September 2010
IMF Country Report No. 10/277

Djibouti: First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Statement by the IMF Staff Representative; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Djibouti

In the context of the First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on March 21, 2009, with the officials of Djibouti on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 18, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a statement by the IMF Staff Representative; and
- a Press Release summarizing the view of the Executive Board as expressed during its June 17, 2009 discussion of the staff report that completed the review;
- a statement by the Executive Director of Djibouti.

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

DJIBOUTI

First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Waivers of Nonobservance of Performance Criteria, and Modification of Performance Criteria

Prepared by the Middle East and Central Asia Department
in collaboration with other departments

Approved by Amor Tahari and Dhaneshwar Ghura

May 18, 2009

- **Discussions** for the first review of the arrangement under the Poverty Reduction and Growth Facility (PRGF) were held in Djibouti during March 7–21, 2009. The staff team comprised Mr. Delgado (head), Ms. Beidas-Strom, Messrs. Al-Ghelaiqah, Puig (all MCD), and Orav (SEC). The mission met with the ministers of finance, energy, trade, labor, and social affairs; the governor of the central bank; other senior officials; private sector representatives; and development partners. Mr. Bah (OED) attended most meetings.

- **The current three-year PRGF arrangement** was approved in September 2008 in the amount of SDR 12.72 million (80 percent of quota). The authorities are requesting the second disbursement under the arrangement (SDR 1.476 million).

- **A safeguards' assessment** mission took place during June 29–July 9, 2008, and an **FSAP** was conducted during October 18–November 1, 2008 and December 14–18, 2008.

Contents Page

EXECUTIVE SUMMARY

Overall performance under the PRGF-supported program has been mixed but the main monetary and fiscal measures have largely been implemented. The overall fiscal position improved and the reduction in domestic arrears was triple the program target. The nonobservance of four performance criteria was either minor (VAT law), temporary (external arrears), technical in nature and nonsubstantive (domestic arrears), or due to exceptional circumstances (nonconcessional finance). The authorities are implementing strong corrective actions to enhance capacity, improve administrative procedures, and strengthen public companies' financial position in order to avoid further nonobservance of conditionality. The main macroeconomic risks going forward are a slowdown in port activity, lower foreign direct investment (FDI), shortfalls in external assistance or budgetary revenues, and a protracted conflict with Eritrea.

The direct impact of the global financial crisis on Djibouti has been limited. Economic growth remained strong at 5.8 percent of GDP while inflation reached 9.2 percent. Fiscal performance strengthened in 2008 despite expenditure overruns due largely to the conflict with Eritrea. However, the overall deficit swung into a surplus of 1.3 percent of GDP due mainly to exceptionally large grants and strong revenue performance. Domestic arrears fell sharply to 13 percent of GDP and the primary fiscal deficit was below its debt-stabilization level. The authorities remain committed to seeking better financing terms through a forthcoming donors' conference.

A deceleration in growth is expected throughout the medium term, but this would not affect the main macroeconomic policies. For the rest of the program period, growth and inflation are projected to decelerate to an average of about 5 ½ percent and 5 percent, respectively, due to lower FDI and international commodity prices. The program's fiscal consolidation path would continue through the introduction of a value-added tax (VAT), wider application of income taxation, and strong nonsocial expenditure control. Improved prioritization is reflected in the growing share of projected social expenditure.

The financial system has not been affected by the global crisis, and capital adequacy has improved slightly despite increased competition. The banking sector is vulnerable to a deterioration of credit quality and interest rate changes. The Central Bank of Djibouti (BCD) aims to enhance its capacity to oversee the growing sector as recommended in the FSAP and address the vulnerabilities noted in the safeguards assessment (SA).

Staff supports the authorities' request for waivers for the nonobservance of four performance criteria on external arrears, domestic arrears, nonconcessional finance, and the submission of VAT to the National Assembly, and the modification of the forward looking performance criterion on domestic arrears.

I. Background

1. **Discussions on the first review of the arrangement under the PRGF were held against the backdrop of record high economic activity in 2008, shadowed by the looming impact of the global economic slowdown**. Djibouti's strategic location and political stability continued to attract sizable FDI inflows. The authorities have grasped these opportunities to lift growth, increase employment and reduce widespread poverty. [1] In this vein, the main objectives of the PRGF-supported program remain fostering balanced growth and financial stability, improving competitiveness, reducing inflation, and strengthening the external position (EBS/08/105).

2. **The political situation remains stable, despite the conflict with neighboring Eritrea and piracy out of Somalia**. Djibouti has complied with UN requests in its border dispute with Eritrea, but troops remain deployed along the disputed territory. The strong foreign military presence reduces the risk of an escalation.

II. Recent Economic Developments and Performance under the PRGF

3. **GDP growth remained strong in 2008 and inflation decelerated during the fourth quarter** (Table 1 and Figure 1). Real GDP growth was estimated at 5.8 percent, driven by strong FDI inflows and bank lending to all sectors but industry. Despite the international financial crisis, the increase in trade-related services (in particular, transshipment and transport activities related to Ethiopia) strengthened economic performance. After peaking at 14.8 percent in September 2008, inflation decelerated to 9.2 percent at year-end, following international commodity price developments.

4. **Despite exceptionally large spending due to the war and peaking commodity prices, strong revenue performance and larger grants swung the overall fiscal balance into a surplus of 1.3 percent of GDP** (Table 2 and Figure 2). The overall fiscal deficit excluding grants, reached over 11 percent of GDP. Nonetheless, the base deficit increased only by 1.1 percent of GDP, as the authorities continued their public wage bill retrenchment

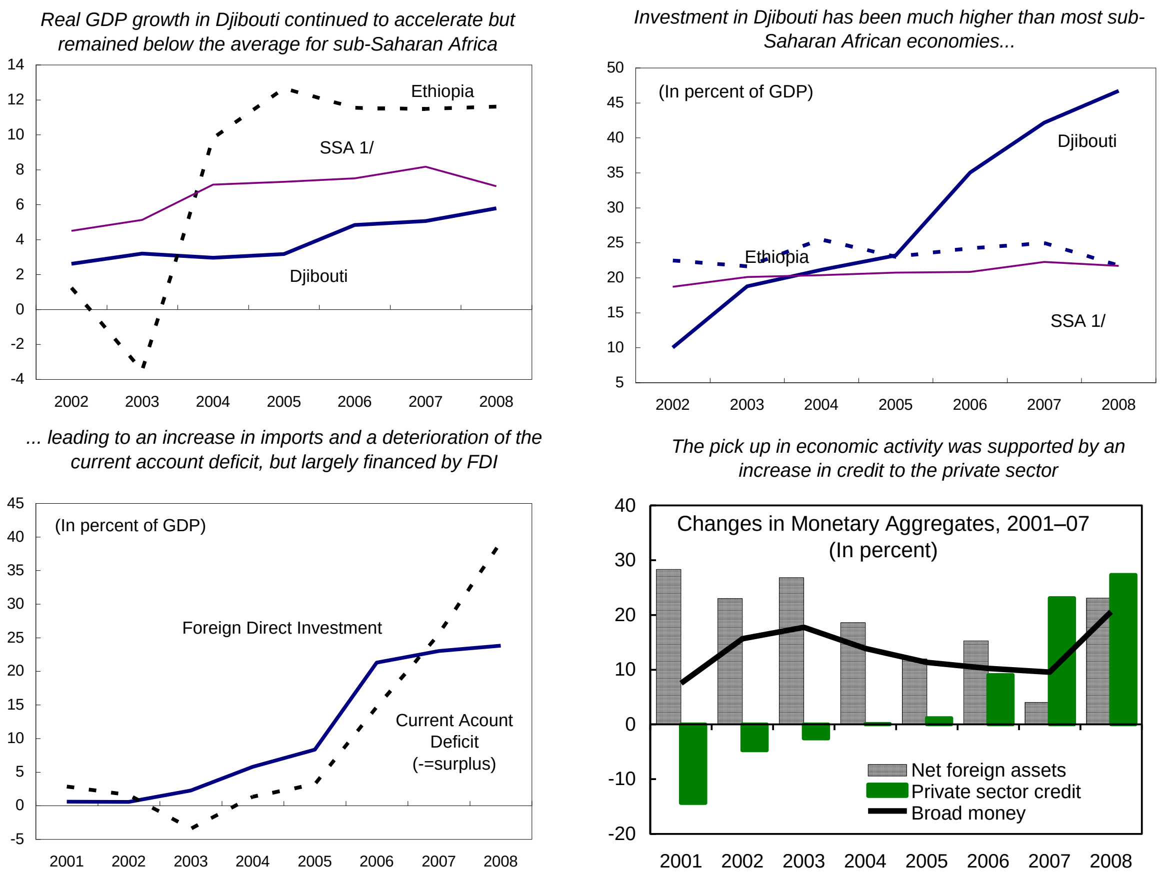
Composition of the nominal wage bill, 2007–08
(in millions of Djiboutian Francs)

	2007	2008	Increase
Nominal wage bill (salaries and benefits)	20 801	22 176	1 375
Health and education	9 256	10 437	1 181
Military	7 056	7 400	344
Other (including sector-wide promotions and strengthening IGF)	4 489	4 339	(150)

Source: Djibouti authorities and Fund staff.
1/ Office of the Inspector-General of Finance (see LOI ¶17).

[1] The latest household and consumption survey conducted in 2002 indicates that 74 percent of the population lives in poverty; 42 percent of the population is considered extremely poor.

Figure 1. Djibouti: Selected Recent Economic Developments



Sources: National authorities; and Fund staff estimes.
1/ Sub-Saharan Africa excluding South Africa and oil exporting SSA economies.

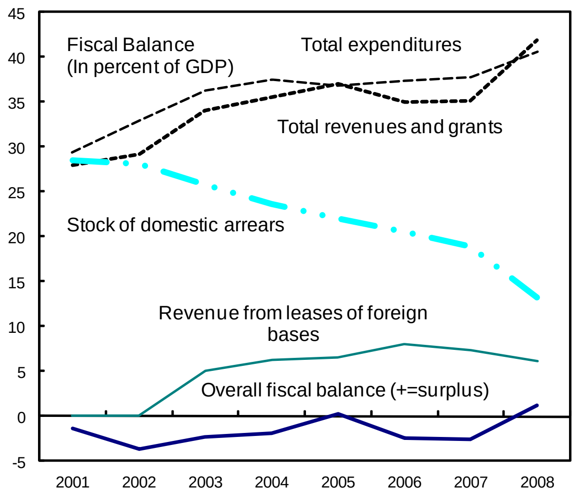
policy,[2] and a substantial part of grants were directed to paying domestic arrears (DF5.6 billion, 3.2 percent of GDP), which were over three times the amount programmed in net terms. In terms of the composition of the nominal wage bill increase in 2008, health, education and the military were the main contributors. Nevertheless, spending overruns due to the food and oil prices shock and the conflict with Eritrea led to a decline in social spending.[3] In addition, monthly gross accumulation of domestic arrears occurred, thus breaching a continuous quantitative performance criterion

[2] However, social sector wages (health and education) increased by 0.5 percent of GDP (85 percent in nominal terms). These wages are set to increase by a further 0.5 percent of GDP in 2009 (a nominal growth of 40 percent).

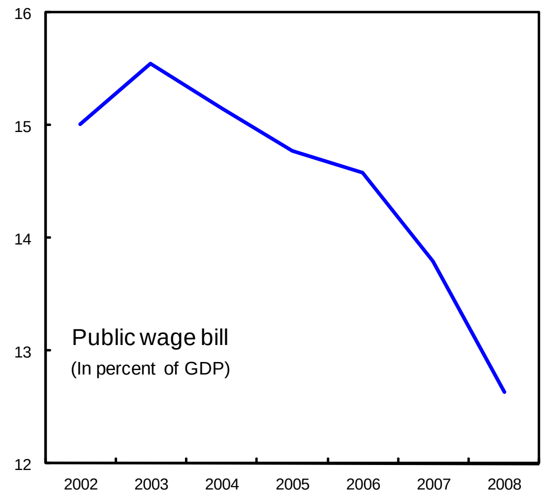
[3] A fall of about 1.3 percent of GDP compared to 2007, 0.3 percent of GDP short of the 2008 program target.

Figure 2. Djibouti: Recent Fiscal Developments

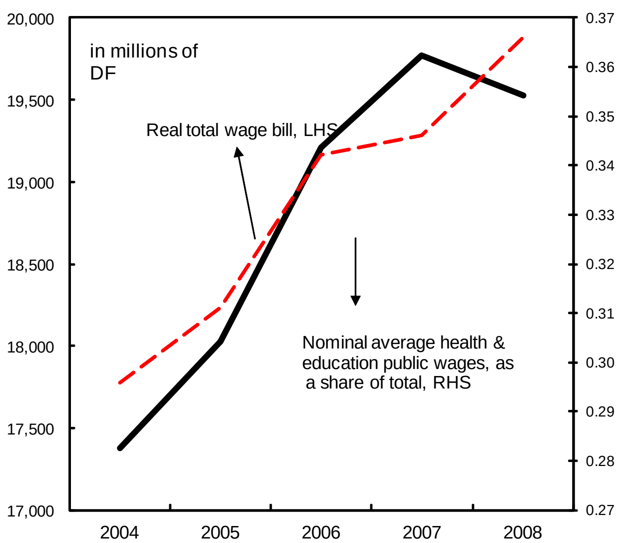
Despite an expansionary fiscal stance in 2008, the overall balance swung into a surplus mainly due to stronger grants and indirect taxes, allowing domestic arrears to trend downwards. Higher expenditures were mainly attributed to foreign-financed investment and overruns in goods (including public utility bills) and military spending.



