamic banking.)
- Simplify the taxation system to encourage SMEs to migrate to the formal sector.
- Simplify access to land and improve mortgage procedures.

23. Authorities' views:

The authorities generally concur with staff recommendations. They highlighted the various ongoing economic reforms and initiatives—aimed at improving water and electricity supply, providing safety nets for the poor, and providing improved training for the labor force—to reiterate their commitment to economic diversification, job creation, and poverty reduction. They consider Vision Djibouti 2035 and its Accelerated Growth Strategy for Employment Creation as a well-defined overarching framework for development. They expect that the recently established committees will improve coordination and management of development initiatives. The authorities agree with staff that financial stability is critical for economic stability and growth in Djibouti, and that central bank supervisory capacity required further strengthening. While accepting that higher commercial bank provisioning requirements should be enforced, they perceive the deterioration of nonperforming loans as largely due to changes in classification procedures.

B. Fiscal Sustainability

24. The current fiscal stance appears unsustainable. The current fiscal stance is unlikely to generate the substantial revenues needed to service the growing public debt and to help translate the benefits of the investment boom into sustained and inclusive growth. The main elements of current fiscal policy are (i) generous tax exemptions for investors; (ii) tax exemption or low tax rates on fuel and basic food imports; and (iii) a hiring freeze in the public sector outside the education and health sectors (resulting in decline in the wage bill as a percentage of GDP). As a result of tax exemptions on investment, while the investment boom is expected to generate growth, the impact on revenues over the medium term would be modest, with the share of tax revenues to GDP declining and large budget deficits arising over the medium term. To ensure fiscal sustainability, reforms are required in public management, tax policy—especially the investment incentive framework—and debt management.

25. Public management capacity is lagging behind investment spending. This is reflected in difficulties in effectively coordinating development projects, and the lack of appropriate appraisal for some projects. The institutional arrangement, including revenue sharing, for the joint railway project with Ethiopia—which is expected to be operational in 2015—has still not been finalized. Staff welcomes the authorities' decision to set up a committee to assess the macroeconomic implications of the mega investment projects and expects that the committee would provide much-needed information on the projects' expected economic impact. Regarding public financial management, the authorities informed staff that a resident expert provided by the US government has been working with staff of the Ministry of Budget to set up the medium-term budget framework which is expected to be operational in 2015. Lastly, the authorities informed staff that they have launched a public enterprise reform program covering ten enterprises including the water company (ONEAD) that will manage the water pipeline project, and the monopoly electricity provider (EDD).

26. Investment risks loom large while contingent liabilities are expanding. Delays in implementing projects for which loans have been contracted would be costly to the budget. This holds for the delayed water pipeline project—the government would be obliged to service the loan, including the commitment fee of 0.5 percent on the undisbursed amount. Also, a rise in world interest rates would increase servicing costs for debt subject to variable interest rates. Meanwhile, the total amount of explicit public guarantees to the non-financial public sector is projected to increase from US$265 million (15 percent of GDP) in 2013 to over 60 percent of GDP over the next few years. This amount excludes debt contracted by public companies without explicit government guarantees and liabilities of public financial companies, which also represent implicit contingent liabilities to the government. With few exceptions, requests by public enterprises for government guarantees are approved even though the central government is unable to evaluate, monitor or manage the projects.

27. Other risks linger.

- **Political and security risks:** Renewed political unrest could raise spending pressures, and undermine revenue collection efforts. Further terrorist attacks in Djibouti could delay or disrupt economic activity, particularly investment.

- **Global recession.** A recession in donor countries could result in reduced aid inflows. A global recession, leading to a decline in world trade and shipping, could reduce the use of Djibouti's ports, and ultimately hurt government revenues. It could also undermine the ports' ability to service the debt contracted to fund their ambitious investment program.

Reform priorities

28. Fiscal consolidation is imperative to: (i) reduce the large fiscal deficits, (ii) generate the resources required to service the growing public debt and create liquidity buffers, (iii) rationalize expenditure to create fiscal space to finance poverty alleviation initiatives, and (iv) reduce aid dependence. Over the medium term, in light of the authorities' commitments, there is little scope for reducing investment expenditures, or for further tightening of current expenditures (dominated by wages) beyond the current freeze on public sector employment outside the education and health sectors. Consolidation would therefore have to focus on increasing revenues through fiscal reform, and reform of public enterprises to increase their profitability.

29. Strengthen public management capacity. The timely execution of the investment projects, and, when operational, the capacity to generate revenues to meet their operating costs and service the associated loans are critical for fiscal sustainability. At present, the required public management capacity is limited. Considering these constraints, staff recommended that the authorities: (i) undertake only economically viable investment projects, integrated in an overarching development framework to ensure consistency with Djibouti's development objectives; (ii) prioritize the execution of the projects, taking into account absorptive capacity and resource constraints; and (iii) reform the public enterprises that will administer the mega investment projects to improve their efficiency and profitability. Staff stressed the importance of expediting the setting up of the institutional framework for managing the joint railway project with Ethiopia—including the revenue-sharing arrangement—before the railway becomes operational. In the area of public financial management, staff urged the authorities to: (i) implement the action plan for the medium-term budget framework to improve budget planning; and (ii) establish the treasury management system to ensure timely payment of government financial obligations and avoid accumulation of arrears. The authorities concurred with staff views and recommendations.

30. Reform the investment incentive system. There is broad consensus that the investment incentive system creates an uneven playing field for investors, has been abused—some firms operating in the free zone are not engaged solely in export activities and others shift activity to the free zone to avoid paying taxes—and entails large fiscal costs. Thus, with current policies the fiscal benefits of the investment boom are likely to be modest, with the share of tax revenues in GDP projected to decline over the medium term. The authorities assured staff of their commitment to reform the investment incentive system towards greater transparency and efficiency, and that reform proposals would be deliberated at the proposed tax conference (paragraph 31).

31. Other reforms to generate revenues. The authorities and private sector stakeholders pointed out that the tax base is narrow, comprising mainly firms not benefiting from fiscal exemptions and formal sector employees. Recognizing the need for reform, the authorities plan to organize in 2015 a tax conference (*Assisses Fiscales*) to deliberate reform proposals with various stakeholders. The reform proposals are yet to be developed. Meanwhile, the authorities and the private sector have set up a high-level Public-Private Partnership forum to discuss fiscal and other issues of common interest. The authorities informed staff that a new strategy has been developed for the monopoly telecommunications sector, with World Bank assistance. The strategy recommends opening up the mobile telephone market to a second operator. Staff would welcome this decision, as its implementation would generate fiscal revenues, and over time, help broaden the tax base. Last, the authorities stated that the legislation is being drafted to unify administration of the VAT and other taxes for large taxpayers, as recommended by an FAD technical assistance mission. The authorities indicated that a large taxpayers' directorate—rather than a unit—is now planned.

32. Policies to protect the poor and vulnerable population from high cost of living. In the wake of the global food price hikes of 2007-2008, the authorities removed import duties on five basic foodstuffs to help protect the welfare of the poor. They also acquired land in Ethiopia to cultivate crops and sell the products back in Djibouti at subsidized prices. Furthermore, to restrain domestic prices, the authorities introduced a negative tax adjustment to the existing taxes on kerosene, gasoline and diesel. The negative tax adjustment lowers—but does not eliminate—net taxes collected on the products.[4] The authorities informed staff that the fall in world fuel prices has obviated the need for this implicit subsidy on gasoline, and reduced the negative tax adjustment on diesel and kerosene. Nevertheless, this could be reversed by a rise in world prices. In line with past staff advice, the authorities reiterated their commitment to eliminate the negative tax adjustment mechanism, and set up a safety net program to protect the poor from any ensuing price increases. They stated that they have developed a timetable for the removal of fuel subsidies and are awaiting the preparation of the social register to set up the safety net program, which would involve cash transfers.

33. Authorities' views. The authorities acknowledge the scale of the fiscal challenges facing the economy and concur with staff that reform is indispensable to help address them. Their reform plans are based on the following pillars. First is reform of public enterprises and the budget framework. They have launched a public enterprise reform program to improve the performance of key enterprises including the enterprise that will manage the water pipeline project. They are also working towards implementing the medium-term budget framework by 2015. The authorities recognize their limited capacity in public management at present, and underscore the importance of technical assistance to enhance it. Second is tax reform. The authorities share staff concerns about the limitations of the tax regime, especially the investment incentive framework. They expect the fiscal conference planned for 2015 to generate concrete reform recommendations that would pave the way for a more efficient and transparent regime. Third is subsidy reform. The authorities remain committed to reforming the fuel subsidy system and intend to put in place social safety nets to protect the poor. Last is the need to restrain spending. Given their commitment to their investment strategy, the authorities plan to maintain the hiring freeze in the public sector outside the education and health sectors.

C. Deb Sustainability and External Stability

34. Debt vulnerabilities have increased significantly over the past two years. In 2013–14, the public sector contracted US$1 billion (70 percent of 2013 GDP) in external loans. This included the two non-concessional loans signed by the central government to finance the railway and water pipeline projects, which are to be disbursed over 2014-2019. As a result, total public and publicly guaranteed debt is expected to exceed 80 percent of GDP in 2017 (see the DSA annex).

35. The updated DSA indicates elevated solvency risks as well as potential near-term liquidity tightness. There are significant and protracted breaches of the present values of the debt-to-GDP and debt-to-exports thresholds. Liquidity ratios breach nearly all the thresholds. External debt ratios are most sensitive to exchange rate depreciation (which is unlikely under the currency board arrangement), and shocks to exports and tightening of the financing terms (some loans have

[4] An FAD technical assistance mission estimated the forgone revenues due to the negative tax adjustment at about 2 percent of GDP for 2012.

floating interest rates). Djibouti remains at a high risk of external debt distress. Given the significant share of debt with floating rates, the central government budget is sensitive to potential tightening of global liquidity. At current US LIBOR rates of about 0.5 percent, the interest rate bill is projected to reach 1.1-1.6 percent of GDP in 2015-2019. To date, no provision has been made for liquidity buffers.

36. Debt service capacity is not mainstreamed into the budget planning process, and is undermined also by limited coordination among relevant agencies. The absence of liquidity management leads to repeated arrears accumulation. Responsibility for financial planning, monitoring, and negotiation is spread between the external debt directorate in the Ministry of Budget, the external financing directorate in the Ministry of Economy and Finance, and other units in the two ministries, with some overlap in functions and no clear lines of subordination.[5] The absence of a medium-term strategy and limited coordination among public finance institutions undermine transparency and effective debt monitoring. Central bank involvement in debt management is crucial, given the risks to external stability caused by excessive borrowing.

Reform priorities

37. Develop a strategy to reduce and manage the external debt burden. Any public or publicly guaranteed borrowing on non-concessional terms would lead to additional debt service costs over the medium term and should be avoided. In addition, any new debt-financed investment should be based on a rigorous assessment of near-term financing costs and potential medium-term benefits. The assessment of debt service capacity and debt sustainability should be integrated into investment management and budget planning. The budget should provide for sufficient liquidity buffers to cover volatile debt service costs and avoid accumulating arrears. Last, alternative options for promoting investment other than direct government debt-financed participation should be considered, noting the risks involved in public-private partnerships in particular.

38. Strengthen coordination among government units involved in debt management and monitoring. Expedite the setting up of the Debt Committee consisting of the ministry of budget, the ministry of economy and finance, and the central bank.

39. Tighten monitoring of government contingent liabilities by: (i) developing rules for issuing government guarantees; and (ii) introducing a monitoring system for debt incurred by public companies without government guarantees.

40. Authorities' views. The authorities acknowledge the risks attached to their current financing strategy. However, they believe this strategy would be viable if it could generate growth and attract large FDI inflows. They stated that external and domestic arrears are being cleared and that, to improve debt management, they are considering setting up a debt committee comprising the ministry of budget, the ministry of economy and finance, and the central bank. The authorities

[5] The September 2013 Medium-Term Debt Strategy TA mission echoed this observation.

underlined the importance of government guarantees as they reduce public enterprises' financing costs.

STAFF APPRAISAL

41. The authorities are fully committed to their investment strategy, despite the concomitant increase in fiscal and external debt vulnerabilities. They view the strategy as vital for the country's development in the face of widespread poverty and unemployment and the absence of natural resources and a viable agricultural sector.

42. Fiscal as well as structural reforms are essential to generate the high economic growth and substantial revenues needed to return the economy to a sustainable fiscal and external debt path and realize the benefits of the investment boom. While the scaling up of investment is expected to generate growth, its medium-term impact on revenues is likely to be modest due to weaknesses in the fiscal regime and in public management. Accordingly, a wide range of reforms is required to enhance the capacity of the central government and public enterprises to raise the revenues needed to return the economy to a path of fiscal and external debt sustainability. At the same time, deep structural reforms are needed to ensure that growth reduces poverty and unemployment and generates widespread benefits.

43. Improving public capacity to manage investment projects is key. Enhancing public management capacity will help ensure that only viable investment projects are undertaken based on absorptive capacity and resource availability. Public enterprises charged with managing investment projects should be reformed to improve their capacity for the task. The institutional arrangement for managing the joint railway project with Ethiopia should be finalized before the railway becomes operational. Improved coordination of the various ongoing initiatives, especially in the electricity sector, would help avoid duplication. Staff welcomes the setting up of a committee to assess the macroeconomic implications of investment projects as a step to fill the gaps in analyzing the impact of the investment projects. Implementing the medium-term budget framework would improve budget planning.

44. A debt management strategy is needed. The strategy should seek to manage and reduce the external debt burden, avoid any public and publicly guaranteed debt that could lead to additional debt service costs over the medium term, and integrate assessment of debt service capacity and debt sustainability into the budget process. Coordination among government units involved in contracting, monitoring, and servicing debt should also be improved. The authorities should remain current on Djibouti's existing obligations. Clearance of existing arrears should be incorporated into the budget. The budget should provide for sufficient liquidity buffers to cover volatile debt service costs and avoid accumulating arrears.

45. The investment incentive system and overall fiscal framework should be revamped. Staff recommends a review of the investment incentive system, in light of the widespread perception that it has not yielded the desired outcomes while generating large fiscal costs. Staff urges the authorities to proceed with the fiscal conference which should provide a forum to examine reform possibilities for the incentive system in particular, and the fiscal framework as a whole, and introduce the reforms needed for fiscal sustainability and growth.

46. Fiscal consolidation is indispensable. The current levels of fiscal deficits cannot be sustained. However, the scope for further expenditure cuts is limited given the tightening of current expenditures already envisaged. This unsustainable situation highlights the urgency of fiscal reform to broaden the tax base and reduce leakages. Over the next few years, it is also important for the investment projects to begin to generate revenues, and thus help cut the deficits.

