IMF Country Report No. 16/248

DJIBOUTI

July 2016

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

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 [Consultation Year] Article IV consultation with Djibouti, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on September 19, 2015, 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 November 17, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF.

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

Selected Issues

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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FOR IMMEDIATE RELEASE
December 28, 2015

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IMF Executive Board Concludes 2015 Article IV Consultation with Djibouti

On December 4, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation discussions[1] with Djibouti, and considered and endorsed the staff appraisal without a meeting.[2]

Djibouti has been pursuing a strategy of developing infrastructure and its port facilities to foster rapid growth and reduce poverty. Economic growth, driven by large investment projects, continued its rapid pace in 2014. However, widespread poverty and unemployment persist. Moreover, the high external debt suggests extremely limited scope for additional borrowing.

Aggregate investment reached 44 percent of GDP in 2014 and is expected to peak at 57 percent in 2015–16. GDP growth is expected to rise from 6 percent in 2014 to about 6.5 percent in 2015–16 and to 7 percent in 2017–19. Inflation is projected at 3 percent in 2015 and about 3.5 percent in 2016–18 as the large infrastructure spending would increase the demand for housing and services.

High public investment spending is exerting considerable fiscal and external debt pressures. The fiscal deficit on commitment basis is projected to rise from 12.2 percent of GDP in 2014 to 16.5 percent in 2015, and decline to 11.4 percent in 2016, in tandem with the investment expenditure profile. Reflecting high non-concessional borrowing, total public and publicly guaranteed (PPG) debt reached 60.5 percent of GDP in 2014 and it is projected to continue rising in the near term, peaking at 80 percent in 2017. The current account deficit would widen from 25.6 percent of GDP in 2014 to 31 percent in 2015, due to large capital goods imports, before declining to 14 percent of GDP in 2017–19 after the completion of most of the large investment projects. The deficit will be financed by loans and foreign direct investment (FDI).

[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.

[2] The Executive Board takes decisions under its lapse of time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

Central bank gross foreign assets are projected to remain strong, permitting full currency board coverage over the period 2015–20. Commercial banks' loan portfolio has deteriorated with the ratio of non-performing loans to total loans rising to more than 22 percent in June 2015.

Executive Board Assessment

Djibouti's economic growth driven by the ambitious infrastructure investment program is gathering pace. Staff calls on the authorities to strengthen public capacity to manage the investment program, including capacity to evaluate and monitor investment projects. Staff recommends prioritizing the proposed projects, based on absorptive capacity and resource constraints, and conducting cost-benefit analyses before any project is undertaken. Expediting the reform of public enterprises that will manage the large investment projects to improve their efficiency and financial standing would ensure the projects' commercial viability and reduce contingent liabilities for the budget.

The non-concessional financing of the investment program is aggravating Djibouti's high risk of debt distress and poses risks to fiscal sustainability. Staff therefore urges the authorities to take steps to ensure a sustainable fiscal and external debt path. To this end, staff exhorts the authorities to be cautious with additional borrowing and limit non-concessional borrowing. Equally important is enhancing debt management capacity, including the monitoring of contingent liabilities, and improving coordination among government units responsible for contracting, monitoring, and servicing debt.

Staff commends the authorities for organizing the successful June 2015 tax conference, with the participation of all stakeholders, notably the private sector and civil society. Staff underscores the need to design and implement comprehensive tax reform based on the conference recommendations. Implementing a simple and transparent tax regime that reduces tax exemptions and levels the playing field for all investors is crucial.

Staff expresses concern over the weaknesses in the banking sector, particularly the recent increase in non-performing loans and decline in return on equity. Strengthening banking supervision and adopting the measures needed to address the problems of banks in difficulty is a priority. Moreover, staff notes that access to financial services remains low, despite the increase in the number of banks. The authorities' plans to establish a credit guarantee fund and develop microfinance are a welcome development which needs to be expeditiously implemented to promote financial inclusion. Also, reinforcing instruments to counter money laundering and the financing of terrorism is essential. The currency board arrangement has served Djibouti well. Consequently, competitiveness should be improved by reducing the cost of utilities and developing human capital.

Staff commends the authorities for the adoption of the Accelerated Growth Strategy for Promoting Employment, and recommends prioritizing projects that foster inclusive growth through job-creation and poverty reduction. Enhanced measures to protect the poor are needed. Finally, diversifying economic activity into more labor-intensive sectors such as fishing and tourism would create employment and promote inclusive and stable growth.

Table 1. Djibouti: Selected Economic and Financial Indicators

(Quota: SDR 15.9 million) (Population: 0.939298 million; 2014)

(Per capita nominal GDP: $1,383; 2010) (Poverty rate: 79 percent; 2012)

(Unemployment rate: 48.4 percent; 2012) (Main export: Port-related services)

	Est.		Proj.					
	2013	2014	2015	2016	2017	2018	2019	2020
			(Annual percentage change)					
National accounts								
Real GDP (annual change in percent)	5.0	6.0	6.5	6.5	7.0	7.0	7.0	6.0
Consumer prices (annual average)	2.4	2.9	2.7	3.5	3.5	3.5	3.0	3.0
Consumer prices (end of period)	2.5	2.8	2.7	3.0	3.0	3.0	3.0	3.0
			(Percentage of GDP)					
Investment and saving								
Total fixed capital investment	40.5	44.1	60.1	53.6	33.4	30.9	27.0	26.6
Private	26.9	24.0	30.0	28.7	20.2	19.3	17.8	17.8
Public 1/	13.7	20.2	30.1	24.9	13.2	11.6	9.2	8.8
Gross national savings	17.3	18.5	29.1	27.8	18.6	16.4	14.4	13.6
Savings/investment balance	-23.3	-25.6	-31.0	-25.8	-14.8	-14.5	-12.6	-13.1
Public finances								
Total revenue and grants	31.8	30.9	37.1	36.2	33.9	29.4	28.3	27.2
Of which: Tax revenue	19.8	18.6	19.3	18.7	18.1	17.6	17.3	17.3
Expenditure and net lending	37.7	43.1	53.6	47.6	35.1	32.3	29.0	27.3
Of which: Current expenditure	24.0	22.9	23.5	22.8	21.9	20.8	19.8	18.5
Investment expenditure	13.7	20.2	30.1	24.9	13.2	11.6	9.2	8.8
Total revenue (excluding grants)	27.4	26.3	29.4	28.0	26.5	25.2	24.2	23.4
Overall balance (commitment basis, incl. grants)	-5.9	-12.2	-16.5	-11.4	-1.2	-3.0	-0.7	-0.1
Overall balance (cash basis, incl grants)	-6.9	-12.7	-17.0	-11.9	-1.6	-3.4	-1.1	-0.1
Domestic financing	5.9	3.8	2.6	-1.4	-2.3	0.9	2.1	2.1
External financing	1.0	8.9	14.4	13.3	3.9	2.5	-1.0	-1.9
Change in domestic arrears (decrease -)	-1.0	-0.5	-0.6	-0.5	-0.5	-0.4	-0.4	0.0
Overall balance (excluding grants)	-10.3	-16.8	-24.2	-19.7	-8.6	-7.2	-4.8	-3.9
			(Annual percentage change)					
Monetary sector								
Net foreign assets	27.2	-1.8	0.0	8.0	10.3	4.1	1.1	1.1
Net domestic assets	-36.9	42.6	37.4	15.0	11.6	24.1	26.2	20.1
Claims on the private sector	15.6	8.6	12.0	14.0	16.0	18.0	18.0	15.0
Broad money	6.9	6.5	9.4	10.2	10.7	10.7	10.4	9.2
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	485	511	601	642	684	741	800	870
Imports of goods and services	-913	-1022	-1318	-1325	-1173	-1203	-1249	-1339
Balance of goods and services	-428	-511	-718	-683	-489	-462	-449	-468
Current account balance (in percent of GDP)	-23.3	-25.6	-31.0	-25.8	-14.8	-14.5	-12.6	-13.1
FDI (in percent of GDP)	19.7	9.1	8.6	8.5	9.7	9.8	10.8	10.8
Stock of external public and publicly guaranteed debt	704	833	1142	1506	1689	1838	1901	1937
Stock of external public and publicly guaranteed debt (in percent of GDP)	48.4	52.5	65.7	78.7	79.6	78.3	73.5	68.6
Gross official reserves	411	381	350	399	476	495	479	460
(in months of next year's imports of goods and services)	4.8	3.5	3.2	4.1	4.7	4.8	4.3	3.7
Gross foreign assets of commercial banks	835	903	958	1015	1076	1140	1209	1281
(in months of imports of goods and services)	9.8	8.2	8.7	10.4	10.7	11.0	10.8	10.2
Memorandum items:								
Nominal GDP (in millions of Djibouti francs)	258,658	282,228	308,688	340,260	376,820	417,310	459,917	502,137
Currency board cover (in percent)	107	110	109	109	109	109	109	109
Private credit to GDP (in percent)	32.4	32.9	34.1	34.9	36.3	38.4	40.8	42.8
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)	95.8	96.4	102.3	…	…	…	…	…
(Change in percent; depreciation -)	0.3	0.5	6.2	…	…	…	…	…
Population (million)	0.913714	0.939298	0.965598	0.992635	1.02043	1.04900	1.07837	1.10857

Sources: Djibouti authorities; and IMF staff estimates and projections.
1/ Public sector includes central government only.

DJIBOUTI

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

November 17, 2015

KEY ISSUES

Context: Faced with scarcity of resources, Djibouti has pursued a strategy of developing infrastructure to exploit its strategic geographic location so as to foster rapid growth, reduce poverty and create much-needed jobs. Djibouti has had to resort to non-concessional financing, which has raised its external debt. Reform is crucial to generate the revenues needed to return to a sustainable external debt and fiscal path, achieve higher growth, and reduce widespread poverty and unemployment.

Focus of the discussions: (i) Fiscal reform; (ii) managing the scaling-up of public investment, especially the implications for debt sustainability; (iii) inclusive growth, job creation and poverty reduction; and (iv) financial inclusion and stability.

Key policy recommendations:

(i) To increase revenues and ensure debt sustainability, develop a timetable to reform the investment incentive framework and the overall tax regime, drawing on proposals from the government-sponsored June 2015 tax conference.

(ii) Develop a strategy to reduce and manage the external debt burden; limit non-concessional public or publicly guaranteed borrowing; tighten monitoring of government contingent liabilities; and strengthen coordination among entities involved in contracting external debt.

(iii) Ensure that investment spending is within absorption capacity and available resources. Strengthen institutional capacity to manage investment projects, including by reforming public enterprises that will manage the projects, manage the projects on a commercial basis so that they can be profitable and generate the revenues needed to service their debt. Finalize with the Ethiopian authorities the arrangement for jointly managing the Djibouti-Addis Ababa railway project.

(iv) Lowering the cost of utilities, improving the business environment, and re-orienting the educational curricula towards skills in demand, would promote economic diversification, job creation, and poverty reduction.

(v) Monitor commercial banks' loan portfolio and ensure that banks provision adequately for nonperforming loans. Expedite the credit guarantee scheme for SMEs.

Approved By
Daniela Gressani and Dhaneshwar Ghura

The team comprised Mr. Mohammed El Qorchi (head), Messrs. Victor Davies, Hamid Reza Tabarraei (all MCD), Mr. Gabor Pula (SPR) and Mr. Gilbert Menard (FAD expert). Mr. Joseph Karangwa, Fund Resident Representative in Djibouti, actively participated in the mission.

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, Ms. Cruz, Mr. Auclair and Mr. Selim (all MCD).

The mission met with the prime minister; the acting central bank governor; the minister of economy and finance responsible for industry; the minister of budget; the Secretary of State in the Ministry of Housing, and other senior officials. The mission also met with the Djibouti Chamber of Commerce, the chief executives of several banks, and bilateral and multilateral development partners.

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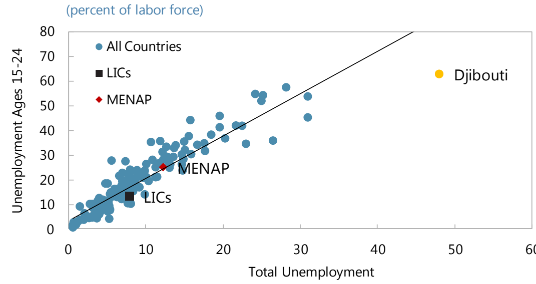
APPENDICES

DESPITE STRONG INVESTMENT-DRIVEN GROWTH, POVERTY AND UNEMPLOYMENT REMAIN WIDESPREAD

1. **Economic activity continued to gather pace in 2014.** Economic growth was estimated at 6 percent in 2014, driven by large-scale investments in infrastructure and port facilities. Aggregate investment reached 44.1 percent of GDP in 2014. Public investment spending was about 20 percent of GDP ($320 million), mainly on the Djibouti-Addis Ababa railway project which is expected to be operational in 2016 and on the pipeline that will transport water from Ethiopia to Djibouti. The high investment resulted in a fiscal deficit (commitment basis) of 12.2 percent of GDP which was financed by external borrowing (8.9 percent of GDP) and the drawdown of revenues from the partial privatization of the Djibouti port in 2013. Inflation remained relatively low at 3 percent, mainly driven by tobacco and services price increases. The current account deficit rose to 25.6 percent of GDP, driven by investment goods imports. Net income from abroad rose from $84 million in 2013 to $94 million in 2014, reflecting the increase in rent for the U.S. military base. Currency board coverage was 110 percent. Central bank gross foreign assets fell from $410 million in 2013 to $381 million in 2014 (3.5 months of imports) as privatization revenues were drawn down.

2. **However, widespread poverty and unemployment persist.** About 22 percent of the population lives in extreme poverty and the unemployment rate is 48 percent. Recent high levels of economic growth have been driven by capital-intensive investment in the ports and port-related activities, with limited trickle-down effects for the rest of the economy. Many of the jobs created have been taken by expatriates, due to a low domestic skills base or preference for foreign labor. Sectors with high growth and employment potential such as fishing and tourism remain underdeveloped. Agricultural activity, the primary source of livelihood in most low-income countries, is minimal due to unfavorable climatic conditions. Access to finance is low, constraining the emergence and growth of smaller enterprises. Only 20 percent of the adult population has access to banking services and only 5 percent of formal-sector enterprises have access to bank financing. The business environment has been challenging and has not created favorable conditions for the expansion of the private sector. The challenges stem in part from high production costs—in particular for electricity, communication and water—and a weak judicial system.

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



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

3. The external debt stock increased to 53.7 percent of GDP in 2014, from 48.4 percent in 2013, driven by borrowing to finance infrastructure investment. Djibouti has been assessed to remain at high risk of debt distress. The authorities stated that they have cleared all arrears to the Paris Club creditors. Arrears to non-Paris Club creditors stood at $18.5 million (1 percent of GDP) at end-August 2015 and were mainly due to Iran and India. The authorities indicated that they are seeking debt rescheduling from these creditors.

4. Commercial banks' loan portfolio has been deteriorating. The non-performing loans (NPLs) ratio has increased since 2011, with the pace accelerating, increasing recently from 18 percent at end-2014 to 22.5 percent at end-June 2015. Furthermore, provisions for non-performing loans declined from 82 percent in 2012 to 52 percent in mid-2015. Similarly, return on equity and return on assets have reached their lowest levels in 2014–15. This deterioration in the NPLs is mainly concentrated in one bank and can be ascribed to excessive risk-taking as well as weak oversight. However, the authorities imputed the deterioration to a rigorous reclassification of loans and the bankruptcy of two oil companies that failed to repay their debt. To address the situation, an understanding has been reached between the government and other shareholders to recapitalize the bank. Regarding the rest of the banking sector, two small banks are under liquidation. All other banks, but one, have met the new minimum capital requirement. A new investment bank has been authorized to operate.

5. The political climate is dominated by the presidential elections scheduled for April 2016. It is expected that President Ismael Omar Guelleh, in office since 1999, will run for a fourth term.

6. Djibouti is experiencing a large influx of people fleeing the conflict in Yemen. According to the UN and the Djibouti authorities, as of early October 2015, 28,389 people had arrived in Djibouti since the conflict erupted in March 2015, of which 4,895 have been registered as refugees by the UN; the remainder stay with relatives in Djibouti or are expected to relocate to other countries. The international community provides the bulk of the assistance offered to people fleeing the conflict. The Djibouti government indicated that as of end-August it had spent $1.7 million on account of refugees from Yemen.