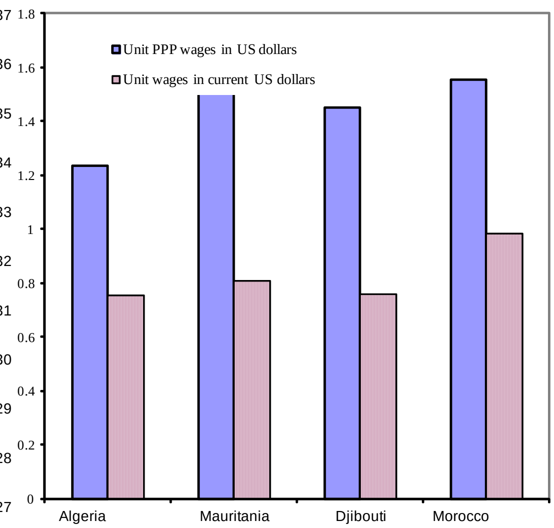
Despite a 1.3% of GDP overrun in 2008, due to higher than expected military and social sector's recruitment, the wage bill continued to trend downwards--a positive development.



While the real total wage bill grew by an average of 4.4 percent over the period 2005–07, it declined by 1.23 percent in 2008. Total public employment grew by an average of 3.1 percent and 6.0 percent during the same periods, respectively. Moreover, the share of health and education of the total wage bill grew continuously.



Average (unit) wages in US dollars during 2008—whether in PPP terms or in current exchange rates—show that Djibouti's public wage bill is in line with other countries in the region.1/



Sources: National authorities; and Fund staff estimates.
1/ Data for Algeria corresponds to 2007 and only includes civil administration employees.

(QPC). This accumulation was mainly due to shortcomings in treasury management, as administrative procedures for payments of new bills were not set up to pay current bills with priority over preprogram ones. Furthermore, the lack of Treasury securities to exchange for preprogram accumulated arrears made it impossible to settle these through interest-bearing debt swaps (LOI ¶3).

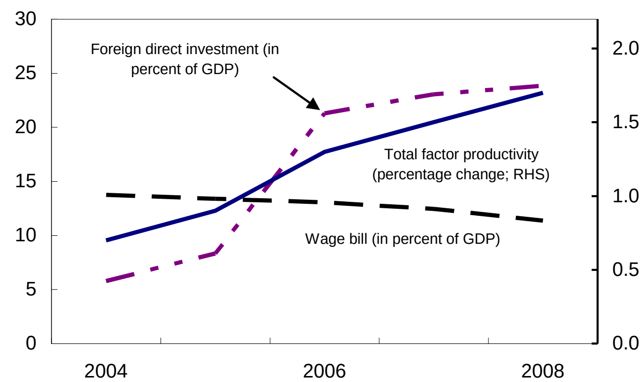
Monthly Variation of Domestic Arrears, September–December 2008
(In millions of Djiboutian Francs)

(- = deaccumulation/repayment)	Sept.	Oct.	Nov.	Dec.
Gross accumulation of domestic arrears				
Salaries of public employees	-244	122	112	-26
Private providers	-58	-206	351	-29
Retirement contributions	137	-191	-125	-11
Other, including public enterprises	817	308	-1 060	-38
Clearance of prior years' domestic arrears				
Salaries of public employees	0	0	0	0
Private providers	0	-116	-11	-42
Retirement contributions	0	0	0	0
Other, including public enterprises	0	-193	-71	-4 769

Source: Djibouti authorities monthly TOFE.

5. **External sector developments have been marked by peaking international commodity prices and record high FDI** (Tables 1, 3 and Figure 1). The current account deficit[4] ballooned to 39 percent of GDP, as a result of FDI-related imports and a deterioration in the terms of trade. However, large capital inflows and exceptional finance contributed to an increase in official reserves to $174 million, resulting in a currency board arrangement (CBA) cover of 121 percent (just under 3 months of prospective imports). Despite a recent reduction in electricity tariffs[5] and the observed improvement in total factor productivity (Figure 3), competitiveness remains low according to most indicators.

Figure 3. Djibouti: Total Factor Productivity, 2004–08

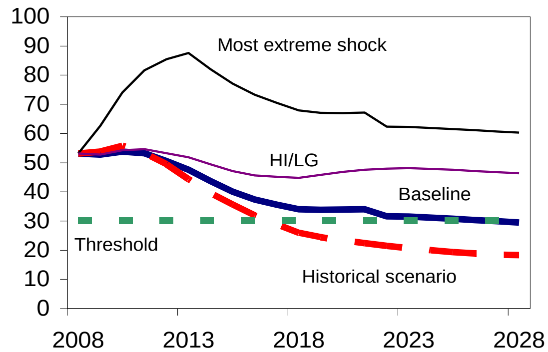


[4] Including current international cooperation grants but excluding exceptional finance.

[5] An average reduction of 7 percent was approved on April 2009. Electricity tariffs used to follow oil price developments until their last increase in October 2007. They were frozen thereafter as part of the authorities' strategy to mitigate the effects of the food and oil price shock on the population. At current levels (and oil prices), tariffs are deemed to be sufficient to cover the electricity company (EDD)'s production costs, but not the amortization and investment needs. However, given their already high level (Djibouti has the second highest electricity tariffs in Africa, after Chad), the authorities rely on alternative energy sources through the interconnection with Ethiopia and the development of renewable resources.

6. **The risk of external debt distress remains high**. While the stock of external debt decreased to 59.2 percent of GDP (Tables 1 and 3), the net present value (NPV) of debt increased to 53 percent of GDP (Box 1). As a result, external debt is expected to remain above the sustainability threshold until the late 2020s (Figure 4). However, the staff's analysis concluded that the projected primary fiscal deficit in 2009 is below its debt-stabilizing level.

Figure 4. Djibouti: NPV of External Debt-GDP under Alternative Scenarios, 2008–28



Source: Staff projections and simulations.

Box 1. Paris Club Rescheduling Agreement

Following the approval of the PRGF, Djibouti reached agreement with Paris Club (PC) creditors to reschedule external debt under Houston terms. The resulting reduction of financing needs during the program period will be limited, as the positive effects of the debt service rescheduling is partly offset by the repayment of post-cut off arrears to be completed by 2012.

The gains in terms of NPV of debt are estimated to be only about 1.5 percent of GDP[1] due to the large share of external debt that is not in the form of Official Development Assistance (ODA)[2] incurred after the cut-off date for eligibility under the agreement. These gains were offset by new debt—with NPV of about 3.5 percent of GDP—uncovered during the reconciliation process.[3]

[1] The staff's projections assume comparable treatment from non-PC creditors.

[2] Under Houston terms, ODA is rescheduled at a concessional rate, while non-ODA is rescheduled at the market rate, implying no reduction in the NPV of non-ODA debt.

[3] The new debt uncovered included arrears to Italy and Germany, as well as a government guaranteed loan from the Netherlands to the Djibouti Port.

7. **The QPC on the accumulation of new external arrears was not met temporarily due to technical delays involving weak coordination between two debtor public companies in financial distress and the Treasury**, which led to a delay in calling up the government guarantee (LOI ¶3 and 8). In both cases, the payments were met after short delays (9 days and two months). Furthermore, while financial resources were sufficient to face external debt payments, Djibouti also incurred arrears to the Fund for three days due to slippages in the payment process. In addition, exceptional circumstances due mainly to the sharp increase in electricity generation equipment costs and the precarious situation of the

EDD,[5] which threatened the electricity supply of the country, led the authorities to obtain a loan from the organization of petroleum exporting countries (OPEC) Fund with a concessional element of 10 percent, resulting in the nonobservance of the corresponding QPC (LOI ¶9).

8. **Broad money aggregates trended higher in 2008 with the entry of new banks, buoyant economic activity and the exceptional amount of capital inflows and grants** (Tables 1, 4 and Figure 1). Lending remained largely focused on trade, although medium-term credit for equipment and construction increased markedly.

9. **Banks remain profitable and have not been affected by the global financial crisis**. However, the stress tests conducted during the recent FSAP indicated that the banking sector is vulnerable to a deterioration of credit quality and interest rate movements. Two subsidiaries of state-owned French banks continue to dominate the banking system and hold most of their assets in foreign currency deposits at their parent banks. While entry of new banks during 2008 further increased competition, profitability remains high, and rapid credit growth has not impacted capital adequacy. The authorities have started to take measures to strengthen the regulatory and supervisory framework, which is not well suited to handle the entry of new banks (Table 8).

Djibouti: Financial Soundness Indicators (FSI), 2005–08

	Capital Adequacy Ratio (percent)	Nonperforming Loans 1/ (percent of total loans)	Return on Assets (percent)	Return on Equity (percent)
2005	15.7	27.8	1.9	28.2
2006	17.4	24.5	1.8	41.8
2007	8.1	17.8	1.8	40.1
2007 (FSAP calculations) 2/	8.3	16.0	2.4	48.2
2008	8.5	16.5	1.8	33.5

Source: BCD, Article IV consultation staff reports and FSAP.

1/ The relatively high NPL ratio concerns the two largest banks and is the legacy of the 1990s civil war period.

2/ The FSAP FSIs cover the four banks operating during 2007, while all other FSI figures cover the two largest banks, accounting for about 95 of total deposits.

10. **The initial safeguards assessment (SA) of the BCD, completed in February 2009, found serious risks in most areas of the safeguards framework**. Risks associated with these weaknesses are partly mitigated by the straightforward nature of the BCD's operations, which include prudent management of foreign reserves in the context of Djibouti's CBA. The BCD has begun to implement the recommendations of the SA by completing the 2007 external audit and appointing auditors for 2008 (LOI ¶15).

11. **There was some progress on the structural front, although at a slower pace than expected**. The authorities signed an electricity sharing agreement with Ethiopia, strengthened coordination of the National Investment Promotion Agency (ANPI) with the MOF, revised the Investment, Free Trade Zone (FTZ) and Commerce Codes, and strengthened governance measures. The World Bank is advising the authorities on three possible reforms to strengthen the social safety net: (a) a nutrition program, (b) a public workfare program, and (c) a cash

transfer system. They have also published the audited accounts of the social security funds and the principal public enterprises, as well as the monthly fiscal operations of the state (TOFE).

III. Policy Discussions

12. **The authorities made progress towards meeting the objectives of the first year of the program, despite nonobservance of some performance criteria**. Thus, policy discussions focused on keeping the main macroeconomic policies on track while implementing corrective actions to avoid further slippages, particularly on: (1) continuing fiscal consolidation and improving debt management; (2) strengthening financial regulation and supervision; and (3) improving competitiveness.

