EXECUTIVE BOARD MEETING

SM/22/30

February 9, 2022

To: Members of the Executive Board

From: The Secretary

Subject: **Djibouti—Staff Report for the 2021 Article IV Consultation**

Board Action:	Executive Directors' **consideration** (Formal)
Tentative Board Date:	**Wednesday, February 23, 2022**
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Questions:	Mr. Rayner, MCD (ext. 38524) Mr. Norton, MCD (ext. 37769) Ms. Rehman, MCD (ext. 34536)
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***At the time of circulation of this paper to the Board, the authorities have indicated that they need more time to consider whether they will consent to the Fund's publication of this paper. Publication will only proceed upon the receipt by the Fund of the member's explicit consent.**

INTERNATIONAL MONETARY FUND

DJIBOUTI

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

February 8, 2022

KEY ISSUES

Context. Large scale infrastructure investments have driven strong economic growth in recent years, but progress on social outcomes has been slow and macroeconomic vulnerabilities have increased. The COVID-19 pandemic and conflict in neighboring Ethiopia have exposed Djibouti's vulnerabilities and weigh on the economic outlook. Once the regional security and health situations improve, growth prospects are strong, with a competitive port sector well-positioned to benefit from a rebound in trade.

Policies. Djibouti's main challenge is to support a durable and inclusive recovery from the COVID-19 crisis and regional conflict. After significant investments in port-related infrastructure, Djibouti now needs to invest in macroeconomic stability, and in people:

- Fiscal policies to raise domestic revenues and stronger oversight of SOE borrowing would help restore debt sustainability and create space for social spending and investments in human capital.

- Although the currency board limits the flexibility of monetary policy, operational adjustments, including to prudential policies, could support financial stability and inclusion.

- Structural reforms to strengthen governance and increase the skills of the labor force and reduce the costs of inputs would help create jobs to share growth dividends more equitably.

Approved By
Taline Koranchelian (MCD) and Gavin Gray (SPR)

Discussions were conducted virtually during October 19–November 2 and December 13 and 20, 2021. The staff team comprised Mr. Rayner (head), Mr. Norton, and Ms. Rehman (all MCD). Mr. Olhaye (OED) also attended the meetings. The team met with Central Bank Governor Ahmed, Minister of Budget Cher, Minister of Economics and Finance Dawaleh, as well as other senior officials and private sector representatives. Support was provided by Lamiae Agoumi and Maria de Mesa.

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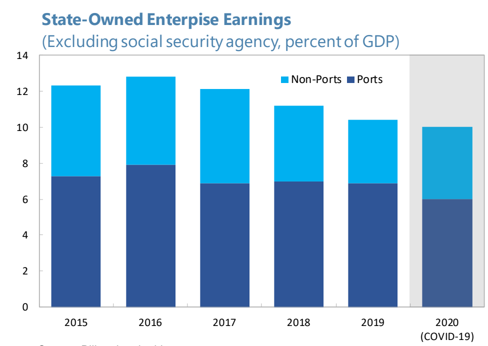
CONTEXT—PRE-EXISTING VULNERABILITIES

1. Djibouti's development strategy has relied on large-scale infrastructure investments to drive economic growth. Taking advantage of its strategic location as a gateway to fast-growing and landlocked Ethiopia, Djibouti has invested in significant port-related infrastructure, including a new multipurpose terminal, a railway to Addis Ababa, a water pipeline, and free trade zones (FTZs). These projects helped to sustain annual growth of almost 7 percent between 2013 and 2019, before the COVID crisis.

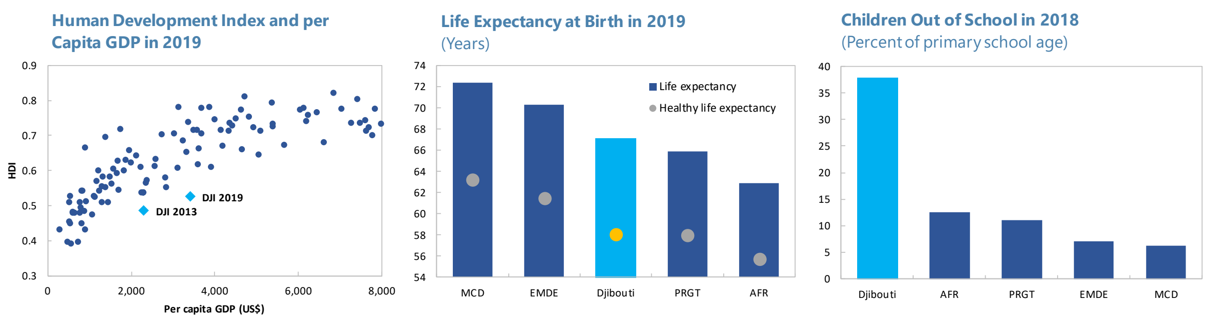
Sources: IMF staff calculations and authorities' data.

2. In an environment of strong growth, state-owned enterprises have been highly profitable. State-owned enterprises (SOEs) have generated gross turnover of about 35 percent of GDP in recent years, with earnings ranging from 10 to 12 percent of GDP. Profits have been largely concentrated in firms operating the country's various port facilities, as well as in the telecom and electricity companies. Progress has also been made to improve the finances of less profitable SOEs. For example, following concerted efforts by the authorities to increase revenue by connecting additional water customers and extending rail tracks directly to the port terminals, the water and rail companies registered positive operating income for the first time in 2020.



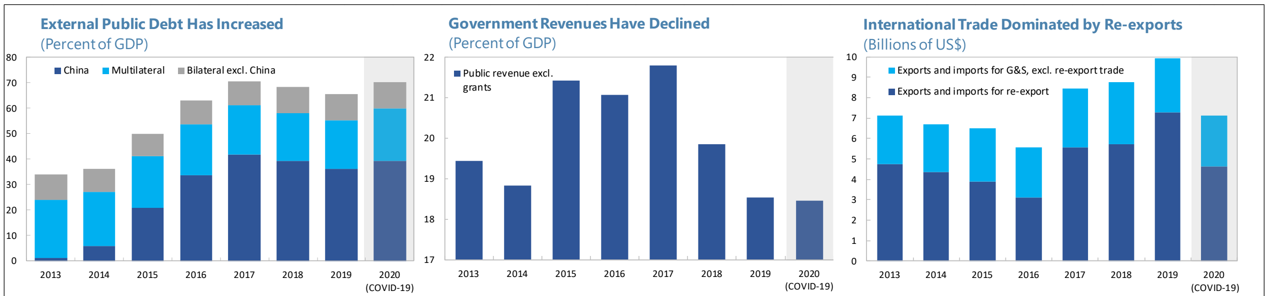
Source: Djibouti authorities.

3. The benefits of high growth and profitable port activity, however, have not been widely shared. With investments centered on capital-intensive projects, few domestic jobs have been created and unemployment remains high at 47 percent, as of the last employment survey conducted in 2017. Youth unemployment was even higher at 86 percent. The transport sector accounted for just 3.6 percent of employment, and FTZs have created less than 4,000 permanent and day laborer jobs. As a result, progress on social outcomes has been slow, particularly compared to the increase in per capita income. Poverty remains widespread with 22.5 percent of the population living on less than US$1.90 per day. Similarly, development outcomes, including on health and education, are low for Djibouti's per capita income, and just 30 percent of adults have access to financial services.



Sources: UNDP, WB, WHO.
Note: Comparators used throughout are countries eligible for financing under the Poverty Reduction and Growth Trust (PRGT), Emerging Market and Developing Economies (EMDEs), the countries of the Middle East and Central Asian Department (MCD), and the African Department (AFR).

4. **Moreover, as investments have grown, macroeconomic vulnerabilities have increased.** External public debt increased from 34 percent of GDP in 2013 to 70 percent in 2017, before declining slightly in 2018–19.[1] With investments increasingly carried out by SOEs and the new sovereign wealth fund (Annex I), an increasing share of fiscal activity is off budget. Tax exemptions intended to support investments have contributed to a steady decline in tax revenues as a share of GDP, even before COVID. Meanwhile, the financial sector has grown rapidly, creating supervisory challenges, and increased dependence on Ethiopia (accounting for 60 percent of port traffic) has elevated Djibouti's exposure to external shocks.

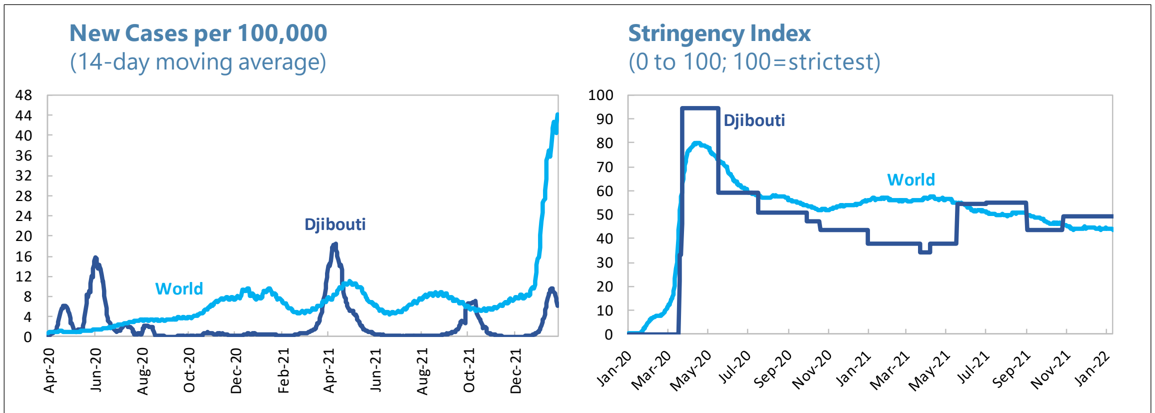


Sources: IMF staff calculations and authorities' data.

RECENT DEVELOPMENTS—COVID AND REGIONAL CONFLICT EXPOSED VULNERABILITIES

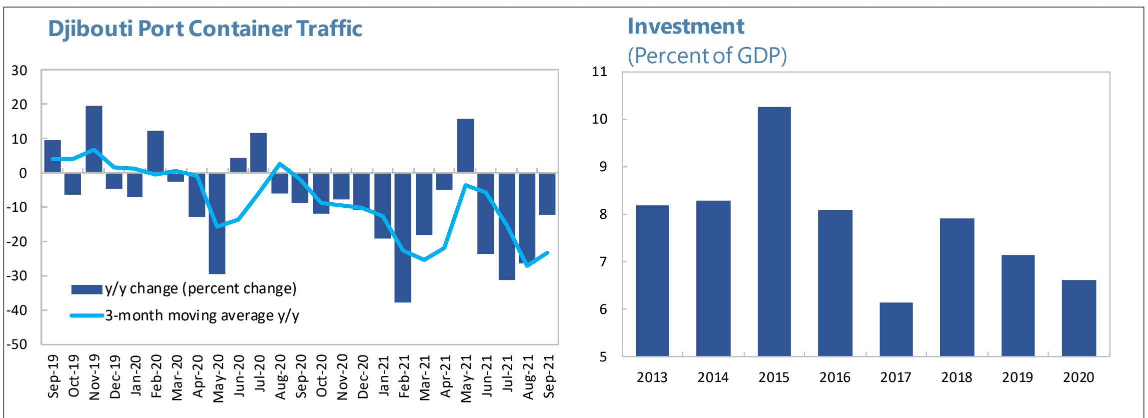
5. **Djibouti has endured several waves of the COVID-19 pandemic.** Djibouti has seen several brief surges in cases since May 2020 but has so far succeeded keeping the virus broadly contained. The availability of vaccines has prompted the authorities to shift from containment measures such as local mobility restrictions and suspension of international travel in 2020 to a vaccination campaign starting in 2021. However, vaccination rates remain at about 15 percent despite ample supply, which the authorities attribute to vaccine hesitancy.

[1] Borrowing by SOEs, mostly from official Chinese creditors and backed by sovereign guarantees, accounts for most of the increase.



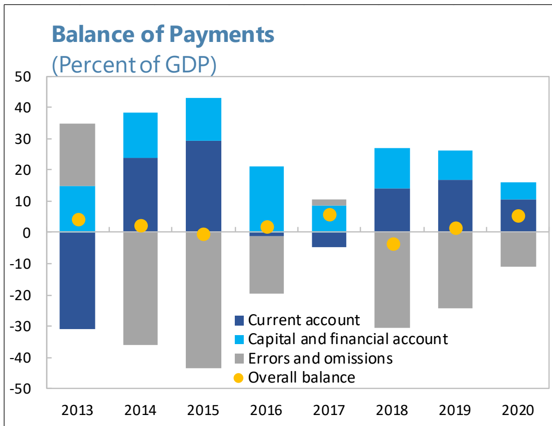
Sources: Haver Analytics, Johns Hopkins University, Oxford.

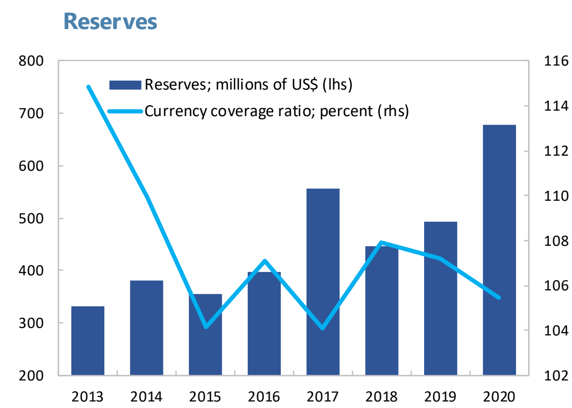
6. **Economic activity has been significantly affected by the global pandemic and the conflict in Ethiopia.** Economic growth slowed to about 1 percent in 2020 due to pandemic-related disruptions to trade and investment. Lower investment also reduced import demand, shifting the underlying current account balance (excluding the reexport trade) to a small surplus in 2020. Port activity then fell further as the conflict in Ethiopia escalated, and container traffic at end-2021 was about 25 percent below 2019 levels. Despite the decline in port activity, growth is expected to have recovered to about 4 percent in 2021 on a modest rebound in investment and construction.



Sources: IMF staff calculations and authorities' data.

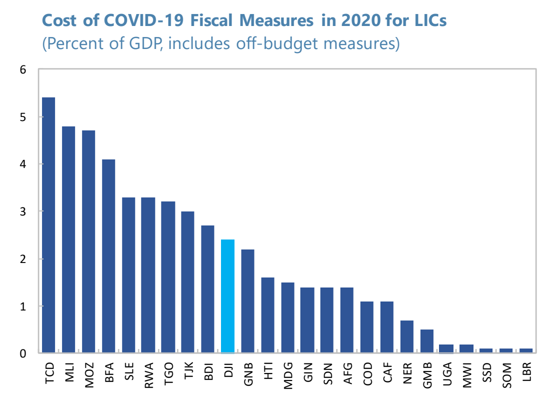
7. **External support helped to cushion the impact on macroeconomic stability.** Djibouti received significant external financial assistance totaling 13.4 percent of GDP in 2020, including US$43 million from the Rapid Credit Facility (RCF). The additional financing, supported by debt rescheduling through the Debt Service Suspension Initiative (DSSI, 3.6 percent of GDP) and debt service relief through the Fund’s Catastrophe Containment and Relief Trust (CCRT, 0.2 percent of GDP), helped regularize arrears, alleviate pressures at the peak of COVID and manage the risk of debt distress. International reserves increased by US$180 million in 2020, further supported by a sharp decline in negative errors and omissions (potentially reflecting a reduction in unrecorded imports or capital outflows). As a result, adequate coverage of the currency board was maintained.





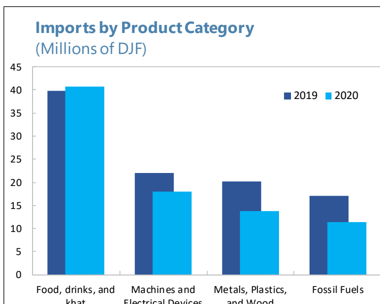
Sources: IMF staff calculations and authorities' data.

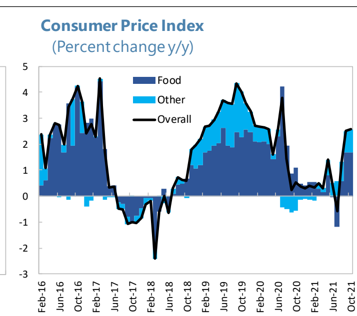
8. External financing and domestic resources also supported a policy response to the COVID crisis. The authorities implemented a fiscal package totaling 2.3 percent of GDP in 2020, including job protection measures, cash transfers, and deferrals of social and corporate tax contributions and loan repayments. The authorities also doubled SOE dividends to the budget to 2.2 percent of GDP in 2020, which helped offset shortfalls in tax revenues. The authorities spent a further 0.6 percent of GDP in COVID-related support to households and businesses in 2021 and expanded credit guarantees, postponed new prudential requirements, and suspended loan provisioning requirements. In late 2021, the authorities exchanged their SDR allocation (about 1.2 percent of GDP) to support social spending in 2022, in line with staff advice.

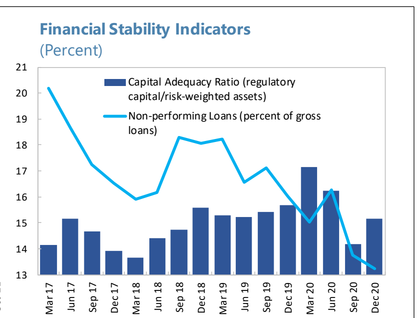


Source: IMF staff calculations.

9. The authorities' policy response underpinned domestic demand and helped maintain financial sector stability. Household consumption appears to have been resilient, with the decline in imports concentrated in inputs for the construction sector. Annual inflation fell to 0.3 percent at end-2020 on low commodity prices and dollar strength, but has risen modestly in recent months, largely on an increase in international food prices. Although total private sector credit shrank by 4 percent in 2020, reflecting a contraction in trade finance, household credit was unchanged.







Sources: IMF staff calculations and authorities' data.