7. Several recommendations of the 2014 Article IV consultation remain valid. These include: (i) pursue fiscal consolidation to enhance fiscal sustainability; (ii) reform the investment incentive system to increase revenues and level the playing field for enterprises; (iii) avoid non-concessional financing to improve fiscal and debt sustainability; (iv) develop a strategy to manage and reduce the external debt burden; (v) strengthen public investment and debt management capacity; and (vi) promote economic diversification and structural transformation by reducing utility costs, especially the high electricity tariffs, providing training in the skills needed in the labor market, and strengthening contract enforcement.

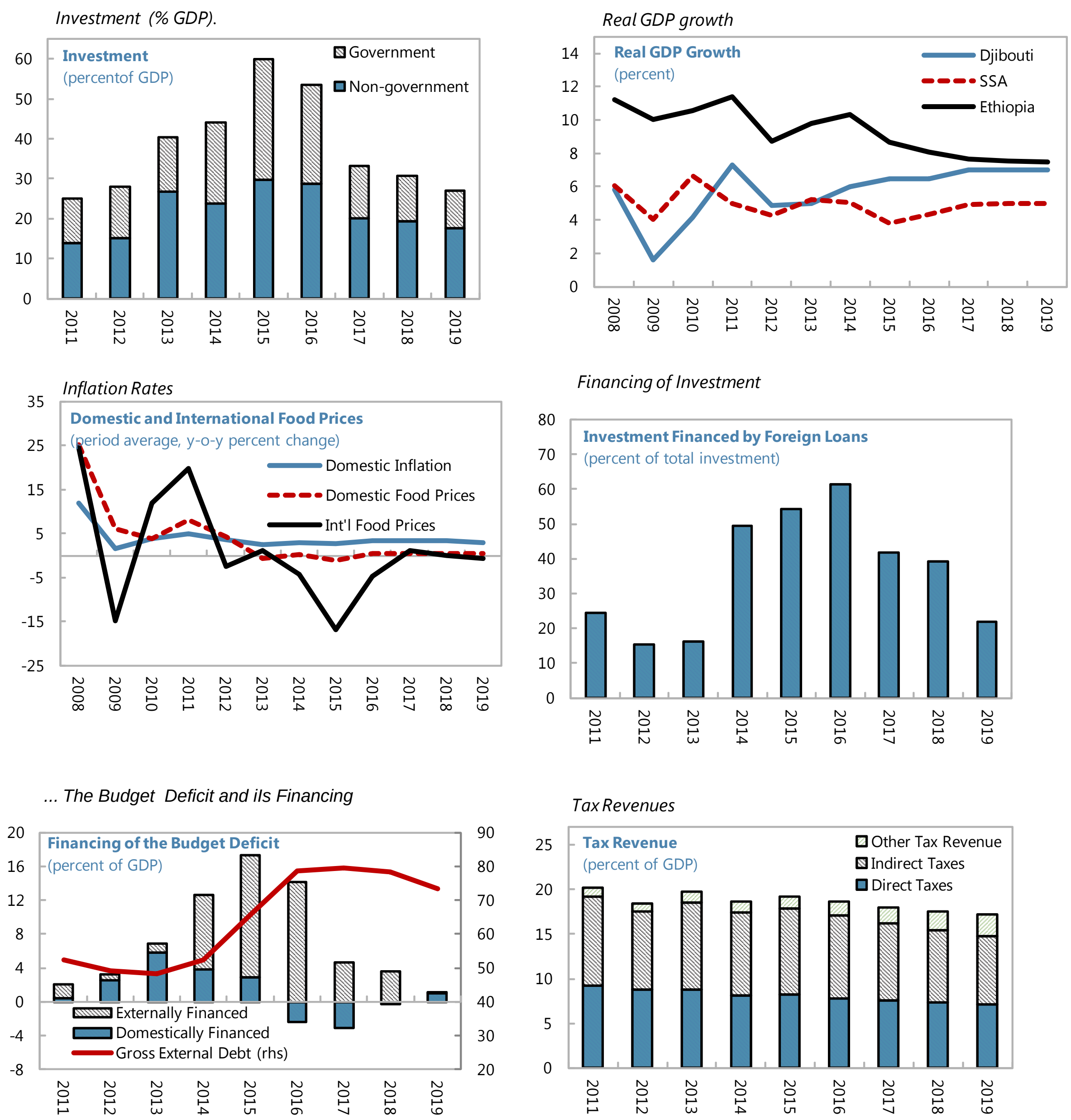
AN ENCOURAGING OUTLOOK AMIDST GROWING RISKS

8. **Economic activity is expected to accelerate in the coming years, driven by the investment boom.** GDP growth is projected at 6.5 percent in 2015 and 2016, rising to 7 percent in 2017–19. Aggregate investment is projected to peak at about 57 percent of GDP in 2015–16, before declining to 30 percent in 2017–19.[1] After peaking at 16.8 percent in 2015, the fiscal deficit is projected to drop to less than 1 percent by 2019, with the completion of the ongoing investment projects triggering a fall in public investment spending from 27.5 percent of GDP in 2015–16 to 11.3 percent in 2017–19. The debt stock is expected to peak at about 80 percent of GDP in 2017, and decline thereafter as disbursements on loans for some infrastructure projects are completed. The inflation rate is projected to stabilize at 3.5 percent in 2016–18. The current account deficit is projected to peak at about 31 percent of GDP in 2015, declining to 14 percent of GDP in 2017–19. Currency board cover is projected at 109 percent throughout 2015–19. Broad money and domestic credit are expected to grow at about 10 percent and 16 percent a year respectively in 2015–19. An agreement signed in June 2015 between Djibouti and China on the establishment of a Chinese naval military base in Djibouti will yield rents of $20 million a year to government revenue.

9. **However, the medium-term outlook is exposed to considerable risks, subjecting the baseline growth projections to a high degree of uncertainty.** First, Djibouti's dependence on close trade links with Ethiopia creates risks. A growth slowdown or recession in Ethiopia—the main client of Djibouti's ports, which are the key engine of the economy—could reduce the use of the ports, adversely affecting growth and fiscal revenues in Djibouti. This risk reinforces the need to diversify economic activity in Djibouti to reduce dependence on a single sector catering largely to a single client. Also, a shock to food production in Ethiopia would impact Djibouti directly which imports the bulk of primary food products from Ethiopia. Second, a sharp slowdown in China, the main source of funding for recent public investment projects, might affect the financing and execution of some of the projects. Third, the risk of political instability in Djibouti could rise in the run-up to the 2016 presidential elections. Fourth, further terrorist attacks in Djibouti—which is exposed to spillovers from the conflict in Somalia—would undermine business confidence, investment and economic activity. Fifth, delays in the implementation of investment projects could increase the fiscal costs for projects for which loans have been disbursed.

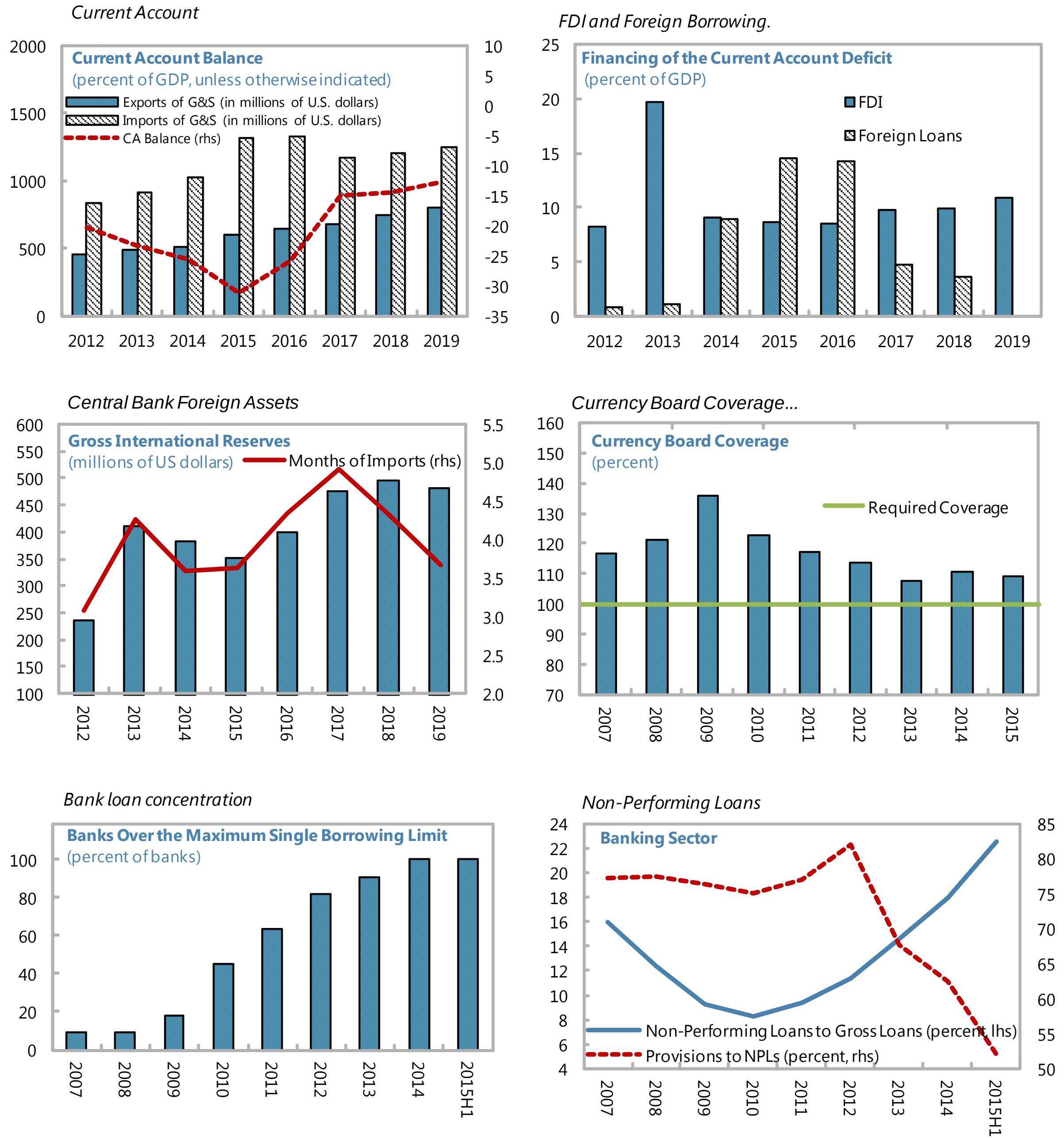
[1] Staff assumes that investment drives economic growth by inducing demand for goods and services. The related job creation and business opportunities will also generate further income, which will also boost economic activity.

Figure 1. Djibouti's Investment Boom



Sources: Djibouti authorities; and IMF staff estimates.

Figure 2. Djibouti: External and Financial Sector



Sources: Djibouti authorities; and IMF staff estimates.

Table 1. Djibouti: Main Investment Projects Contracted or under Negotiation

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

Source: Djibouti authorities.

Table 2. Djibouti: Risk Assessment Matrix

Source of risk	Relative likelihood	Impact if realized	Staff advice on policy response
Growth slowdown or recession in Ethiopia.	Low	High: Ethiopia is the main client of Djibouti's ports and, owing to its sheer size, exerts an inordinate influence on Djibouti's economy.	Encourage diversification of economic activity to reduce dependence on the ports.
Sharp China slowdown in 2015-16.	Low	High: The financing and execution of major investment projects would be affected.	Encourage diversification of investment financing.
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.

POLICY DISCUSSIONS

Discussions focused on: (i) managing the scaling-up of public investment, especially the implications for debt sustainability (ii) fiscal reform, drawing on the recommendations of the June 2015 tax conference; (iii) promoting inclusive growth through poverty reduction and job creation; and (iv) financial inclusion and stability. Selected issues papers have been prepared on fiscal reform, financial inclusion, as well as investment, growth, and debt sustainability.

A. Managing the Scaling-Up of Public Investment, Especially the Implications for Debt Sustainability

10. Public capacity to manage the investment program requires strengthening. The scaling-up of investment to unprecedented levels poses challenges for Djibouti's limited public management capacity. Staff urged the authorities to strengthen public capacity to evaluate and monitor investment projects, and recommended that a cost-benefit analysis should be conducted before any investment project is undertaken. Staff also proposed that the authorities prioritize the execution of proposed projects, taking into account absorptive capacity and resource constraints. Furthermore, staff encouraged the authorities to speed up plans to set up a committee to assess the macroeconomic implications of the large public investment projects. In view of the accelerated execution of the Djibouti-Addis Ababa railway project, staff urged the authorities to expedite the institutional arrangement for managing the joint railway project with Ethiopia, including the cost and revenue-sharing mechanism. Staff expressed concern over the limited progress on the proposed public enterprise reform emphasizing the need to reform in particular enterprises such as the water and electricity supply companies that will take over the operation of the large investment projects, to ensure their commercial viability. Staff urged the authorities to adopt swiftly a comprehensive public enterprise strategy that is supported by all the stakeholders.

11. Public debt management capacity requires strengthening. Responsibility for planning, monitoring, and negotiating external debt agreements is spread between the Ministry of Economy and Finance, and the Ministry of Budget, and other government institutions , with some overlap and no clear lines of subordination. The limited coordination among these entities undermines debt management, which partly accounts for repeated arrears accumulation. Staff therefore urged the authorities to urgently improve coordination among the government entities involved in debt management.

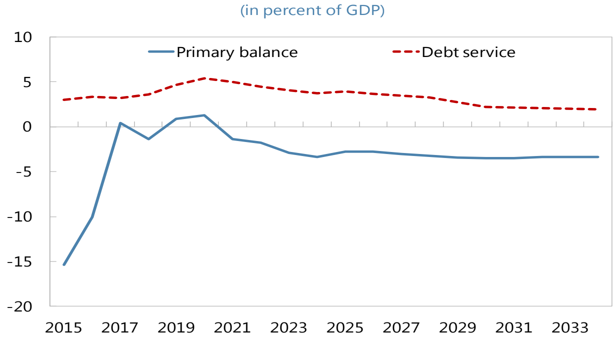
12. Reducing and managing the growing external debt is an urgent priority. The debt sustainability analysis (DSA) results (see DSA report) reaffirm the high risk of external debt distress. The present value of the debt-to-GDP and debt-to-export ratios as well as all other solvency and liquidity ratios breach the relevant thresholds. The DSA suggests that borrowing space is extremely limited, and any further non-concessional borrowing will exacerbate the already high risk of debt distress. Staff therefore proposed that any public or publicly guaranteed borrowing should be limited to projects with high rates of return. Staff recommended that the projects should be run on a commercial basis so that they can be profitable and generate the revenues needed to service their debt. Furthermore, staff stressed that: (i) the authorities should remain current on all debt service obligations; (ii) debt service capacity should be integrated into the budget planning process; (iii) the budget should provide for sufficient liquidity buffers to cover volatile debt service costs on variable-interest-rate debt and avoid accumulating arrears; and (iv) monitoring and management of government contingent liabilities, including debt contracted by public enterprises without government guarantees, should be tightened.

13. Authorities' views: The authorities acknowledged the need to strengthen public capacity to manage the investment scaling-up, and underscored the importance of technical assistance to this end. They also acknowledged the high risk of debt distress but pointed out that the investment projects are vital for Djibouti's development. The authorities are therefore of the view that, in the absence of other financing options, external borrowing to finance the projects is justified. They reiterated their confidence that the investment projects would be profitable in the longer run and generate the revenues needed to service the associated loans. They nevertheless stated that to alleviate the burden of the debt service, they have approached creditors to renegotiate the terms of loans contracted for certain projects.

B. Fiscal Reform

14. The present fiscal path appears unsustainable. To satisfy its inter-temporal budget constraint without default, a government must achieve primary surpluses whose present value should be sufficient to cover the present value of debt service. For Djibouti, over the period 2015–34, primary balances, based on current policy assumptions, are almost always negative and lie way below debt service requirements. For instance, starting in 2021, the shortfall in the primary balance relative to debt service requirements exceeds, on average, 6 percentage points of GDP a year. Given the limited scope for domestic borrowing, the debt service requirements would have to be met through continued foreign borrowing, if available. This raises the prospect of abrupt and large adjustments to government spending or large tax hikes.