47. Economic diversification remains a priority. Much of the scaling up of investment is focused on port and transportation infrastructure catering mainly to Ethiopia, reinforcing the risk associated with reliance on a single sector with one client. Structural reforms aimed at economic diversification towards sectors with high growth and employment potential would help reduce this risk. The key priorities are: (i) reducing the high electricity costs which—despite the importation since 2011 of much cheaper electricity from Ethiopia—have not been reduced for businesses; (ii) improving the business environment, especially through strengthening the protection of property rights and contract enforcement, and reducing red tape.

48. Educational curricula and training programs require reform with an emphasis on skills training, rather than academic training. This would help to develop the skills that are in demand in the job market, thereby improving the ability of Djibouti nationals to fill the jobs created during the investment boom.

49. Strengthening bank supervision is critical for financial stability. Further strengthening of central bank supervisory capacity is needed to deal with the expanding banking sector. Enhanced banking supervision would enable the central bank to improve monitoring the quality of commercial bank lending, enforce higher provisioning requirements for such loans, and encourage commercial banks to improve their risk management capacity.

50. Facilitating access to credit for individuals and labor-intensive micro, small and medium enterprises would help foster inclusive growth. Strengthening banking supervision will foster financial stability. Developing the overall financial infrastructure by modernizing the payments and credit reporting systems, and providing partial credit guarantees for small and medium enterprises, would promote access to financial services and contribute to inclusive growth.

51. Targeted social safety nets are needed to protect the poor and vulnerable population from economic hardship. Poverty alleviation policies have been largely untargeted, with limited impact on intended beneficiaries despite the high incidence of poverty. Staff welcomes the ongoing preparation of the social register that will provide the database for developing safety net programs and urges the authorities to expedite the process.

52. Staff recommends that the next Article IV Consultation be held on the standard 12-month cycle.

Table 1. Djibouti: Selected Economic and Financial Indicators, 2012–19

	Est.		Proj.					
	2012	2013	2014	2015	2016	2017	2018	2019
	(Annual percentage change)							
National accounts								
Real GDP (annual change in percent)	4.8	5.0	6.0	6.5	7.0	7.1	7.1	7.0
Consumer prices (annual average)	3.7	2.4	3.0	3.0	3.5	3.5	3.5	3.0
Consumer prices (end of period)	1.1	2.5	3.0	3.0	3.0	3.0	3.0	3.0
	(Percentage of GDP)							
Investment and saving								
Total fixed capital investment	28.1	29.4	48.2	54.9	51.5	35.3	31.7	30.4
Private	15.1	15.7	24.4	28.4	28.1	21.5	19.2	18.4
Public 1/	13.0	13.7	23.8	26.5	23.4	13.8	12.5	12.0
Gross national savings	7.8	6.1	20.7	27.2	29.7	21.9	18.5	18.4
Savings/investment balance	-20.3	-23.3	-27.4	-27.7	-21.8	-13.4	-13.2	-12.0
Public finances								
Total revenue and grants	34.5	31.8	35.6	35.3	32.8	30.9	26.8	26.4
Of which: Tax revenue	18.5	19.8	19.6	18.3	17.3	16.9	16.6	16.8
Expenditure and net lending	37.2	37.7	47.5	49.4	45.3	34.6	32.7	31.1
Of which : Current expenditure	24.2	24.0	23.7	22.9	21.8	20.8	20.2	19.1
Investment expenditure	13.0	13.7	23.8	26.5	23.4	13.8	12.5	12.0
Total revenue (excluding grants)	25.9	27.4	28.8	27.0	25.3	24.1	23.2	22.8
Overall balance (commitment basis, incl. grants)	-2.7	-5.9	-12.0	-14.1	-12.5	-3.7	-5.8	-4.8
Overall balance (cash basis, incl grants)	-3.3	-6.9	-12.6	-14.7	-13.0	-4.1	-6.3	-5.1
Domestic financing	2.6	5.9	2.6	0.6	-0.6	-1.9	2.7	4.4
External financing	0.7	1.0	9.9	14.1	13.6	6.1	3.5	0.7
Change in domestic arrears (decrease -)	-0.6	-1.0	-0.6	-0.5	-0.5	-0.4	-0.4	-0.4
Stock of domestic arrears	5.6	4.1	3.2	2.4	1.6	1.0	0.5	0.1
Overall balance (excluding grants)	-11.3	-10.3	-18.7	-22.4	-20.0	-10.4	-9.4	-8.3
	(Annual percentage change)							
Monetary sector								
Net foreign assets	13.6	27.2	1.0	3.8	7.0	9.6	-0.4	1.6
Net domestic assets	18.2	-36.9	56.8	26.3	19.3	12.6	34.3	23.0
Claims on the private sector	2.2	15.6	15.0	18.0	18.0	18.0	18.0	15.0
Broad money	15.1	6.9	11.4	9.7	10.7	10.6	11.1	10.2
Velocity of broad money (ratio)	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Average commercial lending interest rate (in percent)	...	...	...	...	...	...		
	(In millions of U.S. dollars)							
External sector								
Exports of goods and services	457	485	589	641	681	730	791	858
Imports of goods and services	-836	-913	-1157	-1302	-1283	-1191	-1227	-1300
Balance of goods and services	-379	-428	-568	-660	-602	-461	-436	-442
Current account balance (in percent of GDP)	-20.3	-23.3	-27.4	-27.7	-21.8	-13.4	-13.2	-12.0
FDI (in percent of GDP)	8.1	19.7	8.1	8.0	8.4	9.6	9.7	10.7
Stock of external public and publicly guaranteed debt	666	704	886	1217	1533	1745	1892	1972
Stock of external public and publicly guaranteed debt (in percent of GDP)	49.2	48.4	55.8	69.8	79.4	81.5	79.8	75.4
Gross official reserves	234	411	388	390	427	495	455	440
(in months of next year's imports of goods and services)	3.1	4.3	3.6	3.6	4.3	4.8	4.2	3.8
Gross foreign assets of commercial banks	774	835	885	938	994	1054	1117	1184
(in months of imports of goods and services)	10.2	8.7	8.2	8.8	10.0	10.3	10.3	10.1
Private credit to GDP (in percent)	30.9	32.4	33.9	36.3	38.5	40.9	43.4	45.1
Memorandum items:								
Nominal GDP (in millions of Djibouti francs)	240,569	258,658	282,403	309,782	343,068	380,286	421,541	464,581
Currency board cover (in percent)	113.2	107.2	107.8	105.0	105.0	105.0	105.0	105.0
Exchange rate (DF/US$) end-of-period	177.7	177.7	177.7	177.7	177.7	177.7	177.7	177.7
Real effective exchange rate (yearly average, 2005=100)	96.1	...	...	...	...	...	...	...
(Change in percent; depreciation -)	-0.72	...	...	...	...	...	...	...

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

1/ Public sector includes central government only.

Table 2. Djibouti: Central Government Fiscal Operations, 2012–19
(In millions of Djibouti francs)

	Est.		Proj					
	2012	2013	2014	2015	2016	2017	2018	2019
Revenues and grants	82,904	82,258	100,408	109,379	112,369	117,460	113,039	122,451
Tax revenues	44,451	51,222	55,282	56,758	59,482	64,280	70,105	77,970
Direct taxes 1/	21,143	22,881	25,799	25,854	27,336	28,943	30,679	33,741
Indirect and other taxes	23,308	28,341	29,484	30,904	32,146	35,337	39,426	44,229
Indirect taxes	21,164	25,108	26,219	27,325	27,617	29,533	31,900	34,369
Other taxes	2,144	3,232	3,265	3,580	4,529	5,805	7,527	9,860
Nontax domestic revenues	7,550	9,254	9,723	8,457	8,724	9,016	9,313	9,627
Nontax external revenues 2/	10,329	10,330	16,380	18,512	18,512	18,512	18,512	18,512
Grants	20,574	11,452	19,022	25,651	25,651	25,651	15,108	16,342
Development projects	17,479	8,969	12,084	12,084	12,084	12,084	12,084	13,318
Budget support for current expenditures	3,095	2,483	6,938	13,567	13,567	13,567	3,024	3,024
Total expenditure	89,473	97,425	134,193	153,075	155,269	131,468	137,692	144,526
Current expenditure	58,170	62,038	67,021	70,872	74,953	79,031	85,000	88,776
Wages and related expenditure	31,845	28,153	29,703	31,341	32,438	33,573	37,215	38,619
Wages and contributions	28,995	25,131	26,483	27,983	28,962	29,976	33,228	34,225
Housing subsidies	2,851	3,022	3,220	3,358	3,476	3,597	3,987	4,395
Goods and services	17,725	19,171	19,678	20,499	21,592	22,745	23,961	25,225
Civil expenditure	14,423	15,574	16,178	16,999	17,970	18,996	20,081	21,228
Military expenditure 3/	3,302	3,597	3,500	3,500	3,623	3,749	3,881	3,997
Maintenance	1,330	1,200	1,352	1,491	1,543	1,597	1,653	1,703
Transfers 4/	4,391	10,628	11,712	11,817	12,231	12,659	13,102	13,495
Interest	1,027	847	2,235	3,384	4,809	6,116	6,727	7,394
Investment expenditure	31,303	35,387	67,172	82,203	80,316	52,437	52,693	55,750
Domestically financed 5/	9,073	20,700	23,288	22,610	17,758	13,965	21,520	29,907
Foreign-financed	22,230	14,687	43,885	59,592	62,558	38,472	31,173	25,843
Grants	17,479	8,969	12,084	12,084	12,084	12,084	12,084	13,318
Loans	4,751	5,718	31,801	47,508	50,474	26,388	19,089	12,525
Overall balance (commitment basis, incl. grants)	-6,568	-15,167	-33,785	-43,696	-42,900	-14,008	-24,653	-22,075
Overall balance (commitment basis, excl. privatization-related expenditure)	-6,568	-1,191	-20,785	-43,696	-42,900	-14,008	-24,653	-22,075
Overall balance (commitment basis, excl. grants)	-27,142	-26,619	-52,808	-69,348	-68,552	-39,659	-39,762	-38,417
Change in arrears (cash payments = -)	-1,365	-2,699	-1,700	-1,700	-1,700	-1,700	-1,700	-1,700
Repayment of domestic arrears	-1,330	-2,700	-1,700	-1,700	-1,700	-1,700	-1,700	-1,700
External arrears (interest)	-35	1	0	0	0	0	0	0
Debt relief on interest payments	0	13	0	0	0	0	0	0
Overall balance (cash basis, incl. grants)	-7,933	-17,866	-35,485	-45,396	-44,600	-15,708	-26,353	-23,775
Financing	7,978	17,866	35,485	45,396	44,600	15,708	26,353	23,775
Domestic financing (net)	6,200	15,264	7,438	1,757	-1,938	-7,335	11,508	20,538
Bank financing	6,296	-26,293	6,983	1,882	-1,813	-7,210	11,633	15,955
Central bank	5,593	-26,307	7,409	2,333	-1,335	-6,703	12,170	5,732
Commercial banks	703	14	-426	-451	-478	-507	-538	10,223
Nonbank financing	-96	41,557	-221	-125	-125	-125	-125	-125
Of which : privatization	0	32,878	0	0	0	0	0	0
External financing (net)	1,778	2,602	28,047	43,639	46,539	23,042	14,846	3,237
Disbursements	4,751	5,718	31,801	47,508	50,474	26,388	19,089	12,525
Amortization payments	-2,973	-3,116	-3,754	-3,869	-3,936	-3,345	-4,243	-9,288

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

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

2/ Annual leasing fees from French (€30 million) and U.S. (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/ 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.

4/ Excludes housing subsidies.

5/ For 2013 includes a US$28.9 million participation in railway project.

Table 3. Djibouti: Central Government Fiscal Operations, 2012–19

(In percent of GDP)

	Est.		Proj					
	2012	2013	2014	2015	2016	2017	2018	2019
Revenues and grants	34.5	31.8	35.6	35	32.8	30.9	26.8	26.4
Tax revenue	18.5	19.8	19.6	18.3	17.3	16.9	16.6	16.8
Direct taxes 1/	8.8	8.8	9.1	8.3	8.0	7.6	7.3	7.3
Indirect and other taxes	9.7	11.0	10.4	10.0	9.4	9.3	9.4	9.5
Indirect taxes	8.8	9.7	9.3	8.8	8.0	7.8	7.6	7.4
Other taxes	0.9	1.2	1.2	1.2	1.3	1.5	1.8	2.1
Nontax domestic revenues	3.1	3.6	3.4	2.7	2.5	2.4	2.2	2.1
Nontax external revenues 2/	4.3	4.0	5.8	6.0	5.4	4.9	4.4	4.0
Grants	8.6	4.4	6.7	8.3	7.5	6.7	3.6	3.5
Development projects	7.3	3.5	4.3	3.9	3.5	3.2	2.9	2.9
Budget support for current expenditures	1.3	1.0	2.5	4.4	4.0	3.6	0.7	0.7
Total expenditure	37.2	37.7	47.5	49.4	45.3	34.6	32.7	31.1
Current expenditure	24.2	24.0	23.7	22.9	21.8	20.8	20.2	19.1
Wages and related expenditure	13.2	10.9	10.5	10.1	9.5	8.8	8.8	8.3
Wages and contributions	12.1	9.7	9.4	9.0	8.4	7.9	7.9	7.4
Housing subsidies	1.2	1.2	1.1	1.1	1.0	0.9	0.9	0.9
Goods and services	7.4	7.4	7.0	6.6	6.3	6.0	5.7	5.4
Civil expenditure	6.0	6.0	5.7	5.5	5.2	5.0	4.8	4.6
Of which : extrabudgetary spending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Military expenditure 3/	1.4	1.4	1.2	1.1	1.1	1.0	0.9	0.9
Maintenance	0.6	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Transfers 4/	1.8	4.1	4.1	3.8	3.6	3.3	3.1	2.9
Interest	0.4	0.3	0.8	1.1	1.4	1.6	1.6	1.6
Foreign-financed current spending	0.8	0.8	0.8	0.8	0.7	0.6	0.6	0.5
Investment expenditure	13.0	13.7	23.8	26.5	23.4	13.8	12.5	12.0
Domestically financed 5/	3.8	8.0	8.2	7.3	5.2	3.7	5.1	6.4
Foreign-financed	9.2	5.7	15.5	19.2	18.2	10.1	7.4	5.6
Grants	7.3	3.5	4.3	3.9	3.5	3.2	2.9	2.9
Loans	2.0	2.2	11.3	15.3	14.7	6.9	4.5	2.7
Overall balance (commitment basis, incl. grants)	-2.7	-5.9	-12.0	-14.1	-12.5	-3.7	-5.8	-4.8
Overall balance (commitment basis, excl. privatization-related expenditure)	-2.7	-0.5	-7.4	-14.1	-12.5	-3.7	-5.8	-4.8
Overall balance (commitment basis, excl. grants and foreign-financed investments)	-2.0	-4.6	-3.2	-3.1	-1.7	-0.3	-2.0	-2.7
Change in arrears (cash payments = -)	-0.6	-1.0	-0.6	-0.5	-0.5	-0.4	-0.4	-0.4
Repayment of domestic arrears	-0.6	-1.0	-0.6	-0.5	-0.5	-0.4	-0.4	-0.4
External arrears (interest)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief on interest payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis, incl. grants)	-3.3	-6.9	-12.6	-14.7	-13.0	-4.1	-6.3	-5.1
Financing	3.3	6.9	12.6	14.7	13.0	4.1	6.3	5.1
Domestic financing (net)	2.6	5.9	2.6	0.6	-0.6	-1.9	2.7	4.4
Bank financing	2.6	-10.2	2.5	0.6	-0.5	-1.9	2.8	3.4
Central bank	2.3	-10.2	2.6	0.8	-0.4	-1.8	2.9	1.2
Commercial banks	0.3	0.0	-0.2	-0.1	-0.1	-0.1	-0.1	2.2
Nonbank financing	0.0	16.1	-0.1	0.0	0.0	0.0	0.0	0.0
External financing (net)	0.7	1.0	9.9	14.1	13.6	6.1	3.5	0.7
Disbursements	2.0	2.2	11.3	15.3	14.7	6.9	4.5	2.7
Amortization payments	-1.2	-1.2	-1.3	-1.2	-1.1	-0.9	-1.0	-2.0

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

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

2/ Annual leasing fees from French (€30 million) and U.S. (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/ 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.