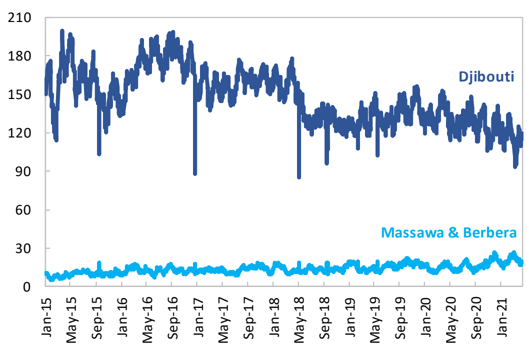
Meanwhile, deposits and net foreign assets of the sector grew substantially, also reflecting a new foreign entrant to the domestic banking system. Banks continued to reduce nonperforming loans in 2020, although the capital adequacy ratio declined on lower net income of banks.

OUTLOOK—RISKS AND OPPORTUNITIES

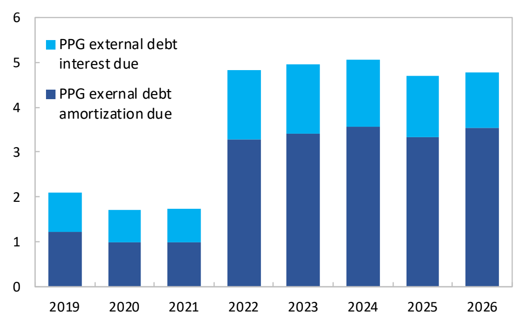
10. The economic outlook is clouded by the conflict in neighboring Ethiopia. Growth is expected to slow again in 2022, to 3 percent, with considerable uncertainty, due to the ongoing conflict in Ethiopia (Annex II). Inflation is expected to fall gradually, closely following international trends. Meanwhile, the dual shocks of COVID and regional conflict have made it more challenging for Djibouti to service its increasing debt obligations, rendering debt unsustainable, in addition to being at high risk of distress.[2]

11. Downside risks are significant. While road and rail connections to Addis Ababa appear uninterrupted so far, risks of trade disruptions are significant. Furthermore, increased violence could result in large refugee inflows, or spillovers of ethnic tensions to Djibouti. Moreover, Djibouti will remain vulnerable to a resurgence of the pandemic until a large percentage of the population is vaccinated, although infections remain low. The ongoing litigation related to the 2018 port contract dispute with DP World could create an additional external liability. Increasing competition from other ports in the region may continue to slowly erode Djibouti's market share.

Port Volumes, 30-day Moving Average
(Thousands of deadweight tonnage)



Medium-term Debt Service
(Percent of GDP)



Source: World Seaborne Trade in Real Time: A Proof of Concept for Building AIS-based Nowcasts from Scratch (Cerdeiro, Komaromi, Liu, and Saeed (2020)), IMF staff calculations and authorities' data.

12. The scope for stabilizing and more inclusive macroeconomic policies remains limited. Djibouti's currency board, while helping to contain inflation, significantly constrains the flexibility of monetary policy. Fiscal policy is also limited by low revenue and a reliance on external financing. Furthermore, as the size of the budget has shrunk relative to GDP, the scope for fiscal policy to promote inclusive growth through social spending and investments in education and health has also decreased.

[2] The PV of debt-to-GDP, although on a declining trend, remains significantly above the threshold throughout the projection horizon, while debt service relative to fiscal revenue is also well above the threshold (see DSA ¶13).

13. Nevertheless, a resolution to the conflict could create significant opportunities for Djibouti. Medium-term growth prospects are strong, but dependent on a resolution to the conflict in Ethiopia. Djibouti's trade services would benefit from a reconstruction-driven rebound in Ethiopian demand, and renewed regional stability would promote foreign investment. In the meantime, the authorities are pursuing economic diversification through new infrastructure projects, including a ship repair yard and a new business district at the old port to reduce dependence on Ethiopian transit by capturing more value-added in international trade. A new sea-to-air freight partnership with Ethiopian Airlines could also help diversify Djibouti's regional connections and contribute to growth. The underlying current account would improve, and debt would decline as service exports recover and large investments wane.

Authorities' Views

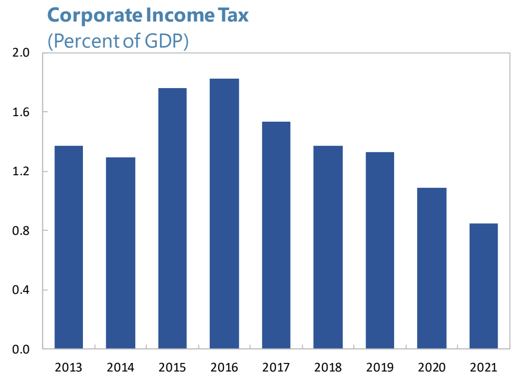
14. The authorities disagreed with staff's macroeconomic outlook and the assessment that debt is unsustainable. They viewed staff's macroframework as overly pessimistic regarding the conflict in Ethiopia and its impact on Djibouti's economy. Furthermore, the authorities noted that their participation in the DSSI, despite the availability of resources to meet debt service obligations, has contributed to the sharp increase in debt service in the near term. They also believed that they have been penalized for modernizing their balance of payments statistics to better reflect imports for reexport to Ethiopia, a key factor resulting in the downgrade in debt-carrying capacity and the associated debt burden thresholds.

POLICIES—REINFORCING A RESILIENT AND INCLUSIVE RECOVERY

Djibouti's main challenge is to achieve a durable and inclusive recovery from the COVID-19 crisis and regional conflict. After significant investments in port infrastructure, Djibouti now needs to invest in macroeconomic stability, and in people. Fiscal policies to raise domestic revenues and stronger oversight of SOE borrowing would help restore debt sustainability and create space for social spending and investments in human capital. Although the currency board limits the flexibility of monetary policy, some operational adjustments, including to prudential policies, could support financial stability and inclusion. Meanwhile, structural reforms would improve governance, strengthen anti-corruption efforts and create jobs to share growth dividends more equitably.

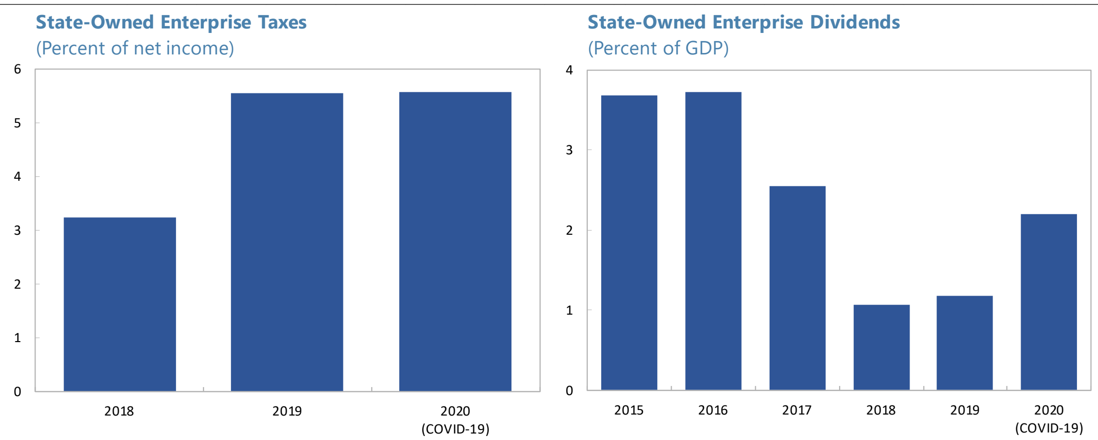
A. Fiscal Policy—Investing in People and Stability

15. Prioritizing domestic revenue mobilization will help restore debt sustainability and create space for social spending. The 2022 budget freezes most spending and introduces several new revenue measures, including a more progressive income tax structure and an exceptional levy on firms operating in the free trade zones. These measures target a reduction in the primary deficit of almost 1 percent of GDP to help create space for increasing debt service, which would reach almost 5 percent of GDP in the medium term because of recent debt reschedulings. Despite the authorities' efforts, staff's view is that the primary balance would deteriorate by almost 1.5 percent of GDP in 2022, as the dual shocks would further dampen revenue and increase the need for social spending. Further measures will therefore be needed to create space for priority spending. The authorities can raise revenues by:



Sources: IMF staff calculations and authorities' data.

- *Narrowing tax exemptions for SOEs.* Three port SOEs alone earned almost 7 percent of GDP in profits in 2020 but paid virtually no income taxes as they benefit from extensive exemptions, driving corporate income tax revenues to under 1 percent of GDP. Furthermore, despite high profits, these firms have paid significantly lower dividends to the budget than they have in recent years. With the role of SOEs becoming even more prominent as new infrastructure projects are completed, Djibouti should establish a rules-based system for the treatment of SOE profits, including standard statutory taxation, fewer exemptions, and an agreement that at least half of after-tax profits be transferred to the budget as dividends. In addition, integrating SOE revenues in a consolidated medium-term budget framework would improve Djibouti's ability to pursue its overall public sector spending priorities.

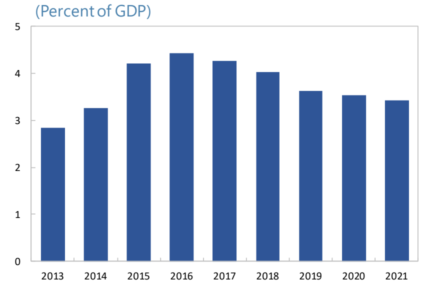


Source: Djibouti authorities.

- *Revisiting the fiscal regime for free trade zones.* Past attempts to estimate tax expenditures, following Fund technical assistance (TA), have struggled to capture the FTZs because many firms there have not complied with their legal obligation to file taxes (Annex III). However, the tax administration has been working with the ports authority to condition the renewal of free zone operating licenses on tax reporting compliance and has recently raised the share of firms filing from under 10 percent to over 50 percent. To raise revenues, the authorities should replace the 50-year tax exemptions with targeted investment allowances or tax credits, to limit tax exemptions to new job-creating investments.

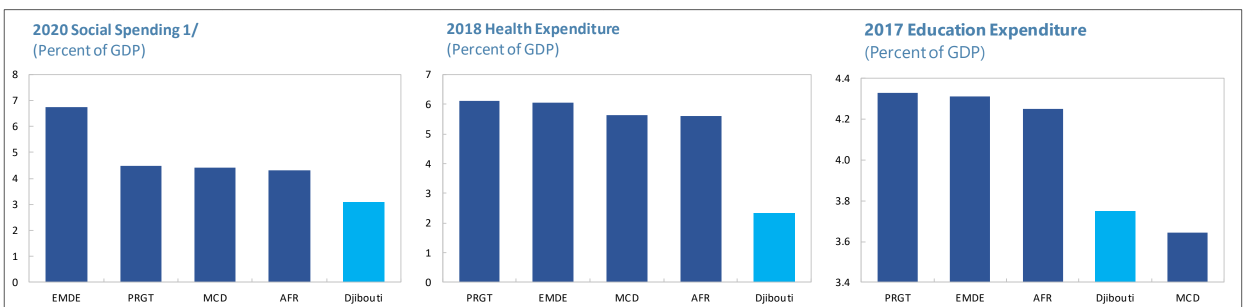
- *Limit other, general tax expenditures.* The five foreign military bases in Djibouti are exempt from all taxation, a tax expenditure estimated to be over 10 percent of GDP. Meanwhile, the bases make lease payments, which are fixed in nominal terms. Relative to GDP, these payments have shrunk since the latest agreements were signed, and now stand at about 3.5 percent of GDP. Separately, the General Investment Code provides for a seven-year tax exemption for investments across a wide range of activities, which could be better targeted. The authorities could also phase out the reduction in the alternative minimum tax introduced during the pandemic and consider shifting from a turnover tax to a minimum tax on profits. In addition, increasing the eligibility threshold for the simplified tax regime would reduce the burden on SMEs and informality.

Foreign Military Base Lease Payments
(Percent of GDP)



Sources: IMF staff calculations and authorities' data.

16. Expenditure rationalization would also create space for social spending and improved public services. Efforts to mobilize revenues should be complemented by efforts to better track and rationalize expenditures, including through strengthened controls and spending reviews. The Budget Ministry was assigned new controls in the 2021 budget to approve large spending commitments, set reference prices for standard contracts, and approve payments on an item-by-item basis. The authorities also adopted a law in early 2022 to reform the operations of Djibouti's 54 administrative public establishments, entities which now account for about 20 percent of current budgetary spending. While the fragmented nature of Djibouti's public spending and a lack of consolidated data make international comparisons difficult, budgetary savings of about 5 percent of GDP will likely be needed to create enough space to match the level of spending on health, education, and household transfers in peer countries.



Sources: WEO, WB.
1/ General government expense, social benefits.

17. Meanwhile, improving public sector governance will be critical to help restore debt sustainability and reduce corruption vulnerabilities. In this context, the authorities should:

- *Improve SOE governance and oversight.* With SOEs accounting for a large and increasing share of public spending, the authorities have formulated a detailed strategy and timeline to enter the Code of Good Governance of Public Enterprises into force by end-2022 by adopting the necessary implementing decrees. The Code would give the Ministry of Finance a clear mandate to exercise control over SOEs, hold SOE management accountable to performance contracts, and subject these firms to ex-post public sector audit. These improvements in SOE governance should be accompanied by the publication of audited financial statements covering the entire

SOE sector, including overseas assets, to shed light on the overall public sector fiscal position and serve as an anchor for debt sustainability.

- *Develop a medium-term fiscal framework and debt strategy.* Formulating fiscal policy in the context of a medium-term framework that accounts for SOE borrowing would help ensure fiscal objectives are consistent with debt sustainability and better prioritize public investment projects. The authorities plan to extend the newly created debt management committee to cover the ports authority and sovereign wealth fund, two key off-budget entities. The government is also advancing a draft public debt law that would require Committee evaluation of potential projects and Ministry of Finance approval before the contracting of new external public or publicly guaranteed debt.
- *Improve cash management*. Cash management is currently governed by the annual budget law, which assigns spending limits to each ministry but lacks clear linkages to revenues and financing, which can give rise to domestic technical arrears. Anchoring a provisional cash flow plan in the annual budget would reduce arrears, improve the efficiency of public spending, promote policy coordination by the Debt and Treasury Directorates, and support the introduction of a Treasury Single Account.
- *Reform the new sovereign wealth fund.* Although fiscal risks have so far been limited by constraining the size of the initial and annual budget transfers, adjustments should be made to safeguard the assets of the social security system, protect budget revenues, and increase transparency (Annex I).

18. In addition to public financial management reforms, strengthened debt management would help to promote macroeconomic stability and manage fiscal risks. With limited scope for monetary policy, fiscal policy plays a key role to underpin macroeconomic stability. However, in the absence of a domestic debt market, the scope for fiscal policy to address shocks is limited to the availability of external financing. The authorities should therefore consider beginning the process of establishing a Treasury bill market to increase the scope for fiscal policy to address shocks and reduce dependence on external borrowing. Although a long process, the reforms discussed above regarding the medium-term fiscal framework, cash flow forecasting, and an annual cash management plan would also inform the establishment of an eventual debt issuance plan.

Authorities' Views

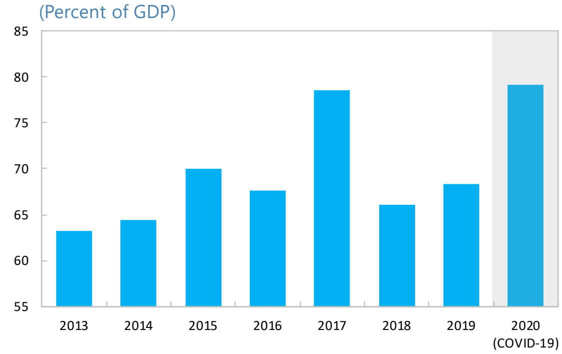
19. The authorities broadly concurred with staff's recommendations. The authorities shared the policy priorities of increasing budget revenue and streamlining tax expenditures, stressing that most measured tax exemptions benefit the foreign military bases. They also agreed with the need for better SOE oversight and reform. The authorities pointed to the establishment of the inter-ministerial debt committee and progress on finalizing the debt law as signals of their commitment to improved coordination between government entities that contract and manage debt and to address shortcomings in SOE debt oversight. They stressed that they would employ all available tools—from raising tax revenue to increased SOE dividends—to meet Djibouti's debt service commitments.

B. Monetary and Financial Sector Policies—Strengthening Stability and Inclusion

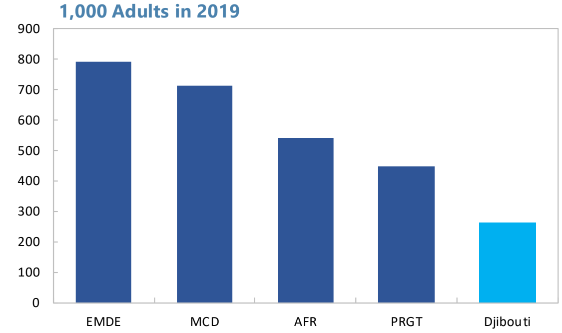
20. Adjustments to the operation of the currency board could reinforce financial stability. The long-standing parity of the Djibouti franc against the U.S. dollar provides the country with an effective nominal anchor, promotes confidence in Djibouti's regional trade hub, and helps to contain inflation. The need to maintain full coverage of franc liabilities with foreign reserves, however, limits the central bank's discretion to respond to shocks (Box 1). To introduce more flexibility to monetary policy once the economy has recovered from the dual shocks, the authorities could gradually increase the currency coverage ratio through retained earnings, including through a bank supervisory levy. A higher coverage ratio would allow Djibouti to introduce an emergency liquidity assistance (ELA) instrument to support institutions under stress, thereby reinforcing financial stability. Eventually, the excess coverage could also be used to conduct monetary policy operations at the margin through a secondary Treasury bill market.