A. Medium-Term Macroeconomic Framework

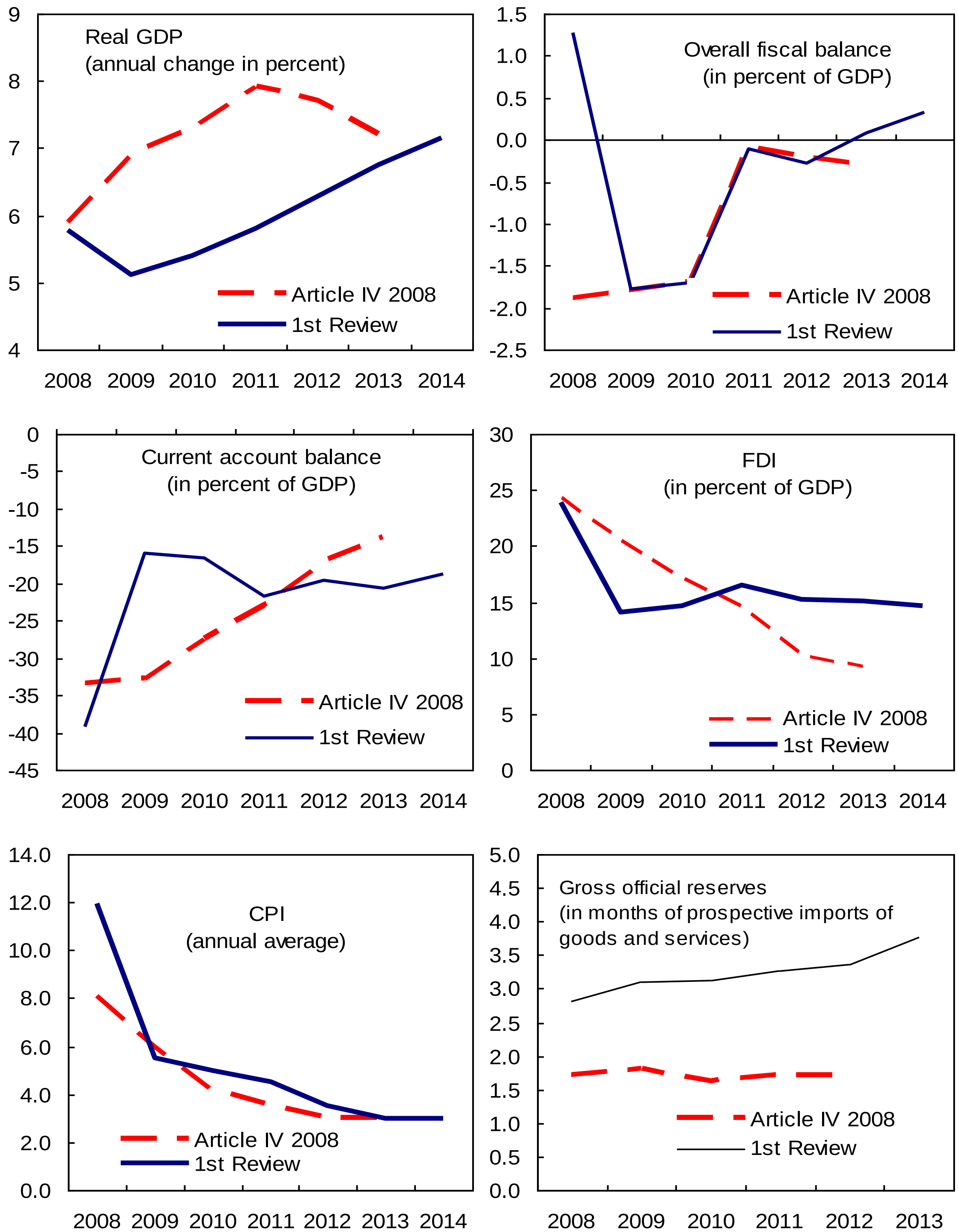
13. **The medium-term macroeconomic framework was influenced by the global economic slowdown** (LOI ¶5, Table 5, and Figure 5). Real GDP growth is projected to decelerate to about 5 percent in 2009, reflecting lower FDI and slower international trade growth,[6] and resume its upward trend slowly after 2010. The authorities' objective of reaching GDP growth rates of 7 percent would not be achieved until 2014, under the current macroeconomic environment. The authorities intend to maintain the program's fiscal consolidation path for 2009–11. The current account deficit would improve in 2009 due to softer international commodity prices and lower FDI-related imports. Thereafter, it is expected to widen, owing to a phased recovery in FDI and its related imports, which will be partly offset by increased export capacity.

B. Macroeconomic Policies During 2009

14. **Fiscal policy discussions focused on measures to achieve the program's fiscal consolidation path**. This included identifying measures to align the authorities' expansionary 2009 budget (deficit of 2.6 percent of GDP) with the program objectives (deficit of 1.8 percent of GDP) while adjusting the original program measures to address the impact of the protracted conflict with Eritrea. The authorities committed to implementing additional revenue and expenditure measures to align the 2009 overall fiscal budget deficit with the program's deficit target (LOI ¶6), while increasing capital and social expenditure

[6] Although some important industrial FDI projects have been delayed or cancelled, causing a reduction of about 2 percentage points of GDP growth vis-à-vis the original program for 2009 projections, a substantial core of projects in mining, construction and energy is ongoing as scheduled, and funding has been secured for the immediate phases. Furthermore, transshipment business is expected to grow substantially in 2009, fostered by the large increase in capacity and the global strategy of Dubai Ports World.

Figure 5. Djibouti: Medium-Term Macroeconomic Projections



Source: National authorities, and Fund staff projections.

despite decelerating growth. The main expenditure measure continues to be the freezing of nominal public sector salaries and recruitment, excluding health and education. On the revenue side, important progress was made in broadening the base through the introduction of a VAT on January 1, 2009. The wider application of income taxation (ITS) in the FTZ and the domestic economy, the suspension of FDI-linked patent exemptions, and an increase in nontax revenues related to the resumption of fees (suspended in 2008) on imported oil, should further increase revenues in 2009 (LOI ¶6 and 11). The reorientation of spending should raise social expenditure to 10.6 percent of GDP in 2009, through a better allocation of goods and services spending (LOI ¶6 and 12). Despite some loosening in the targets of nonsocial current expenditure, a repetition of an overrun looms large should the conflict with Eritrea continue in 2009. The authorities will respond to this by further containing domestic capital spending (LOI ¶7).

15. **The authorities have accelerated the establishment of a single treasury account and implemented a new treasury management system to avoid incurring new domestic payment arrears** (LOI ¶10).[7] Furthermore, the authorities have requested Fund's assistance in order to amending the accounting principles governing the budgetary accounts, to strictly observe of the definition of arrears in the IMF's Government Finance Statistics Manual of 2001 (GFSM 2001) by end-December 2009, and are seeking donors' funding to acquire the required software. On April 1, 2009, they implemented new administrative procedures giving priority to the payment of new bills to private and public providers, and are negotiating with providers on a schedule for the phased repayment of accumulated arrears. Nonetheless, the authorities look forward to the financial assistance of donors for the complete regularization of outstanding arrears. Regarding salaries and contributions to the pension funds of public employees, the authorities contended that the arrears were of an accounting nature, as the one month (one quarter for pension funds) delay in payment was kept constant and, thus, there had been no further arrears. The authorities underscored that paying the current month's salary while leaving unpaid previous ones would likely cause social unrest. They committed, however, to avoiding an increase the lag in these payments and to eliminate payment backlogs as sufficient extra resources become available.

16. **In order to avoid any further temporary accumulation of external arrears, the authorities have instructed the Treasury to honor the government guarantee on public companies' debt which has not been paid on the due date with a maximum delay of one week** after the due date, regardless of administrative, financial or legal considerations affecting the relationship between the government and borrowers (LOI ¶8). They are also making progress in regularizing the situation of the financially weak public companies by speeding up the payment of arrears, and will request Fund technical assistance (TA) to improve current debt management practices. In order to continue to strengthen debt

[7] This will also contribute to avoid future slippages in payments to the Fund.

sustainability, they intend to finalize bilateral agreements with PC creditors before the extended deadline of end-May 2009, to continue negotiations with non-PC bilateral creditors, and to hold a donors' conference to seek highly concessional financing for the poverty reduction strategy (LOI ¶5).

17. **The authorities expressed their commitment to ensuring concessional financing terms in order to improve debt sustainability**, and stressed the exceptionality of the circumstances that lead to the contraction of a nonconcessional loan (LOI ¶9). They are taking corrective action to avoid reoccurrence by stepping up efforts to ensure the continuity of electricity production. The interconnection with the Ethiopian grid, expected in mid-2010, will provide a stable solution to the existing excess demand and high electricity costs. Even though the authorities do not anticipate a repetition of these circumstances, they expressed their commitment to consult with IMF staff should a critical and unforeseen need for financing on nonconcessional terms arise.

18. **The BCD is committed to enhance its capacity to oversee the growing financial sector and address governance vulnerabilities**. In this vein, the authorities have requested Fund TA for the formulation, by end-September 2009, of an action plan to implement the recommendations of the recent FSSA (LOI ¶14–15). Moreover, they are committed to immediately strengthen the BCD's procedures for the selection and appointment of its external auditors as recommended by the SA mission (LOI ¶15). Staff emphasized the need to rapidly strengthening banking supervision in view of the potential adverse effects of the slower economic growth on asset quality.

C. Structural Policies During 2009

19. **Given the essential macroeconomic stability anchor role played by the policies under the program, including the CBA, structural reforms are crucial to improve Djibouti's competitiveness**. In addition to the ongoing measures detailed in the program, the authorities are further lowering production costs through: (1) continuing to invest in infrastructure to support the interconnection with the Ethiopian electricity grid (LOI ¶16), and (2) redrafting the Investment Code to tighten exemptions (LOI ¶11). Some measures have suffered slight delays due to administrative and technical problems but would be implemented in 2009 (LOI ¶16), including the preparation of the study for downsizing the EDD, the final implementation of the Labor Code and the submission of the new Commercial Code to the National Assembly. The population census commenced in February 2009, and will be followed by a census of economic activities (LOI ¶18).

IV. Program Issues

20. **Staff supports the authorities request for waivers on three QPC and one structural performance criterion (SPC)**. The nonobservance of the ceiling on new domestic arrears was, in part, minor from an economic point of view, as no new delays were being incurred in the payments of salaries and public pensions' contributions. The staff

supports the request for a waiver on the grounds of the corrective actions being implemented to improve treasury liquidity management through the implementation of a single treasury account and strengthen administrative procedures so as to avoid an accumulation of new arrears to domestic public and private providers. Regarding the temporary nonobservance of the ceiling on new external arrears, the payment delays were promptly regularized, and the specific problems affecting coordination between borrowing public companies and the Treasury as guarantor seem to be solved through the automatic procedure put in place. The staff concurs with the authorities that the exceptional circumstances leading to the contraction of a nonconcessional loan are unlikely to reoccur. The staff supports the request for a waiver based on the corrective action taken by the authorities as preventive measures to reduce the vulnerability of electricity supply (eliminating arrears with the electricity company, interconnection with Ethiopia, development of geothermal and other renewable energies) should contribute to reduce this risk. Finally, the minor nonobservance of the SPC on the submission of the VAT Law to the National Assembly by 15 days was due to a legal constraints unanticipated by the authorities (the need to present it in parallel with the Budget Law) and was inconsequential from an economic point of view, as the law was approved well ahead of time to be implemented as of January 1, 2009, and in line with the agreed specifications.

21. **Staff also supports the authorities' request for the modification of the performance criterion on domestic arrears** (LOI ¶10, LOI Table 1, and supplementary TMU ¶2), which differentiates between arrears on payments of salaries and pension fund contributions of public employees, on the one hand, and on payments to public and private sector providers, on the other. While the QPC will remain unchanged for the latter, compliance with the QPC for the former category of payments will be measured in terms of delay in payments, which ensures that the government will not increase the delay in paying salaries and pension contributions.

22. **Staff also supports the transformation of the remaining SPC on the implementation of reserve requirements on bank deposits into a structural benchmark (SB)**, in line with recent changes toward a review-based conditionality[8] and the need to delay the introduction of reserve requirements until immediately after the Banking Law is amended by end-2009. Thus, the authorities commit to prepare draft regulations that will incorporate the required amendments into the financial laws by end-August 2009 (LOI ¶14).

23. **Structural benchmarks remain geared to supporting the authorities' efforts to improve competitiveness, a gradual fiscal consolidation, and financial stability** (LOI Table 3). The deadline for four SBs has been extended. The first two, on banking supervision and AML/CFT, have been extended until end-2009 to address the FSAP recommendations

[8] SM/09/69 and Decisions of Supplement 2.

through a comprehensive legal reform encompassing all banking and financial aspects. Regarding the submission of the Commercial Code to the National Assembly, the authorities decided to strengthen the text by first submitting it for validation by the civil society. Given that the resulting text has benefited from stronger ownership, the extension of the deadline until June 2009 seems justified. Finally, lack of financial resources resulted in a delay in the commencement of the census, which made it necessary to extend the deadline of the SB on national accounts by one month. In addition, two new SBs were added: (1) for the appointment of external auditors for 2009–11 of the BCD as a measure to address the weaknesses detected during the SA, and (2) at the behest of the BCD, to separate the drafting of legal amendments to introduce required reserves from its legal enforcement, which is to form part of the broader legal reform of the financial sector. Finally, the indicative benchmark on the ceiling of nonsocial wages as defined in the TMU has been raised to accommodate a slower wage bill retrenchment path needed for military salaries due to the conflict with Eritrea, and all quantitative targets have been extended through end-2009.

24. **The main risks to the program are:**

- *A slower growth path* associated with a worsening global environment, particularly from weaker FDI and transshipment activity;

- *Failure to maintain the fiscal consolidation path* due to underperforming revenues and grants or failure to maintain spending discipline;

- *A loss in competitiveness* resulting from weak progress in resolving the high production costs, further real effective exchange rate appreciation, and other supply side bottlenecks.

V. Staff Appraisal

25. **Performance under the program has been mixed, mainly due to technical slippages reflecting weak administrative capacity**. While corrective measures are being implemented, staff urges the authorities to improve communications with headquarters on program monitoring and implementation. Staff welcomes the authorities' commitment to meet the program's targets, adherence to corrective measures and assurances to avoid any breach of conditionality in future.

26. **The fiscal stance agreed for 2009 is consistent with the program's consolidation effort**. Good progress has been made on structural reforms in the fiscal area, with Fund TA support. Maintaining fiscal and debt discipline is crucial, absent other macroeconomic tools. Staff supports the authorities' commitment to the program targets in this area and their intention to improve debt management strategy and practices.

27. **The policies envisaged under the program have anchored financial stability and supported a significant deceleration in inflation,** in line with international commodity

prices. However, recent exchange rate appreciation has put a premium on speeding up implementation of competitiveness-enhancing structural reforms.