4/ Excludes housing subsidies.

5/ For 2013 includes a US$28.9 million participation in railway project.

Table 4. Djibouti: Balance of Payments, 2012–19
(In millions of U.S. dollars, unless otherwise indicated)

	Est.		Proj.					
	2012	2013	2014	2015	2016	2017	2018	2019
Current account (including grants)	-275	-339	-436	-484	-420	-287	-313	-315
(in percent of GDP)	-20.3	-23.3	-27.4	-27.7	-21.8	-13.4	-13.2	-12.0
Credit	457	485	589	641	681	730	791	858
Exports of goods, f.o.b.	118	120	125	131	139	151	163	175
Exports of services	339	366	464	510	542	579	629	683
Debit	-836	-913	-1157	-1302	-1283	-1191	-1227	-1300
Imports of goods, f.o.b.	-676	-719	-923	-1041	-1019	-979	-1002	-1057
Of which: investment goods	-135	-255	-471	-546	-489	-410	-384	-389
Imports of services	-160	-194	-235	-261	-263	-212	-225	-243
Net income from abroad 1/	84	84	104	111	116	109	117	122
Of which: income related to the lease of military bases	58	58	92	104	104	104	115	126
Net current transfers from abroad	20	4	29	66	66	65	66	67
Private (net)	-9	-10	-10	-10	-11	-11	-12	-12
Official (net)	29	14	39	76	76	76	78	79
drought-related	16	...	...	...	...	...	...	...
Capital and financial account 2/	103	380	413	494	460	359	274	300
Net capital transfers	105	56	71	71	71	72	72	79
Foreign direct investment	110	286	129	140	162	206	230	280
Public sector (net)	-5	77	181	339	318	217	154	85
Disbursements	25	108	233	377	371	248	197	160
Repayments	-29	-31	-52	-38	-53	-32	-43	-75
Of which: Eligible for Paris Club rescheduling	0	0	0	1	2	3	4	5
Commercial banks (- = increase in NFA)	-108	-39	-31	-35	-35	-36	-35	-35
Other investments (net, including errors and omissions)	151	133	63	-21	-56	-99	-148	-109
Overall balance (deficit -)	-22	174	-23	10	40	72	-39	-15
Financing	22	-174	23	-10	-40	-72	39	15
Central bank	13	-177	21	-3	-40	-72	39	15
Assets (- = increase)	-6	-176	22	-1	-38	-68	40	16
Liabilities	19	-1	-2	-2	-2	-5	0	0
Exceptional financing	9	3	2	-7	0	0	0	0
Budget support from donors (grants and loans)	7	0	0	0	0	0	0	0
Change in overdue obligations (decrease-)	2	3	2	-7	0	0	0	0
Memorandum items:								
Central bank gross foreign assets	234	411	388	390	427	495	455	440
Official external debt (including public and publicly guaranteed debt)								
In millions of U.S. dollars	666	704	886	1217	1533	1745	1892	1972
In percent of GDP	49.2	48.4	56	70	79	82	80	75
In percent of exports of goods and services	146	145	151	190	225	239	239	230
Debt service								
In millions of U.S. dollars	38.7	40.2	69.8	64.3	89.3	76.0	93.1	130.8
In percent of GDP	2.9	2.8	4.4	3.7	4.6	3.6	3.9	5.0
In percent of exports of goods and services	8.5	8.3	11.9	10.0	13.1	10.4	11.8	15.2

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

1/ Includes the French and U.S. contributions for the military bases and outflows of interest due on Paris Club and non-Paris Club debt.

2/ Excludes exceptional financing.

Table 5. Djibouti: Monetary Survey and Banking Sector Indicators, 2012–19

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

	Est.		Proj.					
	2012	2013	2014	2015	2016	2017	2018	2019
Broad money	206,184	220,397	245,568	269,376	298,320	329,823	366,558	403,983
Currency in circulation	22,029	24,752	28,403	32,666	37,939	43,404	48,632	51,086
Deposits	184,155	195,644	217,165	236,710	260,381	286,419	317,926	352,897
Demand deposits	112,854	131,116	145,539	158,638	174,502	191,952	213,066	236,504
Djibouti francs	64,130	76,106	84,477	92,080	101,288	111,417	123,673	137,277
Foreign currency	48,724	55,011	61,062	66,558	73,213	80,535	89,393	99,227
Time deposits	71,301	64,528	71,626	78,073	85,880	94,468	104,859	116,394
Djibouti francs	23,862	23,812	26,431	28,810	31,691	34,860	38,695	42,951
Foreign currency	47,439	40,716	45,195	49,262	54,189	59,608	66,164	73,442
Net foreign assets	140,775	179,096	180,848	187,656	200,869	220,132	219,282	222,842
Central bank	30,925	62,363	58,689	59,220	66,254	79,121	72,122	69,418
Assets	41,621	72,955	69,000	69,251	75,929	87,953	80,889	78,119
Liabilities	10,696	10,592	10,311	10,031	9,675	8,832	8,766	8,701
Commercial banks	109,847	116,733	122,158	128,436	134,615	141,011	147,160	153,424
Assets	137,593	148,327	157,227	166,661	176,660	187,260	198,496	210,405
Liabilities	27,746	31,595	35,069	38,224	42,046	46,249	51,336	56,982
Net domestic assets	65,410	41,289	64,720	81,720	97,452	109,691	147,275	181,141
Claims on government (net)	11,634	-12,502	-5,519	-3,637	-5,450	-12,660	-1,028	14,928
Central bank	7,390	-16,732	-9,323	-6,990	-8,325	-15,028	-2,858	2,875
Commercial banks	4,244	4,230	3,805	3,353	2,875	2,368	1,830	12,053
Claims on nongovernment sector	74,284	83,729	95,822	112,502	132,179	155,395	182,786	209,721
Public enterprises	4,685	3,262	3,285	3,308	3,331	3,355	3,378	3,402
Private sector	69,599	80,467	92,537	109,193	128,848	152,041	179,408	206,319
Capital accounts	-17,632	-20,693	-21,595	-22,540	-23,915	-24,974	-26,085	-27,389
Other items (net)	-2,877	-9,245	-3,988	-4,605	-5,362	-8,070	-8,398	-16,119
Broad money	15.1	6.9	11.4	9.7	10.7	10.6	11.1	10.2
Currency in circulation	0.9	1.3	1.7	1.7	2.0	1.8	1.6	0.7
Net foreign assets	9.4	18.6	0.8	2.8	4.9	6.5	-0.3	1.0
Central bank	-1.3	15.2	-1.7	0.2	2.6	4.3	-2.1	-0.7
Commercial banks	10.7	3.3	2.5	2.6	2.3	2.1	1.9	1.7
Net domestic assets	5.6	-11.7	10.6	6.9	5.8	4.1	11.4	9.2
Of which: Claims on government (net)	3.5	-11.7	3.2	0.8	-0.7	-2.4	3.5	4.4
Claims on nongovernment sector	2.2	4.6	5.5	6.8	7.3	7.8	8.3	7.3
Memorandum items:								
Monetary authorities								
Net international reserves (in U.S. dollars million)	3.7	6.1	6.4	-3.0	-1.2	2.0	0.1	-0.6
Gross foreign assets (in U.S. dollars million)	234.2	410.5	388.2	389.7	427.2	494.9	455.1	439.6
In percent of foreign currency deposits	43.3	76.2	64.9	59.8	59.6	62.8	52.0	45.2
In percent of total deposits	22.6	37.3	31.8	29.3	29.2	30.7	25.4	22.1
Banking system								
Credit to the private sector, 12-month percent change	2.2	15.6	15.0	18.0	18.0	18.0	18.0	15.0
Money velocity	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2

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

Table 6. Djibouti: Financial Soundness Indicators, 2000–June 2014
(In percent, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	June-14
Capital adequacy															
Tier I capital to risk-weighted assets	17.3	18.5	21.7	19.1	15.0	15.7	17.4	14.1	8.9	11.0	12.2	9.4	11.7	9.6	10.2
Regulatory capital to risk-weighted assets	2.3	2.6	2.5	2.7	2.1	2.0	4.2	14.1	8.9	11.0	12.2	9.4	11.7	9.6	10.2
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	44.0	…	…	
Asset quality 1/															
Nonperforming loans to gross loans	19.7	26.9	30.6	29.2	28.8	27.8	15.6	16.0	12.4	9.3	8.3	9.4	11.4	14.5	16.2
Nonperforming loans net of provisions to capital	49.6	50.4	59.0	60.5	67.0	73.7	23.5	22.6	20.8	18.0	15.9	17.3	13.3	37.7	44.6
Provisions to nonperforming loans	54.7	55.5	52.3	52.5	55.1	56.6	74.9	77.2	77.4	76.4	75.1	77.0	82.0	67.8	60.0
Banks exceeding maximum single borrower limit 2/	1	0	0	2	1	0	1	1	1	2	5	7	9	10	11.0
Earning and profitability															
Reported return on assets (ROA)	4.8	4.2	2.1	2.8	2.1	1.9	1.8	1.8	1.7	1.8	1.1	1.0	1.3	1.2	0.5
Reported return on equity (ROE) 3/	13.1	11.7	7.9	8.5	21.1	28.2	43.9	43.2	43.3	45.6	26.9	26.6	27.5	28.5	8.9
Interest margin to gross income	33.5	31.7	26.3	22.3	22.7	40.5	49.9	68.8	68.7	68.9	75.6	78.6	59.6	67.4	66.5
Noninterest expenditures to gross income	59.0	60.0	64.7	71.2	72.2	59.1	47.6	54.1	52.2	40.1	56.8	49.7	37.6	59.1	48.2
Salary expenditures to non-interest expenditures	60.9	62.9	61.8	60.7	54.0	56.6	56.4	47.6	46.6	59.9	59.7	56.6	61.0	41.8	58.6
Liquidity															
Liquid assets to total assets	47.5	58.5	64.9	70.5	74.3	76.6	75.4	72.4	69.5	65.8	65.1	61.2	64.0	64.6	62.1
Liquid assets to short-term liabilities	285.6	455.1	494.0	726.0	710.5	736.2	670.3	155.3	148.0	124.7	120.7	112.3	128.0	110.8	80.4
Liquid assets to demand and saving deposits	164.0	180.1	188.7	175.8	209.1	226.6	597.9	170.4	164.6	183.8	211.0	213.2	202.0	251.6	239.1
Liquid assets to total deposits	61.4	72.0	78.8	81.4	85.4	87.7	87.1	81.2	77.9	74.3	76.8	73.6	80.0	82.3	77.2

Sources: Central Bank of Djibouti; and IMF staff estimates.
1/ Nonperforming loans (NPLs) 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: Millennium Development Goals, 1990–2015

	1990	2009	2010	2011	2012	2013	2015 Goal
Goal 1: Eradicate extreme poverty and hunger							
Employment to population ratio, ages 15-24, total (percent)	..	..	..	..	..		..
Malnutrition prevalence, weight for age (percent of children under 5)	..	..	..	..	..		..
Poverty below $2 per day (in percent)		..	..	..	..		28
Prevalence of undernourishment (percent of population)	53	..	..	20	..		..
Goal 2: Achieve universal primary education							
Literacy rate, youth female (percent of females ages 15-24)	..	..	..	..	..		..
Literacy rate, youth male (percent of males ages 15-24)	..	..	..	..	..		..
Persistence to last grade of primary, total (percent of cohort)	..	..	..	..	..		..
Primary completion rate, total (percent of relevant age group)	32	..	..	46	57		..
Total enrollment, primary (percent net)	..	..	..	52	54		..
Goal 3: Promote gender equality and empower women							
Proportion of seats held by women in national parliaments (percent)	-	14	14	14	14		..
Ratio of female to male primary enrollment (percent)	73	89	..	90	89		..
Ratio of female to male secondary enrollment (percent)	..	73	..	80	76		100
Ratio of female to male tertiary enrollment (percent)	..	69	..	67	..		..
Primary completion rate, total (percent of relevant age group)	32	36	..	46	57		100
Share of women employed in the nonagricultural sector (percent of total nonagricultural employment)	..						..
Goal 4: Reduce child mortality							
Immunization, measles (percent of children ages 12-23 months)	85	84	85	84	...		...
Mortality rate, infant (per 1,000 live births)	95	74	73	72	...		...
Mortality rate, under-5 (per 1,000)	123	93	91	90	...		58
Goal 5: Improve maternal health							
Contraceptive prevalence (percent of women ages 15-49)	...	...	...	...	...		...
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	200	...	...		130
Goal 6: Combat HIV/AIDS, malaria, and other diseases							
Incidence of tuberculosis (per 100,000 people)	619	620	620	620	...		...
Prevalence of HIV, female (percent ages 15-24)	...	...	..	0	...		...
Prevalence of HIV, male (percent ages 15-24)	...	...	..	0	...		...
Prevalence of HIV, total (percent of population ages 15-49)	...	2	2	1	...		...
Tuberculosis case detection rate (all forms)	61	...	..	..	...		...
Goal 7: Ensure environmental sustainability							
CO2 emissions (kg per PPP $ of GDP)	...	0	...	...	...		...
CO2 emissions (metric tons per capita)	1	1	...	...	...		...
Forest area (percent of land area)	...	...	0	0	...		...
Improved sanitation facilities (percent of population with access)	...	50	50	..	...		...
Improved water source (percent of population with access)	76	88	88	..	...		...
Marine protected areas (percent of total surface area)	...	0	0	..	...		...
Goal 8: Develop a global partnership for development							
Debt service (PPG and IMF only, percent of exports, excluding workers' remittances)	...	8	8	...	...		...
Internet users (per 100 people)	...	4	7	7	...		...
Mobile cellular subscriptions (per 100 people)	...	15	19	21	...		...
Telephone lines (per 100 people)	1	2	2	2	...		...
Other							
Fertility rate, total (births per woman)	6	4	4	4	...		...
GNI per capita, Atlas method (current US$)	...	1,270	...	...	...		...
GNI, Atlas method (current US$)	...	1,105,274,873	...	...	...		...
Gross capital formation (percent of GDP)	14	...	...	...	...		...
Life expectancy at birth, total (years)	51	57	58	58	...		...
Literacy rate, adult total (percent of people ages 15 and above)	...	...	...	...	...		...
Population, total	560,279	872,090	888,716	905,564	...		...
Trade (percent of GDP)	132	...	...	...	...		...