21. The introduction of key prudential instruments would underpin financial sector stability and inclusion. While the banking sector has grown significantly, some 70 percent of banks' assets are held abroad, posing liquidity risks, creating supervisory gaps, and limiting the intermediation of domestic credit, which remains low at under 20 percent of GDP. To reduce risks and bolster domestic credit, the authorities are working to introduce a liquidity coverage ratio (consistent with Fund TA) and are considering a reserve requirement. Better management of franc liquidity would also support the creation of a domestic money market, which is a key prerequisite to a domestic debt market. The central bank could consider regular auctions of short-term certificates of deposit to help adjust liquidity to macroeconomic conditions. Certificates of deposit would also establish a domestic interest rate benchmark and give banks a liquid franc-denominated asset to use for collateral and to meet liquidity requirements. Market deepening would support financial inclusion and facilitate an eventual introduction of Treasury bills. Modernizing the central bank's credit registry could also help promote inclusion and reduce the amount of collateral required to secure loans, while developing the nascent mobile banking and microfinance sector could expand access to financial services, particularly outside the capital.

Banking Sector Assets
(Percent of GDP)



Number of Depositors with Commercial Banks per 1,000 Adults in 2019



Sources: Authorities' data and IMF staff calculations, IMF financial access survey.

22. Financial sector supervision needs to keep pace with the rapid growth of the financial system. The 2020 Financial Sector Stability Review (FSSR) found that central bank oversight of the banking sector is hampered by the lack of a strategic focus and inadequate internal resources, and important non-bank financial institutions fall outside the Central Bank of Djibouti's (CBD) regulatory perimeter. The central bank has received considerable TA in recent years but has made little progress in implementing key recommendations due to a critical lack of capacity. Daily management and substantive decisions are conducted directly by the Governor, and many critical functions are carried out by a single staff member. Recruitment of qualified staff and governance reforms would help address important areas such as NPL resolution, sector analytics, and systemic risk monitoring. The authorities have also prioritized boosting the central bank's anti-money laundering capacity, including amendments to the legal framework of the central bank ahead of a MENAFATF mutual evaluation of its anti-money laundering (AML) regime in 2023–24.

23. The authorities continue to implement the recommendations of the 2012 safeguards assessment. The authorities reported that the Audit Committee has initiated operations, and that implementation is to improve the internal audit function and for timely publication of the central bank's financial statements, which are approved with a significant delay. In line with the safeguards policy, an update of the 2012 safeguards assessment of the central bank will be conducted in connection with the disbursement under the RCF in May 2020.

Authorities' Views

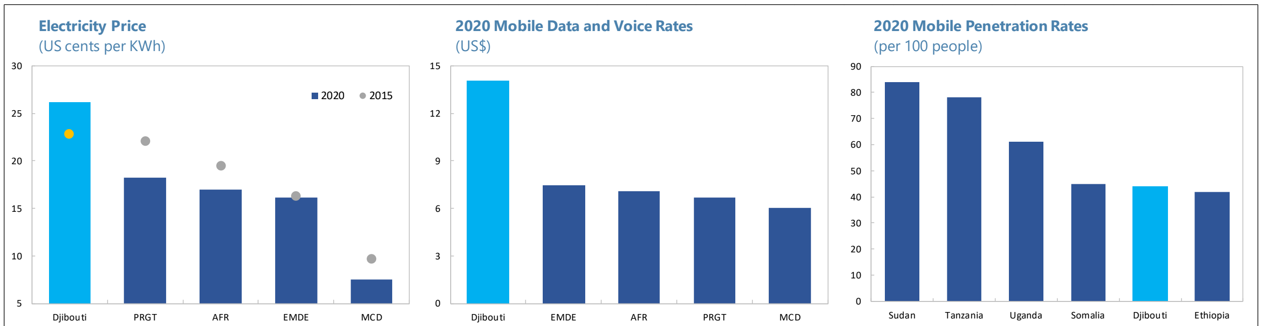
24. The authorities appreciated the advice to expand the policy and supervisory toolkit. The authorities welcomed ideas to strengthen the operations of the currency board and promote financial deepening, noting that this would require amendments to the central bank statute and law on financial supervision. The authorities also stressed the capacity constraints facing the central bank and requested more frequent IMF technical assistance, including a long-term expert on financial supervision as well as TA on central bank operations, governance, and AML policy. The authorities agreed that prudential reforms would support financial deepening, and that their forthcoming financial inclusion strategy would further reduce disparities in access to finance.

C. Structural Reforms—Achieving Resilient Growth and Job Creation

25. Addressing labor market skill mismatches would support broad-based and resilient economic growth. Djibouti has created a modern service economy, but formal employment remains low, in part because much of the population has not acquired the necessary human capital. While Djibouti has expanded access to education and narrowed the gender gap, only 63 percent of children finish primary school, and employer surveys by the World Bank and USAID have found that a lack of skills is a key constraint on the business environment in Djibouti. Formal sector wages are significantly higher than in neighboring Ethiopia, despite Djibouti's high unemployment rate.

26. Progress towards long-planned governance reforms and increased transparency would help improve the business environment and reduce corruption vulnerabilities. The National Anti-Corruption Commission is active, and consistent with a new anti-corruption strategy adopted in November 2021, its capacity and independence should be increased. The Commission will also require 66 senior officials to declare their assets using a new electronic reporting system. While the pandemic has limited progress so far, the authorities should redouble efforts to improve the capacity of law enforcement agencies and the courts to enforce against corruption offenses. The authorities should also conduct and publish the results of an external audit of COVID-related spending, a commitment under the May 2020 RCF. The authorities also committed under the RCF to publish the procurement contracts of all COVID-related expenditures over US$100,000 and have informed staff that all contracts have so far fallen below this threshold.

27. Reduced input costs would promote private sector development and create jobs. Electricity prices in Djibouti are significantly higher than elsewhere in the region, as imported Ethiopian hydropower is seasonally unreliable and must be supplemented by aging thermal generators (Box 2). To improve reliability, Djibouti should continue to diversify its energy supply. Djibouti's first major renewables project, a 60MW wind farm, recently began operations and other projects are planned. Foreign investors have also agreed to construct a 50MW solar plant, and the authorities intend to exploit Djibouti's geothermal resources. These projects would significantly increase Djibouti's generation capacity and allow it to reduce the price of electricity and boost the country's competitiveness. Beyond energy, local IT monopoly Djibouti Telecom charges substantially more for its services than most countries in the region, with low levels of inclusion. The authorities hope to reduce prices and expand access through a sale of a minority stake. Attracting foreign investment in the telecoms sector would also help leverage Djibouti's location as a major entry point for fiber optic cables and create opportunities for more diversified growth. However, the tender has so far drawn limited investor interest given regional instability.



Source: ITU, WB, authorities' data. Note: Mobile data and voice rates based on a package of 140 mins + 70 SMS + 1.5 GB, 3G and above.

28. Improving the coverage and quality of statistics would facilitate policy making. While data are adequate for surveillance purposes, there are deficiencies in the timeliness and scope of national accounts, external sector, and government finance statistics, and gaps in the monetary coverage of non-bank financial institutions. Unrecorded trade hub activity in particular leads to gaps in government finance statistics, large errors and omissions in the balance of payments, and inconsistencies in the national accounts. Djibouti's fragmented public sector and weak statistical capacity have also led to gaps in the reporting of social spending and human development outcomes, which raises challenges in measuring progress on inclusive growth.

Authorities' Views

29. **The authorities noted that they have made significant progress on the structural reform agenda, despite COVID headwinds**. The authorities highlighted the reform focus of their new national development strategy centered on inclusion, interconnectivity, and institutions. They also noted that the terms of reference for the external audit of COVID spending have been prepared and that an auditor would be selected soon. They suggested that educational outcomes have been improving in Djibouti, but that further emphasis should be put on technical and professional training. They were more positive about the potential for light industrial processing to spur job creation, particularly as electricity and IT prices are reduced. Ongoing improvements in infrastructure would promote a further integration of the ports and free zones, allowing Djibouti to benefit more from the access offered under the African Continental Free Trade Zone. They also pointed to the potential offered by the major fiber-optic cables arriving in East Africa through Djibouti, noting that this could establish Djibouti as a regional hub for internet services.

STAFF APPRAISAL

30. **Djibouti's large-scale infrastructure investments have driven strong economic growth in recent years, but the benefits have not been widely shared.** These investments helped to sustain strong annual growth before the COVID crisis. However, with investments centered on capital-intensive projects, few domestic jobs and little tax revenues have been created. As a result, progress on social outcomes has been slow.

31. **As infrastructure investments have grown, macroeconomic vulnerabilities have increased.** Public debt has risen rapidly and represents a major vulnerability. Furthermore, with investments increasingly carried out by SOEs and the new sovereign wealth fund, a large share of fiscal activity is now off-budget. The financial sector has also grown quickly, creating supervisory challenges.

32. **The COVID-19 pandemic and regional conflict have exposed Djibouti's macroeconomic vulnerabilities.** Port activity has fallen, initially due to pandemic-related disruptions to global trade, then on reduced demand from Ethiopia. As a result, output growth slowed sharply in 2020, and debt has become unsustainable.

33. **The economic outlook is clouded by the conflict in Ethiopia.** Growth is expected to have recovered in 2021 on a rebound in investments and construction, but the outlook for 2022 is less favorable and subject to downside risks due to the conflict and a possible resurgence of the pandemic. Once the regional security and health situations improve, growth prospects are strong, with a competitive port sector well-positioned to benefit from a rebound in regional and global trade.

34. **Djibouti's main challenges are to support a durable and inclusive recovery from recent shocks and restore debt sustainability.** The authorities are encouraged to prioritize domestic revenue mobilization and rationalize spending to restore debt sustainability and create space for

social spending. To this end, they should reduce tax exemptions, establish a rules-based system for the treatment of SOE profits, and integrate SOE revenues into a medium-term consolidated budget framework. The authorities should also seek to negotiate higher lease payments from foreign military bases, and reduce tax expenditures in FTZs and under the General Investment Code. Governance and public financial management reforms will also be needed to preserve economic stability.

35. The introduction of key financial and prudential instruments would reinforce financial stability and promote inclusion. While the currency board provides the country with an effective nominal anchor and helps to contain inflation, the need to maintain full coverage of franc liabilities with foreign reserves limits policy flexibility. To increase flexibility, the central bank could gradually increase the currency coverage ratio and introduce an ELA-type instrument. To reduce financial stability risks and bolster domestic credit, the authorities should introduce a liquidity coverage ratio and a reserve requirement, and consider the issuance of central bank certificates of deposit to help adjust liquidity to macroeconomic conditions.

36. Structural and governance reforms would help to create jobs and more resilient growth. Improvements in the educational system would help address labor-skill mismatches. To reduce corruption vulnerabilities, the authorities should increase the capacity of the National Anti-Corruption Commission, redouble efforts to improve the capacity of law enforcement agencies and the courts, and enhance the asset declaration system by senior officials. They should also conduct and publish the results of an external audit of COVID-related spending, a commitment under the May 2020 RCF, as soon as possible this year. Ongoing investments in alternative energy sources would reduce the price of electricity and boost the country's competitiveness. A recently announced partial privatization of Djibouti Telecom could help to reduce IT prices and expand access to cellular services to help diversify economic growth.

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

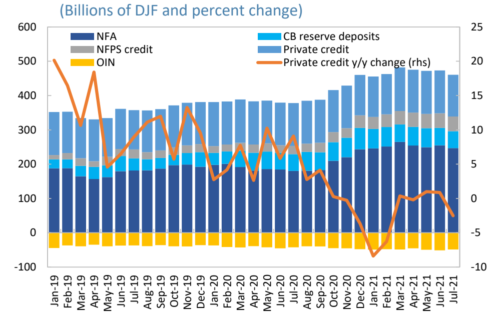
Box 1. Financial Stability and Inclusion

Djibouti's banking system has grown quickly, but most assets are held abroad and most of the population remains unbanked. Greater financial inclusion would promote resilient economic development by widening access to credit, and financial stability by reducing concentration risks. Steps to increase financial stability by onshoring assets would, in turn, promote domestic credit and financial inclusion.

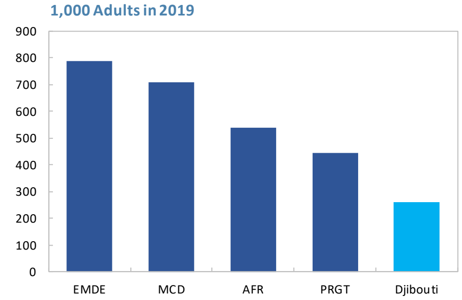
Djibouti's banking sector is relatively large. The number of licensed banks grew from 5 in 2008 to 12 currently, including 3 Islamic banks that now account for about 20 percent of total assets. The entrance of a large foreign-owned bank to the domestic market in 2019 contributed to an increase in system assets from 60 to 80 percent of GDP between 2018 and 2021. Microfinance activity is minimal.

Banking sector assets are largely held offshore. About two-thirds of system assets are held abroad, usually with foreign parent banks and correspondent banks. This asset allocation reflects an underdeveloped domestic market in the context of a deposit base that is over 70 percent demand deposits and dominated by foreign-owned corporations and non-resident deposits, with the latter accounting for about 35 percent of total deposits. Deposits are broadly evenly split between FX (mostly US$) and local currency, but about two-thirds of domestic credit is denominated in local currency. The high level of overseas assets holdings raises risks to financial stability in a stress scenario, particularly since the central bank generally waives asset concentration limits for assets held with affiliates abroad.

Commerical Bank Assets
(Billions of DJF and percent change)



Number of Depositors with Commercial Banks per 1,000 Adults in 2019



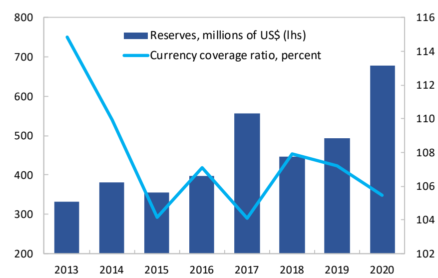
Source: Authorities' data, IMF financial access survey.

Financial inclusion is low. With most assets held abroad, domestic credit is 20 percent of GDP, with household credit under 4 percent of GDP. About 26 percent of adults have access to a bank account, including about 33 percent of men and just 13 percent of women. Including microfinance, almost 30 percent of adults had some access to the financial system in 2019 versus 19 percent in 2013, with the increase due in part to a new requirement that public salaries be paid by direct deposit. This increase in financial inclusion has been accompanied by a doubling of the number of bank branches and ATM locations over the same period.

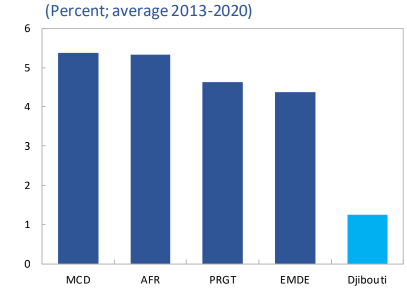
Box 1. Financial Stability and Inclusion (concluded)

The current construction of the currency board imposes tight constraints on the central bank. The currency board promotes Djibouti's status as a regional trade hub, is straightforward to administer, and enjoys deep credibility. Djibouti's exchange system remains free of restrictions on the making of payments and transfers for current international transactions. However, maintaining this currency stability requires the CBD to maintain foreign assets over 100 percent of base money (currency in circulation and commercial bank reserve deposits at the CBD) and government deposits. Effectively, every domestic liability is covered by a foreign asset. This arrangement is comparable to full dollarization except that the CBD earns seigniorage revenue on foreign assets. The CBD provides the government a treasury account free of charge but is not permitted to extend monetary financing. While highly effective in containing inflation, the currency board deprives the central bank of most monetary policy instruments.

Reserves



Inflation
(Percent; average 2013-2020)



Sources: IMF staff calculations and authorities' data.

Increasing the coverage ratio is crucial to create central bank policy space. The key constraint facing currency board arrangements is the need to guarantee the exchange rate by keeping the coverage ratio above 100 percent. In Djibouti, the ratio has consistently remained between 105-110 percent in recent years, with changes in base money closely following changes in foreign assets. This constraint limits the CBD's ability to respond to economic downturns or to support financial stability, because accumulation of domestic assets would reduce the coverage ratio and undermine the credibility of the arrangement. An increase in foreign assets relative to domestic liabilities would mitigate this constraint. The authorities could examine ways to increase central bank profitability, for example in the investment strategy of its FX reserves, or through a bank supervisory levy.

New tools would be needed to use this new policy space. During the pandemic, the central bank encouraged banks to roll over credit to affected borrowers and created incentives by waiving certain prudential requirements. The current constraints imposed by the currency board prevented monetary easing, however, which would require new tools. Possibilities include:

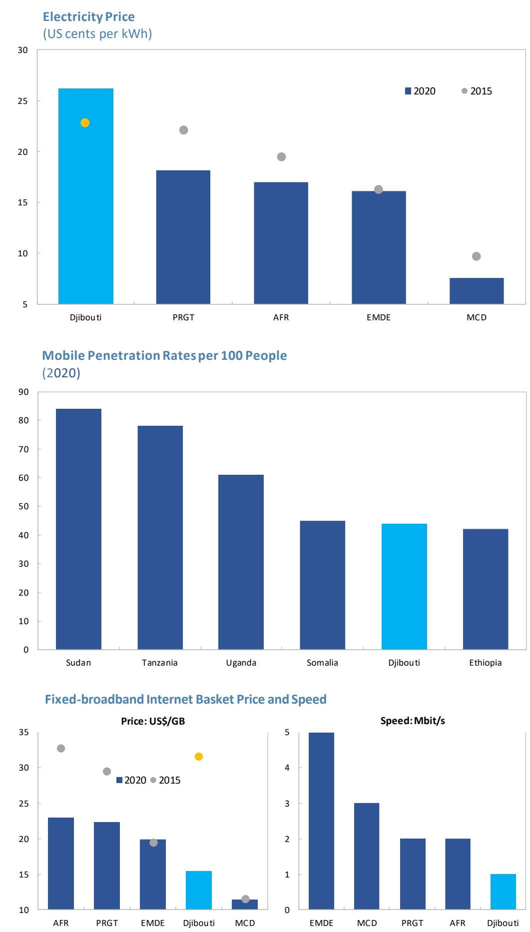
- A *liquidity coverage ratio* (LCR), a requirement to hold high-quality liquid assets to fund potential deposit outflows, which would prompt banks to hold more assets domestically and which could be adjusted in periods of stress.
- A *required reserve ratio* (RRR), a buffer which could be adjusted across the economic cycle to help manage bank liquidity and which has been used successfully in other currency board jurisdictions such as Hong Kong. Over time, both the RRR and LCR could encourage the development of a domestic money market as interbank trading would be an alternative to drawing down FX positions for banks facing DJF reserve shortfalls.
- *Central bank certificates of deposit* (CODs) could also manage liquidity and promote financial stability. Auctions of short-term DJF CODs would absorb liquidity that could be adjusted in the face of macroeconomic conditions. They would also be eligible to meet the LCR requirement or used as collateral for liquidity constraints facing a particular institution. These instruments, which could range in maturity from 7 days to 12 months, would also help establish a domestic interest rate benchmark closely aligned with international US$ rates. In the long term, central bank bills could be replaced by Treasury issuance, which could serve both monetary and fiscal policy goals.