Djibouti: Primary balance and Debt Service Requirements, 2015-34
(in percent of GDP)



Sources: Staff projections

15. Fiscal reform is needed to enhance fiscal sustainability and achieve inclusive growth. Additional revenues will be needed to ensure that the government is able to meet its financial obligations, which are growing rapidly as a result of the on-going debt-financed investment boom. Projections suggest that, given widespread tax exemptions under the current tax regime, fiscal revenues would decline as a percent of GDP over the medium term.[2] Djibouti's growth strategy, based on attracting foreign investment through generous tax concessions, is widely perceived to have sacrificed fiscal revenue without generating commensurate benefits in terms of employment. Furthermore, current fiscal policy could undermine pro-poor inclusive growth. Tax exemptions have created an uneven playing field for investors, sidelining smaller domestic, typically labor-intensive enterprises. Also, implicit subsidies on energy products through reduced taxes—which were intended to cushion the impact of rising international prices—have resulted in forgone fiscal revenues, while benefiting higher-income groups disproportionately. The fiscal situation could be exacerbated by a reduction in aid inflows, which could lead to difficulties in funding planned expenditures: about 10 percent of government expenditure was financed through grants in 2014, and a further 23 percent through loans. In addition, delays in implementing public investment projects for which loans have already been contracted would generate costs to the budget. This has been the case for the water pipeline project which carries a 0.5 percent commitment fee on the undisbursed loan amount. Large-scale external borrowing by public enterprises also poses contingent liabilities to the budget. Lastly, an increase in global oil prices could generate fiscal costs if the authorities do not adjust domestic prices.

16. The government-sponsored June 2015 tax conference is a key step towards a comprehensive reform of the tax regime. The conference launched a broad consultative debate involving the tax administration, the business community, academia, and civil society on the main pillars of tax reform. The guiding themes were: (i) simplifying the fiscal regime; (ii) enhancing fiscal equity; (iii) improving tax efficiency; and (iv) securing fiscal revenues. The conference generated support for reform and promising short, medium, and long-term reform proposals. During the mission, in response to the authorities' request for Fund technical assistance, an FAD expert worked closely with the authorities to synthesize the conference recommendations. Below are the main recommendations made by the expert, drawing on the wider set of conference recommendations. Some recommendations with modest revenue implications might be introduced in the 2016 budget. Staff urged the authorities to expedite the initiation of measures with stronger revenue prospects since these would take longer to produce the expected revenues.

- Reduce tax exemptions for the free zone. All new companies would be exempt from income tax in the first ten years of operation, and subject to an income tax of 15 percent starting in the 11^{th} year. Existing companies would be exempt from income tax in the first ten years of operation, and subject to an income tax of 5 percent starting in the 11^{th} year, 10 percent starting in the 15^{th} year, and 15 percent after 20 years. Enhance efforts to ensure that companies meet their tax obligations including the requirement to submit income statements, and pay the 5 percent dividend tax introduced in 2015.

[2] The decline in fiscal revenues as a percent of GDP is partly driven by a declining ratio to GDP of rents from the military bases, which accounted for 13 percent of total revenues in 2012–14. The rents are exogenous to economic activity. They determined by negotiation with governments of countries using the bases. Similarly, some other revenue sources such as taxes from petroleum products are also exogenous to economic activity.

- Repeal the investment code, one of three channels through which tax concessions have been granted. The other channels are the free zone, and discretionary exemptions granted by the authorities. It is recommended that existing exemptions be honored and, starting in 2017, no new exemption should be issued under the investment code.

- Remove the domestic consumption tax on investment goods (and raw materials). This tax penalizes investment because it is due at the time of investing, before the returns on investment are realized, and without any refund in the event of a loss.

- Raise the lump sum minimum tax from 1 percent to 1.5 percent. All enterprises (including those benefiting from exemptions) are subject to this tax on their business turnover.

- Increase the threshold for the tax on wages and salaries from DF 5,000 ($28) a month to DF 50,000 ($280).

- Set up a system of electronic tax filing and payment.

17. Fiscal consolidation is imperative to return the economy to a sustainable fiscal and debt path. Over the medium term, given the restraint already imposed on current spending and the authorities' determination to pursue their investment plans, there is little scope for cutting aggregate spending. While information is insufficient for a full assessment of the likely quantum of additional revenues from the new investment projects, much of the prospective additional revenues are expected over the longer term. Thus, prospects for additional revenues from this source over the medium term are limited. Scope does exist, however, for increasing tax revenues by broadening the tax base, revising the investment incentive framework (discussed above), and strengthening tax administration by reinforcing human resources and modernizing tax collection processes. Furthermore, improving the performance of public enterprises would enhance their fiscal contribution. Opening up the monopoly telecommunications sector could also generate revenue, and improve efficiency, as experience from other countries shows. Ultimately, cutting investment spending may be necessary to return the economy to a sustainable fiscal and external debt path.

18. The fall in international oil prices offers an opportunity to introduce a market-based pricing mechanism for energy products without increasing domestic prices. Implicit subsidies on kerosene, gasoline and diesel in the form of a reduction of pre-existing tax rates were introduced in the wake of the 2007–08 global financial crisis to cushion the impact of high international oil prices on domestic consumers. The forgone revenues were estimated at about 2 percent of GDP in 2011. The authorities have kept domestic prices largely unchanged while international oil prices have dropped by over 50 percent since the end of 2014, resulting in a de facto elimination of the implicit subsidies. Staff advice has been to introduce a price adjustment mechanism that allows a full pass-through of international prices together with safety nets to protect the welfare of the poor and vulnerable population. During the mission, staff advised that the fall in international oil prices offers an opportunity to introduce the market-based pricing mechanism without increasing domestic prices.

19. Strengthening fiscal and public financial management remains a priority. Several key past staff recommendations are yet to be fully implemented. These include the transition to a medium-term budget framework, and merging the VAT administration and that of other taxes into a large tax payers' unit which will administer all taxes for large taxpayers: VAT, income tax, etc. The authorities have indicated that work with the large taxpayers' unit is progressing. New staff are being recruited and the unit is expected to be operational in 2016.

20. Authorities' views. The authorities acknowledged the need for a far-reaching tax reform to return the economy to a sustainable fiscal and debt path, and foster inclusive growth. They indicated their intention to start implementing the recommendations of the tax conference in the 2016 budget and highlighted the measures implemented to restrain public spending such as the hiring freeze in the public service outside of the health and education sectors. The authorities reiterated their willingness to revise the pricing formula for energy products to eliminate implicit subsidies, but underlined the need to develop beforehand a registry of the poor and vulnerable population which is required for the safety net program.

C. Promoting Inclusive Growth, Job Creation, and Poverty Reduction

21. Eradicating widespread poverty and unemployment remains Djibouti's fundamental development challenge. In addition to a stable macroeconomic framework and fair tax regime, the following reforms are critical:

- **Improving the business environment**: Djibouti ranked 171st out of 189 countries on the World Bank Doing Business Index 2016, reflecting a difficult business environment. A key priority is reforming the judicial system to improve contract enforcement and property rights protection and strengthen anti-corruption efforts.

- **Lowering the cost of utilities and improving the quality of service delivery**: Improving the supply of basic utilities and reducing their cost would stimulate investment and boost competitiveness. Electricity tariffs are among the highest in the region, while telecommunications costs are high and service quality relatively poor.

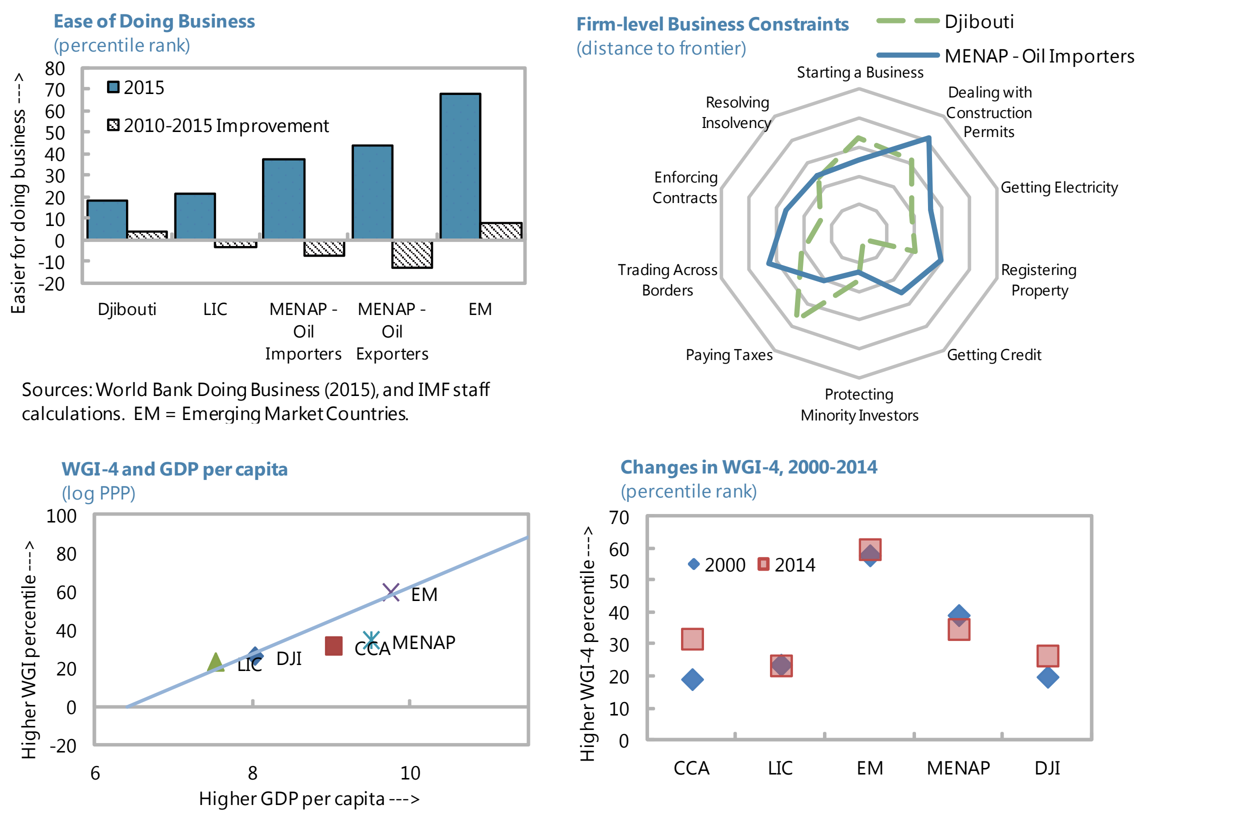
- **Investing in human capital**: To equip Djibouti nationals for the job opportunities created by the investment boom, reforms to the educational system and professional training are needed to improve the match between the available skills and needs of the labor market.

- **Economic diversification** into labor-intensive sectors like fishing and tourism would reduce the risks associated with reliance on the ports while creating jobs and generating fiscal revenues. The reforms proposed in this section would help promote diversification.

- **Social safety nets** are needed to protect the poor and vulnerable population.

- **Encouraging small businesses.** These tend to be labor-intensive, relying on domestic labor. Yet, they have been disadvantaged by the current development strategy of according tax concessions to attract foreign investment, and face additional obstacles, such as limited access to credit.

Figure 3. Djibouti: Business Environment and Governance Indicators



Sources: Worldwide Governance Indicators 2014 (government effectiveness, regulatory quality, rule of law, and control of corruption); the line is the OLS trend for all countries.

22. **The authorities launched in 2015 the Accelerated Growth Strategy for Promoting Employment (SCAPE).** The SCAPE, which encompasses ongoing public investment projects, translates "Vision Djibouti 2035" into five-year rolling plans. Vision 2035, the authorities' long-term development vision, envisions Djibouti as Africa's commercial and logistics hub, and aims to triple per capita income by 2035. The SCAPE aims to enhance diversification of economic activity through a wide range of projects, for which funding has been secured, including: (i) port and transportation facilities: the ongoing Addis-Ababa Djibouti railway project, and construction of new ports and expansion of existing ports; (ii) energy: a second electricity supply line with Ethiopia, a geothermal project involving a consortium of seven donors, and construction of a new power plant close to Djibouti-ville, the capital city (iii) water supply: the ongoing construction of a water pipeline between Djibouti and Ethiopia, and a desalination plant funded with an EU grant. Funding for some of the other projects is yet to be secured.

23. The authorities have launched initiatives to protect the welfare of the poor. Some 16,400 low-income households are scheduled to receive allowances of DF 18,000 ($101) per quarter over twelve months under a cash transfer program.[3] The universal health insurance scheme, which was initially limited to the public sector, has been extended more widely. Other support programs include free vaccination for children from poor households, and allowances to university students from outside the capital city.

24. Authorities' views. The authorities are aware of the challenges facing them in the area of job creation and poverty reduction. They concurred with staff on the reform priorities and expressed confidence that the ongoing investment projects would foster inclusive growth by generating jobs and hence income, and meeting the basic needs of the population, such as access to water supply, health facilities, and education.

D. Financial Inclusion and Stability

25. Access to financial services remains low in Djibouti despite the increase in the number of banks from four in 2006 to ten today. Less than 20 percent of the adult population possesses a bank account. Some banks require a relatively large minimum deposit to open a bank account. Only 4 percent of adults could obtain a loan from a formal-sector financial institution in 2011, while 18 percent of adults had obtained credit from their circles of family or friends. Certain requirements constrain access to credit such as the 2 percent tax for the registration of collateral for mortgage loans, and another 2 percent tax for the release of collateral. Credit to small and medium enterprises represents only 12 percent of total bank credit to enterprises. High-risk premia undermine financial inclusion and development: Lending-deposit rate differentials exceed 10 percentage points. Djibouti banks require high levels of collateralization: 228 percent of the loan amount, compared with 190 percent in other MENA countries and 179 percent in Sub-Saharan Africa. Such low levels of financial inclusion in Djibouti suggest that the economy may be operating well below its potential because productive activity by a large share of the population would be constrained by limited access to financial services.

26. Management problems have stymied the development of microfinance since its emergence in 2008. The *Caisse populaire d'Epargne et de Crédit,* the leading microfinance institution was under central bank receivership from 2012 to 2015 because of management problems. This institution, with a membership of over 14,000 (about less than 3 percent of the adult population), accounted for less than 0.12 percent of bank credit. Its lending interest rate was 26.8 percent a year, which is almost 10 percentage points higher than the average of commercial banks' rates. The microfinance institution did not pay interest on deposits.

27. The central bank is pursuing measures to enhance financial inclusion and development. It has set up a guarantee fund to facilitate access to finance for small companies and established a Sharia Board for Islamic banking. It is also pursuing plans to modernize the payment

[3] The cash transfer program drew on data from a 2013 household consumption survey.

system, develop the electronic payment system, and modernize the credit information system, with support from the World Bank.

28. Developing the financial infrastructure is crucial for financial development:

- **The credit information system needs to be strengthened and developed.** An effective information system that enables real-time access to information on credit applications reduces risks emanating from information asymmetries between lenders and borrowers.

- **Implementation of the credit guarantee fund for SMEs needs to be accelerated.** The fund would enable partial risk sharing, which should encourage financial institutions to lend to perceived high-risk groups such as small businesses.

- **Technological innovation would promote financial inclusion.** Mobile telephony—more than half of the adult population are subscribers—can offer low-cost financial services relative to traditional banking.

29. The central bank's banking supervision capacity and commercial banks' risk management capacity require strengthening to enhance financial stability, in light of the expansion of the banking system and the high level of NPLs in commercial banks' loan portfolio. Rising NPLs in recent years combined with declining provisions to NPLs and banks' profitability suggest that the banking sector may be facing a deeper problem and therefore strengthened banking supervision is required.

30. Persistently high NPLs could undermine financial and economic stability. A continuing deterioration in asset quality could adversely affect banks' profitability and result in a tightening of credit to the private sector. This would hurt economic activity at a time when banks are solicited to support private sector development and economic diversification. **The September 2015 follow-up reserves management TA mission made concrete proposals to bolster central bank reserves management.** The ultimate aim of the proposals is to enhance central bank independence by increasing its income from reserves. In recent years, low international interest rates have reduced significantly central bank income from reserves. The proposals are focused on writing an investment policy, drafting a framework for risk management, implementing a decision-making process for reserves management, and strengthening institutional capacity through training.

31. A review of mortgage procedures and conditions is warranted. The authorities should consider reducing or eliminating the 2 percent tax for the registration of collateral for mortgage loans and the other 2 percent tax for the release of collateral.

32. Authorities' views. The authorities agreed with staff on the need to improve access to financial services for the majority of the population. They expect that the reformed *Caisse populaire d'Epargne et de Crédit,* the main microfinance institution, and ongoing projects such as the modernization of the credit information and payment systems, would play a key role in promoting financial inclusion in Djibouti.

OTHER ISSUES

33. The currency board arrangement has served Djibouti well and should be maintained. It has helped instill confidence in the economy and improve predictability in managing international transactions. Given that the currency board precludes exchange rate adjustment, competitiveness should be pursued by reducing the high cost of utilities—electricity, telecommunications and water supply—and improving human resource productivity through skills training.