Source: World Development Indicators database, 2013.

Annex I. Risk Assessment Matrix

Djibouti: Risk Assessment Matrix

Source of risk	Relative likelihood	Impact if realized	Staff advice on policy response
Political instability or recession in Ethiopia.	Low	High: Ethiopia is the main client of Djibouti's port and, owing to its sheer size, exerts an inordinate influence on Djibouti's economy and political stability.	Encourage diversification of economic activity to reduce dependence on the ports.
Protracted period of slower growth in advanced and emerging economies.	High	High: The predominant port sector would be hurt through slowdown in international trade and shipping.	Encourage economic diversification to reduce dependence on ports. Investigate the scope for reducing the fiscal deficit to increase fiscal buffers.
Political instability in Djibouti.	Low	High: foreign direct investment and overall economic activity would be hurt.	Investigate the scope for reducing the fiscal deficit to increase fiscal buffers.
Further terrorist attacks in Djibouti.	High	High: foreign direct invest and overall economic activity would be hurt.	Enhance the implementation of the AML/CFT framework.
Implementation of investment projects is delayed.	Medium	High: larger budget deficits due to lower growth and fiscal revenues.	Enhance public project management capacity.

Annex II. Major Medium-Term Central Government Investment Projects

The government plans to spend about US$900 million (60 percent of GDP) on two large investment projects in 2014-2018.

The railway project

The electrified railway project involves the construction of a 756 km railway line, stretching from Addis-Ababa, the capital of Ethiopia, to Doraleh port in Djibouti. The Djibouti segment of the railway line costs US$550 million, and the loan contracted is about US$492 million. Ethiopia is financing its own segment of the railway line. The Djibouti government will provide the remaining US$58 million, of which US$28.5 million had already been provided in 2013 from the privatization revenues. Construction of the Djibouti segment is already underway without well-defined institutional arrangements for managing the project. The Djibouti authorities expect that the project will generate the following benefits: (i) reduced travel time, (ii) job creation, and (iii) revenue generation through increased port traffic. Furthermore, they anticipate that the railway line will transform Djibouti into the main port for landlocked South Sudan's imports and oil exports via Ethiopia.

Staff believes that the railway project is likely to generate economic growth, jobs, and, in the long-run, fiscal revenues for Djibouti if it is implemented and managed within a well-defined institutional arrangement for revenue sharing with Ethiopia. Such an arrangement is yet to be put in place. Furthermore, staff does not have the necessary data to quantify the possible positive macroeconomic impact and assess whether the expected benefits are sufficiently large to justify the project cost.

The water pipeline projects

The project involves the construction of a pipeline between Djibouti and Ethiopia to permit the importation of 100,000 cubic meters of water a day free of charge from Ethiopia. The total cost of the project is US$340 million of which about US$322 million is a loan from China. The Djibouti government will provide the additional financing (US$18 million). The current daily demand for water in Djibouti-ville, the capital city, which is home to about 60 percent of the national population, is estimated at 80,000 cubic meters a day. Information on the demand for the entire country is unavailable. The current supply of water is estimated at 36,000 cubic meters a day. Much of the current supply comes from underground sources which are of poor quality and are being depleted. Water from other sources suitable for domestic use is virtually nonexistent. The daily demand is projected at 114,500 cubic meters in 2020 and 144,000 cubic meters in 2030. An estimated 50 percent of water supply is lost due to the dilapidated state of the distribution network. A long-delayed €46 million Euros desalination project is expected to be initiated in 2014 and completed by end-2016.

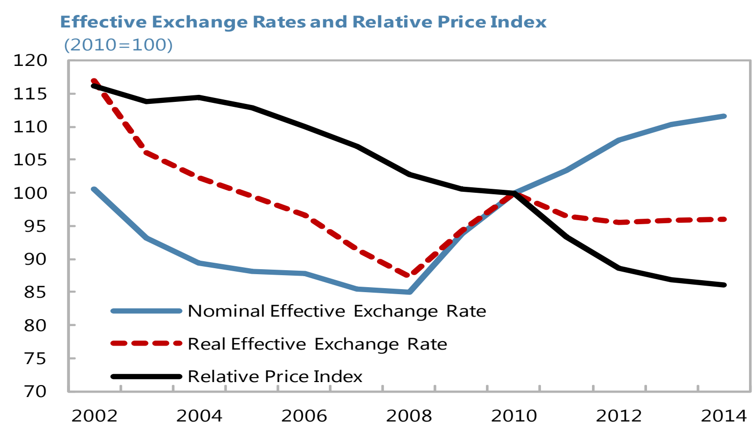
Staff believes that the water pipeline will generate large social benefits by reducing or eliminating the shortfall in the demand for water which has been a potential source of political unrest. The pipeline could also induce investment that has been deterred by insufficient water supply. However, it is unlikely that the revenues generated directly from the project will cover the related debt service obligations unless certain politically difficult decisions are taken, notably water tariff increases, and requiring non-state actors—especially foreign military bases located in the country—to source water from Djibouti's state-owned water company instead of generating their own water supply. Furthermore, the terms and institutional arrangements for accessing the water reserve will need to be clarified with Ethiopia. Lastly, the state-owned water company that will take over the operation of the pipeline and the servicing of the loan requires restructuring.

Annex III. External Sector Assessment and Competitiveness

The current account deficit is forecast to remain large over the medium term reflecting sharp increase in capital imports. However, most of investment imports are linked to external project loans or direct investment flows and may not be realized if disbursements are delayed. Taking into account this financing, real effective exchange rate is assessed to be moderately overvalued. Going forward, the current account could narrow due to increased exports capacity without major adjustment of the REER. In order to mitigate significant external vulnerabilities, the government should continue reforms targeted at improving business environment, promote exports diversification and reduction domestic costs. It is also important to build sufficient buffers of foreign exchange reserve.

The current account gap will exceed 27 percent of GDP in the near term, but is projected to fall back to low double-digits after the construction boom is over. Massive capital goods imports will greatly exceed an expected increase in export revenues (mainly port services) over 2014–17. In the medium term, the on-going expansion of the port infrastructure and related transportation is expected to result in major increase in exports potential as well as to allow Djibouti to benefit from growth of Ethiopia's economy and external trade. Exports of maritime services is forecast to accelerate to about 15 percent in real terms on average in 2014-2019 as construction of new port facilities will allow to ease capacity constraints. Constructions of the new railroad will generate a new stream of export revenues, however for the next decade most of the incomes will be used to cover debt service.

Real Effective Exchange Rates



Sources: Djibouti authorities; and IMF staff estimates.

Limited exports diversification and minimal local production makes the outlook dependent on the economic performance of the neighboring Ethiopia and the global commodity prices. While export revenues are concentrated in trade and transportation services, local production of key consumption goods (such as food) as well as the main factors of production (including water and energy) is almost non-existent. Current account remains prone to food prices and energy shocks.

Public borrowings, predominantly project loans, remain the main source of financing. Most of the investment projects are either directly financed by the government, or by public enterprises under the explicit government guarantee. Due to limited investment opportunities and underdeveloped financial system within the country, banks prefer to accumulate assets abroad or transfer them to the parent companies, draining capital from Djibouti. Information on private debt by nonfinancial enterprises is limited. Overall, the threat of sudden stops in capital flows is perceived to be low.

Major improvement in competitiveness and business environment in particular, are prerequisites for the projected increase in FDI flows. To unlock private investments and benefit fully from its main competitive advantage—geographical position—Djibouti needs to realize major improvements in business environment, increase labor efficiency and reduce costs of other factors of production such as energy. Despite recent steps made by the government to facilitate start of new businesses and access to financing, Djibouti remains behind its peers (See paragraph 13-Djibouti: Business environment and Governance Indicators).

Accounting for the structure of external financing and the drivers of external demand, the real effective exchange rate (REER) is assessed to be moderately overvalued. In 2013, the REER index based on consumer price inflation remained broadly unchanged (figure above) as compared to the previous year. At the same time, as current account remains above the level consistent with the medium-term fundamentals (estimated at around 7 percent), quantitative models provide a range of 15-60 percent for the estimates of the REER gap. Taking into account data constraints, the results should be treated with particular caution for a few reasons:

Estimates of the Current Account Norm and REER Overvaluation

Methodology	CA Norm	REER Gap (Percent)
External balance assessment	-8.3	23.7
Equilibrium real exchange rate	...	15.4
Macroeconomic balance	-7.4	54.8
External sustainability	-4.5	60.2
Memorandum items:		
Elasticity of current account (trade balance) to REER		0.21

- Most capital goods imports are directly financed through accumulation of public and publicly-guaranteed debt or FDI inflows. Net of imports associated with the major on-going and projected investments, estimated gaps would be much lower. This is not captured in MB or EBA estimates.

- Price elasticity of exports and imports is very low. Demand for Djibouti's main exports—port services and the use of its land for military bases—stems from Djibouti's geo-strategic location. At the same time, internal production of the main import items such as food and manufactured goods is non-existent due to unfavorable climate and a range of other of supply-side constraints.

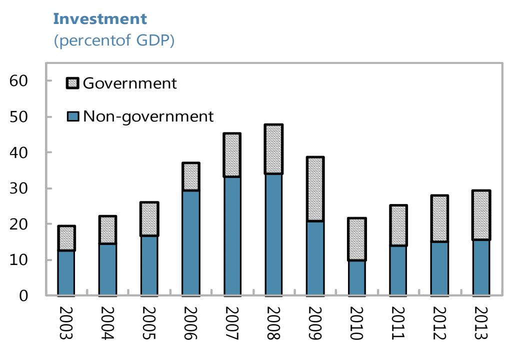
- Djibouti remains dependent on aid flows, which should be captured in the assessment of the gaps. Current account projections are highly sensitive to the assumptions on loan disbursements. As discussed above, after the frontloaded scale-up in investments, the current account is projected to fall to about 13 percent by 2019 and further to about 10 percent in the long term without major movements in the REER.

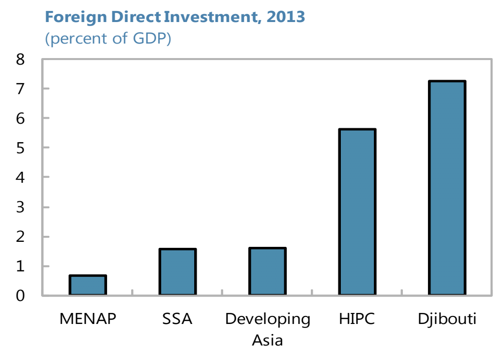
- Sufficient reserves buffers are needed to deal with shocks. Under the baseline, reserves coverage ratio will stay at around 105 percent of the sum of the broad money and the government deposit at the central bank, which is slightly above legally required full coverage. Reserves imports coverage ratio is projected to fluctuate between 3 and 5 months of imports below the 6 months benchmark for countries with fixed exchange rate regime.

Annex IV. Investment and Growth

Public and private investment in Djibouti soared recently, but the potential impacts of these investments on growth have not been carefully evaluated and there are doubts that these investments reduce poverty and unemployment. Investment is expected to reach an unprecedented 48 percent of GDP in 2014 and rise further to 55 percent of GDP in 2015.

Investment Trends





Sources: Djibouti authorities; and IMF staff estimates.
HIPC = Heavily Indebted Poor Countries; SSA = Sub-Saharan African Countries

Indeed, Djibouti has followed the example of many other African countries such as Ghana, Ethiopia, Tanzania, and Zambia in non-concessional borrowing for public investment, although these countries have lower debt-to-GDP ratios than Djibouti. Most of these countries signed loan agreements with the China Exim Bank and China Development Bank for investment in the energy and transportation sectors. For instance, Ghana issued 750 million Eurobond and borrowed US$292 million from Exim Bank in 2007, and then, at end-2011, Ghana and China Development Bank negotiated a “Master Financial Agreement” worth US$3 billion.

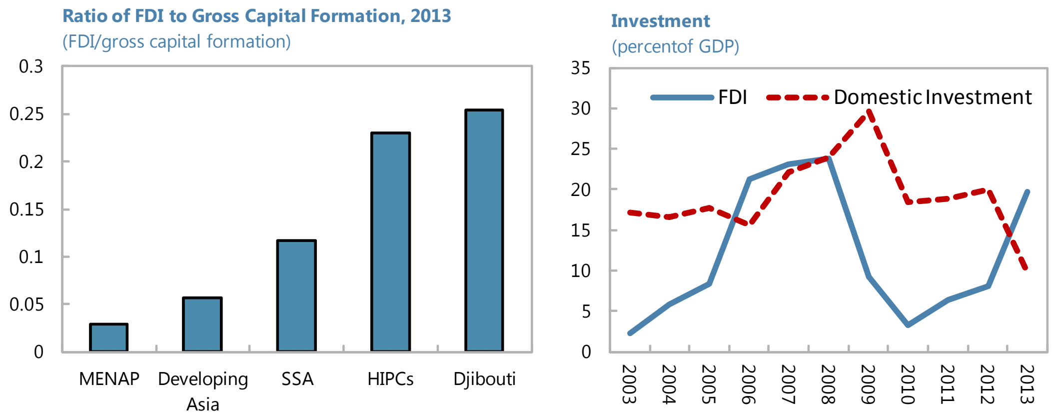
Public investment and growth

The country has engaged in massive public investment projects (see Table 1). In capital- where capital is scarce, such as Djibouti, public investments are expected to have high return, but the impact on growth is often uncertain, especially because of deficiencies in public financial management. In the Public Investment Management Index (PIMI), Djibouti ranked 50th out of 71 developing countries, of which 40 countries are LICs. In turn, the impact on debt sustainability of non-concessional borrowing depends on the impact of investment on growth.

Foreign direct investment and growth

Djibouti has seen not only a boom in the level of public investment, but also in foreign direct investment. FDI decreased during the global crisis, but it reached an unprecedented level in 2013 and is expected to remain at high levels in the coming years.

Foreign Direct Investment Trends



Sources: Djibouti authorities; and IMF staff estimates.