Box 2. Green and Smart Recovery

A green and smart recovery, led by the energy and information technology sectors, would support competitiveness and economic resilience in Djibouti. Complementing recent large-scale infrastructure investments with a well-sequenced reform agenda in these sectors could also support more inclusive growth.

The energy, and information and communication technology (ICT) sectors could play a key role in boosting Djibouti's competitiveness and economic resilience. Reliable, low-cost energy and an efficient ICT sector are important prerequisites for Djibouti's expansion of its transport network, logistics, and trade services. Advances in these sectors would contribute to economic diversification by fostering private sector development and new industries such as light manufacturing.

Djibouti is reliant on external sources of energy while the ICT sector suffers from inefficiencies. Djibouti has no proven hydrocarbon reserves and relies on imports. Djibouti now imports about 90 percent of grid electricity from Ethiopia's lower-cost hydropower sources. However, electricity imports can be unreliable during the dry season, necessitating continued use of aging and expensive backup thermal generation. Djibouti is also strategically placed at the landing site of major fiber-optic cables serving East Africa and is poised to benefit from a digital economy. However, the monopoly of Djibouti Telecom in all telecommunication markets has hindered innovation and competition.



Sources: ITU, WB, authorities' data.

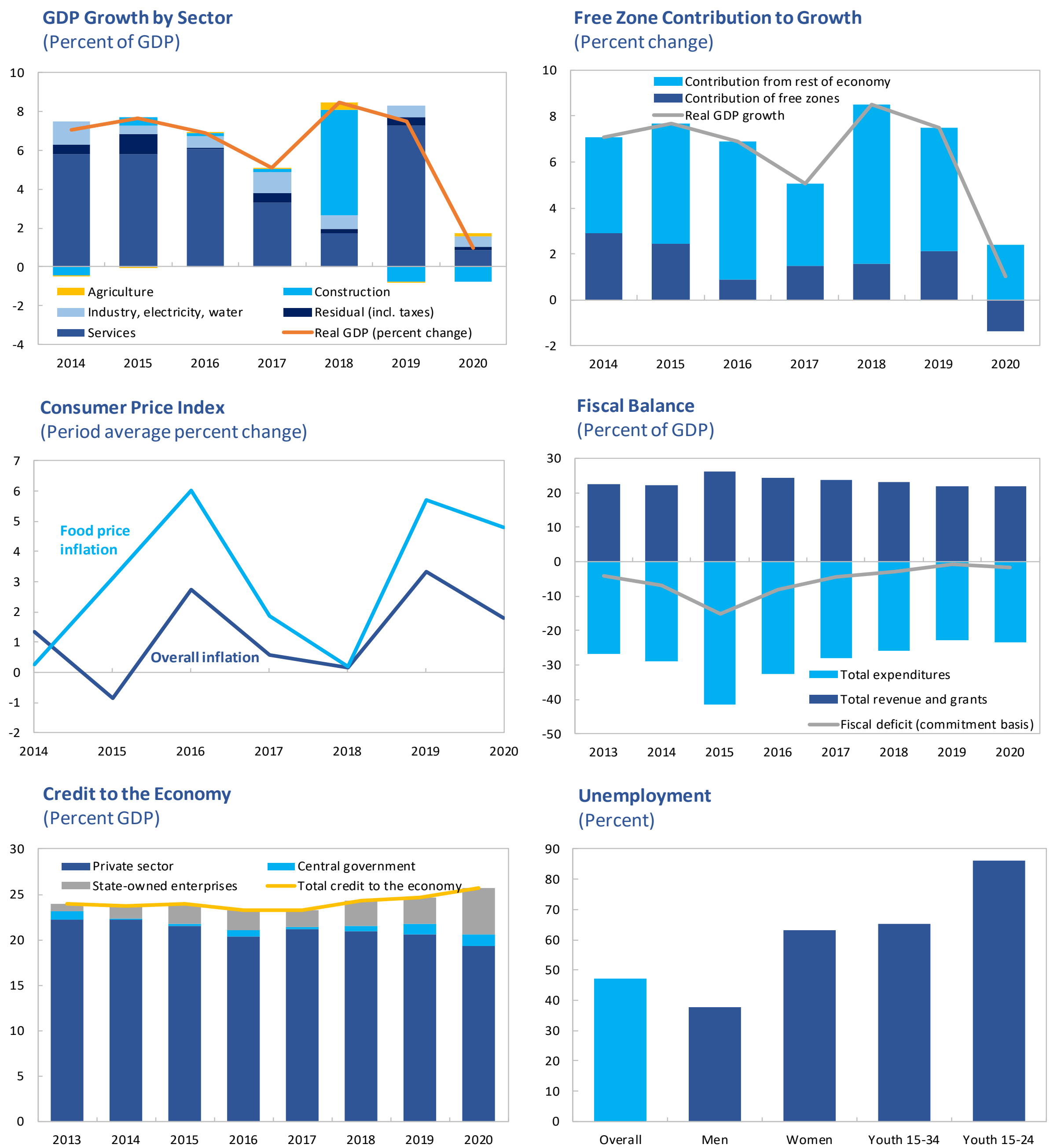
Reflecting inefficiencies, energy and ICT prices in Djibouti are persistently high relative to other regions. Electricity prices remain persistently high relative to other regions. While the ICT sector has experienced some gains recently, the cost and quality of internet access remains elevated by regional standards, limiting competitiveness and inclusiveness of Djibouti's economy. For example, despite income per capita well above most of its neighbors, Djibouti has one of the lowest mobile phone penetration rates in the region.

Complementing existing infrastructure investments with a well-sequenced reform agenda in these sectors has the potential to increase resilient and inclusive growth. Djibouti is endowed with abundant solar, wind, and geothermal energy potential. Djibouti is looking to increase the share of renewables in the country's energy mix, which could reduce energy costs and increase energy security. Djibouti's first major renewables project, a 60MW wind farm in Ghoubet, began operations in December 2021. Foreign investors have also agreed to construct a 50MW solar plant, and the authorities have discussed Djibouti's geothermal resources as well. These projects would significantly increase Djibouti's generation capacity, allow it to reduce the price of electricity, and phase out the remaining thermal facilities.

Box 2. Green and Smart Recovery (concluded)

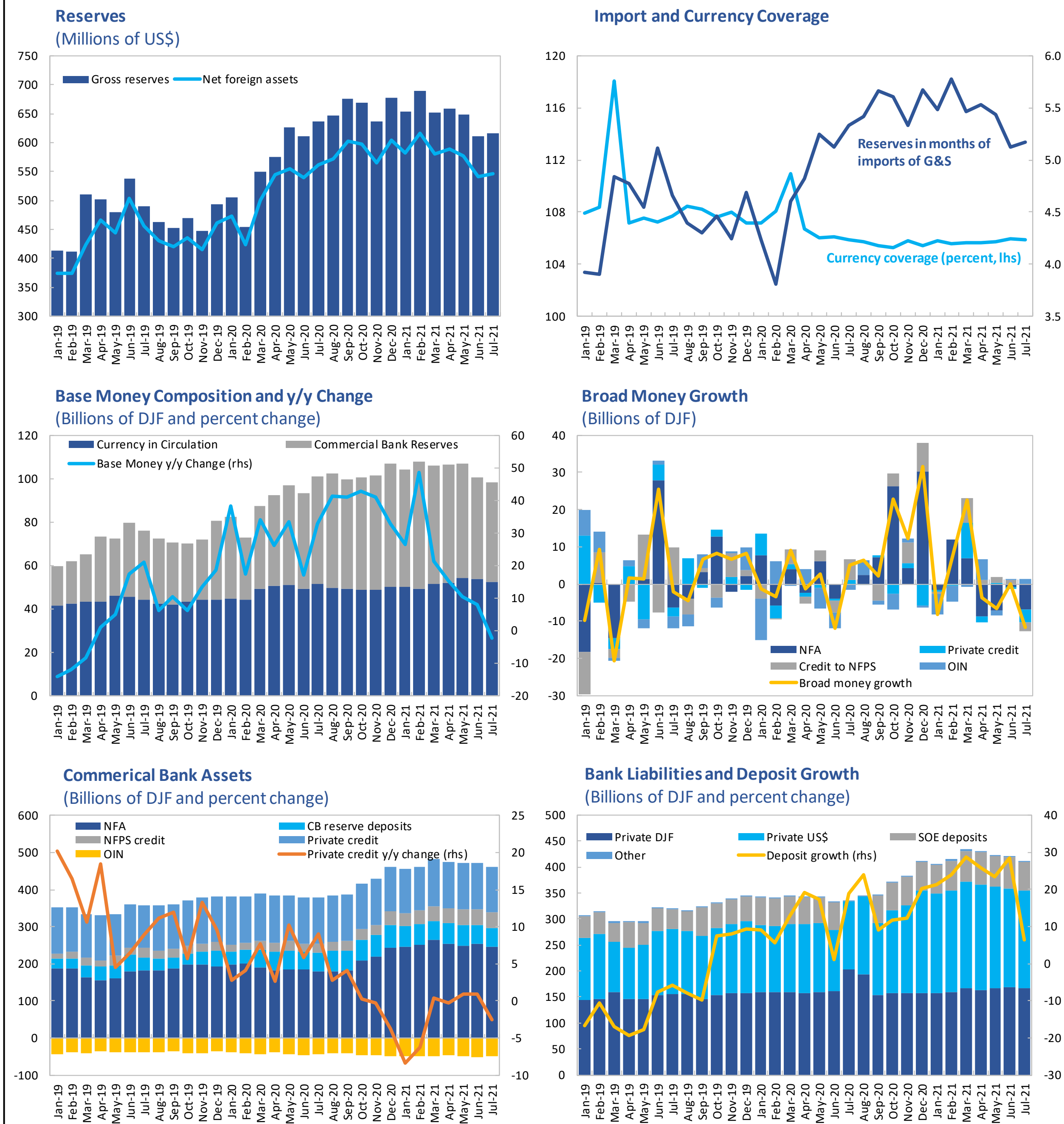
Regulatory reform in telecommunications is also necessary. Meeting the authorities' goal of transforming the country into an international information exchange and as a regional digital platform will require significant improvements in services and reduced costs for businesses and individual consumers. Recently, the government has announced the sale of a minority stake in Djibouti Telecom. The authorities hope that foreign investment will help leverage Djibouti's location as a major entry point for fiber optic cables by establishing the country as a regional hub for data services. ICT investment would also help establish Djibouti as a market for mobile money, potentially providing services across the region. However, investor interest has so far been dampened by the ongoing conflict in Ethiopia. Continuing to advance the Djibouti Telecom sale, and possibly considering selling a majority stake to further promote efficiency gains could translate into lower prices and increased competitiveness.

Figure 1. Djibouti: Selected Macroeconomic Indicators



Source: IMF staff calculations and authorities' data.

Figure 2. Djibouti: Monetary and Financial Indicators, 2019–21



Source: IMF staff calculations and authorities' data.

Table 1. Djibouti: Selected Economic and Financial Indicators, 2019–27

	2019	2020	2021	2022	2023	2024	2025	2026	2027
		Est.				Proj.			
National accounts				(Annual percentage change)					
Real GDP	6.6	1.0	4.0	3.0	5.0	6.0	6.0	6.0	6.0
Consumer prices (annual average)	3.3	1.8	1.2	2.8	2.8	2.5	2.5	2.5	2.5
Consumer prices (end of period)	3.3	0.3	2.5	3.0	2.5	2.5	2.5	2.5	2.5
Saving and investment				(In percent of GDP)					
Fixed capital investment	15.2	16.2	14.6	11.9	15.5	15.9	15.5	14.0	13.1
Non-government	8.0	9.6	7.7	5.9	9.3	9.9	9.5	8.2	7.6
Central government	7.1	6.6	6.9	6.0	6.2	6.1	5.9	5.8	5.5
Gross national savings	32.2	27.0	13.6	7.8	12.8	14.7	15.7	14.9	14.8
Savings/investment balance	17.0	10.7	-1.0	-4.1	-2.7	-1.3	0.2	1.0	1.7
Central government				(In percent of GDP)					
Revenues and grants	21.9	21.9	20.2	18.5	18.3	18.4	18.2	18.0	17.8
Tax revenues	12.1	10.9	10.6	10.4	10.7	11.0	11.3	11.4	11.5
Nontax revenue	6.4	7.6	6.9	6.3	6.1	5.9	5.6	5.4	5.2
Grants	3.3	3.4	2.8	1.7	1.6	1.5	1.4	1.2	1.1
Expenditure	22.7	23.5	22.1	22.3	21.0	20.8	20.4	20.1	19.6
Current expenditure	15.6	16.9	15.2	16.4	14.8	14.7	14.5	14.3	14.1
Capital expenditure	7.1	6.6	6.9	6.0	6.2	6.1	5.9	5.8	5.5
Domestically financed	3.9	3.7	3.1	2.6	2.7	2.6	2.5	2.5	2.5
Foreign-financed	3.3	2.9	3.8	3.3	3.5	3.5	3.4	3.2	3.0
Covid-19/emergency expenditures	…	2.4	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (commitment basis)	-0.9	-1.6	-1.9	-3.9	-2.7	-2.4	-2.2	-2.0	-1.8
Change in arrears	0.5	-1.2	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis)	-0.4	-2.8	-2.2	-3.9	-2.7	-2.4	-2.2	-2.1	-1.8
Monetary sector				(Annual change in percent of broad money)					
Broad money	8.8	19.4	2.6	0.8	6.3	6.7	6.6	6.7	6.8
Net foreign assets	0.5	20.1	-2.0	-2.0	3.0	3.0	3.3	3.6	3.6
Net domestic assets	8.3	-0.7	4.6	2.8	3.3	3.7	3.3	3.1	3.3
Of which: Claims on government (net)	1.0	0.4	1.1	1.5	0.0	0.0	-0.2	-0.3	-0.3
Of which: Claims on non-government sector	3.7	2.4	3.7	1.5	3.5	3.5	3.5	3.5	3.5
Credit to non-government (in percent of GDP)	23.8	24.6	26.0	25.5	25.9	26.1	26.2	26.2	26.2
External sector				(In millions of US dollars)					
Current account balance	564	366	-36	-156	-109	-56	10	51	96
(In percent of GDP)	17.0	10.7	-1.0	-4.1	-2.7	-1.3	0.2	1.0	1.7
Underlying current account balance 1/	-100	62	-36	-156	-109	-56	10	51	96
(In percent of GDP)	-3.0	1.8	-1.0	-4.1	-2.7	-1.3	0.2	1.0	1.7
External public and publicly guaranteed debt	2,228	2,402	2,570	2,771	3,067	3,338	3,556	3,724	3,856
(In percent of GDP)	67.1	70.4	71.6	72.9	74.8	74.9	73.5	70.8	67.5
Foreign direct investment	175	158	161	114	172	214	281	305	331
(In percent of GDP)	5.3	4.6	4.5	3.0	4.2	4.8	5.8	5.8	5.8
Exports of goods and services (percent change)	12.9	-28.3	7.7	-13.7	14.3	14.4	14.5	10.4	10.4
Imports of goods and services (percent change)	13.7	-28.1	19.6	-10.4	12.3	12.6	12.7	9.5	9.5
Gross official reserves	494	677	636	631	671	716	766	816	873
(In months of next year's imports of goods and services, exc. re-exports)	4.7	5.7	5.4	5.0	4.9	4.8	4.8	4.7	4.6
Gross foreign assets of commercial banks	1,408	1,753	1,784	1,734	1,774	1,814	1,859	1,914	1,969
(In months of next year's imports of goods and services, exc. re-exports)	13.4	14.7	15.3	13.7	13.0	12.2	11.6	11.0	10.4
Exchange rate (DF/US$, end of period)	177.7	177.7	177.7	…	…	…	…	…	…
Real effective exchange rate (yearly average, 2010=100)	109.6	112.0	…	…	…	…	…	…	…
(Change in percent; depreciation -)	4.1	2.2	…	…	…	…	…	…	…
Memorandum items									
Nominal GDP (in millions of Djibouti francs)	589,583	606,063	637,773	675,238	728,500	791,516	859,982	934,374	1,015,187
Nominal GDP (in millions of US dollars)	3,317	3,410	3,589	3,799	4,099	4,454	4,839	5,258	5,712
Nominal GDP per capita (US dollars)	3,408	3,452	…	…	…	…	…	…	…
Population (million)	0.974	0.988	1.002	1.016	1.030	1.043	1.056	1.069	1.081

Sources: Djibouti authorities and IMF staff estimates and projections.
1/ Current account balance excluding imports and exports associated with re-export activities.