34. The medium-term outlook for the balance of payments will, among other things, depend on commodity prices and the performance of the Ethiopian economy. Given the high dependence on imports of food and fuel, changes in commodity prices could have significant implications for the balance of payments, household welfare, and government finances. No major changes are expected to the rents from the military bases, as the current contracts with the main countries using the bases are valid for the coming years. The demand for port services by Ethiopia, the principal client, is driven by the performance of the Ethiopian economy

35. The authorities informed staff that there had not been any changes in Djibouti's exchange system and related legal framework since the last Article IV consultation. The authorities also stated that since Djibouti's last notification to the Fund pursuant to Decision No. 144, security concerns had not caused them to impose any exchange measures.

STAFF APPRAISAL

36. The ongoing debt-financed investment boom will boost economic growth, but also aggravates Djibouti's high risk of debt distress, **raising concerns for fiscal sustainability.** Deep, wide-ranging reforms are critical to mitigate the risks and ensure the investment boom helps reduce widespread poverty and creates a large number of jobs for Djibouti nationals.

37. Public capacity to manage the investment scaling-up requires strengthening. It is essential to strengthen public capacity to evaluate and monitor investment projects, prioritize proposed projects based on absorptive capacity and resource constraints, and conduct cost-benefit analysis before any project is undertaken. Coordination among the government entities involved in debt management should be improved. Public enterprises that will manage the large investment projects should be reformed to ensure their commercial viability and reduce contingent liability for the budget.

38. A well-defined arrangement for managing the Djibouti-Addis Ababa railway should be finalized, given that the project is at an advanced stage. The arrangement should include finalizing the agreement on the company that will manage the railway project between the two countries.

39. Reducing and managing the growing external debt is an urgent priority. With Djibouti already at high risk of debt distress, borrowing space is extremely limited. Public and publicly guaranteed non-concessional borrowing should be limited. Debt service capacity should be mainstreamed into the budget process, and the monitoring and management of government contingent liabilities should be tightened.

40. Fiscal reform is needed to enhance fiscal sustainability and inclusive growth. Additional revenues will be needed to ensure the government is able to meet its financial obligations, which are growing rapidly as a result of the ongoing debt-financed investment boom. Against this background, a rapid implementation of a comprehensive tax reform on the basis of the recommendations of the June 2015 Tax Conference is crucial. The goal should be to strive for a simple and transparent tax regime that reduces tax exemptions and level the playing field between onshore and offshore companies with the ultimate goal of promoting investment, economic growth, and job creation.

41. Staff urges the authorities to accelerate the reform of public enterprises. This reform is critical as it would improve the financial situation and efficiency of these enterprises, boost their capacity to manage the large investment projects, and reduce production costs for water and energy.

42. Other structural reforms are needed for poverty reduction and job creation. The reforms should aim to improve the business environment, lower the cost of utilities and improve the quality of service delivery, and equip Djibouti nationals with the skills needed to take the jobs created by the investment boom.

43. Financial stability. Staff exhorts the authorities to swiftly adopt and implement corrective measures to address the problems of banks in difficulty. Reinforcing banking supervision and putting in place appropriate bank resolution mechanisms would enhance the central bank ability to address financial vulnerabilities. Furthermore, the central bank should also take the necessary measures to strengthen its income position, based on the recommendations made by Fund technical assistance, to improve its financial position and safeguard its independence.

44. Access to financial services remains low in Djibouti despite the expansion of the banking system. The establishment of the envisaged guarantee fund and a sustained development of microfinance, together with the development of financial infrastructure and use of innovative technology such as mobile banking, would foster financial inclusion.

45. The currency board arrangement has served Djibouti well and should be maintained at an unchanged parity, despite indications of real exchange rate overvaluation. It has helped instill confidence in the economy and improve predictability in managing international transactions. Competitiveness should be pursued by reducing the high cost of utilities and improving human resource productivity through skills training.

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

Table 3. Djibouti: Selected Economic and Financial Indicators, 2013–20

	Est.		Proj.					
	2013	2014	2015	2016	2017	2018	2019	2020
			(Annual percentage change)					
National accounts								
Real GDP (annual change in percent)	5.0	6.0	6.5	6.5	7.0	7.0	7.0	6.0
Consumer prices (annual average)	2.4	2.9	2.7	3.5	3.5	3.5	3.0	3.0
Consumer prices (end of period)	2.5	2.8	2.7	3.0	3.0	3.0	3.0	3.0
			(Percentage of GDP)					
Investment and saving								
Total fixed capital investment	40.5	44.1	60.1	53.6	33.4	30.9	27.0	26.6
Private	26.9	24.0	30.0	28.7	20.2	19.3	17.8	17.8
Public 1/	13.7	20.2	30.1	24.9	13.2	11.6	9.2	8.8
Gross national savings	17.3	18.5	29.1	27.8	18.6	16.4	14.4	13.6
Savings/investment balance	-23.3	-25.6	-31.0	-25.8	-14.8	-14.5	-12.6	-13.1
Public finances								
Total revenue and grants	31.8	30.9	37.1	36.2	33.9	29.4	28.3	27.2
Of which: Tax revenue	19.8	18.6	19.3	18.7	18.1	17.6	17.3	17.3
Expenditure and net lending	37.7	43.1	53.6	47.6	35.1	32.3	29.0	27.3
Of which : Current expenditure	24.0	22.9	23.5	22.8	21.9	20.8	19.8	18.5
Investment expenditure	13.7	20.2	30.1	24.9	13.2	11.6	9.2	8.8
Total revenue (excluding grants)	27.4	26.3	29.4	28.0	26.5	25.2	24.2	23.4
Overall balance (commitment basis, incl. grants)	-5.9	-12.2	-16.5	-11.4	-1.2	-3.0	-0.7	-0.1
Overall balance (cash basis, incl grants)	-6.9	-12.7	-17.0	-11.9	-1.6	-3.4	-1.1	-0.1
Domestic financing	5.9	3.8	2.6	-1.4	-2.3	0.9	2.1	2.1
External financing	1.0	8.9	14.4	13.3	3.9	2.5	-1.0	-1.9
Change in domestic arrears (decrease -)	-1.0	-0.5	-0.6	-0.5	-0.5	-0.4	-0.4	0.0
Overall balance (excluding grants)	-10.3	-16.8	-24.2	-19.7	-8.6	-7.2	-4.8	-3.9
			(Annual percentage change)					
Monetary sector								
Net foreign assets	27.2	-1.8	0.0	8.0	10.3	4.1	1.1	1.1
Net domestic assets	-36.9	42.6	37.4	15.0	11.6	24.1	26.2	20.1
Claims on the private sector	15.6	8.6	12.0	14.0	16.0	18.0	18.0	15.0
Broad money	6.9	6.5	9.4	10.2	10.7	10.7	10.4	9.2
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	485	511	601	642	684	741	800	870
Imports of goods and services	-913	-1022	-1318	-1325	-1173	-1203	-1249	-1339
Balance of goods and services	-428	-511	-718	-683	-489	-462	-449	-468
Current account balance (in percent of GDP)	-23.3	-25.6	-31.0	-25.8	-14.8	-14.5	-12.6	-13.1
FDI (in percent of GDP)	19.7	9.1	8.6	8.5	9.7	9.8	10.8	10.8
Stock of external public and publicly guaranteed debt	704	833	1142	1506	1689	1838	1901	1937
Stock of external public and publicly guaranteed debt (in percent of GDP)	48.4	52.5	65.7	78.7	79.6	78.3	73.5	68.6
Gross official reserves	411	381	350	399	476	495	479	460
(in months of next year's imports of goods and services)	4.8	3.5	3.2	4.1	4.7	4.8	4.3	3.7
Gross foreign assets of commercial banks	835	903	958	1015	1076	1140	1209	1281
(in months of imports of goods and services)	9.8	8.2	8.7	10.4	10.7	11.0	10.8	10.2
Memorandum items:								
Nominal GDP (in millions of Djibouti francs)	258,658	282,228	308,688	340,260	376,820	417,310	FALSE	502,137
Currency board cover (in percent)	107	110	109	109	109	109	109	109
Private credit to GDP (in percent)	32.4	32.9	34.1	34.9	36.3	38.4	40.8	42.8
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)	95.8	96.4	102.3	...	...	...	...	...
(Change in percent; depreciation -)	0.3	0.5	6.2	...	...	...	...	...

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

1/ Public sector includes central government only.

Table 4. Djibouti: Central Government Fiscal Operations, 2013–20

(In millions of Djibouti francs)

	Est.		Proj					
	2013	2014	2015	2016	2017	2018	2019	2020
Revenues and grants	82,258	87,325	114,668	123,130	127,713	122,484	130,105	136,548
Tax revenues	51,222	52,600	59,455	63,539	68,090	73,385	79,465	86,826
Direct taxes	22,881	22,941	25,654	26,576	28,522	30,645	32,964	35,516
Indirect and other taxes	28,341	29,660	33,801	36,962	39,568	42,739	46,501	51,310
Indirect taxes	25,108	26,485	29,752	31,805	32,918	34,070	35,092	36,145
Other taxes	3,232	3,175	4,049	5,157	6,650	8,669	11,409	15,165
Nontax domestic revenues	9,254	8,683	10,794	10,999	11,030	11,050	11,070	10,152
Nontax external revenues 1/	10,330	12,843	20,644	20,644	20,644	20,644	20,644	20,644
Grants	11,452	13,199	23,775	27,948	27,948	17,405	18,926	18,926
Development projects	8,969	9,521	12,384	14,900	14,900	14,900	16,421	16,421
Budget support for current expenditures	2,483	3,678	11,391	13,048	13,048	2,505	2,505	2,505
Total expenditure	97,425	121,624	165,558	162,063	132,225	134,934	133,405	137,248
Current expenditure	62,038	64,754	72,520	77,440	82,371	86,637	91,024	93,113
Wages and related expenditure	28,153	29,561	31,046	33,196	35,346	37,496	39,646	40,869
Wages and contributions	25,131	26,432	27,770	29,770	31,770	33,770	35,770	36,843
Housing subsidies	3,022	3,129	3,276	3,426	3,576	3,726	3,876	4,026
Goods and services	19,171	20,245	22,461	23,627	24,754	25,945	27,204	27,903
Of which : repayment of arrears to public enterprises 3/	0	0	0	0	0	0	0	0
Civil expenditure	15,574	16,577	18,661	19,727	20,854	22,045	23,304	24,003
Military expenditure	3,597	3,668	3,800	3,900	3,900	3,900	3,900	3,900
Maintenance	1,200	1,456	1,403	1,503	1,603	1,703	1,803	1,903
Transfers 2/	10,628	11,143	12,430	12,630	12,830	13,030	13,230	13,430
Interest	847	892	3,359	4,663	6,017	6,642	7,320	7,186
Investment expenditure	35,387	56,870	93,038	84,623	49,853	48,297	42,380	44,136
Domestically financed 3/	20,700	19,368	30,296	17,770	14,224	14,560	16,700	17,540
Foreign-financed	14,687	37,502	62,742	66,853	35,629	33,737	25,680	26,596
Grants	8,969	9,521	12,384	14,900	14,900	14,900	16,421	16,421
Loans	5,718	27,981	50,358	51,953	20,729	18,837	9,259	10,175
Overall balance (commitment basis, incl. grants)	-15,167	-34,298	-50,891	-38,932	-4,512	-12,450	-3,299	-700
Overall balance (commitment basis, excl. privatization-related expenditure)	-1,191	-21,298	-50,891	-38,932	-4,512	-12,450	-3,299	-700
Overall balance (commitment basis, excl. grants)	-26,619	-47,497	-74,666	-66,880	-32,460	-29,855	-22,225	-19,626
Change in arrears (cash payments = -)	-2,699	-1,546	-1,700	-1,700	-1,700	-1,700	-1,700	0
Repayment of domestic arrears	-2,700	-1,630	-1,700	-1,700	-1,700	-1,700	-1,700	0
External arrears (interest)	1	84	0	0	0	0	0	0
Debt relief on interest payments	13	145	0	0	0	0	0	0
Overall balance (cash basis, incl. grants)	-17,866	-35,844	-52,591	-40,632	-6,212	-14,150	-4,999	-700
Financing	17,866	35,844	52,591	40,632	6,212	14,150	4,999	700
Domestic financing (net)	15,264	10,842	8,068	-4,750	-8,508	3,674	9,742	10,307
Bank financing	-26,293	11,015	3,996	-7,624	-11,314	-798	5,052	4,520
Central bank	-26,359	10,439	4,447	-7,145	-10,807	-261	5,052	4,520
Commercial banks	14	576	-451	-478	-507	-538	0	0
Nonbank financing	41,557	-173	4,975	-125	-125	-125	-125	-125
Of which : privatization 4/	32,878	0	0	0	0	0	0	0
External financing (net)	2,602	25,002	44,523	45,382	14,720	10,477	-4,742	-9,607
Disbursements	5,718	27,981	50,358	51,953	20,729	18,837	9,259	10,175
Amortization payments	-3,116	-2,979	-5,835	-6,570	-6,009	-8,361	-14,002	-19,782

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

1/ Annual leasing fees from French, U.S. and Japanese military bases.

2/ Excludes housing subsidies.

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

4/ Privatization revenues were lodged at central bank in 2013. After 2013, financing from this source is recorded as central bank financing.

Table 5. Djibouti: Central Government Fiscal Operations, 2013–20
(In percent of GDP)

	Est		Proj					
	2013	2014	2015	2016	2017	2018	2019	2020
Revenues and grants	31.8	30.9	37	36.2	33.9	29.4	28.3	27.2
Tax revenue	19.8	18.6	19.3	18.7	18.1	17.6	17.3	17.3
Direct taxes	8.8	8.1	8.3	7.8	7.6	7.3	7.2	7.1
Indirect and other taxes	11.0	10.5	10.9	10.9	10.5	10.2	10.1	10.2
Indirect taxes	9.7	9.4	9.6	9.3	8.7	8.2	7.6	7.2
Other taxes	1.2	1.1	1.3	1.5	1.8	2.1	2.5	3.0
Nontax domestic revenues	3.6	3.1	3.5	3.2	2.9	2.6	2.4	2.0
Nontax external revenues 1/	4.0	4.6	6.7	6.1	5.5	4.9	4.5	4.1
Grants	4.4	4.7	7.7	8.2	7.4	4.2	4.1	3.8
Total expenditure	37.7	43.1	53.6	47.6	35.1	32.3	29.0	27.3
Current expenditure	24.0	22.9	23.5	22.8	21.9	20.8	19.8	18.5
Wages and related expenditure	10.9	10.5	10.1	9.8	9.4	9.0	8.6	8.1
Wages and contributions	9.7	9.4	9.0	8.7	8.4	8.1	7.8	7.3
Housing subsidies	1.2	1.1	1.1	1.0	0.9	0.9	0.8	0.8
Goods and services	7.4	7.2	7.3	6.9	6.6	6.2	5.9	5.6
Civil expenditure	6.0	5.9	6.0	5.8	5.5	5.3	5.1	4.8
Of which : extrabudgetary spending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Military expenditure	1.4	1.3	1.2	1.1	1.0	0.9	0.8	0.8
Maintenance	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Transfers 2/	4.1	3.9	4.0	3.7	3.4	3.1	2.9	2.7
Interest	0.3	0.3	1.1	1.4	1.6	1.6	1.6	1.4
Foreign-financed current spending	0.8	0.5	0.6	0.5	0.5	0.4	0.4	0.4
Investment expenditure	13.7	20.2	30.1	24.9	13.2	11.6	9.2	8.8
Domestically financed 3/	8.0	6.9	9.8	5.2	3.8	3.5	3.6	3.5
Foreign-financed	5.7	13.3	20.3	19.6	9.5	8.1	5.6	5.3
Grants	3.5	3.4	4.0	4.4	4.0	3.6	3.6	3.3
Loans	2.2	9.9	16.3	15.3	5.5	4.5	2.0	2.0
Overall balance (commitment basis, incl. grants)	-5.9	-12.2	-16.5	-11.4	-1.2	-3.0	-0.7	-0.1
Overall balance (commitment basis, excl. privatization-related expenditure)	-0.5	-7.5	-16.5	-11.4	-1.2	-3.0	-0.7	-0.1
Overall balance (commitment basis, excluding foreign debt-financed investment expenditure)	-3.7	-2.2	-0.2	3.8	4.3	1.5	1.3	1.9
Primay balance	-5.5	-11.8	-15.4	-10.1	0.4	-1.4	0.9	1.3
Change in arrears (cash payments = -)	-1.0	-0.5	-0.6	-0.5	-0.5	-0.4	-0.4	0.0
Repayment of domestic arrears	-1.0	-0.6	-0.6	-0.5	-0.5	-0.4	-0.4	0.0
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	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis, incl. grants)	-6.9	-12.7	-17.0	-11.9	-1.6	-3.4	-1.1	-0.1
Financing	6.9	12.7	17.0	11.9	1.6	3.4	1.1	0.1
Domestic financing (net)	5.9	3.8	2.6	-1.4	-2.3	0.9	2.1	2.1
Bank financing	-10.2	3.9	1.3	-2.2	-3.0	-0.2	1.1	0.9
Central bank	-10.2	3.7	1.4	-2.1	-2.9	-0.1	1.1	0.9
Commercial banks	0.0	0.2	-0.1	-0.1	-0.1	-0.1	0.0	0.0
Nonbank financing	16.1	-0.1	1.6	0.0	0.0	0.0	0.0	0.0
External financing (net)	1.0	8.9	14.4	13.3	3.9	2.5	-1.0	-1.9
Disbursements	2.2	9.9	16.3	15.3	5.5	4.5	2.0	2.0
Amortization payments	-1.2	-1.1	-1.9	-1.9	-1.6	-2.0	-3.0	-3.9

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

1/ Annual leasing fees from French, U.S. and Japanese military bases.