The impact of the previous surge of FDI on growth has been positive, but negligible on employment and poverty. The share of FDI in total investment increased from 11 percent in 2003 to about 50 percent in 2007–08 while the annual real growth averaged 5.2 percent during 2006–09. FDI flows can affect economic growth through many channels such as increases in investment and employment, foreign exchange, and tax and customs revenues. Here, also, the impact on growth cannot be taken for granted. According to the literature, FDI flows may generate negligible investment spillovers in countries with less-developed financial markets and weaker institutions. Studies also show the importance of human capital for the technology spillover of FDI flows. For instance findings in Wang and Wong (2009) suggest that FDI promotes growth only when there is a threshold level of human capital in the host country.

Annex V. Past Article IV Recommendations

Recommendation	Remarks
Fiscal Policy	
Reform the fuel subsidy system and introduce targeted compensation measures for the poor.	Ongoing
Review and reform the existing corporate tax exemption system.	Not yet done
Unify the administration of the VAT and other taxes into a large taxpayers' unit.	Ongoing
Financial Sector	
Strengthen prudential standards by expediting the planned introduction of a liquidity ratio.	Ongoing
Strengthen the AML/CFT framework	Ongoing
Business Environment	
Pursue efforts to ensure sufficient supply of electricity and potable water	Ongoing
Introduce a pricing system reflecting reduced electricity costs for business	Not done yet
Address weaknesses in the judiciary system	Not done yet
Enact legislation allowing new operators into the mobile telephony sector	Pending
External Debt	
Avoid non-concessionary borrowing	Non-concessionary loans have been contracted
Minimize issuance of government guarantees for debt contracted by public enterprises.	

Source: IMF Staff.

INTERNATIONAL MONETARY FUND

DJIBOUTI

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 15, 2015

Prepared By

The Middle East and Central Asia Department
(in Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of November 30, 2014)

Membership Status

Joined: December 29, 1978

General Resources Account:

	SDR Million	Percent Quota
Quota	15.90	100.00
Fund holdings of currency	14.80	93.08
Reserve position in Fund	1.10	6.92

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	15.16	100.00
Holdings	7.51	49.56

Outstanding Purchases and Loans:

	SDR Million	Percent Quota
ECF Arrangements	21.49	135.14

Latest Financial Arrangements:

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

[1/] Formerly PRGF.

Projected Payments to the Fund[2/]
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2014	2015	2016	2017	2018
Principal	0.15	1.07	1.36	3.20	4.45
Charges/Interest	0.00	0.06	0.05	0.05	0.04
Total	0.15	1.12	1.42	3.25	4.49

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

Implementation of HIPC Initiative: Not Applicable.

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

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

Safeguards Assessment

A safeguards assessment of the Banque Centrale de Djibouti (BCD) was conducted in 2012 in the context of an augmentation of access under the previous ECF arrangement. It found that limited progress had been made since the last assessment. Fundamental governance and oversight gaps persisted, including the absence of an internal audit function. Statutory compliance was not monitored, and transparency of financial reporting remained limited. The straightforward nature of the BCD's operations, and the currency board arrangement, mitigated these risks to some extent. The assessment recommended the BCD formalize Board and Audit Committee oversight, introduce an internal audit mechanism, improve financial reporting transparency through publication, and clarify the roles and responsibilities in servicing and repayment of IMF loans between the BCD and the Ministry of Finance (now Ministry of Budget) in a memorandum of understanding agreement. The memorandum of understanding has been signed. *The 2013 management letter has been published; however, staff has been unable to obtain a copy of the complete set of 2013 financial statements, including the disclosure notes*.

Exchange arrangements

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

Article IV Consultation

The staff report for the 2013 Article IV consultation was discussed by the Executive Board on July 3, 2013.

FSAP Participation

The FSAP, including the assessment of the AML-CFT framework, was approved by the Board in June 2009. Key findings were (i) the banking sector does not appear to pose an immediate systemic threat, but it is vulnerable to a deterioration of credit quality and interest rate movements; (ii) the BCD's regulatory and supervisory framework is rudimentary and not well suited to handle the entry of new banks; (iii) the BCD should introduce a reserve requirement and bolster its capacity to provide emergency liquidity support, (iv) the BCD should, in cooperation with the banking community, develop a comprehensive modernization strategy for the national payments system that responds to the needs of the growing economy; (v) the assessment of AML/CFT noted a combination of weak capacity to address ML/FT and multiple vulnerability factors. The BCD has started to implement some of these recommendations. It has adopted measures to strengthen banking supervision and regulation, including onsite and offsite bank inspections. Furthermore, the BCD has reinforced prudential measures by increasing the minimum capital requirements and reducing the single-borrower limit.

Technical Assistance

FAD—Budget Control and Cash Management of the Treasury	April 2000
FAD—Direct Tax Reform	September 2000
FAD/MCD—Budget Control and Cash Management of the Treasury	February 2001
FAD—Tax Administration and Possible Introduction of a VAT	April 2002
STA—Government Finance Statistics	May 2001
STA—National Accounts and Balance of Payments Statistics	January 2002
STA—Balance of Payment Statistics	November 2003
MFD—Banking Supervision	December 2002
MFD—Banking Supervision	December 2003
STA—Money and Banking Statistics	November/December 2004
FAD—Tax and Customs Administration	January/February 2005
MFD—Central Banking Accounting	October 2005
FAD—Tax Administration	January 2007
FAD—Tax Policy	January 2007
LEG—AML/CFT	June 2007
STA—Balance of Payments Statistics	June 2007
FAD—Tax Policy	June 2007
FAD—Tax Administration	July 2007
MCM—Central Bank Accounting	November 2007
STA—Monetary and Financial Statistics	December 2007
FAD—Public Fiscal Management	February 2008
MCM—Central Bank Accounting	February 2008
STA—Monetary and Financial Statistics	January 2009
FAD—Public Financial Management	May 2009
MCM—Central Bank Supervision	April, September 2010
MCM—Liquidity Management	May 2010
FAD—Medium Term Fiscal Framework	January 2011
FAD—VAT Assessment and Tax Policy	February-March 2011
MCM—Banking Supervision	April-July 2011
STA—Balance of payments statistics	December 2011
FAD—Public Financial Management	January 2012
FAD—Subsidies Reform	March 2012
MCM—Banking Supervision	March-May 2012
MCM—Banking Supervision	March 2013
FAD—Exemptions	May 2013
FAD—VAT and Tax Administration	May 2013

Resident Representative

The IMF had a resident representative in Djibouti from 1998. The last resident representative, Mr. Samba Thiam, left the post in December 2014 and was replaced by the current resident representative, Mr. Joseph Karangwa, in January 2015.

RELATIONS WITH THE WORLD BANK GROUP

Joint Managerial Action Plan

(June 2013 – December 2015)

Title	Products	Provisional Timing of Missions	Expected Delivery Date
1. Bank Work Program	Energy Sector Assessment (TA)	November 2014	Delivered
	Poverty and Gender Study		November 2015
	Power Access and Diversification Project	November 2014	Delivered
	Rural CDD & Water Mobilization Project		Delivered
	Urban Poverty Reduction Project	November 2014	Delivered
	Urban Poverty Reduction Project II	November 2014	Delivered
	Strengthening Institutional capacity and	November 2014	Delivered
	Management of the Education		Delivered
	Improving Health Sector Performance Project	November 2014	Delivered
	Crisis Response- SSN Project	November 2014	December 2014
	Enhancing Income Opportunities in Djibouti(TF)	November 2014	Delivered
	Geothermal Project	November 2014	Delivered
	Education Access and Quality Project	November 2014	Delivered
	Information & Communication Technology Project	November 2014	Delivered
	Study on Light Manufacturing		Delivered
	Private Sector Development Project	December 2014	Delivered
	Governance TA		January 2015
	Health Sector Project (TF)	November 2014	Delivered
	Procurement Capacity building & Professionalization	November 2014	Delivered
	Strengthening Accountability SAI Djibouti	November 2014	Delivered
	Statistical Capacity Building		
	Disaster Risk Management (TF)	January 2015	

2. Fund Work Program	TA on Reserve Management	January-15	January-15
	TA on VAT	May-13	August-13
	TA on Exemptions	June-13	July-13
	TA on Fuel Subsidies	January-12	March-12
	TA on GDSS	December-11	January-12
	TA on BOP Statistics	November-11	December-11
	TA on Banking Supervision	January-12	February-12
	TA on Public Financial Management	January-12	February-12
	TA on DSA	January-12	February-12
	TA on Reserve Management	March-12	April-12
	5th Review of the ECF	October-11	February-12
	6th Review of the ECF	March-12	May-12
3. Joint Bank/Fund Program	Participation in Post-Disaster Needs Assessment	1-Oct-11	Nov-11
	Joint work on INDS		Jun-12

STATISTICAL ISSUES

General: *Data provided to the Fund are broadly adequate for surveillance*. There are, however, serious shortcomings especially in the areas of national accounts and the balance of payments (BOP), and to a lesser extent, in external debt and fiscal data. These data shortcomings are due to capacity constraints. Djibouti began participating in the General Data Dissemination System (GDDS) in February 2012.

National accounts: The authorities do not compile national accounts data, mostly because of low implementation capacity. An initiative has been launched to compile national accounts data. In the first phase, GDP estimates have been generated for 2008–12. In the second phase, a system of national accounts will be established. A population census was completed in 2009, followed by a poverty survey in 2012. A poverty profile was subsequently developed. A budget-consumption survey has been undertaken which should lead to the revision of the CPI basket weights.

External sector: Substantial progress has been made in improving BOP statistics in line with recommendations made by Fund TA missions over the past few years, including a November 2011 BOP mission to assist the authorities in improving the compilation of BOP and IIP statistics and in preparing an effective transition from *BPM5* to *BPM6*. Problems were identified in compiling trade statistics, coverage of direct investment transactions in the BOP, and estimating workers' remittances; improvements could also be made to several items such as freight transportation, investment income, transactions related to foreign military bases, and other investment of private sector (use of IBS data). Despite the introduction of a new system for the management of external debt in 2002, debt statistics continue to be provided irregularly and with a delay.

Government finance: Fiscal data are available on a monthly basis with a lag of about three months. These data do not cover extra-budgetary accounts and public enterprises. Foreign-financed capital expenditure is reported regularly. However, additional efforts are needed to improve the compilation and coverage of fiscal data, particularly at the institutional level, in order to fulfill the recommendations made by a government finance statistics mission in 2001. The Ministry of Budget is reporting neither annual data for dissemination in the *GFS* Yearbook nor high-frequency data for publication in the *International Finance Statistics* (*IFS*).

Monetary accounts: Monetary statistics are generally adequate and cover the central bank and the aggregated balance sheet of all commercial banks. Djibouti received three monetary and financial statistics missions (2004–09) on compiling monetary and financial statistics in accordance with the Fund's *Monetary and Financial Statistics Manual (MFSM).* Over this period, the BCD has implemented some of the recommendations, particularly those concerning the establishment of a sectorization of the economic entities of Djibouti. However, most of the recommendations have not been implemented, mainly because of staffing constraints at the BCD.

Djibouti—Table of Common Indicators Required for Surveillance (As of December 2014)					
	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Na	na	na	na	na
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	September 2014	November 2014	M	M	NA
Reserve/Base Money	September 2014	November 2014	M	M	M
Broad Money	September 2014	November 2014	M	M	M
Central Bank Balance Sheet	September 2014	November 2014	M	M	A
Consolidated Balance Sheet of the Banking System	September 2014	November 2014	M	M	A
Interest Rates[2]	December 2013	September 2014	M	M	A
Consumer Price Index	September 2014	November 2014	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	August 2014	October 2014	M	M	NA
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	August 2014	October 2014	M	M	NA
Stocks of Central Government and Central Government-Guaranteed Debt[5]	October 2014	November 2014	A	A	NA
External Current Account Balance	December 2013	July 2014	A	A	A
Exports and Imports of Goods and Services	December 2013	July 2014	Q	Q	A
GDP/GNP	December 2013[8]	May 2014	A	A	A
Gross External Debt	December 2013	March 2014	A	A	I
International Investment Position[6]	December 2010	March 2011	A	A	A

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (excluding extra-budgetary funds and social security funds, and state and local governments).
[5] Including currency and maturity composition. .
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); Weekly (W); Monthly (M); Bi-monthly (B); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[8] GDP data estimated by staff on the basis of partial data provided by the authorities.

INTERNATIONAL MONETARY FUND

DJIBOUTI

January 15, 2015

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITYANALYSIS

Approved By
Daniela Gressani and Dhaneshwar Ghura (IMF) and John Panzer (IDA)

Prepared by the International Monetary Fund
The International Development Association

Debt risks have increased significantly after the government of Djibouti contracted large nonconcessional loans in 2013. The current DSA confirms the high risk of external debt distress assigned earlier. There are significant and protracted breaches of the PV of debt-to-GDP and the PV of debt-to-exports thresholds. Liquidity ratios breach the relevant thresholds as well, indicating not only elevated solvency risks, but also potential liquidity tightness in the near term. In order to avoid a downgrade to 'in debt distress', the government would need to clear the existing arrears of $4.7 million in the near term and avoid accumulating new arrears.

External debt ratios are most sensitive to exchange rate depreciation; shocks to exports; and tightening of the financing terms, which is particularly relevant because a significant share of debt has variable interest rates. The debt sustainability analysis suggests that borrowing space is extremely limited, and any further nonconcessional borrowing will exacerbate the already high risk of debt distress.

BACKGROUND

1. **Total public and publicly guaranteed (PPG) debt declined slightly to 56.8 percent of GDP by the end of 2013.** A slight decline in the external debt-to-GDP ratio was driven by the GDP growth; the nominal stock was up by US$42 million and stood at 48.3 percent at the end of 2013. Domestic debt increased as advanced dividend payment by the state bank was converted into a loan. However, this trend is expected to be reversed, driven by disbursements under the new external loans. In 2013 the government contracted two large loans for the total amount of about US$900million (60 percent of GDP). These loans are provided by the Export-Import Bank of China to finance the construction of the Addis Ababa–Djibouti railway and a water pipeline from Ethiopia (see Annex II of the Staff Report and Table 1 below). Disbursements are concentrated over 2014–17. As a result, the external debt-to-GDP ratio is expected to exceed 80 percent of GDP in 2017.

Table 1. Djibouti: Public and Publicly-Guaranteed External Debt Contracted in 2013

Year	Creditor	Total amount, US$ million	Percent of GDP	Grant element, percent	Period of disbursements	Sector
2013	EXIM BANK CHINE	491.8	39.6%	10.6 1/	2014-2017	Transportation
	EXIM BANK CHINE	322.0	22.1%	29.7 1/	2014-2017	Water
	IDA	7.0	0.5%	32.6	2013-2017	Healthcare
	FSD	5.0	0.3%	41.6	2014-2017	Other
	FAD	0.4	0.0%	54.4	2014-2017	Energy

1/ The estimates does not take into account commitment fees. For the railroad project loan LIBOR is assumed to remain fixed at 0.5 percent - the level of interest rates at the time, when the loan was contracted.