Table 2a. Djibouti: Central Government Operations, 2019–27
(In millions of Djibouti francs)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
		Est.				Proj.			
Revenues and grants	128,931	132,580	129,042	124,592	133,536	145,524	156,828	168,368	180,900
Tax revenues	71,420	65,866	67,400	70,258	77,769	87,409	96,810	106,400	116,831
Direct taxes	30,470	28,646	27,230	28,592	31,472	35,361	39,604	43,537	48,316
Indirect and other taxes	40,950	37,220	40,170	41,666	46,297	52,048	57,206	62,864	68,515
Indirect taxes	37,945	34,581	37,400	38,896	42,927	48,078	52,886	58,144	63,395
Other taxes	3,005	2,639	2,770	2,770	3,370	3,970	4,320	4,720	5,120
Nontax revenue	37,863	46,226	43,875	42,713	44,146	46,493	48,395	50,345	52,446
Domestic	16,536	24,761	21,752	20,590	22,023	24,370	26,272	28,222	30,323
External	21,327	21,465	22,123	22,123	22,123	22,123	22,123	22,123	22,123
Grants	19,648	20,487	17,767	11,622	11,622	11,622	11,622	11,622	11,623
Development projects	7,492	7,561	12,390	8,467	8,467	8,467	8,467	8,467	8,467
Budget support	12,156	12,926	5,377	3,155	3,155	3,155	3,155	3,155	3,156
Expenditure	133,968	142,368	141,213	150,818	153,042	164,671	175,815	187,509	198,886
Current expenditure	91,934	102,211	97,259	110,507	108,017	116,697	124,674	133,732	142,964
Wages and related expenditure	39,525	39,920	41,475	44,014	47,481	51,279	54,869	58,709	62,819
Wages and contributions	35,603	35,764	37,391	39,634	42,805	46,230	49,466	52,928	56,633
Housing subsidies	3,922	4,156	4,084	4,380	4,675	5,049	5,403	5,781	6,186
Goods and services	29,393	30,332	33,563	33,135	35,912	38,994	42,201	45,694	49,492
Civil expenditure	23,200	24,736	27,135	26,321	28,690	31,272	34,086	37,154	40,498
Military expenditure	6,193	5,596	6,428	6,814	7,223	7,722	8,115	8,540	8,994
Maintenance	1,305	1,200	1,221	1,294	1,398	1,510	1,645	1,794	1,955
Transfers	14,220	14,850	15,324	25,901	17,056	18,591	19,892	21,284	22,774
Interest	7,111	952	1,012	5,499	5,507	5,660	5,403	5,587	5,260
Foreign-financed current spending	380	604	664	664	664	664	664	664	664
Capital expenditure	42,034	40,157	43,954	40,311	45,026	47,974	51,140	53,776	55,922
Domestically financed	22,750	22,498	19,873	17,886	19,674	20,658	21,897	23,496	25,211
Foreign-financed	19,284	17,659	24,081	22,425	25,351	27,316	29,243	30,280	30,711
Grants	7,492	7,561	12,390	8,467	8,467	8,467	8,467	8,467	8,467
Loans to central government (projects)	11,792	10,098	11,691	13,958	16,884	18,849	20,776	21,813	22,244
COVID-19 related expenditures	…	14,354	4,000	0	0	0	0	0	0
Primary balance (commitment basis)	2,074	-8,837	-11,159	-20,727	-14,000	-13,487	-13,584	-13,554	-12,726
Overall balance (commitment basis)	-5,037	-9,788	-12,171	-26,226	-19,506	-19,147	-18,987	-19,141	-17,986
Change in arrears	2,871	-7,161	-1,700	0	0	0	-192	-192	-192
Domestic	-1,670	-1,947	-1,700	0	0	0	0	0	0
External	4,541	-5,214	0	0	0	0	-192	-192	-192
Overall balance (cash basis)	-2,166	-16,949	-13,871	-26,226	-19,506	-19,147	-19,179	-19,334	-18,178
Financing	2,166	16,949	13,871	26,226	19,506	19,147	19,179	19,334	18,178
Domestic	-6,107	4,026	4,775	6,890	-230	-172	-2,270	-2,962	-2,962
Bank	2,570	838	5,492	6,890	-230	-172	-2,270	-2,962	-2,962
Central bank	2,171	1,027	5,987	7,178	0	0	-2,122	-2,962	-2,962
Of which: SDR Allocation 1/	0	0	7,642	0	0	0	0	0	0
Commercial banks	399	-189	-495	-288	-230	-172	-148	0	0
Nonbank	-8,677	3,187	-717	0	0	0	0	0	0
External	8,273	12,924	9,097	19,336	19,736	19,320	21,449	22,295	21,140
Disbursements	11,792	15,801	12,452	14,113	16,884	18,849	20,776	21,813	22,244
Loans to central government (projects)	11,792	10,098	11,691	13,958	16,884	18,849	20,776	21,813	22,244
Exceptional Financing (CCRT)	…	562	761	155	0	0	0	0	0
Amortization	-3,519	-2,877	-3,356	-15,705	-16,617	-16,760	-14,129	-17,124	-16,599
Other	0	5,141	0	20,928	19,469	17,230	14,803	17,606	15,495
Memorandum									
Overall balance (excl. foreign-financed expenditures)	10,006	-6,247	-1,516	-11,604	-1,958	366	2,260	3,144	4,730

Sources: Djibouti authorities; and IMF staff estimates and projections.
1/ Using the SDR/DJF exchange rate as of October 28, 2021.

Table 2b. Djibouti: Central Government Operations, 2019–27

(In percent of GDP)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
		Est.				Proj.			
Revenues and grants	21.9	21.9	20.2	18.5	18.3	18.4	18.2	18.0	17.8
Tax revenues	12.1	10.9	10.6	10.4	10.7	11.0	11.3	11.4	11.5
Direct taxes	5.2	4.7	4.3	4.2	4.3	4.5	4.6	4.7	4.8
Indirect and other taxes	6.9	6.1	6.3	6.2	6.4	6.6	6.7	6.7	6.7
Indirect taxes	6.4	5.7	5.9	5.8	5.9	6.1	6.1	6.2	6.2
Other taxes	0.5	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5
Nontax revenue	6.4	7.6	6.9	6.3	6.1	5.9	5.6	5.4	5.2
Domestic	2.8	4.1	3.4	3.0	3.0	3.1	3.1	3.0	3.0
External	3.6	3.5	3.5	3.3	3.0	2.8	2.6	2.4	2.2
Grants	3.3	3.4	2.8	1.7	1.6	1.5	1.4	1.2	1.1
Development projects	1.3	1.2	1.9	1.3	1.2	1.1	1.0	0.9	0.8
Budget support	2.1	2.1	0.8	0.5	0.4	0.4	0.4	0.3	0.3
Expenditure	22.7	23.5	22.1	22.3	21.0	20.8	20.4	20.1	19.6
Current expenditure	15.6	16.9	15.2	16.4	14.8	14.7	14.5	14.3	14.1
Wages and related expenditure	6.7	6.6	6.5	6.5	6.5	6.5	6.4	6.3	6.2
Wages and contributions	6.0	5.9	5.9	5.9	5.9	5.8	5.8	5.7	5.6
Housing subsidies	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Goods and services	5.0	5.0	5.3	4.9	4.9	4.9	4.9	4.9	4.9
Civil expenditure	3.9	4.1	4.3	3.9	3.9	4.0	4.0	4.0	4.0
Military expenditure	1.1	0.9	1.0	1.0	1.0	1.0	0.9	0.9	0.9
Maintenance	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Transfers	2.4	2.5	2.4	3.8	2.3	2.3	2.3	2.3	2.2
Interest	1.2	0.2	0.2	0.8	0.8	0.7	0.6	0.6	0.5
Foreign-financed current spending	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital expenditure	7.1	6.6	6.9	6.0	6.2	6.1	5.9	5.8	5.5
Domestically financed	3.9	3.7	3.1	2.6	2.7	2.6	2.5	2.5	2.5
Foreign-financed	3.3	2.9	3.8	3.3	3.5	3.5	3.4	3.2	3.0
Grants	1.3	1.2	1.9	1.3	1.2	1.1	1.0	0.9	0.8
Loans to central government (projects)	2.0	1.7	1.8	2.1	2.3	2.4	2.4	2.3	2.2
COVID-19 related expenditures	...	2.4	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance (commitment basis)	0.4	-1.5	-1.7	-3.1	-1.9	-1.7	-1.6	-1.5	-1.3
Overall balance (commitment basis)	-0.9	-1.6	-1.9	-3.9	-2.7	-2.4	-2.2	-2.0	-1.8
Change in arrears	0.5	-1.2	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	-0.3	-0.3	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
External	0.8	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis)	-0.4	-2.8	-2.2	-3.9	-2.7	-2.4	-2.2	-2.1	-1.8
Financing	0.4	2.8	2.2	3.9	2.7	2.4	2.2	2.1	1.8
Domestic	-1.0	0.7	0.7	1.0	0.0	0.0	-0.3	-0.3	-0.3
Bank	0.4	0.1	0.9	1.0	0.0	0.0	-0.3	-0.3	-0.3
Central bank	0.4	0.2	0.9	1.1	0.0	0.0	-0.2	-0.3	-0.3
Of which: SDR allocation 1/	0.0	0.0	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Nonbank	-1.5	0.5	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
External	1.4	2.1	1.4	2.9	2.7	2.4	2.5	2.4	2.1
Disbursements	2.0	2.6	2.0	2.1	2.3	2.4	2.4	2.3	2.2
Loans to central government (projects)	2.0	1.7	1.8	2.1	2.3	2.4	2.4	2.3	2.2
Exceptional Financing (CCRT)	...	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.6	-0.5	-0.5	-2.3	-2.3	-2.1	-1.6	-1.8	-1.6
Other	0.0	0.8	0.0	3.1	2.7	2.2	1.7	1.9	1.5
Memorandum									
Overall balance (excl. foreign-financed expenditures)	1.7	-1.0	-0.2	-1.7	-0.3	0.0	0.3	0.3	0.5

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

1/ Using the SDR/DJF exchange rate as of October 28, 2021.

Table 3a. Djibouti: Balance of Payments, 2019–27
(In millions of U.S. dollars, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
		Est.				Proj.			
Current account	564	366	-36	-156	-109	-56	10	51	96
Current account, excluding trade for re-exports	-100	62	-36	-156	-109	-56	10	51	96
Trade balance	386	270	-116	-233	-190	-141	-78	-39	8
Exports	5,150	3,695	3,979	3,434	3,927	4,494	5,145	5,678	6,267
Goods	3,996	2,785	2,996	2,580	2,945	3,365	3,846	4,223	4,637
Of which: re-exports	3,980	2,466	2,663	2,264	2,603	2,994	3,443	3,787	4,166
Services	1,153	910	983	854	982	1,130	1,299	1,455	1,630
Imports	-4,764	-3,425	-4,095	-3,667	-4,117	-4,636	-5,223	-5,717	-6,259
Goods	-4,138	-2,911	-3,540	-3,185	-3,597	-4,073	-4,616	-5,062	-5,551
Of which: imports for re-exports	-3,316	-2,162	-2,663	-2,264	-2,603	-2,994	-3,443	-3,787	-4,166
Services	-626	-514	-555	-483	-521	-562	-607	-656	-708
Income	-94	-99	-105	-115	-122	-132	-143	-155	-168
Current transfers	272	195	185	192	204	217	231	245	257
Private	17	10	30	33	35	39	42	45	45
Official	255	184	154	160	168	178	189	200	211
Capital and financial account	302	186	0	151	149	101	45	9	-29
Capital transfers	44	37	39	40	42	44	45	47	49
Foreign direct investment	175	158	161	114	172	214	281	305	331
Public sector	153	255	179	84	186	173	136	63	43
Disbursements	213	312	208	209	327	333	298	249	228
Amortization	-60	-57	-29	-125	-141	-159	-162	-186	-185
Commercial banks	-49	-261	-31	50	-40	-40	-45	-55	-55
Other investment	-22	-3	-349	-137	-212	-290	-372	-351	-398
o/w SDR allocation	…	…	43	0	0	0	0	0	0
Errors and omissions	-810	-369	0	0	0	0	0	0	0
Overall balance (deficit -)	55	183	-36	-5	40	45	55	60	67
Financing	-55	-183	36	5	-40	-45	-55	-60	-67
Central bank	-55	-186	40	4	-40	-45	-54	-60	-67
Change in gross reserves	-49	-183	41	5	-40	-45	-50	-50	-57
Other central bank liabilities	-7	-3	-1	-1	0	0	-4	-10	-11
Repayment of arrears	…	-43	-9	0	0	0	-1	-1	-1
Exceptional financing		46	4	1	0	0	0	0	0
IMF (RCF Disbursment) 1/	…	43	0	0	0	0	0	0	0
CCRT 1/ 2/	…	3	4	1	0	0	0	0	0
Financing Gap	…	0	0	0	0	0	0	0	0
Memorandum items									
Current account (in percent of GDP)	17.0	10.7	-1.0	-4.1	-2.7	-1.3	0.2	1.0	1.7
Exports of goods and services (percent change)	12.9	-28.3	7.7	-13.7	14.3	14.4	14.5	10.4	10.4
Imports of goods and services (percent change)	13.7	-28.1	19.6	-10.4	12.3	12.6	12.7	9.5	9.5
Central bank gross reserves (in millions of US dollars)	494	677	636	631	671	716	766	816	873
In months of next year's imports of G&S (excl. re-exports)	4.7	5.7	5.4	5.0	4.9	4.8	4.8	4.7	4.6
FDI (in percent of GDP)	5.3	4.6	4.5	3.0	4.2	4.8	5.8	5.8	5.8
External public and publicly guaranteed debt									
In millions of US dollars	2,228	2,402	2,570	2,771	3,067	3,338	3,556	3,724	3,856
In percent of GDP	67.1	70.4	71.6	72.9	74.8	74.9	73.5	70.8	67.5
In percent of exports of goods and services	43.3	65.0	64.6	80.7	78.1	74.3	69.1	65.6	61.5
Debt service									
In millions of US dollars	70	58	54	184	203	226	231	256	252
In percent of GDP	2.1	1.7	1.5	4.8	5.0	5.1	4.8	4.9	4.4
In percent of exports of goods and services	1.4	1.6	1.3	5.4	5.2	5.0	4.5	4.5	4.0

Sources: Djibouti authorities; and IMF staff estimates and projections.
1/ Using the SDR/USD exchange rate as of April 20, 2020.
2/ Assumes debt relief under CCRT until April 2022, pending resource availability.

Table 3b. Djibouti: Balance of Payments, 2019–27

(In percent of GDP, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
		Est.				Proj.			
Current account	17.0	10.7	-1.0	-4.1	-2.7	-1.3	0.2	1.0	1.7
Current account, excluding trade for re-exports	-3.0	1.8	-1.0	-4.1	-2.7	-1.3	0.2	1.0	1.7
Trade balance	11.6	7.9	-3.2	-6.1	-4.6	-3.2	-1.6	-0.7	0.1
Exports	155.2	108.3	110.9	90.4	95.8	100.9	106.3	108.0	109.7
Goods	120.5	81.7	83.5	67.9	71.8	75.5	79.5	80.3	81.2
Of which: re-exports	120.0	72.3	74.2	59.6	63.5	67.2	71.2	72.0	72.9
Services	34.8	26.7	27.4	22.5	24.0	25.4	26.8	27.7	28.5
Imports	-143.6	-100.4	-114.1	-96.5	-100.4	-104.1	-107.9	-108.7	-109.6
Goods	-124.7	-85.4	-98.7	-83.8	-87.7	-91.5	-95.4	-96.3	-97.2
Of which: imports for re-exports	-99.9	-63.4	-74.2	-59.6	-63.5	-67.2	-71.2	-72.0	-72.9
Services	-18.9	-15.1	-15.5	-12.7	-12.7	-12.6	-12.5	-12.5	-12.4
Income	-2.8	-2.9	-2.9	-3.0	-3.0	-3.0	-2.9	-2.9	-2.9
Current transfers	8.2	5.7	5.1	5.1	5.0	4.9	4.8	4.7	4.5
Private	0.5	0.3	0.8	0.9	0.9	0.9	0.9	0.9	0.8
Official	7.7	5.4	4.3	4.2	4.1	4.0	3.9	3.8	3.7
Capital and financial account	9.1	5.4	0.0	4.0	3.6	2.3	0.9	0.2	-0.5
Capital transfers	1.3	1.1	1.1	1.1	1.0	1.0	0.9	0.9	0.9
Foreign direct investment	5.3	4.6	4.5	3.0	4.2	4.8	5.8	5.8	5.8
Public sector	4.6	7.5	5.0	2.2	4.5	3.9	2.8	1.2	0.8
Disbursements	6.4	9.1	5.8	5.5	8.0	7.5	6.2	4.7	4.0
Amortization	-1.8	-1.7	-0.8	-3.3	-3.4	-3.6	-3.3	-3.5	-3.2
Commercial banks	-1.5	-7.7	-0.9	1.3	-1.0	-0.9	-0.9	-1.0	-1.0
Other investment	-0.7	-0.1	-9.7	-3.6	-5.2	-6.5	-7.7	-6.7	-7.0
o/w SDR allocation	…	…	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-24.4	-10.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (deficit -)	1.7	5.4	-1.0	-0.1	1.0	1.0	1.1	1.1	1.2
Financing	-1.7	-5.4	1.0	0.1	-1.0	-1.0	-1.1	-1.1	-1.2
Central bank	-1.7	-5.5	1.1	0.1	-1.0	-1.0	-1.1	-1.1	-1.2
Change in gross reserves	-1.5	-5.4	1.1	0.1	-1.0	-1.0	-1.0	-1.0	-1.0
Other central bank liabilities	-0.2	-0.1	0.0	0.0	0.0	0.0	-0.1	-0.2	-0.2
Repayment of arrears	…	-1.3	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing	0.0	1.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0
IMF (RCF Disbursment) 1/	…	1.3	0.0	0.0	0.0	0.0	0.0	0.0	1.0
CCRT 1/ 2/	…	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	…	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items									
Exports of goods and services (percent change)	12.9	-28.3	7.7	-13.7	14.3	14.4	14.5	10.4	10.4
Imports of goods and services (percent change)	13.7	-28.1	19.6	-10.4	12.3	12.6	12.7	9.5	9.5
Central bank gross reserves (in millions of US dollars)	493.8	676.7	635.5	630.6	670.8	715.8	765.9	816.0	873.2
In months of next year's imports of goods and services	1.7	2.0	2.1	1.8	1.7	1.6	1.6	1.6	1.5
In months of next year's imports of G&S (excl. re-exports)	4.7	5.7	5.4	5.0	4.9	4.8	4.8	4.7	4.6
External public and publicly guaranteed debt									
In percent of GDP	67.1	70.4	71.6	72.9	74.8	74.9	73.5	70.8	67.5
In percent of exports of goods and services	43.3	65.0	64.6	80.7	78.1	74.3	69.1	65.6	61.5
Debt service									
In percent of GDP	2.1	1.7	1.5	4.8	5.0	5.1	4.8	4.9	4.4
In percent of exports of goods and services	1.4	1.6	1.3	5.4	5.2	5.0	4.5	4.5	4.0

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

1/ Using the SDR/USD exchange rate as of April 20, 2020.