28. **The risks of a weak banking supervision could be compounded by the rapid increase in the number of banks and lower projected economic growth**. The BCD should strive to promptly implement the FSAP and SA recommendations to upgrade its banking supervision and crisis prevention capacity.

29. **Given the strong macroeconomic performance during 2008, the satisfactory implementation of the main revenue and expenditure measures, and the prompt implementation of corrective actions to avoid nonobservance of QPCs in the future, staff supports the authorities request for a waiver for the nonobservance of four performance criteria** on contracting a nonconcessional loan, external arrears, domestic arrears, and the submission of VAT to the National Assembly. Staff also supports the authorities' request for the modification of the forward-looking performance criterion on domestic arrears and the structural performance criterion on introduction of reserve requirements on bank deposits, and recommends the completion of the first review under the PRGF-supported program.

Table 1. Djibouti: Selected Economic Indicators, 2006–09
(Quota: SDR 15.9 million)
(Population: 0.82 million; 2006)
(Per-capita GDP: $946; 2006)
(Poverty rate: 42 percent; 2002)

			2008		2009	
	2006	2007	EBS/08/105	Est.	EBS/08/105	Prog.
National accounts						
Nominal GDP (in millions of Djibouti francs)	136 604	150 693	172 882	174 554	195 826	193 555
Nominal GDP per capita (in U.S. dollars)	946	1 018	1 139	1 150	1 259	1 244
Real GDP per capita	564	578	599	597	625	612
Real GDP per capita (annual percentage change)	2.3	2.5	3.4	3.2	4.3	2.5
Real GDP (annual change in percent)	4.8	5.1	5.9	5.8	6.9	5.1
Consumer prices (annual average)	3.6	5.0	8.1	12.0	6.0	5.5
Consumer prices (end of period)	3.5	8.2	7.5	9.2	5.5	5.0
			(In percent of GDP)			
Investment and saving						
Total fixed capital investment	35.0	42.2	43.7	46.7	41.9	37.7
Private	27.5	31.0	33.2	32.9	29.7	23.0
Public	7.5	11.2	10.4	13.8	12.3	14.7
Gross national saving	20.4	16.6	10.1	7.5	9.1	21.6
Savings/investment balance 1/	-14.7	-25.6	-33.5	-39.2	-32.9	-16.1
Budgetary operations						
Total revenue and grants	34.9	35.2	32.9	41.9	34.8	36.0
Of which: Tax revenue	20.3	20.5	18.4	20.2	18.6	19.5
Expenditure and net lending	37.4	37.7	34.9	40.6	36.6	37.8
Current expenditure	29.9	26.6	24.4	26.8	24.4	23.1
Capital expenditure	7.5	11.2	10.4	13.8	12.3	14.7
Balance (commitment order basis) 2/	-2.5	-2.6	-1.9	1.3	-1.8	-1.8
Domestic financing	-0.6	-0.2	-1.0	-0.6	-1.0	-1.1
External financing 3/	2.7	3.3	4.0	2.6	4.1	4.2
Change in arrears (decrease -) 4/	0.2	-0.7	-1.1	-3.3	-1.3	-1.3
Stock of domestic arrears	...	18.9	…	13.0	…	10.5
			(Annual change in percent, unless otherwise indicated)			
Monetary sector						
Net foreign assets	15.3	4.0	3.7	23.1	3.7	21.9
Net domestic assets	-11.9	41.4	47.2	10.0	40.6	-35.9
Claims on the private sector	9.1	23.1	34.8	27.3	28.6	14.9
Broad money	10.2	9.6	12.0	20.6	13.0	11.8
Velocity of broad money (ratio)	1.3	1.28	1.29	1.23	1.29	1.22
Average commercial lending interest rate (in percent)	11.6	10.9	11.4	...	…	...
			(In millions of U.S. dollars, unless otherwise indicated)			
External sector						
Exports of goods and services 5/	312	323	420	390	503	523
Imports of goods and services	-489	-601	-815	-836	-938	-739
Current account balance 1/	-113	-217	-326	-385	-362	-175
(in percent of GDP) 1/	-14.7	-25.6	-33.5	-39.2	-32.9	-16.1
FDI in percent of GDP	21.3	23.0	24.3	23.8	20.5	14.1
Stock of external public and publicly guaranteed debt	437	540	573	582	655	663
(in percent of GDP)	56.8	63.6	58.9	59.2	59.5	60.9
Gross official reserves	117	130	132	174	143	226
(in months of imports of goods and services) 6/	2.3	1.9	1.7	2.8	1.8	3.1
Gross foreign assets of commercial banks	480	508	528	576	541	668
(in months of imports of goods and services) 6/	9.6	7.3	6.8	9.4	6.6	9.2
Memorandum items:						
Currency board cover (in percent) 7/	108.7	116.3	103.5	120.9	104.5	126.2
Exchange rate (DF/US$) end-of-period	177.7	177.7	…	177.7	…	…
Real effective exchange rate (yearly average, 2000=100)	87.8	84.4	…	84.7	…	…
(Change in percent; depreciation -)	-0.7	-3.9	…	0.4	…	…

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

1/ The large deterioration in 2008 is due to two components: large FDI-related capital imports and the impact of food and oil price shocks on imports.
2/ Includes grants.
3/ Actual payments made, including net change in arrears and excluding rescheduled debt service.
4/ Domestic arrears include those owed to public wages, private suppliers, the pension funds, and public enterprises. External arrears include on interest only (arrears on principal are counted as an item of "external financing").
5/ Unlike the May 2007 staff report, cattle reexports for 2006 and 2007 are recorded on net basis.
6/ In months of the following year's imports.
7/ Gross foreign assets of the CBD, in percent of monetary liabilities (reserve money and government deposits at CBD).

Table 2a. Djibouti: Central Government Fiscal Operations, 2007–14

(In millions of Djibouti francs)

		2008		2009		2010	2011	2012	2013	2014
	2007	Prog.	Est.	EBS/08/105	Prog.	Prog.			Proj.	
Revenues and grants	53 002	56 964	73 092	68 100	69 758	71 976	81 396	85 288	91 439	98 308
Tax revenue	30 901	31 769	35 005	36 452	37 599	42 860	49 024	54 011	59 862	66 150
Excluding overdue taxes	28 775	30 569	34 199	35 552	36 499	41 760	47 924	52 911	58 862	64 950
Direct taxes 1/	14 831	15 309	15 673	16 074	16 254	18 236	20 959	23 219	25 458	28 017
Indirect and other taxes	16 070	16 460	19 331	20 378	21 345	24 624	28 065	30 791	34 404	38 132
Indirect taxes	14 288	14 665	17 721	18 359	19 284	22 353	25 589	28 080	31 436	34 872
Other taxes	1 782	1 795	1 610	2 019	2 061	2 271	2 476	2 712	2 968	3 261
Nontax domestic revenues	3 633	3 625	4 618	4 057	7 183	6 333	6 758	7 245	7 770	8 367
Nontax external revenues 2/	10 999	11 305	10 631	11 331	10 746	10 783	10 793	10 796	10 791	10 775
Grants	7 469	10 266	22 838	16 260	14 230	12 000	14 821	13 236	13 017	13 017
Total expenditure	56 885	60 287	70 903	71 714	73 208	75 640	81 666	85 869	91 098	97 155
Current expenditure	40 026	42 246	46 738	47 715	44 785	48 929	52 261	55 868	59 648	64 523
Wages and related expenditure	20 801	19 852	22 176	21 401	24 065	25 160	26 406	27 258	28 812	30 456
Of which: Housing subsidies 3/	2 054	...	2 319	…	2 408	2 528	2 642	2 735	2 817	2 901
Goods and services	10 542	11 110	16 467	11 687	11 581	13 807	14 814	15 970	17 227	18 660
Civil expenditure 4/	7 400	8 388	12 044	9 345	10 116	11 149	12 154	13 309	14 567	16 004
Military expenditure 5/	3 142	2 722	4 424	2 342	1 465	2 658	2 660	2 661	2 660	2 656
Maintenance	1 043	660	660	900	1 113	1 226	1 337	1 464	1 602	1 760
Transfers 6/	4 754	5 263	5 503	6 657	5 961	6 557	7 344	8 078	8 886	10 486
Interest	614	734	558	998	864	977	1 160	1 896	1 919	1 959
Foreign-financed current spending 7/	2 272	2 355	1 374	3 665	1 201	1 201	1 201	1 201	1 201	1 201
Investment expenditure	16 859	18 041	24 164	23 998	28 423	26 711	29 405	30 001	31 451	32 632
Domestically financed	5 360	5 156	5 709	5 000	7 037	7 241	8 110	9 327	9 979	9 979
Foreign-financed	11 499	12 885	18 455	18 998	21 386	19 470	21 295	20 674	21 471	22 653
Grants	6 268	6 238	13 105	10 595	11 252	9 022	11 843	10 258	10 039	10 039
Loans	5 231	6 647	5 350	8 403	10 134	10 448	9 452	10 417	11 433	12 614
Overall balance (commitment basis, including grants)	-3 883	-3 322	2 189	-3 613	-3 451	-3 663	-270	-582	341	1 153
Overall balance (commitment basis, excluding grants)	3 586	6 944	25 027	12 647	10 780	8 337	14 550	12 654	13 358	14 170
Change in arrears (cash payments = -)	-999	-1 950	-5 662	-2 500	-2 500	-2 200	-2 200	-2 200	-2 200	-2 200
Domestic arrears	-958	-1 950	-5 560	-2 500	-2 500	-2 200	-2 200	-2 200	-2 200	-2 200
External arrears (interest)	-41	0	-102	0	0	0	0	0	0	0
Overall balance (cash basis, including grants)	-4 882	-5 272	-3 473	-6 113	-5 951	-5 863	-2 470	-2 782	-1 859	-1 047
Financing	4 882	5 273	3 360	-6 114	5 951	5 863	2 470	2 782	1 859	1 047
Domestic financing (net)	-309	-1 649	-1 103	-1 913	-2 127	-2 332	-4 289	-4 148	-6 691	-8 420
Bank financing	-213	-1 553	-1 007	-1 817	-2 031	-2 236	-4 193	-4 052	-6 595	-8 372
Central bank	-531	-1 302	-1 267	-1 692	-1 906	-2 236	-4 193	-4 052	-6 595	-8 372
Commercial banks	318	-251	260	-125	-125	0	0	0	0	0
Nonbank financing	-96	-96	-96	-96	-96	-96	-96	-96	-96	-48
External financing (net)	5 011	6 922	4 463	8 027	8 078	8 194	6 759	6 930	8 551	9 467
Disbursements	6 302	8 737	5 616	9 403	10 134	10 448	9 452	10 417	11 433	12 614
Amortization payments	-1 291	-1 815	-1 153	-1 376	-2 056	-2 254	-2 694	-3 486	-2 882	-3 147
Current obligations 8/	-1 188	-1 175	-1 153	-1 376	-2 940	-3 132	-3 549	-3 486	-2 882	-3 147
Net change in arrears and rescheduling 9/	-103	-640	0	0	884	879	855	0	0	0
Residual/financing gap 10/	180	0	113	0	0	1	1	-1	0	0
Memorandum items:										
Current expenditure for social purposes	15 791	16 543	16 058	20 497	20 511	22 241	24 338	26 309	29 240	33 246
Base fiscal balance 11/	-7 361	-8 346	-10 451	-7 228	-5 840	-4 583	-2 193	-1 542	400	2 407
Domestic revenue	34 534	35 394	39 623	40 509	44 782	49 193	55 782	61 256	67 632	74 516
Domestically financed expenditure	41 895	43 740	50 073	47 737	50 621	53 776	57 975	62 798	67 232	72 110

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

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

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

3/ Previously included in transfers.

4/ For 2008, includes, in order of magnitude: utilities (electricity, water and telecoms), civilian goods and services diverted to the war, health and education, president's office, (misclassified) maintenance of investment spending, and other categories.

5/ Includes €5 million (out of a total of €30 million) of foreign-financed current spending (from French military as stipulated in their leasing agreement).

6/ Excludes housing subsidies. In 2008, one third of these transfers were social if one excludes the National Solidarity Fund.

7/ Excludes DF1,300m of current military spending financed domestically (from the contribution of the port to nontax revenues, i.e. dividends).

8/ Projected repayments are for direct government debt due (i.e. not government guarantees).

9/ Includes Paris Club debt rescheduling.

10/ For 2007–08, the residual is due to TOFE misclassification and adding up errors which have been corrected by staff. For 2009 onwards, the financing gap is naught.