2/ Excludes housing subsidies.

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

Table 6. Djibouti: Balance of Payments, 2013–20

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

	Est		Proj					
	2013	2014	2015	2016	2017	2018	2019	2020
Current account (including grants)	-339	-407	-538	-495	-315	-341	-327	-369
(in percent of GDP)	-23.3	-25.6	-31.0	-25.8	-14.8	-14.5	-12.6	-13.1
Credit	485	511	601	642	684	741	800	870
Exports of goods, f.o.b.	120	129	131	139	151	162	175	188
Exports of services	366	382	470	503	533	579	626	683
Debit	-913	-1022	-1318	-1325	-1173	-1203	-1249	-1339
Imports of goods, f.o.b.	-719	-803	-1052	-1052	-960	-976	-1007	-1076
Of which: investment goods	-255	-314	-561	-526	-402	-371	-355	-375
Imports of services	-194	-218	-267	-273	-214	-227	-242	-263
Net income from abroad 1/	84	94	126	126	113	119	120	98
Of which: income related to the lease of military bases	58	72	116	116	116	116	116	116
Net current transfers from abroad	4	11	54	63	62	63	64	65
Private (net)	-10	-10	-10	-11	-11	-12	-12	-13
Official (net)	14	21	64	73	73	75	76	78
drought-related	...	...	...	...	...	...	...	...
Capital and financial account 2/	337	361	512	552	396	360	311	350
Net capital transfers	56	40	72	87	88	88	96	96
Foreign direct investment	286	144	150	162	206	230	279	305
Public sector (net)	34	186	313	372	187	155	68	41
Disbursements	65	212	358	407	217	196	142	147
Repayments	-31	-26	-44	-35	-29	-41	-74	-107
Of which: Eligible for Paris Club reschedulingOf which: Eligible for Paris Club rescheduling	0	0	1	2	3	4	5	6
Commercial banks (- = increase in NFA)	-39	-9	-29	-29	-29	-29	-29	-33
Other investments (net, including errors and omissions)	176	14	-23	-40	-55	-84	-104	-59
Overall balance (deficit -)	174	-31	-25	57	82	20	-16	-19
Financing	-174	31	25	-57	-82	-20	16	19
Central bank	-177	27	29	-51	-82	-20	16	19
Assets (- = increase)	-176	30	31	-49	-77	-19	16	19
Liabilities	-1	-3	-1	-2	-5	0	0	0
Exceptional financing	3	5	-4	-6	0	0	0	0
Budget support from donors (grants and loans)	0	0	0	0	0	0	0	1
Change in overdue obligations (decrease-)	3	5	-4	-6	0	0	0	0
Memorandum items:								
Central bank gross foreign assets	411	381	350	399	476	495	479	460
Official external debt (including public and publicly guaranteed debt)								
In millions of U.S. dollars	704	833	1142	1506	1689	1838	1901	1937
In percent of GDP	48.4	52	66	79	80	78	73	69
In percent of exports of goods and services	145	163	190	235	247	248	238	223
Debt service								
In millions of U.S. dollars	40.2	33.5	68.3	68.5	72.2	89.6	128.5	161.9
In percent of GDP	2.8	2.1	3.9	3.6	3.4	3.8	5.0	5.7
In percent of exports of goods and services	8.3	6.6	11.4	10.7	10.6	12.1	16.1	18.6

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 7. Djibouti: Monetary Survey and Banking Sector Indicators, 2013–20

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

	Est.		Proj					
	2013	2014	2015	2016	2017	2018	2019	2020
Broad money	220,397	234,774	256,785	283,048	313,462	347,143	383,264	418,448
Currency in circulation	24,752	27,295	27,521	28,565	30,985	33,594	35,225	35,605
Deposits	195,644	207,479	229,264	254,483	282,476	313,549	348,039	382,843
Demand deposits	131,116	143,928	159,041	176,535	195,954	217,509	241,435	265,578
Djibouti francs	76,106	82,773	91,464	101,525	112,693	125,089	138,849	152,734
Foreign currency	55,011	61,155	67,576	75,010	83,261	92,420	102,586	112,844
Time deposits	64,528	63,551	70,224	77,948	86,522	96,040	106,604	117,265
Djibouti francs	23,812	24,292	26,842	29,795	33,072	36,710	40,748	44,823
Foreign currency	40,716	39,259	43,381	48,153	53,450	59,330	65,856	72,442
Net foreign assets	179,096	175,893	175,890	189,985	209,604	218,229	220,581	223,087
Central bank	62,363	57,633	52,436	61,459	75,958	79,441	76,660	73,367
Assets	72,955	67,626	62,163	70,846	84,538	87,958	85,114	81,758
Liabilities	10,592	9,993	9,727	9,386	8,579	8,517	8,454	8,391
Commercial banks	116,733	118,260	123,454	128,526	133,646	138,788	143,921	149,720
Assets	148,327	160,543	170,176	180,387	191,210	202,682	214,843	227,734
Liabilities	31,595	42,283	46,722	51,860	57,564	63,895	70,922	78,013
Net domestic assets	41,289	58,881	80,895	93,063	103,857	128,914	162,684	195,361
Claims on government (net)	-12,502	1,238	5,234	-2,390	-13,704	-14,502	-9,450	-4,929
Central bank	-16,733	-3,568	880	-6,266	-17,073	-17,334	-12,281	-7,761
Commercial banks	4,230	4,806	4,355	3,876	3,369	2,832	2,832	2,832
Claims on nongovernment sector	83,729	92,765	105,133	118,883	136,782	160,125	187,661	214,739
Public enterprises	3,262	5,400	7,284	7,335	7,386	7,438	7,490	7,543
Private sector	80,467	87,365	97,849	111,548	129,396	152,687	180,171	207,196
Capital accounts	-20,693	-24,214	-25,505	-27,095	-28,318	-29,601	-31,081	-32,635
Other items (net)	-9,245	-10,909	-3,967	3,664	9,096	12,892	15,553	18,185
	(Annual change (percentage of broad money))							
Broad money	6.9	6.5	9.4	10.2	10.7	10.7	10.4	9.2
Currency in circulation	1.3	1.2	0.1	0.4	0.9	0.8	0.5	0.1
Net foreign assets	18.6	-1.5	0.0	5.5	6.9	2.8	0.7	0.7
Central bank	15.2	-2.1	-2.2	3.5	5.1	1.1	-0.8	-0.9
Commercial banks	3.3	0.7	2.2	2.0	1.8	1.6	1.5	1.5
Net domestic assets	-11.7	8.0	9.4	4.7	3.8	8.0	9.7	8.5
Of which: Claims on government (net)	-11.7	6.2	1.7	-3.0	-4.0	-0.3	1.5	1.2
Claims on nongovernment sector	4.6	4.1	5.3	5.4	6.3	7.4	7.9	7.1
Memorandum items:								
Monetary authorities								
Net international reserves (in U.S. dollars million)	6.1	14.0	7.4	11.4	17.7	19.3	18.0	16.5
Gross foreign assets (in U.S. dollars million)	410.5	380.5	349.8	398.6	475.7	494.9	478.9	460.0
In percent of foreign currency deposits	76.2	67.3	56.0	57.5	61.8	58.0	50.5	44.1
In percent of total deposits	37.3	32.6	27.1	27.8	29.9	28.1	24.5	21.4
Banking system								
Credit to the private sector, 12-month percent change	15.6	8.6	12.0	14.0	16.0	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 8. Financial Soundness Indicators, 2001–March 2015

(In percent, unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Mar-15	Jun-15
Capital adequacy																
Tier I capital to risk-weighted assets	18.5	21.7	19.1	15.0	15.7	17.4	14.1	8.9	11.0	12.2	9.40	11.7	9.6	10.7	10.4	10.6
Regulatory capital to risk-weighted assets	2.6	2.5	2.7	2.1	2.0	4.2	14.1	8.9	11.0	12.2	9.40	11.7	9.6	10.7	10.4	10.6
Reported total capital to risk weighted assets (K1-1)	99.5	96.5	104.5	101.5	106.2	102.7	80.9	85.4	86.4	112.3	44.00	...	...	...	...	...
Asset quality 1/																
Nonperforming loans to gross loans	26.9	30.6	29.2	28.8	27.8	15.6	16.0	12.4	9.3	8.3	9.40	11.4	14.5	18.0	20.3	22.5
Nonperforming loans net of provisions to capital	50.4	59.0	60.5	67.0	73.7	23.5	22.6	20.8	18.0	15.9	17.30	13.3	37.7	48.2	67.7	81.8
Provisions to nonperforming loans	55.5	52.3	52.5	55.1	56.6	74.9	77.2	77.4	76.4	75.1	77.00	82.0	67.8	62.4	55.4	52.1
Banks exceeding maximum single borrower limit 2/	0	0	2	1	0	1	1	1	2	5	7.00	9	10	11.0	11.0	11.0
Earning and profitability																
Reported return on assets (ROA)	4.2	2.1	2.8	2.1	1.9	1.8	1.8	1.7	1.8	1.1	1.00	1.3	1.2	0.7	0.2	0.4
Reported return on equity (ROE) 3/	11.7	7.9	8.5	21.1	28.2	43.9	43.2	43.3	45.6	26.9	26.60	27.5	28.5	15.7	5.4	8.9
Interest margin to gross income	31.7	26.3	22.3	22.7	40.5	49.9	68.8	68.7	68.9	75.6	78.60	59.6	67.4	61.2	58.6	58.6
Noninterest expenditures to gross income	60.0	64.7	71.2	72.2	59.1	47.6	54.1	52.2	40.1	56.8	49.70	37.6	59.1	55.3	69.2	57.2
Salary expenditures to non-interest expenditures	62.9	61.8	60.7	54.0	56.6	56.4	47.6	46.6	59.9	59.7	56.60	61.0	41.8	48.4	53.9	43.7
Liquidity																
Liquid assets to total assets	58.5	64.9	70.5	74.3	76.6	75.4	72.4	69.5	65.8	65.1	61.20	64.0	64.6	60.4	61.1	59.5
Liquid assets to short-term liabilities	455.1	494.0	726.0	710.5	736.2	670.3	155.3	148.0	124.7	120.7	112.30	128.0	110.8	94.5	91.3	92.3
Liquid assets to demand and saving deposits	180.1	188.7	175.8	209.1	226.6	597.9	170.4	164.6	183.8	211.0	213.20	202.0	251.6	266.9	280.7	253.6
Liquid assets to total deposits	72.0	78.8	81.4	85.4	87.7	87.1	81.2	77.9	74.3	76.8	73.60	80.0	82.3	79.9	78.6	76.4

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 exclude 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.

Appendix I. External Sector Assessment for Djibouti

The currency board arrangement should be maintained *because it has helped instill confidence in the economy and improve predictability in managing international transactions. There is some empirical evidence of real exchange rate overvaluation. However, Djibouti's imports of mainly basic food and fuel products and exports of mainly port services are unlikely to be sensitive to real exchange rate changes. External competitiveness should therefore be pursued by reducing the high cost of utilities and improving the regulatory environment for business.*

Assessing Djibouti's current account is challenging because the economy has been undergoing rapid change. The economy's fundamentals are therefore likely to be changing. In particular, the ongoing investment boom period represents an episode of exceptionally high imports and investment. Djibouti's current account deficit has been rising steadily from 13.7 percent of GDP in 2011 to 25.6 percent in 2014. It is projected to peak at 31.4 percent in 2015, and then fall to 14.9 percent in 2019. The large current account deficit is driven mainly by capital goods imports associated with the mega investment projects. These have been financed directly by the associated project loans.

Estimates based on the External Balance Assessment (EBA)-lite methodology suggest that the real exchange rate is overvalued. The EBA-lite comprises three methods. The first two methods—the EBA-lite CA and REER—provide regression-based estimates of current account and real effective exchange rate norms and gaps for countries. Norms are the estimated levels of the current account or (real effective exchange rate) based on underlying fundamentals. Gaps are the deviation of the current account (or real effective exchange rate) from the norms. The third EBA-lite method, the external sustainability method, assesses the sustainability of a country's external position by comparing the current account balance (percentage of GDP) expected to prevail in the medium term to the current account balance that would stabilize the NFA/GDP ratio at a specified benchmark. The EBA-lite REER and external sustainability approach suggest that the real effective exchange rate is overvalued by 39 percent and 45 percent respectively. Data limitations preclude the application of the EBA-lite current account method to Djibouti.

EBA-lite Estimates of Current Account (% GDP) and REER Norms and GAPS

	Equilibrium REER	External sustainability
REER norm	65	
Underlying REER	96	
Reer gap (percent)	39	45
CA Norm		-6.5
Underlying CA (2019)		-14.9
CA Gap		-8.4

Source: IMF staff estimates.

Staff's view is that the sensitivity of the current account to real exchange rate fluctuations is likely to be low. Domestic production of food or manufactured goods in Djibouti is minimal, leaving the country highly dependent on imports: Fuel is entirely imported, and over 90 percent of food consumed domestically is imported. The main sources of foreign exchange have little or no relation with real exchange rate movements. They are port services catering mainly to neighboring Ethiopia, and rents from the military bases which are determined by mutual agreement with the countries using the bases.

The Djibouti economy has been uncompetitive by other indicators. Production costs are high: electricity tariffs have been among the highest in the world. Djibouti's ranking on the World Bank Doing Business Index was 171st out of 189 countries in 2016. Certain aspects of the business regulatory environment remain particularly inauspicious such as enforcing contracts, getting credit and electricity (see table).

Doing Business in Djibouti, 2016

Indicator	Rank (out of 189 countries)
Ease of doing busines	171
Starting a business	171
Getting electricity	172
Getting credit	181
Enforcing contracts	183

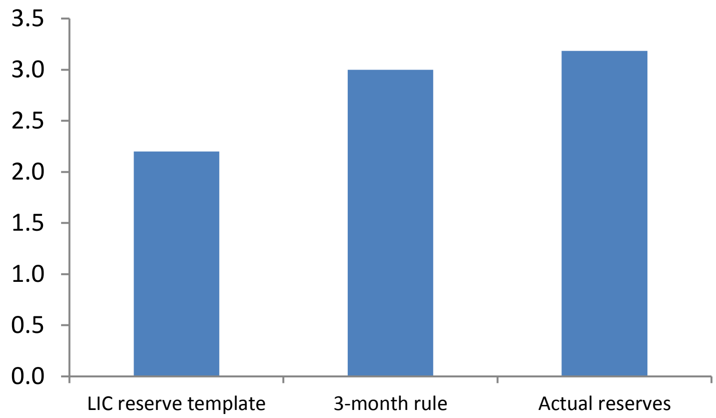
Source: "Doing Business 2016," World Bank

Limited export diversification highlights the importance of maintaining adequate reserves to cope with potential large scale shocks. Staff's analysis, based on the reserve adequacy methodology that accounts for costs and benefits of holding reserves, indicates that the optimal level of reserves for Djibouti averages about 2.2 months of imports at end-2015. The analysis assumes a cost of holding reserves of 6.15 percent which is consistent with the marginal product of capital for Djibouti. This result appears to imply that the reserve coverage in Djibouti is above the optimal level. However, under the currency board arrangement, Djibouti must maintain at least 100 percent reserve cover, which is equivalent to three months of imports.