2/ Assumes debt relief under CCRT until April 2022, pending resource availability.

Table 4. Djibouti: Summary Accounts of the Banking System, 2019–27

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

	2019	2020	2021	2022	2023	2024	2025	2026	2027
		Est.				Proj.			
					I. Central Bank				
Net foreign assets	81,978	107,332	92,950	92,285	99,359	107,281	116,966	127,551	139,403
(In millions of US$)	461.3	604.1	523.0	519.3	559.1	603.6	658.1	717.7	784.4
Gross Foreign Reserves	87,761	120,291	112,948	112,076	119,223	127,212	136,112	145,018	155,191
Currency Coverage, in percent 1/	*107.2*	*105.4*	*105.3*	*105.6*	*105.1*	*104.5*	*104.2*	*103.7*	*103.6*
Fund Credit Outstanding	1,898	8,977	8,409	8,202	8,275	8,342	7,557	5,878	4,199
SDR Allocation	3,725	3,880	11,522	11,522	11,522	11,522	11,522	11,522	11,522
Net domestic assets	-1,244	-240	6,469	13,478	13,730	14,086	13,289	11,960	10,034
Net credit to the central government	734	2,548	8,752	16,045	16,119	16,186	15,401	13,721	12,042
Other Items and Capital Account	-1,978	-2,788	-2,284	-2,567	-2,388	-2,100	-2,111	-1,762	-2,008
Base Money	80,735	107,127	99,418	105,763	113,089	121,366	130,255	139,511	149,437
Currency in circulation	44,165	49,939	52,935	57,170	61,743	66,683	72,017	77,779	84,001
Reserve Deposits	36,570	57,188	46,483	48,594	51,346	54,683	58,238	61,732	65,436
					II. Consolidated Banking System				
Net foreign assets	274,395	350,708	341,759	332,208	346,391	361,422	379,104	399,464	421,091
(In millions of US$)	1,544	1,973	1,923	1,869	1,949	2,034	2,133	2,248	2,369
Of which: Commercial banks NFA	192,417	243,376	248,809	239,923	247,032	254,141	262,138	271,913	281,688
Net domestic assets	106,206	103,650	124,512	137,606	153,170	171,836	189,449	207,336	227,241
Credit to the nonfinancial public sector	23,680	38,778	49,771	58,776	61,619	64,514	66,581	67,902	69,223
Of which: Net credit to the central government	6,343	7,968	12,960	19,965	19,809	19,704	18,771	17,091	15,412
Credit to the private sector	122,699	118,202	128,840	133,650	147,035	161,739	177,427	194,283	212,545
In francs	74,554	76,426	83,305	86,414	95,069	104,576	114,720	125,618	137,426
In foreign currency	48,145	41,776	45,535	47,235	51,966	57,163	62,707	68,665	75,119
Other Items and Capital Account	-40,174	-53,330	-54,099	-54,820	-55,485	-54,417	-54,559	-54,849	-54,527
Broad money	380,601	454,358	466,271	469,814	499,561	533,258	568,554	606,800	648,332
Currency held by the public	37,667	43,839	45,835	49,653	53,633	57,871	62,444	67,377	72,700
franc deposits	195,567	200,970	207,132	208,358	221,164	232,075	242,646	254,063	266,486
Foreign currency deposits	147,367	209,550	213,304	211,804	224,764	243,312	263,464	285,360	309,147
					(12-month percentage change)				
Currency in circulation	6.3	13.1	6.0	8.0	8.0	8.0	8.0	8.0	8.0
Base money	18.7	32.7	-7.2	6.4	6.9	7.3	7.3	7.1	7.1
Franc money (M2)	6.9	5.0	3.3	2.0	6.5	5.5	5.2	5.4	5.5
Broad money (M3)	8.8	19.4	2.6	0.8	6.3	6.7	6.6	6.7	6.8
Franc deposits	7.7	2.8	3.1	0.6	6.1	4.9	4.6	4.7	4.9
Foreign currency deposits	11.9	42.2	1.8	-0.7	6.1	8.3	8.3	8.3	8.3
Credit to the private sector	9.5	-3.7	9.0	3.7	10.0	10.0	9.7	9.5	9.4
Credit in francs	2.0	2.5	9.0	3.7	10.0	10.0	9.7	9.5	9.4
Credit in foreign currency	23.6	-13.2	9.0	3.7	10.0	10.0	9.7	9.5	9.4
Memorandum items:									
Foreign currency deposits (percent of total private deposits)	43.0	51.0	50.7	50.4	50.4	51.2	52.1	52.9	53.7
Foreign curr. credit to priv. sector (percent of total)	39.2	35.3	35.3	35.3	35.3	35.3	35.3	35.3	35.3
Commercial Banks' Credit to Private Sector (percent of GDP)	20.8	19.5	20.2	19.8	20.2	20.4	20.6	20.8	20.9
Velocity of Broad Money (M3/GDP)	1.55	1.33	1.37	1.44	1.46	1.48	1.51	1.54	1.57

Sources: Central Bank of Djibouti; and Fund staff estimates and projections.

1/ Gross foreign assets as a percentage of base money and other domestic liabilities of the central bank.

Table 5. Djibouti: Financial Soundness Indicators, 2013–2020
(In percent)

	2013	2014	2015	2016	2017	2018	2019	2020
Core FSIs								
Regulatory capital to risk weighted assets	10.7	12.0	14.1	13.9	13.9	15.6	15.7	15.2
Regulatory Tier 1 capital to risk-weighted assets	10.7	12.0	14.1	13.9	13.9	15.6	15.7	15.2
Non-performing loans net of provisions to capital	36.1	49.7	44.0	37.9	19.8	27.0	16.8	9.7
Non-performing loans to total gross loans	15.3	18.7	20.0	22.5	16.5	18.1	16.0	13.3
Return on assets	1.3	0.8	0.8	1.1	0.7	0.9	1.1	0.5
Return on equity	30.3	19.1	15.2	18.4	13.2	14.2	17.7	8.0
Interest margin to gross income	72.4	69.7	69.3	68.7	68.8	67.8	68.3	70.6
Non-interest expenses to gross income	60.5	64.3	65.1	62.2	68.4	64.8	59.6	73.8
Liquid assets to total assets	65.3	62.9	66.9	67.5	69.2	64.2	63.3	63.7
Liquid assets to short-term liabilities	70.5	67.8	71.9	73.0	74.9	75.9	69.1	69.3
Sectoral distribution of loans								
General government	1.6	6.0	10.0	11.0	11.0	14.7	23.7	20.7
Nonfinancial corporations	74.3	68.5	62.1	58.5	72.1	68.7	52.0	60.1
Households	24.1	25.5	28.0	30.5	17.0	16.6	24.3	19.2
Additional FSIs								
Capital to assets (leverage ratio)	4.3	4.4	5.3	5.8	5.4	6.3	6.5	6.7
Large exposures to capital	535.3	514.9	316.4	154.2	123.8	231.6	240.6	284.4
Trading income to total income	7.4	8.1	8.1	8.8	9.0	7.6	7.1	7.5
Personnel expenses to total income	40.3	41.2	42.4	42.0	40.8	43.5	46.5	42.4
Customer deposits to total non-interbank loans	259.7	253.0	271.4	270.4	307.6	261.4	261.0	250.4
FX loans to total loans	23.6	24.7	28.4	28.5	33.3	49.8	51.9	45.7
FX liabilities to total liabilities	53.9	55.4	54.1	50.8	52.4	51.4	32.7	59.1

Sources: Djiboutian authorities.

Annex I. Djibouti's Sovereign Wealth Fund

Djibouti launched a sovereign wealth fund (Fonds Souverain de Djibouti, FSD) in September 2020. While supportive of Djibouti's development strategy, the FSD poses fiscal and governance risks that should be reduced by bringing it under central government oversight.

Objectives of the FSD

1. **The FSD is a key part of the country's development strategy and could help promote economic diversification.** The authorities' development plan (Vision 2035) aims to establish Djibouti as a leading regional trade and logistics hub, and the FSD intends to channel inflows associated with the country's strategic position towards projects to diversify the economy and secure broad-based economic growth. Described as a "national investment and inter-generational savings fund," the FSD will prioritize investments in technology industries, infrastructure, and financial services to move Djibouti up the international value chain.

2. **The fund has a broad mandate to pursue these goals.** The FSD is responsible for several of the country's key SOEs, make long-term investments to promote the country's economic development (alone or in partnership with other investors), and serves as a manager of public sector financial assets, including the social security fund. The authorities believe that the FSD is necessary to improve the management of Djibouti's SOEs and to plan investments for the benefit of future generations.

Fiscal Risks

3. **The FSD controls a large share of Djibouti's limited public resources.** The law establishing the FSD called for an initial 15-30 billion DJF endowment (2.5 to 5 percent of GDP), but only 3.5 billion DJF was transferred in 2020. The main source of recurring revenue for the FSD so far is 20 percent of the of the lease payments from Djibouti's five foreign military bases (about 4 billion DJF). These transfers are recorded in the budget as investment spending, but actual project execution is at the discretion of the FSD, which has been screening potential projects. Public stakes and dividend rights in key SOEs were also transferred into the fund, including 40 percent of the port holding company and 100 percent of the electricity company, petroleum terminal, and telecom firm. If the proposed sale of a minority state in the telecom proceeds (Box 2), the FSD would receive the proceeds. The FSD could in the future also benefit from variable payments from the country's free zones, the planned Ethiopian-Djibouti gas pipeline, and 50 percent of the revenue associated with all future land concessions. While the value of its holdings are large and its control of certain SOE revenues could imply yearly inflows as large as 5 percent of GDP, transfers to the FSD so far have been under 1 percent of GDP.

4. **The FSD also poses risks to the social security system.** The fund manages assets of the state social security agency, another state-owned entity that in 2020 recorded an operating surplus of 3 percent of GDP, 80 percent of which is due to finance future pension commitments. While a

Djibouti-specific investment focus is appropriate for a domestic development institution, pension assets require much greater diversification to maximize risk-adjusted return. Since long-term infrastructure investments are by nature highly illiquid, Djibouti's limited buffers give rise to liquidity risks. It is also unclear what supervisory role over SOEs is envisaged for the FSD, how it would contribute to SOE management reform, or whether the FSD might pledge the assets of SOEs for collateralized borrowing.

Governance Risks

5. The design of the fund raises governance risks. The FSD is *de jure* independent and endorses the Santiago Principles of international best practices for sovereign wealth funds. However, it may be challenging to meet these objectives given administrative capacity constraints, as there are just 13 total staff at the FSD so far. The FSD is under the direct supervision of the President, who also names the head of the Executive Board and Director-General (tasked with high-level strategy and daily management, respectively). The Executive Board recently dismissed the first Director-General after only a few months. The FSD will be subject to both internal and external audit, but the fund will be exempt from normal government oversight processes as its contracts are to be placed under private corporate law.

Limiting Risks

6. Staff proposes the following reforms to reduce these risks:

- *The FSD should not manage the assets of the social security system.* With a clear development objective, the FSD should not risk the ability of the state to meet its pension obligations by investing in potentially risky and illiquid domestic development projects.

- *Budget revenues should be safeguarded.* Ideally, the activities of the FSD should be consolidated into the central government budget. At a minimum, however, the authorities should restrict the size of the fund by limiting initial transfers to what has already been budgeted and imposing a floor on domestic budget revenues, beyond which a proportion of additional revenues may be transferred to the FSD. This would also increase incentives for domestic revenue mobilization.

- *The Ministry of Finance should conduct fiscal risk oversight over the FSD.* There should be detailed reporting requirements including the publication of annual audited financial statements and the production of quarterly statements of cash flows and financial position. Reporting should disclose transfers between the fund and SOEs as part of a broader strategy to improve governance. Budget documents should contain a discussion of fiscal risks and contingent liabilities from the FSD and other SOEs, as proposed in recent IMF TA.

- *Transactions conducted by the FSD should be transparent.* The FSD should publish a clear set of criteria to be used for the selection of projects and disclose the motivation for the selection of each project. The government should also publish guidelines for FSD's procurement to ensure equal treatment of bidders, and a transparent disclosure of the contracts and their beneficial owners.

Annex II. Risk Assessment Matrix (June 2021)[1]

Risks	Likelihood	Economic Impact	Policy Responses
		Country Specific	
Extended conflict in neighboring Ethiopia. Protracted civil war in Ethiopia leads to a sustained decline in the demand for Djibouti's trade services and generates other spillovers.	**Medium**	**High** Delayed economic recovery, increased unemployment. Lower exports, investment, and weaker external balance. Rising pressure on the budget and reserves. Increased risks to debt sustainability.	Adopt a medium-term fiscal adjustment plan covering the entire public sector including the SOEs with large external debt used to finance the construction of the trade hub. Accelerate the implementation of structural reforms to promote economic activity outside of the ports and free zones.
Increased competition from other regional ports. Ports in Somalia, Eritrea, Kenya, and Sudan erode Djibouti's market share of Ethiopian trade and set back Djibouti's position as a leading regional trade and logistics hub.	**High**	**Medium** A large share in the projected rebound in Ethiopia's international trade is serviced by other ports in the region, leaving Djibouti with excess capacity in its debt-financed port infrastructure and reduced margins.	Adopt a medium-term fiscal adjustment plan covering the entire public sector including the SOEs with large external debt used to finance the construction of the trade hub. Accelerate the implementation of structural reforms to promote economic activity outside of the ports and free zones.
		Conjunctural shocks and scenarios (Global)	
Uncontrolled Covid-19 local outbreaks and subpar/volatile growth. Outbreaks in slow-to-vaccinate countries force new lockdowns. **Global resurgence of the Covid-19 pandemic.** Local outbreaks lead to a global resurgence of the pandemic (possibly due to vaccine-resistant variants).	**High** **Medium**	**Medium** ***(Local); High (Global)*** Delayed economic recovery, rising inflation and unemployment. Lower exports, investment, FDI and weaker external balance. Rising pressure on the budget and reserves. Increased risks to debt sustainability.	Accelerate vaccinations, adopt containment measures as needed. Provide additional temporary and targeted fiscal support to the most vulnerable within the existing budget envelope. Seek concessional external financing for additional budget support, as needed. Pursue medium-term reforms to increase resilience.
Disorderly transformations. Covid-19 triggers structural transformations, but resource reallocation is	**Medium**	**Medium** Disorderly transformation would set back Djibouti's effort to position itself as a leading regional trade and logistics	Adopt a medium-term fiscal adjustment plan covering the entire public sector, including SOEs with large external debt.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

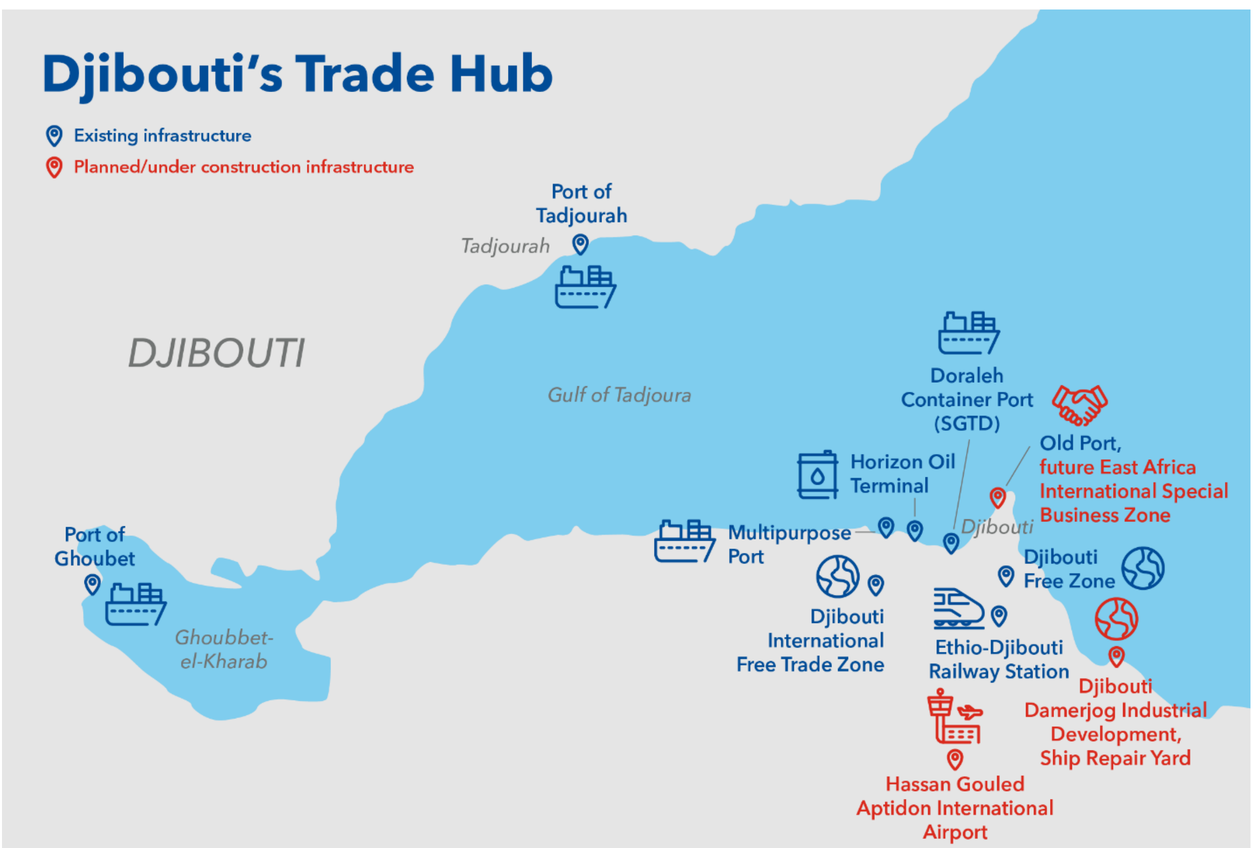
Risks	Likelihood	Economic Impact	Policy Responses
impeded by labor market rigidities, debt overhangs, and inadequate bankruptcy resolution frameworks.		hub, worsening the balance of payments and weakening debt sustainability.	Accelerate the implementation of structural reforms to promote economic activity outside of the ports and free zones.
De-anchoring of inflation expectations in the U.S. leads to rising core yields and risk premia. A fast recovery in demand (supported by excess private savings and stimulus policies), combined with Covid-19-related supply constraints, leads to sustained above-target inflation readings and a de-anchoring of expectations.	Medium	Medium Financial spillovers would be limited in the short-term given Djibouti's limited global financial integration. However, rising interest rates would increase the debt service on the portion of Djibouti's debt that is linked to variable international interest rates.	Prioritize grants and concessional borrowing from international creditors. Adopt a medium-term fiscal adjustment plan adjustment plan covering the entire public sector including SOEs with large external debt.
Widespread social discontent and political instability. Social tensions erupt as a withdrawal of pandemic-related policy support results in unemployment and, amid increasing prices of essentials, hurts vulnerable groups (often exacerbating pre-existing inequities).	Medium	High Rising social tensions could exacerbate Djibouti's domestic fragilities, while regional political instability would reduce exports and increase security costs and refugee flows. This would delay the recovery and threaten debt sustainability.	Provide targeted fiscal support to the most vulnerable within the existing budget envelope. Adopt a medium-term fiscal adjustment plan covering the entire public sector including SOEs. Seek additional concessional external financing to fill any financing gap.
Structural Risks (Global)			
Intensified geopolitical tensions and security risks. Protracted conflict in the region causes economic/political disruption, disorderly migration, higher volatility in commodity prices (if supply is disrupted), lower confidence, and spillovers.	High	Medium/High Regional tensions would further reduce the demand for Djibouti's trade services and increase pressures on security and social spending.	Provide targeted fiscal support to the most vulnerable. Expand the budget envelope by mobilizing reducing tax expenditures. Adopt a medium-term fiscal adjustment plan covering the entire public sector including SOEs.
Higher frequency and severity of natural disasters related to climate change cause severe economic damage to smaller economies susceptible to disruptions and accelerate emigration from these economies.	Medium	High Djibouti is one of the countries most vulnerable to climate change, including through drought, flooding of urban areas from rising sea levels, and regional migration.	Provide targeted support to the vulnerable. Refocus investment spending on climate change adaptation. Pursue PFM reforms to increase the efficiency of public spending. Deepen the currency board to permit a monetary response. Develop prudential instruments to maintain financial stability.