2. **Domestic debt remains a small portion of the total debt stock.** Domestic debt increased in 2013 as advanced dividend payment by the state bank was converted into a loan. The government continues clearing the old stock of domestic arrears according to the schedule set at the beginning of the 2008 ECF; however, new domestic arrears were accumulated. The exact amount of the total outstanding stock of domestic arrears is unclear. It is assumed that new domestic arrears were cleared by the end of 2014.

3. **The major scaling-up of investment will exert considerable fiscal pressures in the near term.** The government interest rate bill is projected to increase to at least 1.6 percent of GDP in 2018–19, from 0.3 percent in 2013; including at least 0.7 percentage point associated with the interest rate on the disbursed amounts and commitment fees paid on undisbursed amounts under the water pipeline and the railway loan agreements.

4. As of November 2014, the stock of arrears (excluding technical arrears) on PPG external debt amounted to US$4.7 million (less than 0.3 percent of GDP and 1 percent of the total debt stock). About half of these arrears have been outstanding for less than 3 months and represent missed payments to Arab funds covered by the GCC grant agreement.[1] The remaining portion of arrears (including arrears to Paris Club members) is expected to be repaid by February 2015.

Table 2. Djibouti: Composition of External Public and Publicly-Guaranteed Debt, End-2013

	Millions of US$	Percent of GDP	Percent of external debt
External Debt	699	48	100
Public debt	510	35	73
Multilateral	340	23	49
IMF, AMF	34	2	5
IDA	148	10	21
Other Multilateral	158	11	23
Official Bilateral	170	12	24
Paris Club	61	4	9
Non-Paris Club	108	7	16
Publicly-guaranteed debt	262	18	37
Stock of external arrears	5	0	1

Sources: Djibouti authorities; IMF and World Bank staff calculations.

[1] In December 2013, the Gulf countries decided to grant Djibouti US$200 million over 2014–17. Out of this amount, US$40 million will be used to repay debt due to the Gulf countries.

MACROECONOMIC ASSUMPTIONS

5. The scaling-up of investment is expected to accelerate economic activity starting in 2014, but also to result in widening of the fiscal and current account deficits over the medium term.

- GDP growth was revised up to about 7 percent in 2016–17, compared with 6.5 percent in the previous DSA (Table 3) under the assumption that ongoing investments will create new production and export capacity. It is projected to moderate to 6 percent in the long term, slightly higher than the previous DSA (5.8 percent).

- The current account gap is projected to reach 27 percent of GDP over 2014–15, because large capital imports will exceed the expected increase in exports, mainly port services. Most of the projects have already secured financing in the form of debt (mainly PPG), FDI, and capital grants.

- Net FDI inflow (mainly the development of port-related activities) is projected to fluctuate around 8–11 percent of GDP per annum.

- Inflation forecasts were revised upward to 3–3.5 percent over the next five years, from 2.5 percent assumed under the previous DSA.

- Given data on the loan agreements signed since the last review and data on loans under negotiation, in the current DSA update the grant element of new public borrowings remains at about 25 percent.

- It is projected that the central government will reduce usage of external financing after 2019 and increase borrowing from the domestic market to cover its remaining budget financing needs. The real interest rate of new domestic debt is set at 2 percent.

- Effective interest rates on external debt are projected to remain elevated in 2014–15 because of a large share of relatively expensive loans, and to decline gradually to 2.7–3 percent in the long term, assuming a constant LIBOR rate. However, the effective interest rate on the railway project loan, which is linked to six months LIBOR, could increase.

6. The current DSA uses a discount rate of 5 percent, up from 3 percent used in the previous DSA.

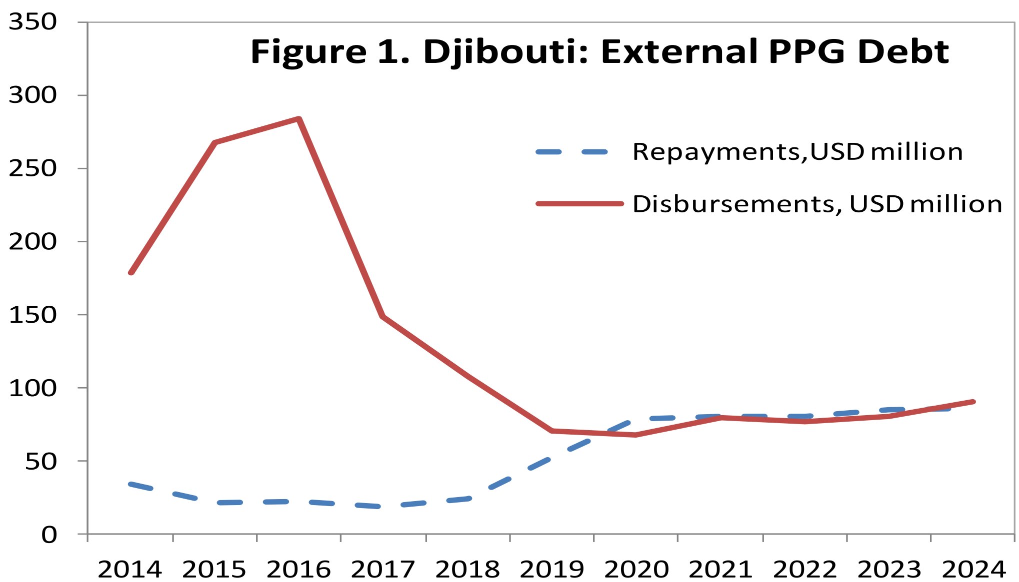
Table 3. Djibouti: Evolution of Selected Macroeconomic Indicators

	2014	2015	2016	2017	2018	Average 2019–33
Real GDP growth						
Current DSA	6.0	6.5	7.0	7.1	7.1	6.0
Previous DSA, June 2013	6.0	6.5	6.5	6.5	6.0	5.8
Overall fiscal balance (cash basis, percent of GDP)						
Current DSA	-12.6	-14.4	-12.7	-3.9	-6.0	-0.3
Previous DSA, June 2013	-6.0	0.0	0.0	0.0	0.0	0.0
Current account deficit (percent of GDP)						
Current DSA	-27.5	-27.7	-21.8	-13.6	-13.4	-11.3
Previous DSA, June 2013	-15.2	-13.0	-12.8	-12.6	-12.3	-10.3
External PPG debt (nominal, percent of GDP)						
Current DSA	55.5	69.8	79.4	81.5	79.8	53.4
Previous DSA, June 2013	47.7	48.1	45.6	44.0	42.7	33.9

Source: IMF staff.

EXTERNAL DSA

7. Under the baseline, total nominal public and publicly guaranteed (PPG) external debt is projected to exceed 80 percent of GDP with the present value (PV) of debt-to-GDP ratio almost reaching 75 percent over the medium term[2] (Table 4). Disbursements are projected to significantly outpace the repayments over the next five years, leading to rapid buildup of the debt stock (Figure 1). Under the baseline scenario, the present value (PV) of the external debt-to-GDP ratio and the PV debt–to-exports ratio remain above their respective thresholds beyond 2025 (Figure 2). PV of debt-to-revenues ratio is breached temporarily over the medium term. Debt service ratios remain below indicative thresholds under the baseline, but are breached under most of the stress tests.



8. The updated DSA shows that exchange rate depreciation and combined shock are likely to have the most significant effect on debt ratios (Table 5). The bound tests indicate that a one-time 30 percent nominal depreciation in 2014 leads to an increase in the PV of the external debt-to-GDP ratio above 100 percent and to prolonged breaches of the relative threshold. The combined shock may push the PV of the external debt-to-revenue threshold beyond 200 percent, at least in the medium term. The shock to new public sector financing on less favorable terms (200 basis points on all new financing in 2012-34) could be used as a proxy for the potential effect of high floating rates on the railway project loan in the medium term. Under this shock, the PV of the debt-to GDP ratio rises to 85 percent in 2017, and debt service-to-revenue ratio breaches its threshold in 2019.

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[2] Because information on the stock and flows of the private external debt is limited, the current DSA uses simplified assumptions about the evolution of the private external debt. These projected flows, together with capital grants, are behind large negative residuals in the summary of the drivers of net changes in external debt (Table 4).

PUBLIC DSA

9. The dynamic of the total public debt mainly reflects that of external debt as the share of PPG domestic debt remains small (Table 6). Overall public debt is projected to increase from 57 percent in 2013 to about 85 percent in 2017 and remain well above the 38 percent benchmark for the next 10 years. Simulations under the baseline scenario show a significantly stronger debt position as compared to fixed primary balance and historical scenarios, which could be explained by i) projected acceleration of economic growth in the medium term; and ii) expected improvement in the fiscal position (taking into account privatization proceeds received in 2013), which is not captured by these alternative scenarios. According to stress tests, public debt indicators are most vulnerable to exchange rate shock: a one-time 30 percent depreciation in 2014 leads to a major increase in all key ratios and has the most significant impact on the debt-service-to-revenue ratio.

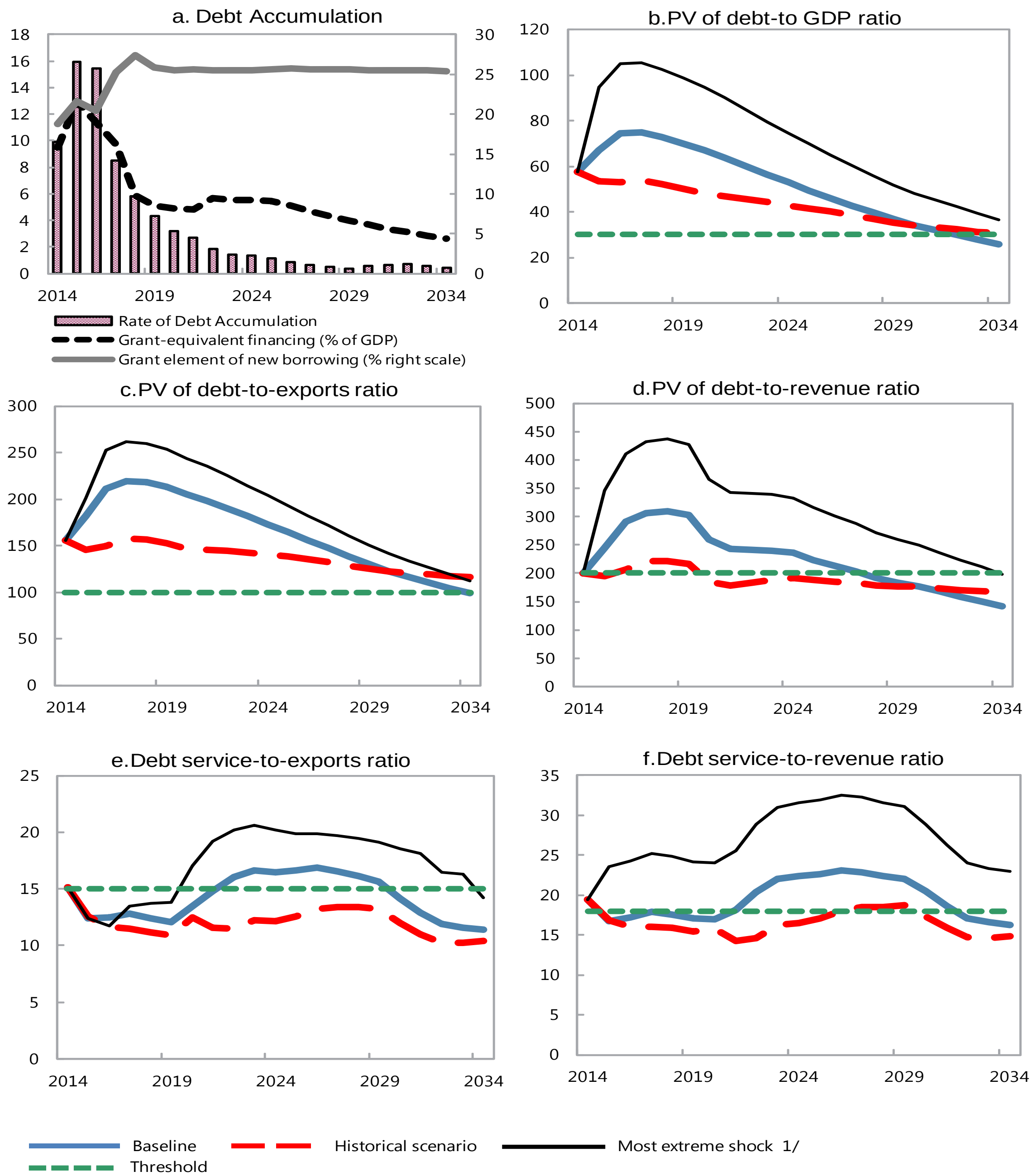
CONCLUSION

10. Djibouti remains at a high risk of debt distress, and both solvency and liquidity risks increased significantly since the last DSA. There are significant and protracted breaches of thresholds for the present values of the external debt-to-GDP and the debt-to-exports ratios. Under the baseline scenario, both ratios are sensitive to exchange rate depreciation. The DSA also indicates that Djibouti may face liquidity pressures in the near future. Debt service indicators are sensitive to most standardized stress tests, including higher cost of financing and exchange rate depreciation.

11. The debt sustainability analysis suggests that the borrowing space is extremely limited. Policy advice would be to minimize issuance of government debt guarantees and encourage private sector participation in direct financing of investment projects. Any PPG borrowing on nonconcessional terms would lead to additional debt service costs over the medium term and should be avoided.

12. The authorities acknowledge high risk attached to the current financing strategy. They believe, however, that this strategy may be viable if it generates growth and that it will crowd in sufficient inflow of FDI. They claim that both domestic and external arrears are being cleared. The setting up of a Debt committee comprising the Ministry of budget, the Ministry of economy and finance, and the central bank, is being considered. The authorities have also underscored that provision of government guarantees can significantly reduce the cost of financing.