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

Table 2b. Djibouti: Central Government Fiscal Operations, 2007–14

(In percent of GDP)

	2007	2008		2009		2010	2011	2012	2013	2014
		Prog.	Est.	EBS/08/105	Prog.	Prog.		Proj.		
Revenues and grants	35.1	32.9	42.3	34.8	36.0	33.6	34.4	32.7	31.9	31.1
Tax revenue	20.5	18.4	20.2	18.6	19.4	20.0	20.7	20.7	20.9	20.9
Excluding overdue taxes	19.1	17.7	19.8	18.2	18.9	19.5	20.2	20.3	20.5	20.5
Direct taxes 1/	9.8	8.9	9.1	8.2	8.4	8.5	8.9	8.9	8.9	8.9
Indirect and other taxes	10.6	9.5	11.2	10.4	11.0	11.5	11.9	11.8	12.0	12.1
Indirect taxes	9.5	8.5	10.3	9.4	10.0	10.4	10.8	10.8	11.0	11.0
Other taxes	1.2	1.0	0.9	1.0	1.1	1.1	1.0	1.0	1.0	1.0
Nontax domestic revenues	2.4	2.1	2.7	2.1	3.7	3.0	2.9	2.8	2.7	2.6
Nontax external revenues 2/	7.3	6.5	6.1	5.8	5.6	5.0	4.6	4.1	3.8	3.4
Grants	4.9	5.9	13.2	8.3	7.4	5.6	6.3	5.1	4.5	4.1
Total expenditure	37.7	34.9	41.0	36.6	37.8	35.3	34.5	33.0	31.8	30.7
Current expenditure	26.5	24.4	27.0	24.4	23.1	22.8	22.1	21.4	20.8	20.4
Wages and related expenditure	13.8	11.5	12.8	10.9	12.4	11.7	11.2	10.5	10.1	9.6
Of which: social housing subsidies 3/	1.4	...	1.3	...	1.2	1.2	1.1	1.0	1.0	0.9
Goods and services	7.0	6.4	9.5	6.0	6.0	6.4	6.3	6.1	6.0	5.9
Civil expenditure 4/	4.9	4.9	7.0	4.8	5.2	5.2	5.1	5.1	5.1	5.1
Military expenditure 5/	2.1	1.6	2.6	1.2	0.8	1.2	1.1	1.0	0.9	0.8
Maintenance	0.7	0.4	0.4	0.5	0.6	0.6	0.6	0.6	0.6	0.6
Transfers 6/	3.1	3.0	3.2	3.4	3.1	3.1	3.1	3.1	3.1	3.3
Interest	0.4	0.4	0.3	0.5	0.4	0.5	0.5	0.7	0.7	0.6
Foreign-financed current spending 7/	1.5	1.4	0.8	1.9	0.6	0.6	0.5	0.5	0.4	0.4
Investment expenditure	11.2	10.4	14.0	12.3	14.7	12.5	12.4	11.5	11.0	10.3
Domestically financed	3.5	3.0	3.3	2.6	3.6	3.4	3.4	3.6	3.5	3.2
Foreign-financed	7.6	7.5	10.7	9.7	11.0	9.1	9.0	7.9	7.5	7.2
Grants	4.2	3.6	7.6	5.4	5.8	4.2	5.0	3.9	3.5	3.2
Loans	3.5	3.8	3.1	4.3	5.2	4.9	4.0	4.0	4.0	4.0
Overall balance (commitment basis, including grants)	-2.6	-1.9	1.3	-1.8	-1.8	-1.7	-0.1	-0.2	0.1	0.4
Overall balance (commitment basis, excluding grants)	-7.5	-7.8	-11.9	-10.1	-9.1	-7.3	-6.4	-5.3	-4.4	-3.8
Change in arrears (cash payments = -)	-0.7	-1.1	-3.3	-1.3	-1.3	-1.0	-0.9	-0.8	-0.8	-0.7
Domestic arrears	-0.6	-1.1	-3.2	-1.3	-1.3	-1.0	-0.9	-0.8	-0.8	-0.7
External arrears (interest)	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis)	-3.2	-3.0	-2.0	-3.1	-3.1	-2.7	-1.0	-1.1	-0.6	-0.3
Financing	3.2	3.0	1.9	3.1	3.1	2.7	1.0	1.1	0.6	0.3
Domestic financing (net)	-0.2	-1.0	-0.6	-1.0	-1.1	-1.1	-1.8	-1.6	-2.3	-2.7
Bank financing	-0.1	-0.9	-0.6	-0.9	-1.0	-1.0	-1.8	-1.6	-2.3	-2.6
Central bank	-0.4	-0.8	-0.7	-0.9	-1.0	-1.0	-1.8	-1.6	-2.3	-2.6
Commercial banks	0.2	-0.1	0.2	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Nonbank financing	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External financing (net)	3.3	4.0	2.6	4.1	4.2	3.8	2.9	2.7	3.0	3.0
Disbursements	4.2	5.1	3.2	4.8	5.2	4.9	4.0	4.0	4.0	4.0
Amortization payments	-0.9	-1.0	-0.7	-0.7	-1.1	-1.1	-1.1	-1.3	-1.0	-1.0
Current obligations 8/	-0.8	-0.7	-0.7	-0.7	-1.5	-1.5	-1.5	-1.3	-1.0	-1.0
Net change in arrears and rescheduling 9/	-0.1	-0.4	0.0	0.0	0.5	0.4	0.4	0.0	0.0	0.0
Residual/financing gap 10/	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
GDP	151 033	172 882	172 882	195 826	193 555	214 190	236 814	260 507	286 434	316 109
Current expenditure for social purposes	10.5	9.6	9.3	10.5	10.6	10.4	10.3	10.1	10.2	10.5
Base fiscal balance 11/	-4.9	-4.8	-6.0	-3.7	-3.0	-2.1	-0.9	-0.6	0.1	0.8
Domestic revenue	22.9	20.5	22.9	20.7	23.1	23.0	23.6	23.5	23.6	23.6
Domestically financed expenditure	27.7	25.3	29.0	24.4	26.2	25.1	24.5	24.1	23.5	22.8

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

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

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

3/ Previously included in transfers.

4/ For 2008, includes, in order of magnitude: utilities (electricity, water and telecoms), civilian goods and services diverted to the war, health and education, the president's office, (misclassified) maintenance of investment spending, and other categories.

5/ Includes €5 million (out of a total of €30 million) of foreign-financed current spending (from French military as stipulated in their leasing agreement).

6/ Excludes housing subsidies. In 2008, one third of these transfers were social if one excludes the National Solidarity Fund.

7/ Excludes DF1,300m of current military spending financed domestically (from the contribution of the port to nontax revenues, i.e. dividends).

8/ Projected repayments are for direct government debt due (i.e. not government guarantees).

9/ Includes Paris Club debt rescheduling.

10/ For 2007–08, the residual is due to TOFE misclassification and adding up errors which have been corrected by staff. For 2009 onwards, the financing gap is naught

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

Table 3. Djibouti: Balance of Payments, 2007–14

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

	2007	2008 EBS/08/105	2008 Est.	2009 EBS/08/105	2009 Program	2010 Program	2011 Program	2012 Projections	2013 Projections	2014 Projections
Current account (including grants)	-217	-326	-385	-362	-175	-200	-290	-287	-331	-334
(In percent of GDP)	-25.6	-33.5	-39.2	-32.9	-16.1	-16.6	-21.7	-19.6	-20.5	-18.8
Credit	323	420	390	503	523	637	736	828	906	950
Exports of goods, f.o.b. 1/	58	98	76	113	94	128	144	159	176	198
Exports of services	265	323	315	391	429	509	592	669	730	752
Of which: services to foreign military bases	156	166	166	171	172	178	184	191	197	203
maritime transportation	53	85	82	126	177	210	254	291	324	331
Debit	-601	-815	-836	-938	-739	-874	-1 073	-1 189	-1 310	-1 350
Imports of goods, f.o.b.	-483	-667	-693	-768	-601	-717	-887	-985	-1 088	-1 120
Of which: investment goods	-218	-261	-284	-274	-251	-304	-433	-456	-503	-514
crude oil and petroleum products	0	-121	-190	-142	-73	-93	-106	-118	-130	-143
Imports of services	-119	-148	-142	-170	-137	-157	-186	-204	-222	-231
Net income from abroad 2/	89	86	90	89	71	69	81	98	98	94
Of which: income related to the lease of military bases	62	64	60	64	60	60	60	60	60	60
Net current transfers from abroad	-28	-17	-29	-16	-30	-32	-34	-24	-25	-27
Private (net)	-38	-40	-40	-41	-41	-43	-44	-46	-48	-50
Official (net)	11	22	11	25	11	11	11	22	23	23
Capital and financial account 3/	262	311	343	350	208	236	319	333	389	410
Net capital transfers	38	38	77	62	66	54	69	61	61	61
Foreign direct investment	195	236	234	226	154	177	219	224	244	261
Public sector (net)	34	56	115	70	80	104	90	85	81	59
Disbursements	52	76	133	93	109	134	125	121	113	93
Repayments	-18	-20	-18	-23	-29	-30	-35	-37	-32	-34
Of which: eligible for Paris Club rescheduling	...	-32	-60	-5	-7	-5	-2	0	0	0
commercial banks (- = increase in NFA)	-6	-20	-82	-8	-92	-99	-59	-37	3	29
Errors and omissions	-62	0	28	0	0	0	0	0	0	0
Overall balance (deficit -)	**-17**	**-16**	**-13**	**-12**	**33**	**35**	**29**	**45**	**58**	**76**
Financing	17	16	13	12	-33	-35	-29	-45	-58	-76
Central bank	-16	-6	-49	-17	-58	-58	-47	-46	-58	-76
Assets	-13	-1	-43	-12	-53	-53	-43	-44	-57	-75
Liabilities	-3	-5	-6	-5	-5	-5	-4	-1	-1	-1
Exceptional financing	33	22	62	29	25	22	18	0	0	0
Budget support from donors (grants and loans)	0	16	48	17	10	10	10	0	0	0
Change in overdue obligations (decrease-)	33	-35	-60	0	0	0	0	0	0	0
Expected debt relief	0	34	66	7	9	8	4	0	0	0
Paris Club	0	34	61	6	7	5	2	0	0	0
Non-Paris Club	0	0	5	2	3	3	2	0	0	0
Program financing	1	6	8	5	6	4	4	0	0	0
IMF (PRGF)	0	6	6	5	4	4	4	0	0	0
Memorandum items:										
Central bank gross foreign assets	130	132	174	143	226	279	323	367	424	499
In number of months of imports 4/	1.9	1.7	2.8	1.8	3.1	3.1	3.3	3.4	3.8	...
Currency board cover	116.3	103.5	120.9	104.5	126.2	124.6	116.6	112.6	107.4	105.2
FDI in percent of GDP	23	24	24	21	14	15	16	15	15	15
Official external debt (including public enterprises)										
In millions of U.S. dollars	539.6	573.0	582	655	663	776	876	956	1 036	1 092
In percent of GDP	64	59	59	59	61	64	66	65	64	61
In percent of exports of goods and services	167	136	149	130	127	122	119	115	114	115
Debt service										
In millions of U.S. dollars	28	28	26	33	33	35	43	55	54	56
In percent of GDP	3.3	2.8	2.6	3.0	3.0	2.9	3.2	3.8	3.3	3.2
In percent of exports of goods and services	8.7	6.6	6.5	6.6	6.3	5.5	5.9	6.7	5.9	5.9

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

1/ Includes net exports of cattle since 2006.

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

3/ Excludes exceptional financing.