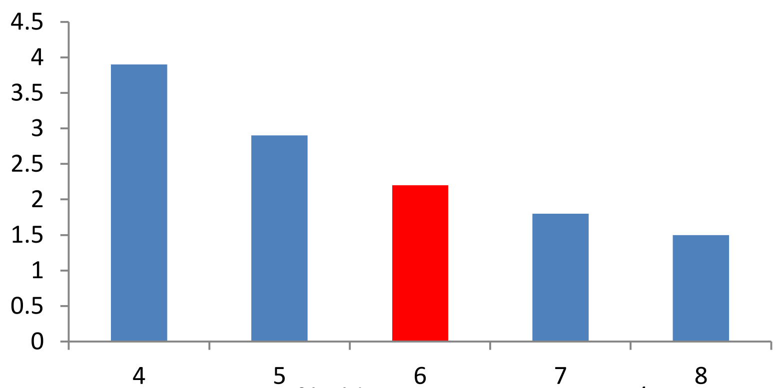
The medium-term outlook for the balance of payments will depend on commodity prices and the performance of the Ethiopian economy. Given the high dependence on imports of food and fuel, changes in commodity prices could have significant implications for the balance of payments, household welfare, and government finances—in the case of fuel which was subsidized until the recent decline in international prices. China has already paid $20 million as rent for its military base for 2015.No other major changes are expected to the rents from the military bases, as the current contracts with the main countries using the bases are valid for the coming years. The demand for port services by Ethiopia, the principal client, is driven by the performance of the Ethiopia economy

Reserve Adequacy Assessment

The actual reserves are higher than optimal level of reserves

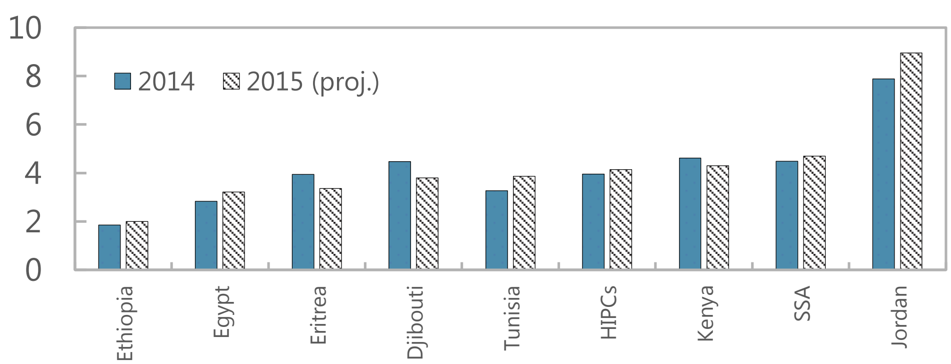


The optimal level of reserves for Djibouti in 2015 in terms of months of current's year imports.



1/ The unit cost of holding reserves is defined as foregone investment opportunies and it is estimated by the marginal product of capital.

Reserves in Months of Imports, 2014-15



Sources: WEO and IMF staff estimates.

Note: SSA = Sub-Saharan Africa; HIPCs = Highly Indebted Poor Countries.

Appendix II. The Railway and Water Pipeline Projects

The railway project

The 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 $550 million, for which a loan of about $492 million was contracted from EXIM Bank of China. The Djibouti government will provide the remaining $58 million mainly from revenues from a partial privatization of a state-owned port in 2013. Ethiopia is financing its own segment of the railway line. Construction of the railway line is currently at an advanced stage and a trial run has already being staged. The Djibouti authorities expect the railway to be operational in 2016. However, certain key questions remain unanswered. First, the institutional arrangements for managing the project are yet to be determined. Second, the source of energy that will be used to power the railway, and its financing, remain unclear. Third, the arrangement for acquiring and paying for the locomotive to run the train and the cars that will be used to transport goods and passengers, also remain unclear.

The authorities expect the project to reduce travel time, create jobs, and generate revenue through increased port traffic; and transform Djibouti into the main port for landlocked South Sudan's imports and oil exports via Ethiopia. Staff view is that for the potential benefits to be realized, the project should be well managed with a well-defined institutional arrangement for revenue sharing with Ethiopia. Staff does not have the necessary data to quantify the possible positive macroeconomic impact of the project.

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 $340 million for which a loan of about $322 million has been obtained from EXIM Bank of China. The Djibouti government will provide the additional financing of 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 for Djibouti-ville 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 desalination project is expected to be initiated in 2015 and completed by end-2017.

Staff believes that the water pipeline will generate large social benefits by reducing or eliminating the shortfall in the demand for water remains a potential source of political unrest. The pipeline could also induce investment that has been deterred by insufficient water supply. However, politically difficult decisions will need to be taken for the project to operate on a sound financial footing, and take over the servicing of the investment loan: 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.

INTERNATIONAL MONETARY FUND

DJIBOUTI

November 17, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

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

CONTENTS

RELATIONS WITH THE FUND

(As of September 30, 2015)

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	6.44	42.5

Outstanding Purchases and Loans:

	SDR Million	Percent Quota
ECF Arrangements	20.42	128.42

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				
	2015	2016	2017	2018	2019
Principal	0.15	1.36	3.20	4.45	3.53
Charges/interest	0.00	0.00	0.00	0.00	0.03
Total	**0.15**	**1.37**	**3.21**	**4.46**	**3.56**

[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

The most recent safeguards assessment of the Banque Centrale de Djibouti (BCD) was completed in 2012. The assessment found that safeguards risks remained elevated. The main weakness related to: fundamental gaps in governance and oversight arrangements; the absence of an internal audit function; persistent non-compliance with statutory requirements; and limited transparency in the financial reporting practices. Monitoring efforts since the assessment have been difficult and limited progress has been made in addressing priority recommendations. The audited financial statements for the last two years have not been shared with IMF staff nor published on the BCD website. Further, the 2014 management letter on internal controls issued by the external auditors has not been received by staff. Providing IMF staff with this information and timely publication of annual financial statements is required under the safeguards policy.

Exchange arrangements

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

Article IV consultation

The staff report for the 2014 Article IV consultation (IMF Country Report 15/338) was discussed by the Executive Board on January 30, 2015.

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 CBD's regulatory and supervisory framework is rudimentary and not well-suited to handle the entry of new banks; (iii) the CBD should introduce a reserve requirement and bolster its capacity to provide emergency liquidity support, (iv) the CBD 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 CBD 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 CBD 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
MCMR—eview of Islamic Finance Regulatory and Supervisory Framework	Nov 2014
MCM—Reserve Management	Jan 2015
MCM—Improving Debt Management Capacity	May 2015
STA—Monetary and Financial Statistics	July 2015
MCM- Reserve Management	September 2015

Resident Representative

The IMF had a resident representative in Djibouti from 1998. The previous resident representative, Mr Samba Thiam left the post in December 2014 and the current resident representative, Mr. Joseph Karangwa replaced him since February 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	Rural CDD & Water Mobilization Project	T.B.C.	Delivered
	Rural CDD & Water Mobilization Project AF	T.B.C.	May 2016
	Urban Poverty Reduction Project	November 2015	Delivered
	Urban Poverty Reduction Project II	November 2015	Delivered
	Strengthening Institutional capacity and Management of the Education	November 2015	Delivered
	Improving Health Sector Performance Project	November 2015	Delivered
	Crisis Response- SSN Project	December 2015	Delivered
	Enhancing Income Opportunities in Djibouti(TF)	December 2015	Delivered
	Geothermal Project	October 2015	Delivered
	Education Access and Quality Project	November 2015	Delivered
	PSD Project		Delivered
	Response to displacement in the Horn: Regional Project	December 2015	April 2016
	Governance TA	T.B.C.	June 2016
	Health Sector Project (TF)	December	Delivered
	Disaster Risk Management (TF)	November 2015	Delivered
	Tax Reform TA	T.B.C.	May 2016
	National Accounts TA	T.B.C.	May 2016

Joint Managerial Action Plan (Concluded) (June 2013 – December 2015)			
2. Fund Work Program	TA on price statistics	November-15	November-2015
	Multi-topic TA on financial sector assessment	November-15	November-2015
	TA on Reserve Management	September-15	September-2015
	TA on Monetary and Financial Statistics	July-15	July-2015
	TA on Improving Debt Management Capacity	May-15	May-2015
	TA on Reserve Management	January-15	January-15
	TAon Islamic Banking	November-14	December-14
	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	1-Nov-11
	Joint work on INDS		1-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 the areas of external debt, and recently in fiscal data. Djibouti began participating in the General Data Dissemination System (GDDS) in February 2012.

National accounts: The authorities do not compile national accounts data, mostly due to 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 2012–13. A poverty profile was subsequently developed. A budget-consumption survey has been undertaken which should lead to the revision of the CPI basket weights from January 2016.

External sector: Substantial progress has been made in improving balance of payments statistics in line with recommendations made by Fund's TA missions over the past few years. However, significant issues remain, which were highlighted by a June 2007 BOP mission. 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. A technical assistance mission on external sector BOP has visited Djibouti in November 2011 to assist the authorities in improving the compilation of BOP and IIP statistics and in preparing an effective transition from *BPM5* to *BPM6*.

Government finance: Fiscal data are available on a monthly basis although with a substantial delay (2 month lag). Moreover, these data do not cover a number of extra-budgetary accounts, including three pension funds. Foreign-financed capital expenditure is reported regularly. Moreover, 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 MOF is reporting neither annual data for dissemination in the *GFS* Yearbook nor high-frequency data for publication in the *International Finance Statistics* (*IFS*). To improve data collection and reporting, a macroeconomic unit has been set up in the MOF.

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

Djibouti—Table of Common Indicators Required for Surveillance (As of October 2015)					
	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]	July 2015	July 2015	M	M	NA
Reserve/Base Money	July 2015	July 2015	M	M	M
Broad Money	July 2015	July 2015	M	M	M
Central Bank Balance Sheet	July 2015	July 2015	M	M	A
Consolidated Balance Sheet of the Banking System	July 2015	July 2015	M	M	A
Interest Rates[2]	June 2015	August 2015	M	M	A
Consumer Price Index	August 2015	August 2015	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	June 2015	September 2015	M	M	NA
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	June 2015	September 2015	M	M	NA
Stocks of Central Government and Central Government-Guaranteed Debt[5]	July 2015	September 2015	A	A	NA
External Current Account Balance	December 2014	March 2015	A	A	A
Exports and Imports of Goods and Services	March 2015	September 2015	Q	Q	A
GDP/GNP	December 2014 [8]	May 2015	A	A	A
Gross External Debt	August 2015	September 2015	A	A	I
International Investment Position[6]	December 2014	March 2015	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); Not Applicable (na).
[8] GDP data estimated by staff on the basis of partial data provided by the authorities.

INTERNATIONAL MONETARY FUND

DJIBOUTI

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

November 17, 2015

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

Prepared by the International Monetary Fund and the International Development Association

The current DSA Update confirms the high risk of external debt distress assigned by the 2014 DSA exercise. Acute solvency and liquidity risks are due to recently contracted and expected external borrowing to fund public investment projects. Baseline projections of all solvency indicators are significantly above the policy-dependent thresholds for the majority of the projection period. Liquidity ratios also breach their thresholds in the medium term, as debt servicing for investments come due.[1]

External debt ratios are most sensitive to a combined shock to GDP growth and non-debt creating flows and to the tightening of the financing terms. Given its stability under the currency board, the depreciation of the franc vis-à-vis the US dollar represents a tail risk event. However, bilateral movement of the US dollar vis-à-vis other major currencies composing Djibouti's external debt (Kuwait dinar, euro and renminbi) could contribute to sizeable valuation effects. Going forward, these valuation effects are expected to be mitigated by the growing share of US dollar denominated debt. Tighter financing conditions pose a risk to debt sustainability, given the significant share of debt with variable interest rate and potential need for debt roll-over in the medium run.

Overall, the analysis suggests extremely limited scope for additional borrowing. Any borrowing leading to additional service costs over the medium term should be avoided. The authorities should adjust their fiscal strategy to reduce and manage the external debt burden, including strengthening the coordination among government entities in charge of contracting external debt.

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[1] Djibouti is classified as a 'weak' performer based on the average CPIA score in 2012–14 of 3.08. Indicative thresholds for debt burden indicators are set at 30 percent for the present value (PV) of PPG external debt-to-GDP ratio, 100 percent for the PV of PPG external debt-to-exports ratio, and 200 percent for the PV of PPG external debt-to revenue ratio. Liquidity thresholds are 15 percent and 18 percent for the for the debt service-to-exports and debt service-to-revenue ratios, respectively.

BACKGROUND

1. **Total public and publicly guaranteed (PPG) debt increased to 60.5 percent by the end of 2014, from 58.1 percent the year before.** The increase has come from higher external borrowing by the government to finance large public expenditures, mainly related to ongoing infrastructure investments. While external public debt increased by US$65 million and its ratio to GDP reached 52.5 percent by end-2014, domestic debt continued to contract, falling to 8 percent of GDP.

2. **The pace of debt accumulation is expected to accelerate further in the next three years driven by large disbursements under existing and new external loans**. In 2013 the government contracted two large loans to finance the building of the Addis Ababa—Djibouti railway and a water pipeline from Ethiopia for the amount of US$860 million. In the 2013–18 period, loan disbursements are expected to reach a cumulative US$1.5-1.6 billion. The average grant element of new public sector borrowing is expected to be around 9 percent in 2015, mainly on the account of non-concessional terms on the railway loan.[2] Once the disbursement of the railway project ends in 2016, the grant element of new borrowing will pick up to 28 percent temporarily. By 2025, the grant element is projected to gradually decline to 12 percent in line with the assumption of tightening financial conditions for Djibouti in the longer-term.[3]

Djibouti: Public and Publicly Guaranteed External Debt, disbursements, 2013–18

	Total amount, US$ million	Grant element, percent	Disbursement period	Creditor	Currency
Ethiopia-Djibouti railway	538	-9.9	2014-16	China EximBank	USD
Ethiopia waterpipeline	322	29.7	2015-17	China EximBank	USD
Water infrastructure renovation	56	25.4	2013-18	FADES	KWD
Geothermic energy	13	44.5	2015-18	OPEC, IDA	USD, SDR
Jabanhas power plant	30	27.7	2015-18	KFAED	KWD
Port de Goubet	70	26.3	2013-16	China EximBank	CNY
Port de Tadjourah	90	23.4	2013-18	OPEC, FADES, FSD	USD, KWD, SAR
Road Tadjourah Balho	76	30.5	2013-18	KFAED	KWD
Telecom cable under sea	17	4.4	2016-18	BID	USD
Social housing Djibouti	50	43.9	2015-18	FADES	KWD, SAR
Ali Sabieh cement plant	39	49.2	2013-18	India	USD
Other	273				
Total	1,573				
Percent of 2014 GDP	99.1				

Source: Djibouti authorities. Grant elements are calculated by staff. For the railroad project the 6 month USD LIBOR is assumed to gradually increase to 3.85 percent by 2019, in line with the projected rate in the latest (Fall) WEO.

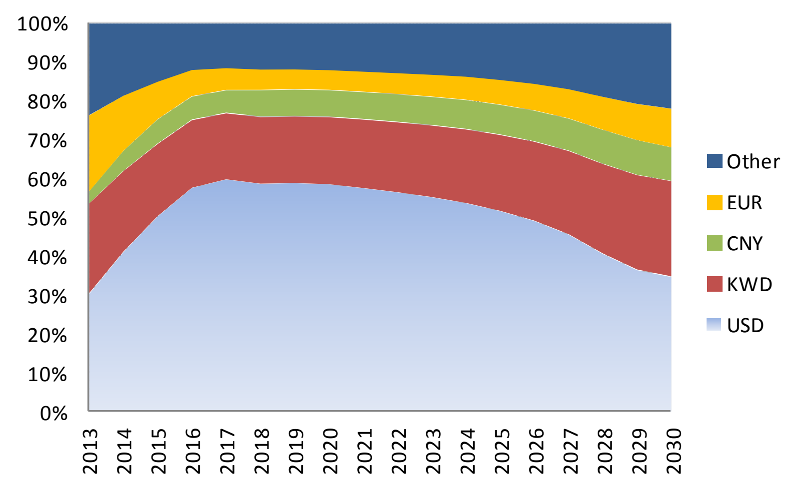
[2] Under the assumption that the 6 month LIBOR rates will gradually increase to 3.85 percent by 2019, as projected by the latest WEO.

[3] We assume a gradually increasing debt rollover starting from 2018 reaching US$280 bn by 2030, or 4 percent of GDP and 10 percent of outstanding debt. Main bilateral creditors, in particular China (accounting for 50 percent of Djibouti's total debt service in 2030), should allow debt rollover in the form new investment projects. The interest rate on this new debt is projected at 4 percent.

3. The major scale-up of infrastructure investments will contribute to a rapid accumulation of external PPG debt and an elevated debt service burden in the coming years. The external PPG debt-to-GDP ratio will peak at 80 percent in 2017, with the amount of external PPG debt doubling from its 2013 level. As a result, debt service will increase to an annual US$200 million after 2020, reaching 6 percent of GDP.