Figure 2. Djibouti: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2014–34



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024. In figure b. it corresponds to a One-time depreciation shock; 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 One-time depreciation shock

Table 4. Djibouti: External Debt Sustainability Framework, Baseline Scenario, 2011–34 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-2019 Average	2024	2034	2020-2034 Average
External debt (nominal) 1/	**52.3**	**49.2**	**48.4**			**55.8**	**69.8**	**79.4**	**81.5**	**79.8**	**75.4**		**59.2**	**31.4**	
of which: public and publicly guaranteed (PPG)	52.3	49.2	48.4			55.8	69.8	79.4	81.5	79.8	75.4		59.2	31.4	
Change in external debt	-2.3	-3.1	-0.8			7.4	14.0	9.6	2.1	-1.8	-4.3		-3.4	-2.2	
Identified net debt-creating flows	2.5	7.8	0.2			16.7	16.4	9.0	-1.1	-1.5	-3.5		-2.4	-2.8	
Non-interest current account deficit	**13.0**	**19.6**	**22.7**	**12.0**	**9.4**	**25.2**	**25.4**	**20.3**	**11.0**	**11.4**	**11.4**		**9.7**	**8.9**	9.6
Deficit in balance of goods and services	20.6	28.0	29.4			35.8	37.9	31.2	21.5	18.3	16.8		16.4	15.6	
Exports	33.9	33.8	33.4			37.0	36.8	35.3	34.1	33.4	32.9		30.7	26.6	
Imports	54.4	61.8	62.7			72.8	74.7	66.4	55.7	51.7	49.7		47.1	42.2	
Net current transfers (negative = inflow)	-1.3	-1.5	-0.3	-0.8	0.8	-1.8	-3.8	-3.4	-3.0	-2.8	-2.6		-1.8	-0.8	-1.5
of which: official	-2.0	-2.2	-1.0			-2.5	-4.4	-4.0	-3.6	-3.3	-3.0		-2.2	-1.1	
Other current account flows (negative = net inflow)	-6.3	-6.9	-6.4			-8.8	-8.7	-7.5	-7.5	-4.1	-2.8		-4.9	-5.9	
Net FDI (negative = inflow)	**-6.4**	**-8.1**	**-19.7**	**-12.9**	**8.0**	**-8.1**	**-8.0**	**-8.4**	**-9.6**	**-9.7**	**-10.7**		**-10.7**	**-10.7**	-10.7
Endogenous debt dynamics 2/	**-4.1**	**-3.7**	**-2.8**			**-0.4**	**-1.0**	**-2.9**	**-2.4**	**-3.2**	**-4.2**		**-1.5**	**-1.0**	
Contribution from nominal interest rate	0.8	0.7	0.6			2.2	2.3	1.5	2.7	2.0	0.9		2.0	0.8	
Contribution from real GDP growth	-2.2	-2.3	-2.3			-2.7	-3.3	-4.4	-5.1	-5.2	-5.1		-3.4	-1.8	
Contribution from price and exchange rate changes	-2.7	-2.1	-1.2			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-4.8**	**-10.9**	**-1.0**			**-9.3**	**-2.3**	**0.6**	**3.2**	**-0.3**	**-0.8**		**-0.9**	**0.6**	
of which: exceptional financing	-1.1	-0.7	-0.2			0.2	0.1	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	52.9			57.5	67.0	74.4	74.8	72.8	69.9		52.9	25.9	
In percent of exports	...	...	158.4			155.3	182.1	211.0	219.0	217.6	212.4		172.0	97.6	
PV of PPG external debt	**...**	**...**	**52.9**			**57.5**	**67.0**	**74.4**	**74.8**	**72.8**	**69.9**		**52.9**	**25.9**	
In percent of exports	**...**	**...**	**158.4**			**155.3**	**182.1**	**211.0**	**219.0**	**217.6**	**212.4**		**172.0**	**97.6**	
In percent of government revenues	**...**	**...**	**193.1**			**199.5**	**245.0**	**291.1**	**306.3**	**309.6**	**302.7**		**235.6**	**141.0**	
Debt service-to-exports ratio (in percent)	**8.2**	**8.8**	**8.4**			**15.1**	**12.4**	**12.5**	**12.8**	**12.4**	**12.0**		**16.4**	**11.3**	
PPG debt service-to-exports ratio (in percent)	**8.2**	**8.8**	**8.4**			**15.1**	**12.4**	**12.5**	**12.8**	**12.4**	**12.0**		**16.4**	**11.3**	
PPG debt service-to-revenue ratio (in percent)	**9.9**	**11.5**	**10.2**			**19.4**	**16.7**	**17.2**	**17.9**	**17.6**	**17.1**		**22.4**	**16.3**	
Total gross financing need (Billions of U.S. dollars)	0.1	0.2	0.1			0.4	0.4	0.3	0.1	0.1	0.1		0.2	0.1	
Non-interest current account deficit that stabilizes debt ratio	15.3	22.7	23.5			17.8	11.4	10.7	8.8	13.2	15.8		13.1	11.1	
Key macroeconomic assumptions															
Real GDP growth (in percent)	4.5	4.8	5.0	4.4	1.0	6.0	6.5	7.0	7.1	7.1	7.0	6.8	6.0	6.0	6.0
GDP deflator in US dollar terms (change in percent)	5.1	4.2	2.4	4.2	2.2	3.0	3.0	3.5	3.5	3.5	3.0	3.2	3.0	3.0	3.0
Effective interest rate (percent) 5/	1.5	1.5	1.4	1.4	0.1	5.0	4.5	2.4	3.7	2.7	1.2	3.3	3.5	2.7	3.1
Growth of exports of G&S (US dollar terms, in percent)	-0.3	9.0	6.1	6.9	5.5	21.2	8.9	6.2	7.3	8.5	8.5	10.1	7.4	7.4	7.6
Growth of imports of G&S (US dollar terms, in percent)	36.8	24.0	9.2	12.8	17.3	26.7	12.5	-1.5	-7.1	3.0	5.9	6.6	8.1	6.9	8.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	18.8	21.6	20.4	25.3	27.4	25.9	23.2	25.6	25.4	25.6
Government revenues (excluding grants, in percent of GDP)	28.1	25.9	27.4			28.8	27.3	25.6	24.4	23.5	23.1		22.4	18.4	21.5
Aid flows (in Billions of US dollars) 7/	0.1	0.1	0.1			0.1	0.2	0.2	0.2	0.1	0.1		0.2	0.2	
of which: Grants	0.1	0.1	0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.2	0.2	
of which: Concessional loans	...	...	...			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			9.5	13.0	11.4	9.7	5.9	5.1		5.5	2.6	4.4
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			44.3	43.3	42.7	52.7	49.3	52.9		60.0	55.6	57.4
Memorandum items:															
Nominal GDP (Billions of US dollars)	1.2	1.4	1.5			1.6	1.7	1.9	2.1	2.4	2.6		4.1	9.8	
Nominal dollar GDP growth	9.8	9.2	7.5			9.2	9.7	10.7	10.8	10.8	10.2	10.3	9.2	9.2	9.2
PV of PPG external debt (in Billions of US dollars)			0.8			0.9	1.2	1.4	1.6	1.7	1.8		2.1	2.5	
(PVt-PVt-1)/GDPt-1 (in percent)						9.9	16.0	15.4	8.5	5.9	4.3	10.0	1.3	0.4	1.1
Gross workers' remittances (Billions of US dollars)	...	...	...			...	...	...	...	...	...		...	...	
PV of PPG external debt (in percent of GDP + remittances)	...	...	52.9			57.5	67.0	74.4	74.8	72.8	69.9		52.9	25.9	
PV of PPG external debt (in percent of exports + remittances)	...	...	158.4			155.3	182.1	211.0	219.0	217.6	212.4		172.0	97.6	
Debt service of PPG external debt (in percent of exports + remittance	...	...	8.4			15.1	12.4	12.5	12.8	12.4	12.0		16.4	11.3	

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 5. Djibouti: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014–34

		Projections						
	2014	2015	2016	2017	2018	2019	**2024**	2034
PV of debt-to GDP ratio								
Baseline	57	67	74	75	73	70	**53**	26
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	57	53	53	54	52	50	**43**	31
A2. New public sector loans on less favorable terms in 2014-2034 2	57	71	82	85	84	82	**67**	41
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	57	69	79	80	77	74	**56**	28
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	57	69	79	79	77	74	**55**	26
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	57	68	76	77	75	72	**54**	27
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	57	72	85	84	82	78	**58**	27
B5. Combination of B1-B4 using one-half standard deviation shocks	57	72	86	86	84	80	**60**	28
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	57	94	105	106	103	99	**75**	37
PV of debt-to-exports ratio								
Baseline	155	182	211	219	218	213	**173**	99
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	155	145	150	158	156	152	**140**	117
A2. New public sector loans on less favorable terms in 2014-2034 2	155	194	233	248	251	248	**218**	156
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	155	182	211	219	218	213	**173**	99
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	155	201	253	261	259	253	**204**	112
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	155	182	211	219	218	213	**173**	99
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	155	196	240	247	245	239	**190**	101
B5. Combination of B1-B4 using one-half standard deviation shocks	155	200	246	255	253	246	**197**	107
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	155	182	211	219	218	213	**173**	99
PV of debt-to-revenue ratio								
Baseline	200	245	291	306	310	303	**236**	141
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	200	195	207	221	222	216	**191**	167
A2. New public sector loans on less favorable terms in 2014-2034 2	200	261	322	346	356	353	**297**	222
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	200	252	310	326	330	322	**251**	150
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	200	252	310	325	328	320	**246**	143
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	200	248	298	314	317	310	**242**	145
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	200	264	331	346	348	340	**258**	144
B5. Combination of B1-B4 using one-half standard deviation shocks	200	263	337	353	356	347	**266**	152
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	200	346	411	432	437	427	**332**	199

Table 5. Djibouti: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014–34 (concluded)

Debt service-to-exports ratio

Baseline	15	12	12	13	12	12	**16**	11
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	15	13	12	11	11	11	**12**	10
A2. New public sector loans on less favorable terms in 2014-2034 2	15	12	12	13	14	14	**20**	14
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	15	12	12	13	12	12	**16**	11
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	15	13	14	15	14	14	**20**	13
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	15	12	12	13	12	12	**16**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	15	12	13	14	13	13	**18**	12
B5. Combination of B1-B4 using one-half standard deviation shocks	15	13	14	14	14	13	**19**	13
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	15	12	12	13	12	12	**16**	11

Debt service-to-revenue ratio

Baseline	19	17	17	18	18	17	**22**	16
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	19	17	16	16	16	15	**17**	15
A2. New public sector loans on less favorable terms in 2014-2034 2	19	17	16	19	20	20	**28**	20
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	19	17	18	19	19	18	**24**	17
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	19	17	17	18	18	18	**24**	17
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	19	17	18	18	18	18	**23**	17
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	19	17	18	19	19	18	**25**	18
B5. Combination of B1-B4 using one-half standard deviation shocks	19	17	19	20	19	19	**26**	18
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	19	24	24	25	25	24	**32**	23
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	23	23	23	23	23	23	**23**	23

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 as an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 6. Djibouti: Public Debt Sustainability Framework, Baseline Scenario, 2011–34

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-19 Average	2024	2034	2020-34 Average
Public sector debt 1/	60.6	58.5	56.8			62.0	74.3	83.2	84.6	82.3	79.1		60.5	31.7	
of which: foreign-currency denominated	52.3	49.2	48.4			55.8	69.8	79.4	81.5	79.8	75.4		59.2	31.4	
Change in public sector debt	-6.2	-2.2	-1.7			5.2	12.3	8.9	1.4	-2.2	-3.2		-3.5	-2.2	
Identified debt-creating flows	-4.9	-2.4	-10.9			7.1	8.2	5.0	-4.7	-2.7	-3.1		-5.3	-2.7	
Primary deficit	0.6	2.0	5.2	1.4	2.2	9.7	11.5	10.7	0.8	3.6	3.6	6.6	-1.9	-0.7	-1.6
Revenue and grants	34.1	34.5	31.8			35.6	35.6	33.0	31.2	27.1	26.6		26.7	20.3	
of which: grants	6.0	8.6	4.4			6.7	8.3	7.5	6.7	3.6	3.5		4.3	1.9	
Primary (noninterest) expenditure	34.7	36.5	37.0			45.3	47.1	43.7	31.9	30.6	30.2		24.8	19.6	
Automatic debt dynamics	-5.2	-4.4	-3.5			-2.5	-3.2	-5.7	-5.5	-6.3	-6.8		-3.4	-2.0	
Contribution from interest rate/growth differential	-3.7	-3.3	-3.0			-1.9	-2.5	-4.6	-4.4	-5.3	-6.0		-2.8	-1.7	
of which: contribution from average real interest rate	-0.8	-0.5	-0.2			1.3	1.3	0.2	1.2	0.3	-0.7		0.8	0.2	
of which: contribution from real GDP growth	-2.9	-2.8	-2.8			-3.2	-3.8	-4.9	-5.5	-5.6	-5.4		-3.6	-1.9	
Contribution from real exchange rate depreciation	-1.5	-1.2	-0.5			-0.6	-0.7	-1.1	-1.1	-1.0	-0.7		...	...	
Other identified debt-creating flows	-0.3	0.0	-12.7			-0.1	-0.1	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	-12.7			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)	-0.3	0.0	0.0			-0.1	-0.1	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	-1.3	0.2	9.2			-1.9	4.1	3.9	6.1	0.5	0.0		1.8	0.5	
Other Sustainability Indicators															
PV of public sector debt	...	...	61.2			63.7	71.5	78.2	77.8	75.3	73.6		54.2	26.2	
of which: foreign-currency denominated	...	...	52.9			57.5	67.0	74.4	74.8	72.8	69.9		52.9	25.9	
of which: external	...	...	52.9			57.5	67.0	74.4	74.8	72.8	69.9		52.9	25.9	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	3.6	5.3	8.1			15.4	16.1	15.1	5.2	7.7	7.6		3.2	2.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	192.5			179.2	200.8	236.8	249.7	278.1	276.6		203.0	129.0	
PV of public sector debt-to-revenue ratio (in percent)	...	...	223.7			221.1	261.6	306.0	318.7	320.5	318.7		241.4	142.4	
of which: external 3/	...	...	193.1			199.5	245.0	291.1	306.3	309.6	302.7		235.6	141.0	
Debt service-to-revenue and grants ratio (in percent) 4/	8.8	9.4	9.0			15.9	13.0	13.4	14.1	15.4	14.9		18.8	14.8	
Debt service-to-revenue ratio (in percent) 4/	10.7	12.5	10.5			19.6	16.9	17.3	18.0	17.7	17.2		22.4	16.3	
Primary deficit that stabilizes the debt-to-GDP ratio	6.8	4.2	6.9			4.5	-0.8	1.8	-0.6	5.8	6.8		1.6	1.5	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.5	4.8	5.0	4.4	1.0	6.0	6.5	7.0	7.1	7.1	7.0	6.8	6.0	6.0	6.0
Average nominal interest rate on forex debt (in percent)	1.5	1.5	1.4	1.4	0.1	5.0	4.5	2.4	3.7	2.7	1.2	3.3	3.5	2.7	3.1
Average real interest rate on domestic debt (in percent)	-4.5	-3.9	...	-3.9	2.1	...	...	...	...	...	...		...	...	
Real exchange rate depreciation (in percent, + indicates depreciation)	-2.8	-2.3	-1.0	-1.9	2.0	-1.3	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	5.1	4.2	2.4	4.2	2.2	3.0	3.0	3.5	3.5	3.5	3.0	3.2	3.0	3.0	3.0
Growth of real primary spending (deflated by GDP deflator, in percent)	1.8	10.2	6.7	1.9	3.6	29.6	10.8	-0.7	-21.8	2.8	5.6	4.4	3.2	3.8	3.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	18.8	21.6	20.4	25.3	27.4	25.9	23.2	25.6	25.4	...