Table 4. Djibouti: Monetary Survey and Banking Sector Indicators, 2005–09

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

	2005	2006	2007	2008		2009
				Prog.	Est.	Prog.
Broad money	97 709	107 718	118 032	133 960	142 310	159 098
Currency in circulation	13 272	15 445	15 500	17 478	17 624	18 074
Deposits	84 437	92 273	102 532	116 482	124 686	141 024
Demand deposits	34 456	40 924	52 041	59 121	64 612	73 078
Djibouti francs	23 746	26 371	33 080	37 581	40 296	45 576
Foreign currency	10 710	14 553	18 961	21 541	24 316	27 502
Time deposits	49 981	51 349	50 491	57 361	60 074	67 946
Djibouti francs	10 850	13 743	14 666	16 661	19 841	22 441
Foreign currency	39 131	37 606	35 825	40 699	40 233	45 505
Net foreign assets	79 604	91 766	95 468	98 979	117 498	143 194
Central bank	11 241	16 954	19 634	19 678	27 093	36 368
Assets	15 581	20 843	23 165	23 396	30 873	40 218
Liabilities	4 340	3 889	3 531	3 718	3 780	3 850
Commercial banks	68 363	74 812	75 834	79 301	90 405	106 825
Assets	76 533	85 301	90 276	93 887	102 308	118 728
Liabilities	8 170	10 489	14 442	14 586	11 903	11 903
Net domestic assets	18 105	15 952	22 564	34 981	24 812	15 904
Claims on government (net)	5 192	4 448	4 235	2 689	3 236	1 199
Central bank	4 366	3 249	2 718	1 423	1 459	-453
Commercial banks	826	1 199	1 517	1 266	1 777	1 652
Claims on nongovernment sector	26 346	28 523	35 683	47 497	44 730	51 147
Public enterprises	1 064	951	1 744	1 744	1 519	1 519
Private sector	25 282	27 572	33 939	45 753	43 211	49 628
Capital accounts	-8 471	-8 687	-9 412	-13 462	-9 786	-9 786
Other items (net)	-4 962	-8 332	-7 942	-1 743	-13 368	-26 656
	(Change from previous year; in percent of broad money)					
Broad money	11.3	10.2	9.6	12.0	20.6	11.8
Currency in circulation	1.0	2.2	0.1	1.7	1.8	0.3
Demand deposits	-0.7	6.6	10.3	6.0	10.7	…
Time deposits	11.0	1.4	-0.8	5.8	8.1	…
Net foreign assets	9.7	12.4	3.4	3.0	18.7	18.1
Central bank	-1.2	5.8	2.5	0.0	6.3	6.5
Commercial banks	10.9	6.6	0.9	2.9	12.3	11.5
Net domestic assets	1.7	-2.2	6.1	10.5	1.9	-6.3
Of which: Claims on government (net)	-0.3	-0.8	-0.2	-1.3	-0.8	-1.4
Claims on nongovernment sector	0.3	2.2	6.6	10.0	7.7	4.5
Memorandum items:						
Monetary authorities:						
Net international reserves (in U.S. dollars million)	6.3	9.4	18.2	5.0	30.0	47.0
Gross foreign assets (GFA) (in U.S. dollars million)	87.7	117.3	130.3	132.0	173.7	191.1
GFA in percent of foreign currency deposits of banks	31.3	40.0	42.3	37.6	47.8	55.1
GFA in percent of total banking system deposits	18.5	22.6	22.6	20.1	24.8	28.5
Banking system:						
Credit to the private sector, 12-month percent change	1.2	9.1	23.1	34.8	27.3	14.9
Money velocity	1.29	1.27	1.28	1.29	1.23	1.22

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

Table 5. Djibouti: Medium-Term Macroeconomic Projections, 2008–14

	2008	2009	2010	2011	2012	2013	2014
	Est.	Program			Projections		
National accounts							
Real GDP per capita	597	612	629	649	673	701	733
Real GDP per capita (annual percentage change)	3.2	2.5	2.8	3.2	3.7	4.1	4.5
Real GDP (annual change in percent)	5.8	5.1	5.4	5.8	6.3	6.7	7.1
Consumer prices (annual average)	12.0	5.5	5.0	4.5	3.5	3.0	3.0
	(In percent of GDP)						
Consumption	92.5	78.4	78.3	82.5	80.1	81.4	80.5
Private	70.1	60.0	60.1	65.2	63.5	65.3	65.0
Public	22.4	18.4	18.2	17.4	16.6	16.1	15.5
Total fixed capital investment	46.7	37.7	38.4	39.2	39.5	39.1	38.2
Private	32.9	23.0	25.9	26.8	28.1	28.2	27.9
Public	13.8	14.7	12.5	12.4	11.5	11.0	10.3
Gross national saving	7.5	21.6	21.7	17.5	19.9	18.6	19.5
Savings/investment balance	-39.2	-16.1	-16.6	-21.7	-19.6	-20.5	-18.8
Budgetary operations							
Total revenue and grants	41.9	36.0	33.6	34.3	32.6	31.9	31.0
Of which: Tax revenue	20.2	19.5	20.1	20.8	20.7	20.9	20.9
Expenditure and net lending	40.6	37.8	35.3	34.4	32.9	31.8	30.7
Current expenditure	26.8	23.1	22.8	22.1	21.4	20.8	20.4
Capital expenditure	13.8	14.7	12.5	12.4	11.5	11.0	10.3
Overall fiscal balance (commitment order basis, including grants)	1.3	-1.8	-1.7	-0.1	-0.3	0.1	0.3
Domestic financing	-0.6	-1.1	-1.1	-1.8	-1.5	-2.3	-2.6
External financing 1/	2.6	4.2	3.8	2.9	2.7	3.0	3.0
Change in domestic and external arrears (decrease -)	-3.3	-1.3	-1.0	-0.9	-0.8	-0.8	-0.7
Overall fiscal balance (cash basis, including grants)	-2.0	-3.1	-2.7	-1.0	-1.1	-0.7	-0.4
	(In millions of U.S. dollars, unless otherwise indicated)						
External sector							
Exports of goods and services	390	523	637	736	828	906	950
Imports of goods and services	-836	-739	-874	-1 073	-1 189	-1 310	-1 350
Current account balance	-385	-175	-200	-290	-287	-331	-334
(in percent of GDP)	-39.2	-16.1	-16.6	-21.7	-19.6	-20.5	-18.8
FDI (in percent of GDP)	23.8	14.1	14.7	16.4	15.3	15.1	14.7
External public debt (in percent of GDP)	59.2	60.9	64.4	65.7	65.2	64.3	61.4
Gross FA of the central bank (in mnths of imports of G&S)	2.8	3.1	3.1	3.3	3.4	3.8	...
Gross FA of commercial banks (in mnths of imports of G&S)	9.4	9.2	8.6	8.3	7.9	7.7	...

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

1/ Includes external arrears on amortizations.

Table 6. Djibouti: Reviews and Disbursements, PRGF Arrangement, 2008–11

Date	Action/Status	Disbursement	In Percent of Quota 1/
September 2008	Board approval of PRGF arrangement	SDR 3.864 million	24.00
May 2009	Completed first review based on end-December 2008 performance criteria	SDR 1.476 million	9.28
September 2009	Completed second review based on end-June 2009 performance criteria	SDR 1.476 million	9.28
March 2010	Completed third review based on end-December 2009 performance criteria	SDR 1.476 million	9.28
September 2010	Completed fourth review based on end-June 2010 performance criteria	SDR 1.476 million	9.28
March 2011	Completed fifth review based on end-December 2010 performance criteria	SDR 1.476 million	9.28
September 2011	Completed sixth review based on end-June 2011 performance criteria	SDR 1.476 million	9.28
Total		SDR 12.720 million	80.00

Source: Fund staff estimates and projections.

1/ Djibouti's quota is SDR 15.9 million.

Table 7. Djibouti: Indicators of Capacity to Repay the Fund, 2007–18

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
		Projections										
Fund obligations based on existing credit												
(in millions of SDRs)												
Principal	1.82	2.73	2.73	2.18	1.64	0.91	0.00	0.77	0.77	0.77	0.77	0.77
Charges and interest	0.09	0.08	0.06	0.04	0.03	0.03	0.02	0.02	0.02	0.01	0.01	0.01
Fund obligations based on existing and prospective credit												
(in millions of SDRs)												
Principal	1.82	2.73	2.73	2.18	1.64	0.91	0.00	0.92	1.51	2.10	2.54	2.54
Charges and interest	0.09	0.08	0.06	0.06	0.07	0.07	0.07	0.07	0.06	0.05	0.04	0.03
Total obligations based on existing and prospective credit												
In millions of SDRs	1.91	2.81	2.79	2.24	1.71	0.98	0.07	0.99	1.57	2.15	2.58	2.57
In billions of Djibouti francs	0.52	0.79	0.74	0.59	0.44	0.26	0.02	0.26	0.41	0.57	0.68	0.68
In percent of government revenue	1.0	1.1	1.1	0.8	0.5	0.3	0.0	…	…	…	…	…
In percent of exports of goods and services	0.9	1.1	0.8	0.5	0.3	0.2	0.0	…	…	…	…	…
In percent of debt service 1/	88.0	170.4	73.5	58.5	86.4	44.3	1.8	…	…	…	…	…
In percent of GDP	0.3	0.5	0.4	0.3	0.2	0.1	0.0	…	…	…	…	…
In percent of quota	12.03	17.65	17.54	14.09	10.73	6.15	0.44	6.24	9.89	13.54	16.24	16.18
Outstanding Fund credit 1/												
In millions of SDRs	10.18	11.32	11.54	12.31	13.63	12.72	12.72	11.80	10.29	8.19	5.64	3.10
In billions of Djibouti francs	2.77	3.18	3.04	3.22	3.56	3.33	3.34	3.10	2.71	2.15	1.48	0.81
In percent of government revenue	5.2	4.4	4.3	4.5	4.4	3.9	3.7	...	...	...	...	...
In percent of exports of goods and services	4.8	4.6	3.3	2.8	2.7	2.3	2.1	...	...	...	...	...
In percent of debt service 1/	468.3	687.4	566.0	624.0	615.6	495.3	565.1	...	...	...	...	...
In percent of GDP	1.8	1.8	1.6	1.5	1.5	1.3	1.2	...	...	...	...	...
In percent of quota	64.01	71.16	72.58	77.42	85.72	80.00	80.00	74.21	64.72	51.51	35.47	19.50
Net use of Fund credit (millions of SDRs)	-1.82	1.14	0.23	0.77	1.32	-0.91	0.00	-0.92	-1.51	-2.10	-2.54	-2.54
Disbursements	0.00	3.86	2.95	2.95	2.95	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Repayments and Repurchases	1.82	2.73	2.73	2.18	1.64	0.91	0.00	0.92	1.51	2.10	2.54	2.54
Memorandum items:												
Nominal GDP (in billions of DF)	151	175	194	214	237	261	286	316	...	...	...	...
Exports of goods and services (in billions of DF)	57	69	93	113	131	147	161	169	...	...	...	...
Government revenue and grants (in billions of DF)	53	73	70	72	81	85	91	98	...	...	...	...
Debt service (in billions of DF) 1/	1	0	1	1	1	1	1	1	...	...	...	...
DF/SDR (period average)	272	281	264	261	261	261	262	263	...	...	...	...

Sources: Fund staff estimates and projections.

1/ Total debt service includes IMF repurchases and repayments.

Table 8. Djibouti: Key FSSA, Safeguards Assessment, and AML/CFT Recommendations

Recommendation[1]	Status
Systemic Liquidity	
Grant the power to change the exchange rate to a qualified parliamentary majority, and formally fix the official exchange rate in legal documentation.	To be included under a revised Banking Law, submitted to the National Assembly by end-December 2009; MCM TA requested.
Improve liquidity management, including introduction of a reserve requirement consistent with international standards.	
Set up a single deposit account for the Treasury at the BCD.	An inventory of Treasury accounts at commercial banks is complete; structural benchmark for end-May 2009.
Banking Regulation and Supervision	
Develop Islamic banking regulatory and supervisory framework.	TA requested from Islamic Development Bank, and reached cooperation agreement with Central Bank of Sudan to develop Islamic finance.
Create a unit dedicated to banking supervision within the BCD.	Incorporated under revised Banking Law; MCM TA requested.
Strengthen the licensing process.	
Gradually increase the minimum capital requirement to USD 5 million.	Revised Banking Law to double minimum requirement to approximately $3.4 million.
Upgrade on- and off-site banking supervision.	2009 budget foresees increase in staffing, and discussions ongoing with Bank of France to establish a training program. One on-site inspection completed at end-February 2009, and two additional inspections by end-August 2009; MCM TA budgeted in FY 2009.
Safeguards Assessment	
Adopt external auditor selection procedures in accordance with ISA.	New procedures in train, to be implemented by end-June 2009.
Appoint the next external auditors for 2009–11	Preparations underway for issue of tender; selection by end-September 2009.
Strengthen Board oversight by establishing an internal audit function and holding formal quarterly Board meetings	Internal audit function to be established by end-December 2009. MCM currently providing ongoing, intermittent TA
Improve financial reporting transparency, including by completing preparatory steps for formally adoption of IFRS	
Payment System	
Amend BCD statute to make the central bank responsible for payment systems, and appoint a manager in the BCD to be responsible for payment systems.	MCM TA requested.
Reject any modification or submission of new payment instructions presented to the clearing house during its session.	
Collateralize overdraft facilities provided by the BCD to commercial banks.	
Microfinance	
Set up the Microfinance Unit at the central bank with adequate resources.	IFC TA requested to create credit bureau and finalize microfinance regulations.
Finalize the rules and regulations being prepared by the BCD after consulting the relevant stakeholders.	
AML/CFT	
Amend AML Law	To be submitted to the National Assembly by end-December 2009. LEG TA in pipeline to assist in drafting.
Increase resources at Financial Intelligence Unit (FIU)	Efforts underway to build capacity and establish contacts with other FIUs; additional 2009 budget resources for bank supervision shared with the FIU.

[1] The mission used an earlier version of the FSSA. Therefore, these recommendations differ slightly from the one included in Table 1 of the latest version of the FSSA.

APPENDIX I

Letter Of Intent

Djibouti, May 10, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

1. To supplement our letter of September 10, 2008, and the Memorandum on Economic and Financial Policies (MEFP) attached to it, we wish to inform you of the progress made in implementing the three-year program (September 1, 2008–August 30, 2011) approved by the International Monetary Fund under the Poverty Reduction and Growth Facility (PRGF).

2. In 2008, we made substantial progress toward meeting the objectives of the first year of the program (September 1, 2008–August 30, 2009). In particular, we achieved a growth rate of 5.8 percent, compared with an objective of 5.9 percent. We managed to bring down inflation and expect to reach our goal of 5.5 percent in 2009 despite the strong impact of the food and oil price shocks in 2007–08. We also performed better than expected as regards our 2008 fiscal consolidation objective (despite exceptional military expenditure related to the conflict at our northern border with Eritrea, the upsurge in commodity prices, and transfers made to ease the effects of severe drought on the poorest segments of the population), the net repayment of domestic arrears, the accumulation of government deposits (a quantitative performance criterion—QPC—under the program), the ceiling on the nonsocial wage bill (a quantitative benchmark—QB—under the program), currency board coverage (QPC), and the accumulation of official reserves.