4. Disbursements under the new loans also increase the share of US dollar in total external debt. In 2013, approximately one-third of Djibouti's external debt was denominated in US dollar, followed by the Kuwait dinar (23 percent) and the euro (19 percent). Disbursements related to the Ethiopia railway project increased the US dollar share to 41 percent in 2014. Together with the Ethiopia water pipeline project, this share is expected to reach 60 percent in 2017, and remain above 50 percent through 2025. Under the currency board, a larger share of US dollar-denominated debt would lower valuation effects associated with movements in the US dollar exchange rate.

Djibouti: The Currency Composition of External Debt



Source: staff calculations based on inputs from the authorities

5. As of August 2015, the stock of arrears (excluding technical arrears)[4] on PPG external debt declined to US$3 million (about 0.2 percent of GDP), from US$4.7 million at end-2014. By February 2015, Djibouti cleared all its arrears to the Paris Club creditors according to the agreed schedule. As regards the remaining arrears, the outstanding arrears to the Saudi Fund of US$2.1 million are expected to be repaid from the GCC grant secured in December 2013.

[4] Djibouti's technical arrears to Iran and India amounted to US$ 15.6 million. While the Djiboutian authorities are engaged in discussions to facilitate the clearance of these arrears, so far no clear timeline has been set.

MACROECONOMIC ASSUMPTIONS

6. The sharp increase of public investment is expected to accelerate economic performance starting from 2014, but also to widen the fiscal and current account deficits in the near term.

- GDP growth is projected at 6.5 percent in 2015, and is expected to accelerate to 7 percent in the medium term on the back of massive investments in port facilities, railways and energy. We assume GDP growth to stabilize at 6 percent in the long term.

- The current account gap is projected to exceed 25 percent of GDP in 2015 due to large capital goods imports. The current account will stabilize below 15 percent from 2017 onwards. The non-interest current account deficit is projected at 11 percent in the long-run.

- Net FDI inflow, mainly driven by the development of port-related activities, are projected to fluctuate around 10 percent of GDP per annum, almost fully covering the non-interest current account deficit beyond 2020.

- Consumer price inflation is anticipated to accelerate to 3.5 percent till 2018, and stabilize at 3 percent in the longer run.

- Effective interest rates on external debt are projected to remain around 2.5 percent in 2015-18. In line with the assumption of gradual tightening of financing conditions the cost of external financing is expected to pick up in the long run reaching 3.9 percent by 2035. We assume a variable LIBOR rate that would increase to 3.85 percent by 2019. In the current DSA update the grant element of new public borrowings will jump from 10 percent to close to 30 percent as the disbursement of the variable-rate railway loan ends and the grant element is projected to gradually decline to 12 percent by 2025 in line with the assumption of tightening financial conditions for Djibouti in the longer-term.

EXTERNAL DSA

7. Under the baseline, total nominal public and publicly guaranteed (PPG) debt is projected to reach 79.4 percent of GDP in 2017 with the present value of the debt-to-GDP ratio peaking at 69 percent over the medium term.[5] Similar to the previous DSA exercise, all solvency indicators (the present value (PV) of external debt-to-GDP ratio, the PV debt-to-exports ratio and PV of debt-to-revenues ratio) remain above the respective thresholds for the entire

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[5] Given limited information on private external debt stocks and flows simplified assumptions are made about the evolution of the private external debt. These projected flows, together with capital grants, are behind the negative residuals in the summary of the drivers of net changes in external debt.

projection period (Figure 1). This indicates the presence of significant solvency risks. The respective thresholds of the debt service ratios are breached temporarily. During 2020-2030, the debt service will amount to almost one-fifth of export revenues or one-quarter of fiscal revenues, implying also high liquidity risks in the longer term.

8. **The updated DSA shows that an exchange rate depreciation and the combined shocks are likely to have the most significant effect on debt ratios.** The bound tests indicate that a one-time 30 percent nominal depreciation in 2015 would raise the PV of the external debt-to-GDP ratio close to 100 percent and lead to prolonged breaches of the relative threshold. Combined shock may push the PV of external debt -to-GDP ratio close to 80 percent for at least a few years.

9. **However, given the Djibouti franc's exceptional stability under the currency board (DF/USD exchange rate has been unchanged at 177.721 since 1973), the DSA exchange rate stress scenario could be considered as a tail risk event.** At the same time, the bilateral movement of the US dollar exchange rate vis-à-vis other major currencies composing Djibouti's debt (most importantly the Kuwait dinar, euro and renminbi) could contribute to a sizeable variation in the value of outstanding debt. Going forward, valuation effects are expected to be mitigated by the gradually increasing share of US dollar denominated debt, which is expected to reach 60 percent in 2017, and remain above 50 percent till 2025.

10. **The shock to new public sector financing on less favorable terms (200 basis points on all new financing in 2015-2035) could be used as a proxy for the potential effect of higher than expected floating rate on the railway loan in the medium term.** Given that interests paid on the railway project will account for 40 percent of total interest payments in the next five years, the impact of tighter financing conditions would have a sizeable impact on external debt. Under this shock the PV of debt-to-GDP ratio increases to 74 percent in 2017.

PUBLIC DSA

11. **The dynamics of the total public debt reflect the high share of external obligations as domestic debt remains small (Table 2).** Overall public debt is projected to increase from 60 percent of GDP in 2014 to 83 percent in 2016 and remains well above the 38 percent benchmark for the next 10 years. Simulations under the baseline scenario show significantly lower debt levels as compared to fixed primary balance and historical scenarios, which could be explained by (i) projected acceleration of economic growth in the medium term; as well as (ii) expected improvement in the fiscal position due to the unwinding of large public infrastructure projects, which is not captured by these alternative scenarios. According to the stress tests, public debt indicators are most vulnerable to exchange rate shock: a one-time 30 percent depreciation in 2014 leads to major increase in all key ratios and has the most significant impact on debt service-to-revenue ratio.

CONCLUSION

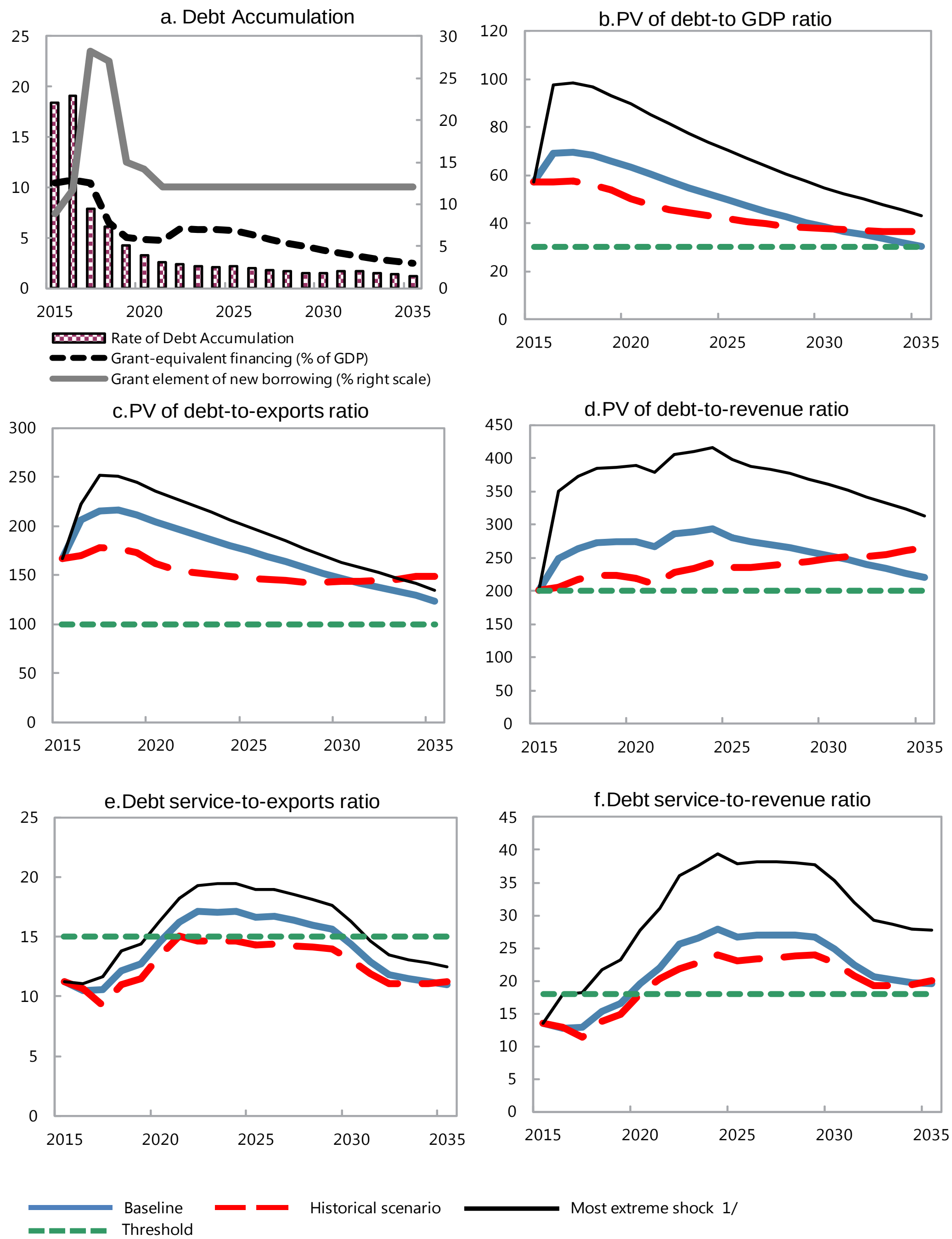
12. Djibouti remains at a high risk of debt distress and both solvency and liquidity risks increased significantly since the previous DSA. There are significant and protracted breaches of thresholds for all the solvency ratios, i.e. the present values of the external debt-to-GDP, debt-to-exports and debt-to-revenue ratios, under the baseline scenario. The DSA also indicates that Djibouti will face liquidity pressures in the near future. Solvency and debt service indicators are sensitive to most standardized stress tests, including the combined shock to GDP growth and non-debt creating flows and to the higher cost of financing.

13. The debt sustainability analysis suggests that the fiscal space is extremely limited. Policy advice would be to minimize issuance of government debt guarantees and encourage private participation in financing of investment projects. Projects should be run on a commercial basis so that they can be profitable and generate the revenues needed to service their debt. Any PPG borrowing that could lead to additional debt service costs over the medium term should be limited. The authorities should develop a strategy to reduce and manage the external debt burden, including strengthening the coordination among government entities in charge of contracting external debt.[6] Deepening of domestic debt markets would also help to alleviate risks associated with the high level of external indebtness.

14. The authorities acknowledge the high risk attached to the current financing strategy. They pointed out, however, that the investment projects are critical for Djibouti's development and that their strategy will be viable if it generates growth and crowds in sufficient FDI. The authorities are therefore of the view that, in the absence of other financing options, external borrowing to finance the projects is justified. They also acknowledged the need to strengthen public capacity to manage the investment scaling-up, and underscored the importance of technical assistance to this end.

[6] The World Bank and UNCTAD have provided training to the authorities in recent years on developing a medium-term debt management strategy, focusing on capacity building and on the quantification of costs and risks of alternative borrowing strategies, to lead eventually to a structured approach to future borrowing.

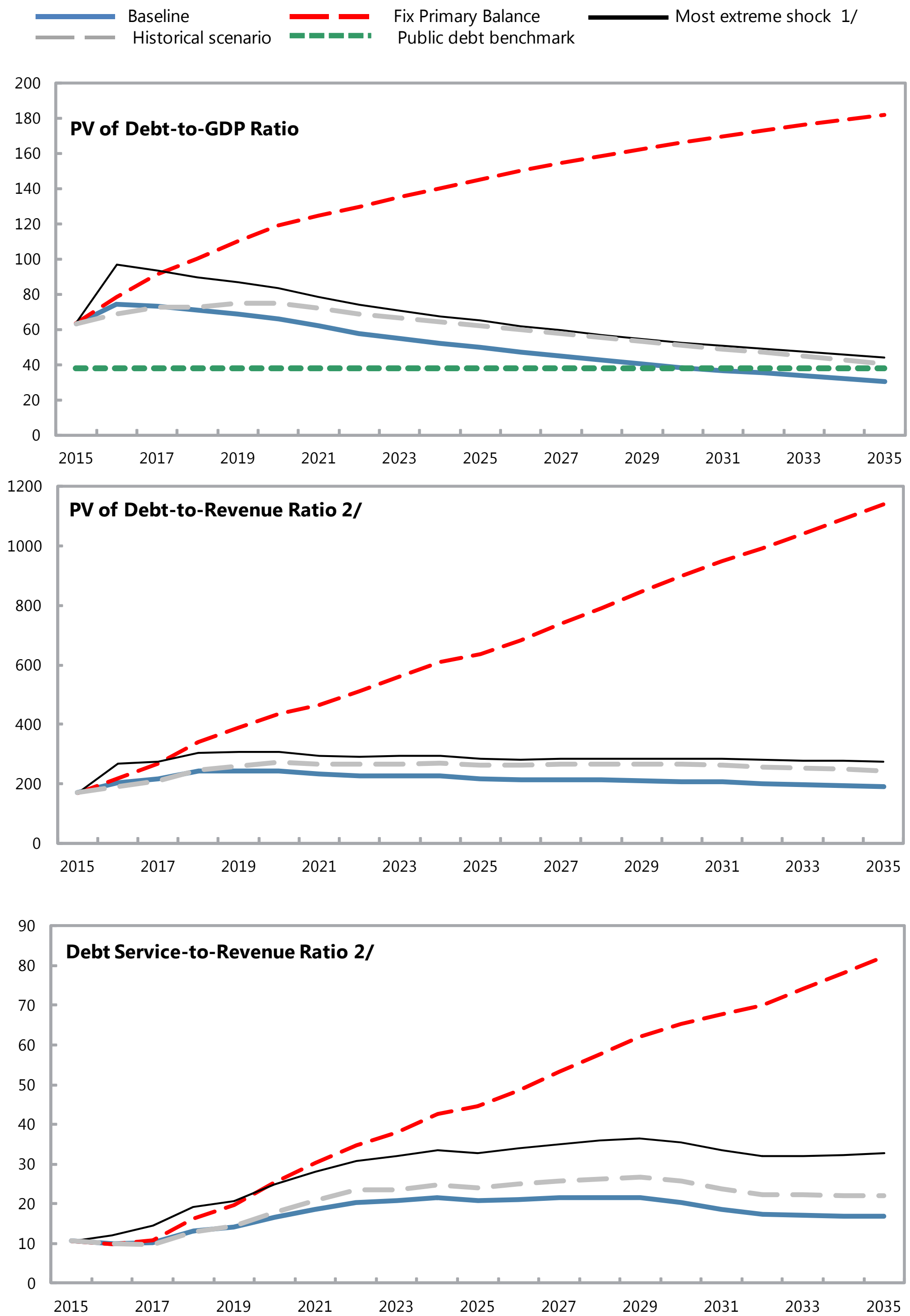
Figure 1. Djibouti: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2015–35 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Non-debt flows shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Djibouti: Indicators of Public Debt Under Alternative Scenarios, 2015-35 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.
2/ Revenues are defined inclusive of grants.