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.]

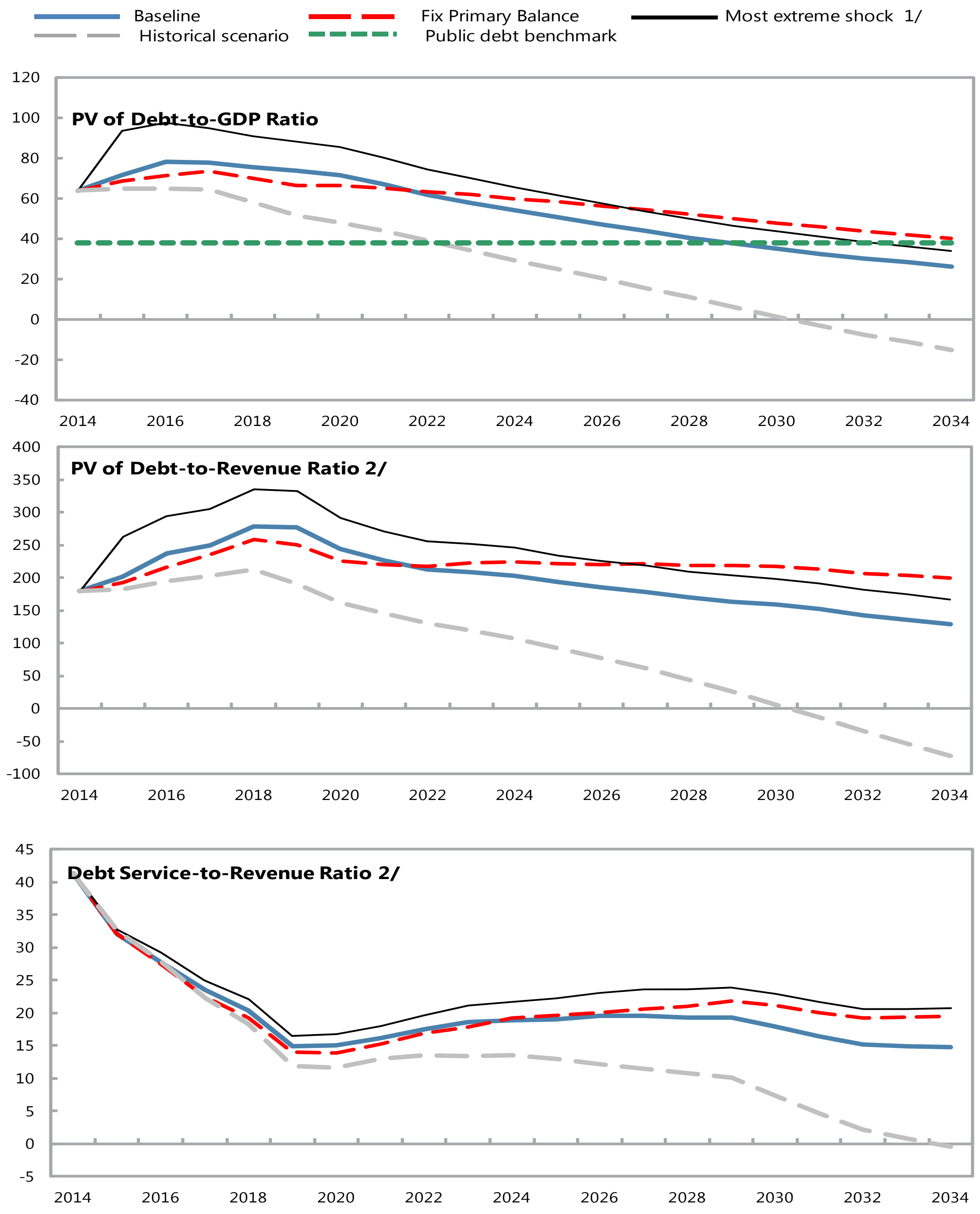
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

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.

Figure 3. Djibouti: Indicators of Public Debt Under Alternative Scenarios, 2014–34



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024.

2/ Revenues are defined inclusive of grants.

Table 7. Djibouti: Sensitivity Analysis for Key Indicators of Public Debt, 2014–34

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
PV of Debt-to-GDP Ratio								
Baseline	64	72	78	78	75	74	54	26
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	64	65	67	69	67	66	67	57
A2. Primary balance is unchanged from 2014	64	70	76	83	85	87	108	124
A3. Permanently lower GDP growth 1/	64	72	79	79	76	75	57	32
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-2016	64	74	85	86	84	83	67	41
B2. Primary balance is at historical average minus one standard deviations in 2015-2016	64	66	67	67	65	64	47	22
B3. Combination of B1-B2 using one half standard deviation shocks	64	66	69	70	69	69	55	34
B4. One-time 30 percent real depreciation in 2015	64	93	97	95	91	88	66	34
B5. 10 percent of GDP increase in other debt-creating flows in 2015	64	79	86	85	82	80	59	29
PV of Debt-to-Revenue Ratio 2/								
Baseline	179	201	237	250	278	277	203	129
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	179	182	200	218	245	243	243	269
A2. Primary balance is unchanged from 2014	179	197	231	265	313	328	404	609
A3. Permanently lower GDP growth 1/	179	201	238	252	281	281	213	158
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-2016	179	207	254	272	308	310	249	201
B2. Primary balance is at historical average minus one standard deviations in 2015-2016	179	184	203	216	241	241	176	110
B3. Combination of B1-B2 using one half standard deviation shocks	179	185	206	222	254	257	206	165
B4. One-time 30 percent real depreciation in 2015	179	263	294	304	336	332	246	167
B5. 10 percent of GDP increase in other debt-creating flows in 2015	179	222	259	272	302	299	220	141
Debt Service-to-Revenue Ratio 2/								
Baseline	16	13	13	14	15	15	19	15
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	16	13	13	13	14	14	20	25
A2. Primary balance is unchanged from 2014	16	13	13	14	16	17	28	50
A3. Permanently lower GDP growth 1/	16	13	13	14	16	15	19	17
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-2016	16	13	14	15	17	17	22	21
B2. Primary balance is at historical average minus one standard deviations in 2015-2016	16	13	13	12	13	13	16	12
B3. Combination of B1-B2 using one half standard deviation shocks	16	13	13	13	14	14	18	17
B4. One-time 30 percent real depreciation in 2015	16	16	19	20	23	22	29	28
B5. 10 percent of GDP increase in other debt-creating flows in 2015	16	13	14	16	17	16	21	16

Sources: Country authorities; and staff estimates and projections.

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

2/ Revenues are defined inclusive of grants.

Statement by Ngueto Yambaye, Executive Director for Djibouti and Mr. Abdoulaye Tall, Senior Advisor
January 30, 2015

I. Introduction

Djibouti has made significant stride recently in achieving high growth rates and reducing poverty. The authorities' policies, in particular improvements to the investments climate and socio-political stability, helped usher a boom in foreign direct investment and financing for major infrastructure projects.

Djibouti's strategic location, as a preferred port outlay for landlocked east African countries, and at a critical juncture for global maritime and trade routes, provides it with unique opportunities and also challenges. The authorities are determined to leverage Djibouti strengths to enhance the region's growth prospects and address the high unemployment and poverty rates.

As noted by staff, extreme poverty and unemployment rates remain high, at 41.9 and 48 percent respectively in 2012. Translating high economic growth rates into job creation, particularly for the youth, remain an essential priority for the authorities. To that regard, they recently adopted a strategic framework to turn Djibouti into an Emerging market economy status, Djibouti Vision 2035 and the Accelerated Growth Strategy for Employment Creation, which lays out the governments' long term priorities, and will inform medium term reforms, and current policies.

Djibouti's authorities are appreciative of the Fund's constructive policy dialogue and the technical assistance provided over the years in furthering their growth and macroeconomic stability agenda. As well reflected in the report, the authorities have implemented, to a greatest extent, Fund's previous Article IV consultations advice- Cf. Annex V of the staff report, and there is a broad agreement between the authorities and Fund staff on the challenges facing Djibouti going forward. To help support their reforms efforts, and increase the traction of the Fund's advice further, the authorities reiterate their interest in a program with the IMF.

II. Recent Developments and Outlook

Economic growth accelerated in Djibouti, driven by the scaling up of investments in priority infrastructure projects. Inflation remained subdued and significantly below the rate registered in comparable economies, including due to the strong currency board anchor. The current account deficit is expected to initially deteriorate while capital investment and heavy equipment imports are absorbed, and to gradually revert as the projects' production cycle mature.

Fiscal policy sought to further the authorities' growth and poverty reduction agenda, while containing fiscal risks. The implementation of fiscal and tax administration reforms, increased revenues from the leasing of military bases, as well as lower oil prices and improved recovery of tax payment arrears, helped generate higher fiscal revenues.

On spending, the authorities moved forward with investment for key water, transportation and energy projects, while containing non priority spending. The investment in the major water generation and transport project will contribute to reducing the severe drinking water shortages, and help achieve one of Djibouti's Millennium Development Goals. The regional electric power interconnection and railroad projects will help strengthen Djibouti's competitiveness, while reducing the cost of doing business related to high electricity and transportation costs.

While the authorities sought to improve the share of investment in the budget, they also strived to contain non-priority spending. Hence, public sector hiring was limited to education and health sectors in an effort to control the wage bill. On social spending, the authorities benefited from the technical expertise, and support from the World Bank in designing and implementing well targeted social safety nets for the poor and vulnerable households notably in Djibouti-ville and in fragile rural areas. In this vein, progress was made towards building a registry of the poor to better target social spending.

As regards monetary policy, the authorities' continued to maintain the coverage of base money in foreign reserves at a level comfortably above the full coverage legal requirement of the currency Board. They took steps to enhance the supervision of the financial system, with the issuance of new instructions and prudential regulation, notably for commercial banks. Although there has been no recent deterioration of the banking system's health indicators, the authorities are closely monitoring the compliance of the financial system to prudential regulation, including in particular the provisioning for non-performing loans, as well as the banks' loan concentration. The authorities have stepped up onsite inspections, and are prepared to forcefully act should risks increase.

On structural reforms, the authorities continued to make progress towards improving public sector efficiency, particularly of public utilities. In this vein, they initiated a comprehensive public enterprise reform program covering the ten largest public enterprises. They also initiated reforms to streamline business regulation with the view to improving further the climate for business.

III. Policies Going Forward

Job Creation and Poverty Reduction

The authorities broadly share staff's diagnostic and recommendations for reducing the widespread poverty and unemployment. The Government recently launched its homegrown strategic development plan, Djibouti Vision 2035 after extensive consultations with the private sector, civil society organizations, and development partners, including the World Bank. The plan recognizes the essential role of the private sector as an engine for growth, and calls for reforms to improve the climate for business, as well as substantial investments in infrastructure to reduce the cost of doing business, particularly in the area of electric power, water, transport, and telecommunication.

Economic diversification is another key axis of the strategy to create jobs and reduce the economy's vulnerability to shocks, with tourism development and the promotion of small and medium sized enterprises as immediate priority action areas.

In order to promote economic growth and poverty reduction, the government plans to improve the governance and efficiency of public social transfers, improve access to finance for the poor, and promote stronger linkages between training programs and employers to better match the needs of companies.

Fiscal Sustainability

The authorities recognize the fiscal risks highlighted by staff, and remain committed to fiscal consolidation with the view to achieving its jobs and poverty reduction objectives while preserving fiscal sustainability. The reforms planned will be multi-pronged. To increase revenues and improve the transparency and efficiency of the tax code, they are convening a fiscal forum this year that is expected to make a comprehensive proposal, including with regard to closing tax loopholes, reviewing the cost effectiveness of generous investment tax incentives, and improving the fairness of the tax code.

On spending, the authorities plan to continue restraining non-priority spending, including by pursuing the hiring freeze outside of the health and education sectors aimed at containing the wage bill. They are committed to ensuring that investments are properly appraised going forward and contribute to achieving their development objectives. They will further seek to revert to a balanced budget, and will implement reforms aimed at strengthening the fiscal policy framework, including by adopting a medium term fiscal framework.

The authorities plan to deepen reforms aimed at improving the governance and balance sheets of public enterprises to ensure that the scaled up public investments in infrastructure are sustainable in the long run. Amongst other reforms, they plan to improve the competiveness of the telecommunication industry by considering the entry of additional operators in the sector, and to strengthen the management of the water company, ONEAD.

The authorities are committed to improving spending efficiency and public financial management, with the valuable technical assistance provided by the Fund and other development partners.

External and Financial Stability

The Central Bank of Djibouti will continue to ensure that the coverage of base money is comfortably above the legal target. The authorities welcome the IMF's assessment that Djibouti's external stability is well anchored, and will continue to strengthen the

regulation of the financial sector and supervisory capacity. They will also enforce prudential regulation, including the higher provisioning requirements for commercial banks, and the AML/CFT framework.
Promoting financial inclusion is also priority reform area for the authorities. With the support of the World Bank, they plan to modernize the payment system, and improve access to financing, particularly for small and medium sized enterprises, and the poor.

Debt Sustainability

The authorities take good note of staff's advice on debt sustainability especially on non-concessional borrowing contracted after the previous ECF program had expired. The limitations of the Debt Sustainability analysis methodologies are well recognized by the Fund, in the context of small emerging economies like Djibouti where a handful of projects could lead to a substantial change in the debt sustainability profile. The authorities also welcome staff's own recognition that the DSA models which are country specific are not well equipped to assess the impact of projects with a regional dimension.

Notwithstanding these caveats, the authorities take note of the concerns expressed by staff and will take appropriate measures to preserve debt sustainability. As abovementioned, they are taking steps to ensure that debt-financed investments are properly appraised, and generate the revenues needed to service the debt, while crowding in FDI. Even though they note that the DSA's stress test scenario of an exchange rate shock is highly unlikely given the currency board's arrangement, the authorities plan to continue efforts aimed at diversifying the economy to promote job creation and broaden the productive basis of the economy. They are also strengthening further debt management capabilities, including through better coordination between the agencies involved and improved integration into the budget planning of debt service-related liquidity needs.

IV. Conclusion

Djibouti's authorities have been implementing an ambitious policy agenda aimed at turning Djibouti into an emerging market economy, while reducing unemployment and widespread poverty. They have a track record of implementing sound policies which benefited from Fund's advice.

Djibouti continues to face significant challenges in mitigating fiscal risks, while pursuing their inclusive growth strategy. The authorities' had been actively seeking an IMF supported program as they are convinced that the Fund's advice would have had more traction in the context of a program. Based on their overall strong track record of implementing Fund advice, and given that they have already implemented the prior-actions approved by the Board for a new program arrangement, Directors' support for the Fund to engage program discussions with the authorities at the earliest will be greatly appreciated.