3. Djibouti also met the end-December QPC on the settlement of all external payment arrears. However, we request three waivers of the continuous QPCs regarding the ceilings on the accumulation of new domestic and external arrears and on new medium- and long-term nonconcessional loans. The temporary nonobservance of the requirement for a zero ceiling on external arrears resulted from a problem of coordination between the debtor (a public enterprise) and the Treasury delaying (by nine days) a repayment to the African Development Bank (AfDB) and (by two months) a repayment to the European Investment Bank (EIB). The reduction of net domestic arrears totaled DF 5.6 billion, (equivalent to 3.2 percent of GDP) well over the programmed target of DF 1.9 billion. However, the carryover of old wage arrears,[1] the lack of financial instruments to manage the stock of

[1] Public sector wages are being paid with one month delay, with the accumulation of new arrears for salaries due in the current month offset by the payment of the previous month's arrears. This way, previous' month arrears are cleared every month.

accumulated arrears separately from the flow of new invoices, and some misunderstandings about the definition of conditionality in the program led to nonobservance of the QPC regarding the ceiling of zero on the accumulation of new domestic arrears, defined as the maintenance of a ceiling on the gross amount of new arrears. The need to contract a new nonconcessional loan to supplement the 2006 concessional loan due to the increase in the cost of machinery critical to the production of electricity and to the prevention of economic disruption in Djibouti resulted in nonobservance of the QPC concerning the ceiling of zero on new medium- and long-term nonconcessional loans.

4. We implemented the main structural reforms as planned. We request a waiver with respect to being 15 days late in observing the structural performance criterion (SPC) on submission of the draft Value-Added Tax (VAT) Law to the National Assembly by end-November 2008. This delay resulted from the legal necessity to submit the draft VAT Law at the same time as the initial Budget Law. We observed, well before the agreed date, the structural benchmark (SB) on revising the Investment Code to streamline tax exemptions and strengthen the procedure for monitoring exempt projects. We also complied with the continuous SB on publishing the audited accounts of the social security funds and the principal public enterprises, as well as fiscal operations of the state (TOFE), on the website of the Ministry of Economy, Finance, and Planning, Responsible for Privatization (MOF) within the prescribed period. However, the SB on submitting the new Commercial Code to the National Assembly by end-November 2008 could not be observed in the scheduled timeframe because the process of harmonization with the laws on intellectual property, competition, and company law which took longer than planned, and we provided an additional period of time for the discussion of the new code with the private sector. We also validated the Code through an outreach seminar on March 19, 2009. As a result, we revised our commitment date and plan to submit these draft laws to the National Assembly by end-June 2009.

5. Although Djibouti has so far remained relatively safe from the direct impact of the international financial crisis, we expect to be affected, like other African countries, by the global economic slowdown. We shall therefore continue to implement prudent macroeconomic policies in the context of the program, so as to soften the impact of the postponement or cancellation of certain foreign direct investment (FDI) projects and ease the effects of a less substantial increase in trade with Ethiopia. We expect externally financed public investment and increasing services diversification to take real economic growth to about 5 percent in 2009. According to our forecasts, economic activity is expected to recover over the medium term, along with the global economy and FDI, which will continue to enhance our export potential. The FDI, together with continued support from donors, will help keep our external position manageable. The decline in food and oil prices has already reduced our projected external financing needs during the Fund-supported program period. We intend to make up for any remaining gaps in the financing of our poverty reduction strategy through an increase in the concessionary element of assistance and thus reducing our external debt vulnerability, by holding a roundtable meeting of donors. The latter action was

postponed to late 2009 so that the results of the ongoing census could be used as a basis for the analysis of the poverty situation in the country.

6. Fiscal policy will remain the principal instrument for implementing the macroeconomic framework defined in the Poverty Reduction Strategy Paper (PRSP)—"Initiative Nationale pour le Développement Social" (INDS). Our fiscal policy will continue to be designed to ensure a gradual narrowing of the overall deficit (on a commitment basis) over the program period. Although performance was better than expected in 2008, we intend to maintain the original program's (EBS/08/105) envisaged deficit target for 2009, as grants and indirect tax revenue were exceptionally high in 2008, and we expect exceptional military spending to continue in 2009. Therefore, we anticipate an overall deficit of about 1.8 percent of GDP in 2009 and remain determined to take steps for achieving a balanced fiscal position by 2011. Given that our approved 2009 Budget Law envisaged an overall deficit equivalent to 2.6 percent of GDP—i.e. was more expansionary than the target that we are committing to in this LOI—we have identified and shall implement additional measures to reduce nonsocial current expenditure by an additional 0.4 percent of GDP and to increase tax revenue by 1.2 percent. In particular, we feel we can improve the performance/efficiency of indirect taxation by 0.5 percent of GDP and increase by 0.7 percent of GDP the nontax external revenue generated by the differential between the euro and the dollar. The excess resources (0.8 percent of GDP) would be mainly devoted to increase capital expenditure growth).

7. The revised program targets take into account the effect of the protracted conflict with Eritrea over current expenditure. However, should revenue and external financing be less than programmed during 2009, or if the economic slowdown becomes more pronounced, we undertake to implement a more ambitious wage bill retrenchment—by attempting to return as much as possible to the level envisaged in the original program's (EBS/08/105), that is, 10.9 percent instead of the revised program's target of 12.4 percent of GDP—and reduce domestically financed investment; this would make it possible to observe the deficit target. We remain committed to lowering the nonsocial wage bill as a percentage of GDP, in line with the agreed QB, and to increasing social expenditure to reach about 10.6 percent of GDP.

8. Following a debt rescheduling agreement reached with the Paris Club in October 2008, we are currently seeking to finalize bilateral agreements with individual Paris Club creditors for debt rescheduling under the agreed terms. We have already completed discussions with Belgium, Spain, and Italy. Negotiations are under way with the other non-Paris Club bilateral creditors to obtain rescheduling on comparable terms. The temporary accumulation of new external payment arrears affected two payments of government-guaranteed external loans, for these payments were not made on time by the borrowing public enterprises. Because of the latter's technical, financial, and institutional capacity constraints, as well as issues of coordination with the Treasury and a legal dispute affecting one of the loans, there were delays in the payment of the Treasury's guarantee. To avoid any future resurgence of this problem, we shall be careful to: (a) as of April 1, 2009, ensure payment during the grace period, with the immediate repayment of government loans

guaranteed if a borrowing enterprise fails to meet its obligations within a week of the due date; and (b) pursue our efforts to regularize the situation of the financially weak public companies by reconciling and settling cross debts with the Treasury. We also intend to request technical assistance to improve current debt management practices, in particular, by asking the IMF's Fiscal Affairs Department (FAD) for a long-term adviser to the Treasury to strengthen its debt management strategy.

9. Exceptional circumstances related to the international economic situation prevented us from observing the QPC regarding the ceiling on new medium- and long-term nonconcessional loans. The acquisition of an additional 7.84 MW generator for the electricity company (EDD), which was critical to the production of electricity and to preventing economic disruption in Djibouti, was supposed to be covered by a 2006 concessional loan from the Islamic Development Bank (IsDB). However, because of the sharp increase in equipment prices in 2008, the final procurement cost was almost double the amount initially budgeted by the IsDB. As additional financing was not available from the IsDB, and no other multilateral organization could be found to finance the remaining cost within the required timeframe, we were obliged to contract a further loan from the OPEC Fund with a concessional element of 10 percent; overall, this reduced the concessionary element of the financial package to about 17.7 percent, i.e., below the requirement of 35 percent. More generally, we are stepping up our efforts to ensure the continuity of electricity production by means of several projects, in partnership with the European Union and the AfDB, the interconnection with the Ethiopian grid; with the International Finance Corporation (IFC) and other international investors, construction of geothermal plant; and with other international investors for assessing the development of wind and solar power plants. The interconnection with the Ethiopian grid is expected in mid-2010 and will provide a stable solution to the existing excess demand and high electricity costs. We therefore do not anticipate a repetition of the circumstances that forced us to resort, in the country's economic interests, to financing that was not fully concessional. However, should such circumstances arise, we shall consult with Fund staff prior to any commitment on nonconcessional terms.

10. We remain determined to reduce the stock of domestic arrears, in line with the program's target. We regret the accumulation of new gross domestic arrears and intend to take corrective measures to avoid further accumulation by: (a) accelerating the establishment of a single Treasury account, already at quite an advanced stage; and (b) amending the accounting principles governing the budgetary accounts, to strictly observe the definition of arrears in the IMF's Government Finance Statistics Manual of 2001 (GFSM 2001) by end-December 2009, with FAD technical and financial assistance and with the purchase of the required software. In particular, we will refine our observance of the pertinent QPC as of April 1, 2009,[2] so as to: (a) not incur delays of more than a month, as now exist, in paying

[2] Further breaches of conditionality have occurred until end-March 2009, as the new procedures could not be implemented before April 1, 2009.

wages to public sector employees, and submit a memorandum item monthly TOFE report to Fund staff to enable them to monitor wage payment arrears; (b) make every effort to eliminate delays in paying public sector wages as soon as economic circumstances allow for the emergence of surplus budgetary resources that could be devoted to it; (c) assess the QPC regarding the ceiling on arrears to the Pension Funds with a time lag of one quarter instead of continuously, as the payment agreement is quarterly and any accumulations in the interim are notional, serving only accounting purposes, and would disappear once GFSM 2001 is adopted; (d) observe, for all other arrears to private suppliers and all other categories, including state enterprises, the initial continuous performance criterion on not accumulating new gross domestic arrears, and submit the same memorandum data as part of the monthly TOFE to Fund Staff; (e) give preference to the approach of fully repaying the stock of arrears with financing from donors that could possibly be obtained during the upcoming consultative group meeting; should funding of the latter type prove insufficient, we undertake to follow a schedule of gradual repayments, as envisaged in the program projections; and (f) request the assistance of Fund staff to garner resources from Djibouti's development partners for settling all domestic arrears.

11. On the revenue side, we have now succeeded in broadening the revenue base by introducing the VAT as of January 1, 2009. We remain committed to a VAT contribution to net revenue equivalent to at least 1.1 percent of GDP in 2009. The large taxpayers unit created at the beginning of the year, VAT enforcement in the Free Trade Zone (FTZ), and the amending of the Investment Code will further streamline exemptions and enlarge the revenue base, with a net fiscal effect estimated at about 0.5–0.6 percent of GDP a year (the effect in 2009 will more than offset the decline in the domestic sales tax (TIC) given exceptionally high performance in 2008 as a result of peaking prices and the repayment of EDD to TIC arrears in 2008). We have also placed the FTZ on the same footing as the rest of the economy concerning personal income tax and, as recommended by Fund staff, intend to lower the VAT liability threshold gradually from the current DF 80 million to DF 50 million, in a first bracket, once our VAT management capabilities and tax administration are enhanced and beginning by no later than the 2012 budget. We have noted the concerns expressed by Fund staff about the amended Investment Code and the FTZ Taxation Law and shall make every effort to follow the Fund's advice for streamlining eligibility and tax exemptions so as to avoid eroding the tax base in the context of the 2010 budget. By end-July 2009 we shall send revised drafts of these laws to the IMF for comments and submit the necessary amendments within the framework of the 2010 Budget Law.

12. We maintain our commitment to control current expenditure by freezing recruitment in the public sector (except for the Ministries of Health and Education and the Tax Administration) and the scale of nominal wages (excluding promotions) until the end of the program, as well as by completing the civil service reform (paragraph 22 of the initial MEFP). However, it has been difficult to follow the programmed path for reducing the overall wage bill as a percentage of GDP, partly because of the calling-up of military reserves due to the conflict with Eritrea and the standardization of military wages by category. Nevertheless, the wage bill will continue to decline by comparison with previous

years, and we shall observe the indicative benchmark defined in the Technical Memorandum of Understanding.

13. Djibouti has received a large amount of external financing, mainly in the form of grants and concessional loans in 2008, during which time public capital expenditure also increased; this will help sustain growth over the long term. Public investment thus rose to about 13 percent of GDP in 2008. We expect externally financed public investment to remain strong at about 11 percent of GDP in 2009 despite the weakness of the global outlook.