Table 1. Djibouti: External Debt Sustainability Framework, Baseline Scenario, 2012–35 1/

(In percent of GDP unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-2020 Average	2025	2035	2021-2035 Average
External debt (nominal) 1/	**49.2**	**48.4**	**52.5**			**65.6**	**78.3**	**79.4**	**78.2**	**73.5**	**68.6**		**51.8**	**32.2**	
of which: public and publicly guaranteed (PPG)	49.2	48.4	52.5			65.6	78.3	79.4	78.2	73.5	68.6		51.8	32.2	
Change in external debt	-3.1	-0.8	4.1			13.1	12.7	1.2	-1.2	-4.7	-4.9		-2.9	-1.7	
Identified net debt-creating flows	7.8	0.2	12.5			16.6	13.6	0.0	0.0	-2.0	-0.4		-0.5	-1.1	
Non-interest current account deficit	**19.6**	**22.7**	**25.2**	**14.5**	**9.3**	**27.3**	**24.5**	**12.9**	**13.1**	**12.9**	**13.9**		**11.8**	**9.4**	11.2
Deficit in balance of goods and services	28.0	29.4	32.2			38.8	36.1	23.1	20.2	18.6	18.1		18.3	17.5	
Exports	33.8	33.4	32.2			34.3	33.6	32.2	31.6	31.1	31.1		28.4	24.7	
Imports	61.8	62.7	64.3			73.1	69.7	55.3	51.8	49.8	49.1		46.7	42.2	
Net current transfers (negative = inflow)	-1.5	-0.3	-0.7	-0.7	0.6	-3.2	-3.4	-3.0	-2.8	-2.6	-2.4		-1.6	-0.8	-1.4
of which: official	-2.2	-1.0	-1.3			-3.8	-3.9	-3.6	-3.3	-3.0	-2.8		-2.0	-1.1	
Other current account flows (negative = net inflow)	-6.9	-6.4	-6.4			-8.3	-8.2	-7.1	-4.3	-3.2	-1.8		-4.9	-7.3	
Net FDI (negative = inflow)	**-8.1**	**-19.7**	**-9.1**	**-13.3**	**7.7**	**-8.6**	**-8.5**	**-9.7**	**-9.8**	**-10.8**	**-10.8**		**-10.8**	**-9.9**	-10.7
Endogenous debt dynamics 2/	**-3.7**	**-2.8**	**-3.6**			**-2.0**	**-2.5**	**-3.2**	**-3.3**	**-4.1**	**-3.5**		**-1.5**	**-0.6**	
Contribution from nominal interest rate	0.7	0.6	0.5			1.1	1.4	1.7	1.8	0.9	0.6		1.5	1.2	
Contribution from real GDP growth	-2.3	-2.3	-2.7			-3.1	-3.9	-4.9	-5.0	-5.0	-4.0		-3.0	-1.9	
Contribution from price and exchange rate changes	-2.1	-1.2	-1.4			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-10.9**	**-1.0**	**-8.5**			**-3.5**	**-0.9**	**1.2**	**-1.2**	**-2.8**	**-4.5**		**-2.4**	**-0.5**	
of which: exceptional financing	-0.7	-0.2	-0.3			0.2	0.3	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	44.0			57.1	69.1	69.5	68.3	65.8	63.2		49.6	30.4	
In percent of exports	...	...	136.9			166.5	205.6	215.6	215.7	211.3	203.6		174.6	123.2	
PV of PPG external debt	**...**	**...**	**44.0**			**57.1**	**69.1**	**69.5**	**68.3**	**65.8**	**63.2**		**49.6**	**30.4**	
In percent of exports	**...**	**...**	**136.9**			**166.5**	**205.6**	**215.6**	**215.7**	**211.3**	**203.6**		**174.6**	**123.2**	
In percent of government revenues	**...**	**...**	**167.7**			**200.2**	**247.9**	**263.6**	**272.1**	**273.2**	**274.4**		**280.5**	**219.6**	
Debt service-to-exports ratio (in percent)	**8.8**	**8.4**	**6.9**			**11.3**	**10.5**	**10.5**	**12.2**	**12.7**	**14.5**		**16.6**	**11.0**	
PPG debt service-to-exports ratio (in percent)	**8.8**	**8.4**	**6.9**			**11.3**	**10.5**	**10.5**	**12.2**	**12.7**	**14.5**		**16.6**	**11.0**	
PPG debt service-to-revenue ratio (in percent)	**11.5**	**10.2**	**8.4**			**13.6**	**12.7**	**12.9**	**15.4**	**16.5**	**19.6**		**26.7**	**19.6**	
Total gross financing need (Billions of U.S. dollars)	0.2	0.1	0.3			0.4	0.4	0.1	0.2	0.2	0.2		0.3	0.2	
Non-interest current account deficit that stabilizes debt ratio	22.7	23.5	21.1			14.2	11.8	11.7	14.3	17.6	18.8		14.7	11.1	
Key macroeconomic assumptions															
Real GDP growth (in percent)	4.8	5.0	6.0	4.8	1.6	6.5	6.5	7.0	7.0	7.0	6.0	6.7	6.0	6.0	6.0
GDP deflator in US dollar terms (change in percent)	4.2	2.4	2.9	4.1	2.2	2.7	3.5	3.5	3.5	3.0	3.0	3.2	3.0	3.0	3.0
Effective interest rate (percent) 5/	1.5	1.4	1.0	1.4	0.2	2.2	2.3	2.4	2.5	1.3	0.9	1.9	3.0	3.9	3.6
Growth of exports of G&S (US dollar terms, in percent)	9.0	6.1	5.2	7.5	4.8	16.6	8.0	6.3	8.7	8.5	8.9	9.5	7.3	9.1	7.5
Growth of imports of G&S (US dollar terms, in percent)	24.0	9.2	11.9	13.0	17.3	24.2	5.2	-12.1	3.7	5.9	7.8	5.8	8.1	9.1	8.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	8.9	11.7	28.2	27.0	15.1	14.2	17.5	12.0	12.0	12.1
Government revenues (excluding grants, in percent of GDP)	25.9	27.4	26.3			28.5	27.9	26.4	25.1	24.1	23.0		17.7	13.8	16.6
Aid flows (in Billions of US dollars) 7/	0.1	0.1	0.1			0.2	0.2	0.2	0.1	0.1	0.1		0.2	0.2	
of which: Grants	0.1	0.1	0.1			0.2	0.2	0.2	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/	...	...	...			10.5	10.8	10.4	6.6	5.0	4.9		5.7	2.5	4.3
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			36.0	36.8	58.4	51.4	51.5	52.2		57.1	51.3	54.1
Memorandum items:															
Nominal GDP (Billions of US dollars)	1.4	1.5	1.6			1.7	1.9	2.1	2.3	2.6	2.8		4.4	10.5	
Nominal dollar GDP growth	9.2	7.5	9.1			9.4	10.2	10.7	10.7	10.2	9.2	10.1	9.2	9.2	9.2
PV of PPG external debt (in Billions of US dollars)			0.7			1.0	1.3	1.5	1.6	1.7	1.8		2.2	3.2	
(PVt-PVt-1)/GDPt-1 (in percent)						18.4	19.1	7.9	6.1	4.3	3.2	9.8	2.2	1.2	1.8
Gross workers' remittances (Billions of US dollars)	...	...	...			...	...	...	...	...	...		...	...	
PV of PPG external debt (in percent of GDP + remittances)	...	...	44.0			57.1	69.1	69.5	68.3	65.8	63.2		49.6	30.4	
PV of PPG external debt (in percent of exports + remittances)	...	...	136.9			166.5	205.6	215.6	215.7	211.3	203.6		174.6	123.2	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	6.9			11.3	10.5	10.5	12.2	12.7	14.5		16.6	11.0	

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 2. Djibouti: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–35
(In percent)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
PV of debt-to GDP ratio								
Baseline	57	69	70	68	66	63	**50**	30
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	57	57	57	56	54	50	**42**	37
A2. New public sector loans on less favorable terms in 2015-2035 2	57	71	74	74	73	71	**61**	46
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	57	71	75	73	71	68	**53**	33
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	57	71	73	72	69	67	**52**	31
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	57	70	72	71	68	66	**51**	32
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	57	75	81	79	76	73	**57**	33
B5. Combination of B1-B4 using one-half standard deviation shocks	57	74	81	80	77	74	**57**	34
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	57	98	98	97	93	89	**70**	43
PV of debt-to-exports ratio								
Baseline	166	206	216	216	211	204	**175**	123
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	166	170	178	177	173	162	**147**	148
A2. New public sector loans on less favorable terms in 2015-2035 2	166	212	229	234	233	228	**216**	185
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	166	206	216	217	212	205	**176**	125
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	166	221	248	248	243	234	**200**	139
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	166	206	216	217	212	205	**176**	125
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	166	222	251	250	245	236	**199**	134
B5. Combination of B1-B4 using one-half standard deviation shocks	166	221	247	246	241	232	**197**	136
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	166	206	216	217	212	205	**176**	125
PV of debt-to-revenue ratio								
Baseline	200	248	264	272	273	274	**280**	220
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	200	205	217	223	224	218	**236**	265
A2. New public sector loans on less favorable terms in 2015-2035 2	200	256	280	295	301	308	**347**	330
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	200	257	283	293	294	295	**302**	238
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	200	254	278	287	288	289	**294**	228
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	200	252	273	282	283	284	**291**	229
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	200	268	307	316	316	318	**320**	239
B5. Combination of B1-B4 using one-half standard deviation shocks	200	266	309	318	319	320	**324**	247
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	200	350	373	385	387	388	**398**	313

Table 2. Djibouti: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–35 (concluded)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
Debt service-to-exports ratio								
Baseline	11	11	11	12	13	15	**17**	11
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	11	11	9	11	11	13	**14**	11
A2. New public sector loans on less favorable terms in 2015-2035 2	11	11	10	12	13	15	**18**	13
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	11	11	11	12	13	15	**17**	11
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	11	11	12	14	14	16	**19**	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	11	11	11	12	13	15	**17**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	11	11	11	14	14	16	**19**	12
B5. Combination of B1-B4 using one-half standard deviation shocks	11	11	11	14	14	16	**19**	12
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	11	11	11	12	13	15	**17**	11
Debt service-to-revenue ratio								
Baseline	14	13	13	15	16	20	**27**	20
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	14	13	11	14	15	18	**23**	20
A2. New public sector loans on less favorable terms in 2015-2035 2	14	13	12	15	17	21	**29**	23
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	14	13	14	16	18	21	**29**	21
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	14	13	13	16	17	20	**28**	20
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	14	13	13	16	17	20	**28**	20
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	14	13	14	17	18	21	**30**	22
B5. Combination of B1-B4 using one-half standard deviation shocks	14	13	14	17	19	22	**31**	22
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	14	18	18	22	23	28	**38**	28
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	14	14	14	14	14	14	**14**	14

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3. Djibouti: Public Sector Debt Sustainability Framework, Baseline Scenario, 2015–35

(In percent of GDP unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	59.9	58.1	60.5			72.0	83.3	83.2	81.0	76.7	71.5		52.0	32.2	
of which: foreign-currency denominated	49.2	48.4	52.5			65.6	78.3	79.4	78.2	73.5	68.6		51.8	32.2	
Change in public sector debt	-2.5	-1.8	2.3			11.5	11.3	-0.1	-2.2	-4.3	-5.2		-2.9	-1.7	
Identified debt-creating flows	-2.5	-11.0	7.3			11.2	4.7	-6.9	-5.1	-6.8	-6.3		-1.1	0.8	
Primary deficit	2.0	5.2	11.7	2.4	3.9	15.2	9.8	-0.6	1.1	-0.2	-0.4	4.1	1.9	2.4	2.0
Revenue and grants	34.5	31.8	30.9			37.1	36.2	33.9	29.4	28.3	27.2		22.8	16.0	
of which: grants	8.6	4.4	4.7			8.6	8.3	7.5	4.3	4.2	4.1		5.1	2.1	
Primary (noninterest) expenditure	36.5	37.0	42.6			52.3	46.0	33.3	30.5	28.1	26.8		24.8	18.3	
Automatic debt dynamics	-4.6	-3.6	-4.4			-3.9	-5.0	-6.3	-6.2	-6.6	-5.9		-3.1	-1.6	
Contribution from interest rate/growth differential	-3.4	-3.1	-3.8			-3.4	-4.0	-5.2	-5.3	-5.9	-5.2		-2.6	-1.3	
of which: contribution from average real interest rate	-0.5	-0.3	-0.5			0.3	0.3	0.3	0.2	-0.6	-0.9		0.5	0.6	
of which: contribution from real GDP growth	-2.9	-2.9	-3.3			-3.7	-4.4	-5.4	-5.4	-5.3	-4.3		-3.1	-1.9	
Contribution from real exchange rate depreciation	-1.2	-0.5	-0.6			-0.5	-1.0	-1.1	-0.9	-0.7	-0.7		...	...	
Other identified debt-creating flows	0.0	-12.7	0.0			-0.1	-0.1	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	-12.7	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			-0.1	-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	0.1	9.2	-5.0			0.3	6.6	6.7	2.9	2.5	1.1		-1.7	-2.4	
Other Sustainability Indicators															
PV of public sector debt	...	...	52.0			63.5	74.1	73.2	71.0	69.0	66.1		49.8	30.4	
of which: foreign-currency denominated	...	...	44.0			57.1	69.1	69.5	68.3	65.8	63.2		49.6	30.4	
of which: external	...	...	44.0			57.1	69.1	69.5	68.3	65.8	63.2		49.6	30.4	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	5.3	8.1	14.0			19.1	13.4	2.8	5.0	3.8	4.1		6.7	5.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	168.2			170.9	204.8	216.1	242.0	243.9	243.2		218.3	190.6	
PV of public sector debt-to-revenue ratio (in percent)	...	...	198.2			222.7	266.0	277.7	283.2	286.5	287.0		281.8	220.0	
of which: external 3/	...	...	167.7			200.2	247.9	263.6	272.1	273.2	274.4		280.5	219.6	
Debt service-to-revenue and grants ratio (in percent) 4/	9.4	9.0	7.4			10.6	9.9	10.2	13.3	14.1	16.7		20.7	16.9	
Debt service-to-revenue ratio (in percent) 4/	12.5	10.5	8.7			13.8	12.9	13.1	15.5	16.6	19.7		26.7	19.6	
Primary deficit that stabilizes the debt-to-GDP ratio	4.5	7.0	9.4			3.7	-1.5	-0.5	3.3	4.1	4.8		4.8	4.0	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.8	5.0	6.0	4.8	1.6	6.5	6.5	7.0	7.0	7.0	6.0	6.7	6.0	6.0	6.0
Average nominal interest rate on forex debt (in percent)	1.5	1.4	1.0	1.4	0.2	2.6	2.7	2.6	2.6	1.3	0.9	2.1	3.1	4.0	3.7
Average real interest rate on domestic debt (in percent)	-3.9	-2.3	...	-3.8	2.2	-2.0	-2.9	-3.0	-3.2	...	...		...	...	
Real exchange rate depreciation (in percent, + indicates depreciation)	-2.3	-1.0	-1.3	-1.9	2.0	-0.9	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.2	2.4	2.9	4.1	2.2	2.7	3.5	3.5	3.5	3.0	3.0	3.2	3.0	3.0	3.0
Growth of real primary spending (deflated by GDP deflator, in percent)	10.2	6.7	22.0	3.9	7.3	30.7	-6.4	-22.6	-2.0	-1.4	1.0	-0.1	4.9	3.4	3.4
Grant element of new external borrowing (in percent)	...	...	...	...	...	8.9	11.7	28.2	27.0	15.1	14.2	17.5	12.0	12.0	...

Sources: Country authorities; and staff estimates and projections.

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

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

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

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

Table 4. Djibouti: Sensitivity Analysis for Key Indicators of Public Debt, 2015–35
(In percent)

		Projections						
	2015	2016	2017	2018	2019	2020	2025	2035
PV of Debt-to-GDP Ratio								
Baseline	63	74	73	71	69	66	50	30
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	63	69	72	73	75	75	62	40
A2. Primary balance is unchanged from 2015	63	79	91	100	110	119	145	182
A3. Permanently lower GDP growth 1/	63	74	74	72	71	68	54	40
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	63	77	81	80	79	77	64	46
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	63	71	76	74	72	69	52	32
B3. Combination of B1-B2 using one half standard deviation shocks	63	71	77	76	75	73	59	42
B4. One-time 30 percent real depreciation in 2016	63	97	94	90	87	83	65	44
B5. 10 percent of GDP increase in other debt-creating flows in 2016	63	83	81	79	76	73	55	34
PV of Debt-to-Revenue Ratio 2/								
Baseline	171	205	216	242	244	243	218	191
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	171	190	212	246	261	272	262	243
A2. Primary balance is unchanged from 2015	171	217	269	341	389	437	636	1138
A3. Permanently lower GDP growth 1/	171	206	218	245	249	250	236	248
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	171	212	235	269	276	280	274	288
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	171	197	225	253	254	253	228	199
B3. Combination of B1-B2 using one half standard deviation shocks	171	195	224	256	262	265	255	260
B4. One-time 30 percent real depreciation in 2016	171	267	276	305	307	306	284	275
B5. 10 percent of GDP increase in other debt-creating flows in 2016	171	228	240	268	270	269	242	212
Debt Service-to-Revenue Ratio 2/								
Baseline	11	10	10	13	14	17	21	17
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	11	10	10	13	15	18	24	22
A2. Primary balance is unchanged from 2015	11	10	11	16	20	25	44	82
A3. Permanently lower GDP growth 1/	11	10	10	13	14	17	22	21
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	11	10	11	14	16	19	24	24
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	11	10	10	13	15	17	21	18
B3. Combination of B1-B2 using one half standard deviation shocks	11	10	10	13	15	18	23	22
B4. One-time 30 percent real depreciation in 2016	11	12	15	19	21	25	33	33
B5. 10 percent of GDP increase in other debt-creating flows in 2016	11	10	11	15	16	18	23	19

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.