Annex III. Transforming Investments into Jobs

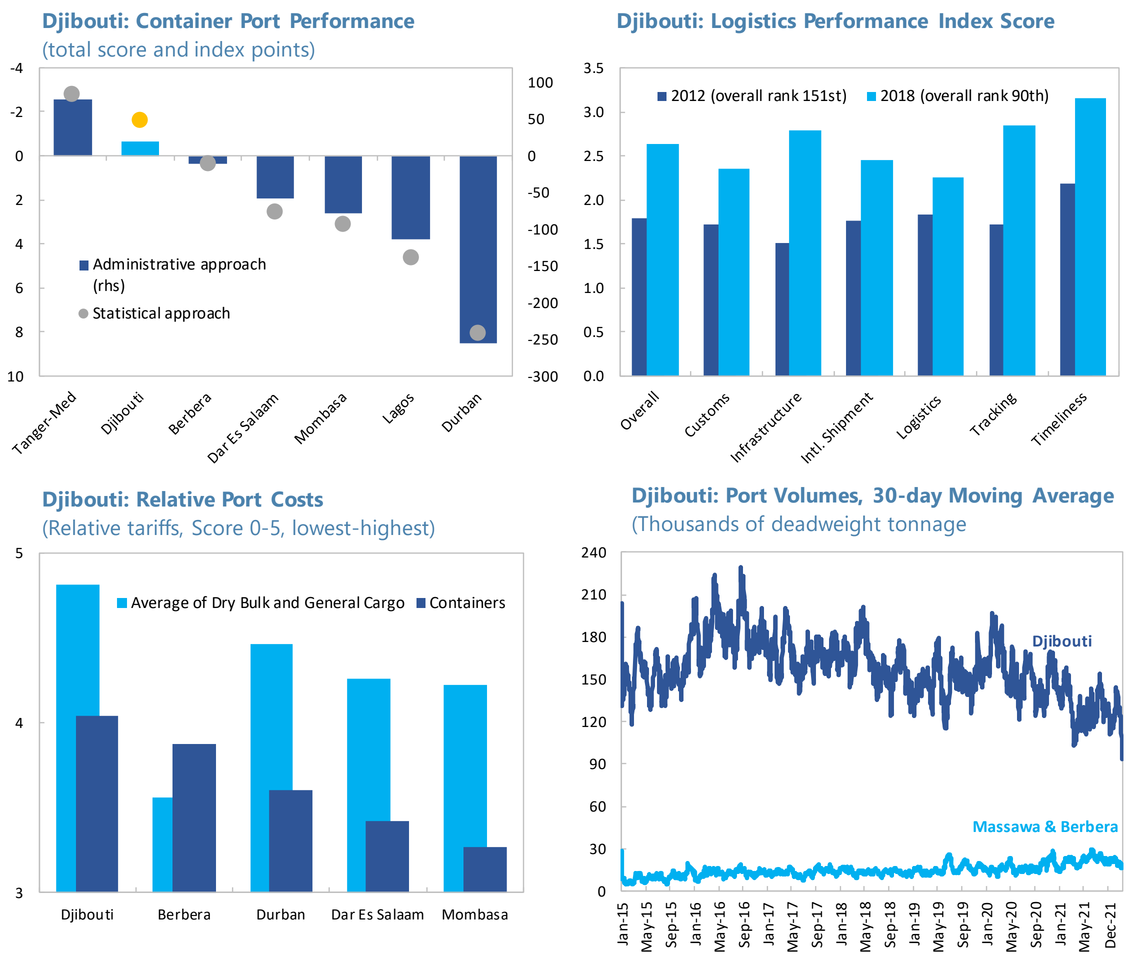
Djibouti has invested heavily in port infrastructure, but this has not reduced the country's high rates of unemployment because modern ports are relatively capital intensive. The authorities are now promoting free trade zones (FTZs) as an employment driver, but the country's high wages and input costs mean that the zones are unlikely to become manufacturing centers. Djibouti should instead promote trade-related services both inside and outside the zones, which will need investments in human capital to develop the required skills. This in turn will require revenue mobilization, including by revisiting generous fiscal incentives and regimes, including broad tax exemptions in the FTZs.

Djibouti's Trade Hub Is Efficient but Creates Few Jobs

1. Most of Djibouti's investments in recent years have focused on building up its trade hub. Djibouti's "trade hub" refers to the network of ports, free trade zones, and supporting infrastructure such as railways, pipelines, and airports. For a small state with few natural resources, the trade hub is a crucial tool to leverage Djibouti's strategic location alongside major global trade routes and service growing regional markets, especially landlocked Ethiopia. There are currently six ports spread around the country, with a seventh under construction.



2. Djibouti's port infrastructure is efficient but expensive, and faces increasing competition. IHS Markit and the World Bank rank Djibouti top amongst all container ports in Sub-Saharan Africa. It has also improved steadily in its relative performance, reaching 90th place in the World Bank's logistics performance index in 2018. Djibouti has particularly made progress in the quality of its infrastructure and timeliness of delivery. However, port tariffs are amongst the highest in Africa, which together with relatively slow customs clearance and logistical support, make it costly to source goods through Djibouti's ports. Ethiopia has prioritized reducing the costs of its international trade and has recently announced a strategy to reduce its heavy reliance (90–95 percent) on Djibouti. This has allowed ports in neighboring Somalia and Eritrea to begin to erode Djibouti's regional market share, and the country will face increasing competition as ports in Kenya and Sudan vie to service the Ethiopian market.



Source: IHS Markit; World Bank, World Seaborne Trade in Real Time: A Proof of Concept for Building AIS-based Nowcasts from Scratch (Cerdeiro, Momaromi, Liu, and Saeed (2020)), IMF staff calculations.

3. The efficiency of the country's ports is a result of a high level of automation, which translates to relatively few jobs. In 2015, the entire transport sector accounted for just 3.6 percent of employment despite very low employment in Djibouti overall (just 25 percent of the working age population is in formal employment). Total direct and indirect employment at the country's ports is unknown but is estimated to be in the low thousands. Studies on logistics by the World Bank concluded that further efficiency gains will continue to reduce the demand for low-skilled labor for a given volume of business. For example, an agreement with Ethiopia to permit direct transit of sealed containers will accelerate customs processing, but also reduces local labor demand for unpacking containers upon arrival. Given that the shipping business is dominated by Ethiopian truckers, few new jobs will be even if the transit trade expands significantly.

Can Free Trade Zones Drive Job Creation?

4. **The authorities have turned to an expansion of free trade zones as an employment driver.** Djibouti has two principal free zones, with a third under development in Damerjog. These zones are intended both to promote the competitiveness of Djibouti's ports by offering a suite of related services from warehousing to logistics and financial services, and to help capture a greater portion of the value-added of the trade passing through Djibouti by promoting some domestic assembly of imported goods passing through the zones. Other infrastructures such as the ports and airport are also treated as free zones.

5. **The ports authority has sole authority over affairs in the free zones.** The Djibouti Ports and Free Zone Authority (DPFZA), an off-budget autonomous government agency, is wholly responsible for affairs within the zones, including registration of firms and the setting of fees. The DPFZA serves as the sole interface between firms located there and the rest of the public sector, including on taxation, environmental standards, and visa issuance. The DPFZA also independently negotiates with external partners to develop infrastructure in the zones.

6. **The free zones offer broad tax advantages, which are valid for 50 years.** Firms registered in the zones are exempt from almost all direct and indirect taxes, including corporate profit tax and business turnover tax. The 50-year length of the tax exemption compares with 10 years in Tunisia, and 5-15 years in Morocco. Registered firms, with a minimum investment of US$70,000–US$140,000 are also exempt from a tax on remuneration of non-residents. The free zone also exempts these firms from the standard set of licensing taxes and registration fees that are payable in the rest of the country, with any fees being set at the discretion of the DPFZA, which appear to be set on a case-by-case basis. Imports into the free zones are also exempt from VAT and customs duties, and may reexport duty free, although any sales to the domestic economy must pay all standard import duties and taxes. Free zone firms are required to pay a 5 percent tax on dividends, and free zone employees must pay personal income tax as in the rest of the country, although expatriate employees may opt out of the social security system. The 2022 budget did introduce an exceptional levy on firms operating in the free zones equal to the greater of 1 percent of turnover or 10 percent of net profits.

7. **Most firms registered in the free zones do not report their finances to the tax authority, making it impossible to quantify related tax expenditures.** Firms registered in the free zones are legally obligated to file taxes with the General Directorate of Taxation, but only 10 percent of the 300 firms registered there did so in 2019, according to a document annexed to the 2020 budget law. This makes it impossible to quantify the extent of tax expenditures in the zones. Furthermore, without adequate reporting, it is difficult to determine whether firms located in the zones are fulfilling their tax obligations on VAT or income tax of local employees.

Text Table Djibouti: Comparison of Tax Treatment Inside and Outside Free Zones

Tax	Reference Rate	Free Zone
Business Profit Tax	25 percent of net business profits	Exempt; exceptional levy in 2022 of 10 percent
Minimum Tax	1 percent of turnover ex. VAT	Exempt; exceptional levy in 2022 of 1 percent
Capital Gains Tax	5 percent of net capital gains	Exempt
Tax on remuneration paid to non-residents	15 percent of gross remuneration ex. VAT	Exempt
Business Licensing Tax	Fixed and variable annual tax depending on business type, size, and location	All fees set by DPFZA.
Registration, Stamp Duties	Various	
Real Estate Tax	10–25 percent of projected yearly rental value	n.a., land owned by state.
VAT, Customs	10 percent VAT, various customs fee	Exempt in zone and for reexport, but payable on goods sold on domestic market.
Personal Income Tax	7 progressive brackets from 2 percent to 45 percent	Fully taxable as outside free zone.
Social Contributions	up to 21.7 percent, divided between employee and employer	Participation required for Djibouti citizens, but foreign workers may opt out.

8. **Employment in the free trade zones remains small despite large tax expenditures.** Total direct employment in the free zones is under 4,000, according to the DPFZA, mostly in the original free zone located near the ports and which is focused on warehousing. It is difficult to gauge the level of activity inside the zones, or how the zones contribute to economic diversification. This lack of transparency complicates the compilation of national accounts and balance of payment data, both of which do not accurately measure activity inside the zones despite frequent IMF technical assistance. The World Bank has concluded that the zones are used largely for storage. There is some final assembly of imported goods in the free zones (including solar panels), but this appears limited and that Djibouti is capturing little added value from the transit trade.

9. **Labor-skills mismatches may explain the apparent failure of the trade hub to reduce unemployment.** Employer surveys by the World Bank and USAID have found that a lack of skills is a key constraint on doing business in Djibouti. While Djibouti has expanded access to education and narrowed the gender gap, only 63 percent of children finish primary school, and most of the working-age population has no formal education at all. The skills gap is a key constraint on Djibouti's competitiveness given that formal sector wages are several times higher than in neighboring Ethiopia despite Djibouti's high unemployment rate. Addressing these skills gaps is particularly important given that youth unemployment stands at 86 percent, potentially challenging social cohesion.

10. **Successful development of free trade zones has emphasized backward and forward linkages with the broader economy.** Mauritius is in some ways comparable to Djibouti as a trade-focused small state, has likewise struggled to evolve the manufacturing base in the free zones. Mauritius has however succeeded in a broader strategy combining financial and other professional services, tourism, and transshipment and logistics for Africa. Ghana's success in promoting free zones has hinged in large part on making their enhanced infrastructure available to local firms, not just export-oriented foreign investment, which has promoted integration of activity inside and outside the zones.

Recommendations

11. **Free zone tax expenditures should be measured and assessed for effectiveness in**

promoting economic development. Most urgently, the DPFZA should cooperate with the tax authority to ensure that firms comply with their legal obligations to file taxes and revoke their registration if necessary. This will allow the authorities to quantify the level of tax expenditures in the zones and provide information on the level of economic activity there. This in turn will permit an assessment of whether the advantages awarded to these firms are justified by increased value-added to the broader economy. This assessment should include the benefits of improved infrastructure that the public sector incurred significant debts to build, and whether any fees imposed by DPZFA are sufficient to recoup these costs.

12. Unproductive tax expenditures should be reduced, and the gap narrowed with the standard tax regime. The generous benefits given to free zone firms compare to a relatively burdensome general tax regime, with high rates and low thresholds. An employer survey by the United States Agency for International Development (USAID) found taxation to be the third-biggest obstacle to doing business in Djibouti (after electricity and corruption, and ahead of education levels). The authorities should consider narrowing the range of tax benefits available to free zone firms, based on the principle that tax holidays should incentivize investments and not exempt from taxation economic activity that would take place even if taxed (IMF 2015). A starting point may be to repeal the exemption for free zone firms from the 1 percent alternative minimum turnover tax and to reduce the 50-year tax holiday to 7 years, in line with tax incentives offered outside the zones in the Investment Code. Alternatively, the authorities could consider faster phase-outs for firms entering free zones after they have become well-established, to reflect reduce risk. At the same time, the threshold for the simplified general tax regime intended for SMEs could be increased, which could reduce obstacles to business registration outside the zones without much lost revenue.

13. The authorities should promote human capital to increase Djibouti's overall competitiveness. Further increasing the efficiency of Djibouti's trade hub will depend on improving logistical support, for which a skilled labor force is essential. There is also a persistent shortage of skilled staff in the construction sector, increasing the demand for foreign labor. With female unemployment at 63, addressing gender imbalances should be a key part of Djibouti's human capital strategy, and the recent creation of a new gender equality office is a positive step. Raising Djibouti's education levels would also more broadly address the country's labor skills mismatches, and education spending should be a priority once revenue levels have increase. Educational reforms would increase the supply of skilled labor, boost Djibouti's competitiveness, and help the country capture more the value-added from the trade hub, including on priority areas such as financial services.

14. Djibouti should pursue a more balanced development strategy. Djibouti's wage gap with its intended export market of Ethiopia is unlikely to change significantly in the near term, and other production inputs from electricity to IT are similarly much more expensive in Djibouti. This suggests that leveraging the country's ports to promote final assembly for export to Ethiopia may not be viable for Djibouti. This underscores the importance of promoting development outside the zones, including in labor-intensive sectors such as tourism, which could benefit from the country's safety and strong air connections. Encouraging broader development will require reducing the regulatory treatment inside and outside the zones. Cross-country analysis of free trade zones suggests that their success is closely linked to the competitiveness of the broader economy.

Annex IV. External Sector Assessment

Overall Assessment: *Djibouti's external position in 2020 was weaker than the level implied by fundamentals and desirable policies. While Djibouti has invested heavily in port and free zone infrastructure, so far, FX earnings have not durably outweighed investment, notwithstanding a temporary decrease in construction-related imports in 2020. This assessment is subject to considerable uncertainty given statistical challenges.*

Potential Policy Responses: *Staff's analysis suggests that moderate real exchange rate overvaluation is likely to be temporary as FX earnings begin to outweigh infrastructure investments over the medium term. The stability provided by the currency board plays a key role in promoting confidence and predictability in international transactions and in keeping inflation low. The authorities should therefore prioritize structural reforms to improve competitiveness and economic resilience, including by addressing high costs in electricity and telecommunications and by expanding access to education.*

Foreign Assets and Liabilities: Position and Trajectory

Background. Djibouti's net international investment position stood at -63 percent of GDP in 2020, compared to -20 percent of GDP in 2013, reflecting debt and direct investment flows for the construction of the trade hub. Gross external assets stood at about 77 percent of GDP, reflecting foreign assets of commercial banks, which channel a large share of the domestic deposit base to overseas affiliates. Gross liabilities stood at about 140 percent of GDP, with external debt to official creditors accounting for just over half of this amount. The stock of foreign direct investment accounted for the rest. The country's net external position is expected to stabilize as infrastructure projects slow.

Assessment. Djibouti's net debtor position appears unsustainable given the large projected increase in public and publicly-guaranteed external debt service. However, the projected stabilization of Djibouti's net international investment position is consistent with restoring sustainability and does not indicate the need for substantial current account and exchange rate adjustment.

2020 (% GDP)	NIIP: -63	Gross Assets: 77	Debt Assets: 4	Gross Liab.: 140	Debt Liab.: 78

Current Account

Background. The headline current account has been strongly positive over the past three years (with a surplus of over 10 percent in 2020), in part because available data generally record substantially more reexports than imports for reexports. Excluding the reexport trade, the current account has been close to balance, including a 1.8 percent of GDP surplus in 2020, and is projected to improve over the medium term.

Assessment. The current account (CA) model finds a significant current account gap in 2020 after accounting for desirable policy settings. These results should be treated with caution, however, given data challenges in the balance of payments.

Djibouti: Model Estimates for 2020 (in percent of GDP)

	CA model	REER
CA-Actual (excluding reexport trade)	**1.8**	
Cyclical contributions (from model) (-)	-0.4	
COVID-19 adjustor (+) 1/	0.5	
Additional temporary/statistical factors (+)	0.0	
Natural disasters and conflicts (-)	0.0	
Adjusted CA	**2.8**	
CA Norm (from model) 2/	**-4.5**	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	**-4.5**	
CA Gap	**7.3**	**-3.7**
o/w Relative policy gap	6.8	
Elasticity	-1.12	
REER Gap (in percent)	**-6.5**	**3.3**

1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism (1.1% of GDP)
2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. Djibouti's nominal effective exchange rate appreciated strongly over the past decade, reflecting the relative strength of the U.S. dollar to which the Djibouti franc is pegged. The real effective exchange rate (REER) appreciated by less, however, due to a negative inflation differential with Djibouti's trading partners.

Assessment. The REER model finds a small overvaluation of about 3.3 percent, implying a current account gap of -3.7 percent and a weaker external position. Policies to increase competitiveness via human capital development and reducing costs in the electricity and telecoms sectors would help address this imbalance in the context of the currency board.

Capital and Financial Accounts: Flows and Policy Measures

Background. Djibouti's capital and financial account inflows are dominated by long-term official financing and FDI inflows. Outflows represent the accumulation of foreign assets by banking system which saw an increase of over US$300 million in 2020. Djibouti maintains open capital account policies.

Assessment. Capital and financial account flows in Djibouti appears unsustainable given the large projected increase in external debt service. The accumulation of net foreign assets by the banking system may provide some buffers in the event of adverse shocks.

FX Intervention and Reserves Level

Background. Official reserves are a function of dollar inflows and the demand for franc-denominated assets. Reserve adequacy in the context of the currency board is best measured by the coverage ratio, which stood at 105 percent at end-2020, similar to the average of the past five years.

Assessment. Reserve coverage is adequate for maintaining the currency board, but there is currently little margin for the central bank to pursue discretionary policies.

Annex V. Capacity Development Strategy

Capacity development priorities include public financial management, revenue mobilization, financial sector surveillance and financial inclusion, and improved data reporting. Integrated and sequenced Fund engagement across surveillance, TA, and training should help strengthen policy making to support macroeconomic stability and durable and inclusive growth.

1. **Close engagement with Djibouti is critical to strengthen institutional capacity.** Djibouti has large CD needs, but delivery has slowed significantly since the pandemic as the authorities prefer in-person missions. With hybrid CD delivery now likely a permanent part of the toolkit, it will be crucial to implement innovative solutions to capacity-building to maintain reform and improve CD absorption and policy traction.

2. **In the near term, engagement will support policies to maximize fiscal space and increase the transparency and effectiveness of public sector operations.** Specifically, fairer tax policies, including reduced tax expenditures, will help level the playing field for inclusive growth and create space for social spending. In addition, governance reforms to improve the business environment and strengthen institutions will be necessary to improve debt management and increase the efficiency of public resources. In the financial sector, with household credit under 4 percent of GDP and most deposits channeled abroad, the Fund will also support financial inclusion and supervision reforms.

3. **CD in the medium term should focus on strengthening institutions.** Steps to improve public investment management, including capital budgeting, SOE governance, and development of a medium-term fiscal framework, will help to share the benefits of public investments more broadly. Strengthened debt management, including through training on the IMF-WB DSA framework and TA on a medium-term debt strategy, will help limit fiscal risks. CD on statistics, including standards, national accounts, and government finance statistics will promote transparency and good governance. In the financial sector, risk-based financial supervision, financial inclusion, and AML/CFT will promote macro stability and inclusive growth.

Summary of Technical Assistance Needs

	FY22–23	FY24–26
Fiscal – Priority 1	Public Financial Management-Budget Execution and ControlPublic Financial Management-Budget Execution and ControlPublic Financial Management-Budget Execution and Control	Public Financial Management-Budget Execution and ControlPublic Financial Management-Budget Execution and ControlPublic Financial Management-Budget Execution and Control
Fiscal – Priority 2	Public Financial Management-Budget PreparationPublic Financial Management-Budget PreparationPublic Financial Management-Budget Preparation	Public Financial Management-Fiscal ReportingPublic Financial Management-Fiscal ReportingPublic Financial Management-Fiscal Reporting
Fiscal – Priority 3	Tax Policy-Revenue QuantityTax Policy-Revenue QuantityTax Policy-Revenue Quantity	Tax Policy-Revenue QuantityTax Policy-Revenue QuantityTax Policy-Revenue Quantity
Monetary/ Financial – Priority 1	Financial Supervision and Regulation-Risk Based SupervisionFinancial Supervision and Regulation-Risk Based SupervisionFinancial Supervision and Regulation-Risk Based Supervision	Financial Supervision and Regulation-Risk Based SupervisionFinancial Supervision and Regulation-Risk Based SupervisionFinancial Supervision and Regulation-Risk Based Supervision
Monetary/ Financial – Priority 2	Debt Management-Medium Term Debt StrategyDebt Management-Medium Term Debt StrategyDebt Management-Medium Term Debt Strategy	Debt Management-Medium Term Debt StrategyDebt Management-Medium Term Debt StrategyDebt Management-Medium Term Debt Strategy

Summary of Technical Assistance Needs (concluded)

	FY22–23	FY24–26
Monetary/ Financial – Priority 3	Financial Supervision and Regulation-Regulatory & Prudential FrameworkFinancial Supervision and Regulation-Regulatory & Prudential FrameworkFinancial Supervision and Regulation-Regulatory & Prudential Framework	Financial Supervision and Regulation-Regulatory & Prudential FrameworkFinancial Supervision and Regulation-Regulatory & Prudential FrameworkFinancial Supervision and Regulation-Regulatory & Prudential Framework
Legal – Priority 1	Financial Integrity-AML/CFT Structures & Tools (FIU)Financial Integrity-AML/CFT Structures & Tools (FIU)Financial Integrity-AML/CFT Structures & Tools (FIU)	Financial Integrity-AML/CFT Structures & Tools (FIU)Financial Integrity-AML/CFT Structures & Tools (FIU)Financial Integrity-AML/CFT Structures & Tools (FIU)
Legal – Priority 2	Financial Integrity-AML/CFT Anti-Corruption Measures: Financial Intel.Financial Integrity-AML/CFT Anti-Corruption Measures: Financial Intel.Financial Integrity-AML/CFT Anti-Corruption Measures: Financial Intel.	Financial Integrity-AML/CFT Anti-Corruption Measures: Financial Intel.Financial Integrity-AML/CFT Anti-Corruption Measures: Financial Intel.Financial Integrity-AML/CFT Anti-Corruption Measures: Financial Intel.
Statistics – Priority 1	Compilation and dissemination-Balance of PaymentsCompilation and dissemination-Balance of PaymentsCompilation and dissemination-Balance of Payments	Compilation and dissemination-Balance of PaymentsCompilation and dissemination-Balance of PaymentsCompilation and dissemination-Balance of Payments
Statistics – Priority 2	Compilation and dissemination-Real Sector - National AccountsCompilation and dissemination-Real Sector - National AccountsCompilation and dissemination-Real Sector - National Accounts	Compilation and dissemination-Real Sector - National AccountsCompilation and dissemination-Real Sector - National AccountsCompilation and dissemination-Real Sector - National Accounts

Annex VI. Implementation of 2019 Article IV and 2020 FSSR Recommendations

Recommendation	Implementation
Debt Vulnerabilities and Enhancing Fiscal Space for Poverty Reduction	
Develop a medium-term debt strategy, strengthen debt management. Formulate fiscal policy in the context of a medium-term framework. Tax policy reforms to enhance domestic resource mobilization. Strengthen governance and oversight of SOEs. Improve controls over public investments, procurement, and cash management.	The national public debt committee is operational but does not yet meet regularly or cover borrowing by off-budget entities. The individual income tax structure was made more progressive and the annual budget includes an analysis of tax expenditures. However, new tax expenditures were created in response COVID-19. Oversight of key SOEs has been transferred to the new sovereign wealth fund. However, the "Code of Good Governance" has not been implemented. The 2021 budget centralizes procurement and expenditure control in the Ministry of Budget.
Maintaining Monetary, External and Financial Stability	
Strengthen board oversight and autonomy, and bolster internal control and audit. Enhance AML/CFT risk-based supervision and improve compliance.	The BCD has announced a new internal control unit, but it is not yet operational.
Fostering Higher and More Inclusive Growth	
Strengthen contract enforcement and property rights. Strengthen the capacity and independence of the National Anti-Corruption Commission. Improve the capacity of law enforcement agencies and the courts. Enhance the implementation of the asset declaration system by senior officials. Reduce electricity and communications prices.	Djibouti strengthened access to credit by implementing a functional secured transactions system and a unified notice-based collateral registry. The authorities have also made resolving insolvency easier by facilitating the commencement of proceedings and increasing the effectiveness of court processes. Djibouti also strengthened minority investor protections by increasing corporate transparency. Electricity and IT prices have been declining but remain higher than regional comparators. Wind turbine production and a pending partial privatization of the national telecom firm show promise in reducing costs.
Recommendations of the 2020 FSSR	
Review the current governance structure, develop the internal audit function. Finalize solvency and liquidity coverage ratios, consider a bank levy. Differentiate between off-site and on-site supervision, prepare for risk-based supervision. Improve liquidity risk management. Increase staff capacity for supervision. Review the CBD's structure to ensure it has the resources to support a macroprudential policy mandate.	The authorities have drafted solvency and liquidity coverage ratio regulations with IMF TA.

PRESS RELEASE

Appendix I. Draft Press Release

IMF Executive Board Concludes the 2021 Article IV Consultation with Djibouti

FOR IMMEDIATE RELEASE

Washington, DC – February 23, 2022: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Djibouti.

Large-scale infrastructure investments generated strong economic growth in the years before the COVID crisis. In an environment of strong growth, state-owned enterprises have been highly profitable. However, with investments centered on capital-intensive projects, few domestic jobs and little tax revenues have been created. As a result, progress on social outcomes has been slow.

Meanwhile, macroeconomic vulnerabilities have increased. Public debt has risen to about 70 percent of GDP. Furthermore, with investments increasingly carried out by state-owned enterprises and the new sovereign wealth fund, a large share of fiscal activity is now off-budget. The financial sector has grown quickly, creating supervisory challenges.

The COVID-19 pandemic and regional conflict have exposed Djibouti's macroeconomic vulnerabilities. Port activity has fallen, initially due to pandemic-related disruptions to global trade, then on reduced demand from Ethiopia. As a result, output growth slowed to about 1 percent in 2020, and debt has become unsustainable. Significant external support helped to cushion the impact on macroeconomic stability.

The economic outlook is clouded by the conflict in Ethiopia. Growth is expected to have recovered to about 4 percent in 2021 on a rebound in investments and construction, but the outlook for 2022 is less favorable and subject to downside risks due to the conflict in Ethiopia and a possible resurgence of the pandemic. Once the regional security and health situations improve, growth prospects are strong, with a competitive port sector well-positioned to benefit from a rebound in regional and global trade.

Executive Board Assessment[2]

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

Djibouti: Selected Economic and Financial Indicators, 2019–2027

	2019	2020	2021	2022	2023	2024	2025	2026	2027
		Est.			Proj.				
National accounts			(Annual percentage change)						
Real GDP	6.6	1.0	4.0	3.0	5.0	6.0	6.0	6.0	6.0
Consumer prices (annual average)	3.3	1.8	1.2	2.8	2.8	2.5	2.5	2.5	2.5
Consumer prices (end of period)	3.3	0.3	2.5	3.0	2.5	2.5	2.5	2.5	2.5
Saving and investment			(In percent of GDP)						
Fixed capital investment	15.2	16.2	14.6	11.9	15.5	15.9	15.5	14.0	13.1
Non-government	8.0	9.6	7.7	5.9	9.3	9.9	9.5	8.2	7.6
Central government	7.1	6.6	6.9	6.0	6.2	6.1	5.9	5.8	5.5
Gross national savings	32.2	27.0	13.6	7.8	12.8	14.7	15.7	14.9	14.8
Savings/investment balance	17.0	10.7	-1.0	-4.1	-2.7	-1.3	0.2	1.0	1.7
Central government			(In percent of GDP)						
Revenues and grants	21.9	21.9	20.2	18.5	18.3	18.4	18.2	18.0	17.8
Tax revenues	12.1	10.9	10.6	10.4	10.7	11.0	11.3	11.4	11.5
Nontax revenue	6.4	7.6	6.9	6.3	6.1	5.9	5.6	5.4	5.2
Grants	3.3	3.4	2.8	1.7	1.6	1.5	1.4	1.2	1.1
Expenditure	22.7	23.5	22.1	22.3	21.0	20.8	20.4	20.1	19.6
Current expenditure	15.6	16.9	15.2	16.4	14.8	14.7	14.5	14.3	14.1
Capital expenditure	7.1	6.6	6.9	6.0	6.2	6.1	5.9	5.8	5.5
Domestically financed	3.9	3.7	3.1	2.6	2.7	2.6	2.5	2.5	2.5
Foreign-financed	3.3	2.9	3.8	3.3	3.5	3.5	3.4	3.2	3.0
Covid-19/emergency expenditures	...	2.4	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (commitment basis)	-0.9	-1.6	-1.9	-3.9	-2.7	-2.4	-2.2	-2.0	-1.8
Change in arrears	0.5	-1.2	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis)	-0.4	-2.8	-2.2	-3.9	-2.7	-2.4	-2.2	-2.1	-1.8
Monetary sector			(Annual change in percent of broad money)						
Broad money	8.8	19.4	2.6	0.8	6.3	6.7	6.6	6.7	6.8
Net foreign assets	0.5	20.1	-2.0	-2.0	3.0	3.0	3.3	3.6	3.6
Net domestic assets	8.3	-0.7	4.6	2.8	3.3	3.7	3.3	3.1	3.3
Of which: Claims on government (net)	1.0	0.4	1.1	1.5	0.0	0.0	-0.2	-0.3	-0.3
Of which: Claims on non-government sector	3.7	2.4	3.7	1.5	3.5	3.5	3.5	3.5	3.5
Credit to non-government (in percent of GDP)	23.8	24.6	26.0	25.5	25.9	26.1	26.2	26.2	26.2
External sector			(In millions of US dollars)						
Current account balance	564	366	-36	-156	-109	-56	10	51	96
(In percent of GDP)	17.0	10.7	-1.0	-4.1	-2.7	-1.3	0.2	1.0	1.7
Underlying current account balance 1/	-100	62	-36	-156	-109	-56	10	51	96
(In percent of GDP)	-3.0	1.8	-1.0	-4.1	-2.7	-1.3	0.2	1.0	1.7
External public and publicly guaranteed debt	2,228	2,402	2,570	2,771	3,067	3,338	3,556	3,724	3,856
(In percent of GDP)	67.1	70.4	71.6	72.9	74.8	74.9	73.5	70.8	67.5
Foreign direct investment	175	158	161	114	172	214	281	305	331
(In percent of GDP)	5.3	4.6	4.5	3.0	4.2	4.8	5.8	5.8	5.8
Exports of goods and services (percent change)	12.9	-28.3	7.7	-13.7	14.3	14.4	14.5	10.4	10.4
Imports of goods and services (percent change)	13.7	-28.1	19.6	-10.4	12.3	12.6	12.7	9.5	9.5
Gross official reserves	494	677	636	631	671	716	766	816	873
(In months of next year's imports of goods and services, exc. re-exports)	4.7	5.7	5.4	5.0	4.9	4.8	4.8	4.7	4.6
Gross foreign assets of commercial banks	1,408	1,753	1,784	1,734	1,774	1,814	1,859	1,914	1,969
(In months of next year's imports of goods and services, exc. re-exports)	13.4	14.7	15.3	13.7	13.0	12.2	11.6	11.0	10.4
Exchange rate (DF/US$, end of period)	177.7	177.7	177.7	...	...	...	...	...	...
Real effective exchange rate (yearly average, 2010=100)	109.6	112.0	...	...	...	...	...	...	...
(Change in percent; depreciation -)	4.1	2.2	...	...	...	...	...	...	...
Memorandum items									
Nominal GDP (in millions of Djibouti francs)	589,583	606,063	637,773	675,238	728,500	791,516	859,982	934,374	1,015,187
Nominal GDP (in millions of US dollars)	3,317	3,410	3,589	3,799	4,099	4,454	4,839	5,258	5,712
Nominal GDP per capita (US dollars)	3,408	3,452	...	...	...	...	...	...	...
Population (million)	0.974	0.988	1.002	1.016	1.030	1.043	1.056	1.069	1.081

Sources: Djibouti authorities and IMF staff estimates and projections.

1/ Current account balance excluding imports and exports associated with re-export activities.