14. Regarding our foreign exchange, monetary, and financial policies, we have requested technical assistance from the Fund to help us strengthen liquidity management by introducing reserve requirements. However, the introduction of reserve requirements, initially planned for end-August 2009 (paragraph 29 of the initial MEFP) will have to be delayed until the Banking Law is amended. We undertake to draft regulations that will incorporate the required amendments into the financial laws, in consultation with the banking sector and in accordance with the recommendations of Fund staff, by end-August 2009. We therefore request the amendment of the structural performance criterion (SPC) (paragraph 29 of the initial MEFP) regarding implementation of reserve requirements on bank deposits, as their implementation requires approval of the legal amendments to the financial laws, to be submitted to the National Assembly by end-December 2009. We commit to introduce reserve requirements on bank deposits, as defined in the original SPC, immediately after approval of the legal amendments. To improve the supervisory skills of the Central Bank of Djibouti (BCD), we intend to formulate by end-September 2009 an action plan, based on the recommendations of the recent Financial Sector Stability Assessment, to revise the Banking Law and the banking regulations to make them consistent with international best practices, create a BCD unit responsible for banking supervision, strengthen licensing requirements, gradually raise the capital adequacy ratio, and upgrade on- and off-site bank inspections. We consider these measures to be of high priority for addressing the new challenges arising from the rapid expansion of Djibouti's banking sector and therefore intend to implement this action plan upon its formulation. We have already conducted one full on-site bank inspection since the program was approved and expect to meet our commitment to double the required minimum capital of banks and carry out two additional on-site bank inspections. However, as this measure requires an amendment of the Banking Law, it will be incorporated into the legal reforms that are to be part of the above-mentioned action plan and submitted to the National Assembly by end-December 2009. The minimum capital requirement will thus be actually increased immediately after approval of the necessary legal amendments rather than by August 2009 as planned (paragraph 31 of the initial MEFP). We shall also place before the National Assembly by end-December 2009 the amendments recommended in the Financial Sector Assessment Program that are necessary to strengthen the legislation creating the currency board, especially by specifying the exact official exchange rate in the BCD Law and empowering a qualified majority of parliamentarians to change the exchange rate upon a proposal by the Council of Ministers and in exceptional circumstances.

15. As regards anti-money laundering (AML) efforts and combating the financing of terrorism (CFT), the need to ensure effective coordination across ministries has delayed progress toward a revised AML/CFT Law. We remain committed to implementing the recommendations of the IMF's Legal Department (LEG) and shall submit the AML/CFT Law to the National Assembly by end-December 2009, with a view to enforcing certain provisions as recommended by LEG. We also plan to strengthen BCD financial controls, following the recommendations of the Fund's safeguards assessment mission. In particular, we have already hired the external auditors for 2008, and, by end-June 2009, we shall adopt procedures for the selection of external auditors to ensure retention by the BCD of the services of an international audit firm to perform the annual audit of the accounts in accordance with the International Standards on Auditing. Furthermore, by end-September 2009 we shall appoint the next external auditors for 2009–11. Other measures to be taken by end-December 2009 include: (i) strengthening Board oversight by establishing a formal program of quarterly meetings, as required by the existing legislation; (ii) selecting a qualified person to fill the vacant Board position; and (iii) formulating a plan to establish an independent internal audit unit.

16. The need for urgent measures to improve Djibouti's competitiveness is underscored by the most recent estimates of the equilibrium real effective exchange rate, which show a moderate increase in the overvaluation of the Djibouti franc in 2008. With this in mind, we have signed an electricity exchange agreement with Ethiopia in the context of the "on-demand contract" procedure, under which the rates to be applied to electricity exchanges through the connecting line are to be set on the basis of the mutual interest of the parties. Also, we plan to initiate a study on how to reduce personnel costs at the EDD, as soon as we identify a financing partner, and, in any case, the study will be finished by end-September, 2009; we have strengthened coordination of the one-stop shop at the National Investment Promotion Agency (ANPI) with the MOF, through the formalization of periodic meetings as of December 2008. We remain committed to liberalization of the labor market, which is already well under way within the legal framework provided by the Labor Code. To facilitate orderly finalization of the collective bargaining process, we have extended the deadline by a year, to end-2009. Because of the delay in preparing the terms of reference, we have had to postpone to end-September 2009 finalization of the action plan for implementing the recommendations of the World Bank study on the strategy for reducing the technical losses of the National Water and Sanitation Office (ONEAD). We shall prepare an action plan by end-November 2009 for implementing the recommendations of the study financed by the World Bank on the causes of electricity distribution losses, which will be completed by end-August 2009. Consultants have already been hired to undertake the study.

17. We have implemented the recommendations made by the World Bank in the context of its technical assistance to strengthen the Office of the Inspector General of Finance (IGF), in particular to finalize the institutional restructuring, the procedures, and coordination with the other institutions well before the end-May 2009 deadline. We also drafted and submitted in November 2008 an annual program of audit commitment for 2009.

18. To improve the quality of our statistical system and obtain the tools necessary for effectively combating poverty, we launched the population census on February 28, 2009. The census will be completed in June 2009, a little later than initially projected because of technical and financial difficulties. The ensuing poverty and economic assessments will be completed by end-September 2009. We expect to prepare an annual progress report on implementation of the PRSP by end-September 2009, in the context of our domestic process of monitoring implementation of the poverty reduction strategy.

19. The government of Djibouti believes that the policies and measures set forth in this letter are adequate to achieve the objectives of its program. It stands ready to take any further steps that may prove necessary for this purpose. It will consult with Fund staff on the adoption of such measures and in advance of any revisions of the policies described in this letter, in accordance with the Fund's policies on such consultations.

20. Considering the performance achieved under the program and the progress and policies described in this letter, the government hereby asks the Executive Board of the International Monetary Fund to approve the first review of the PRGF arrangement and second the disbursement in the amount of SDR 1.476 million.

Sincerely yours,

/s/	/s/
Ali Farah Assoweh	Djama M. Haïd
Minister of Economy, Finance,	Governor
and Planning, Responsible for Privatization	Central Bank of Djibouti

Table 1. Djibouti: Performance Criteria and Indicative Targets, 2008–09

(In millions of Djibouti francs; unless otherwise indicated)

	2007	Cumulative Flows from Beginning of the Year (unless otherwise indicated)							
		2008				2009			
		Sept. 30		Dec. 31		Mar. 31	Jun. 30	Sept. 30	Dec. 31
	Dec. 31	Indicative Targets		Performance Criteria		Indicative	Performance	Indicative	Performance
	Estimate	Prog.	Act.	Prog.	Act.	Targets	Criteria	Targets	Criteria
Performance criteria and benchmarks									
I. Ceiling on accumulation of new domestic arrears (MEFP ¶18, ¶24, revised/supplementary MEFP ¶9, TMU ¶3, ¶50 and supplementary TMU ¶2) 1/ 2/	4 416	0	-244 3/	0	-26 3/	0	0	0	0
II. Ceiling on accumulation of new external arrears (MEFP ¶18, TMU ¶51) 4/ 5/	1 560	0	0	0	0	5/	0	0	0
III. Clear outstanding external arrears (MEFP ¶18, TMU ¶51)	6 220 6/			0	0				
IV. Ceiling on net credit to government from the banking system (MEFP ¶21, ¶24, TMU ¶52) 7/	113	0	-325	-500	-1 248	-100	-100	-300	-500
V. Ceiling on new medium- and long-term nonconcessional loans contracted or guaranteed by the government or by the CBD (MEFP ¶35, TMU ¶53) 2/	0	0	0	0	2 221 8/	0	0	0	0
VI. Floor on currency board cover (MEFP ¶12, ¶18, TMU ¶54) 2/ 9/	116	105	125	105	121	105	105	105	105
Quantitative benchmarks									
I. Ceiling on the wage bill (MEFP ¶13, ¶22, TMU ¶55) 10/	11 545	9 500	9 847	12 081	11 739	4 715	7 192	9 669	12 385
Memorandum items:									
External budgetary grants	0	500	711	1 673	9 733	…	…	…	2 978
External budgetary loans	0	500	0	2 090	173	…	…	…	0
Externally financed public investment	11 499	7 000	13 165	12 885	18 455	…	…	…	21 386

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

2/ Continuous performance criterion except for public sector salaries and pension fund payments, which are to be paid after a delay of one month (one quarter for pension fund contributions).

3/ Despite these negative figures, which show no breach but rather a gross repayment for end September and December, rudimentary treasury management tools led to new gross domestic arrear accumulations in October and November thus breaching the continous PC. However, on a net basis (i.e. including the repayment made to clear prior years' arrears) the breach would have been for September and October only since November and December registered net repayments. The full year ended with a large net repayment that brought total domestic arrears from 18.9 to 13.0 percent of GDP. See supplementary TMU ¶2.

4/ Includes arrears on direct and guaranteed debt.

5/ Arrears owed to the AfDB were accumulated for 9 days in the amount of SDR 597million in February 2009, and to the EIB for two months in the amount of SDR $79,764 million in February and March, 2009.

6/ Precondition for approval of arrangement.

7/ Excluding IMF and AMF counterpart funds and treasury bills that might be issued for liquidity management purposes.

8/ A nonconcessional loan in the amount of €8.5 was contracted in October 2008 from the OPEP Fund. It has a grace period of 3 years and an interest rate of libor plus 40 basis points.

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

10/ Excluding wages, housing subsidies, and other in-kind benefits of education and health employees.

Table 2. Djibouti: Status of Structural Reforms for the First Review, through end-February 2009

Measures	Date	Status
• VAT: Submit the draft VAT Law to the National Assembly, with a single general rate set at 7 percent and implementation to begin with the 2009 budget (MEFP ¶19).	Performance Criterion for end-November 2008	Observed, with a 15-day delay in the submission of the law to the National Assembly
• Competitiveness and private sector investment: Submit the new Commercial Code, prepared with the assistance of the European Union, to the National Assembly (MEFP ¶37).	Structural benchmark for end-November 2008	Not observed. (See Table 3's point 7.)
• Tax administration: Revise the Investment Code to streamline tax exemptions (duration of exemptions, list of tax benefits) and strengthen the procedures and resources for monitoring exempt projects (MEFP ¶20).	Structural benchmark for end-February 2009	Observed
• Transparency: Publish: (a) the audited accounts of the social security funds and of the principal public enterprises, within nine months of year-end; (b) the TOFE within 60 days of each month-end; and (c) preliminary year-end budget execution data, within five months of the end of the year (MEFP ¶25, TMU ¶57).	Continuous	Observed

Table 3. Djibouti: Structural Reforms for the Second Review through end-December 2009

Measures	Date	Status
1 • Strengthen Liquidity Management by: (a) preparing draft regulations that include the required modifications to financial laws, in consultation with the banking sector and in accordance with IMF staff recommendations approved). (MEFP ¶29).	Structural benchmark for end-August 2009	Technical assistance has been requested from IMF's MCM Department
(b) submitting revised versions of banking law and central bank law to the National Assembly to introduce required reserves (required reserves will be introduced once the legal revisions have been approved) .	Structural benchmark for end-December 2009	
2 • Strengthen the BCD's safeguards framework by: (a) adopting external auditor selection procedures to ensure that the Bank appoints international audit firms to conduct the annual external audits in accordance with International Standards on Auditing; and	Structural benchmark for end-June 2009	The external auditor has been appointed for 2008.
(b) appointing the external auditors for 2009–11.	Structural benchmark for end-September 2009	
3 • Budget and expenditure management by: (a) introducing a single Treasury account (MEFP ¶21, TMU ¶57) and, in addition, implementing additional measures as discussed in ¶5 of this LOI.	Structural benchmarks for end-May 2009.	The inventory of Treasury accounts in commercial banks has been completed and a joint committee of the Ministry of Finance and the BCD is currently working on transferring the balances to a single Treasury account at the BCD.
(b) modifying the accounting criteria in budget accounts to comply strictly with the definition of arrears in the IMF's 2001 GFSM (LOI ¶9)	Structural benchmark for end-December 2009	FAD's first TA mission took place in February 2008 and a follow-up and planning mission is scheduled for April 2008.
(c) introducing a mechanism to ensure that payment is made during the grace period by immediately reimbursing external debt loans endorsed by the Government if the borrowing enterprise has not settled its obligations during the week following the due date (LOI ¶7).	Continuous structural benchmark beginning on April 1, 2009	The Debt Department and the Treasury are currently implementing the mechanism.
4 • Banking supervision: Conduct full on-site inspections of at least three banking institutions (MEFP ¶31).	Structural benchmark for end-December 2009	An MCM expert has been budgeted for FY 2009. An on-site inspection took place end-February. Assistance from an MCM expert has been budgeted for FY 2 [sic].
5 • AML/CFT: Increase the staffing of the Financial Intelligence Unit (FIU), its resources, and its independence, to enable it to carry out its mission properly, taking account of the recommendations of the AML/CFT mission.	Structural benchmark for end-December 2009	Given that the 1999 UN agreement on the financing of terrorism has been ratified by Djibouti, the authorities have decided to adopt a specific CFT law. SRF's capacities were enhanced through a four-week training course in March 2009 on AML/CFT techniques.
6 • Competitiveness and energy cost: Produce a progress report and then a final report on the reorganization and adjustment of human resources to the EDD so as to reduce personnel costs, in accordance with the results of a study to be undertaken by an independent, specialized international firm regarding the size of the adjustment, with early retirement plans and redeployment of redundant staff in other departments that require additional staff. The report and recommendations will be ready by end-December 2009 and a progress report on the study will be prepared by end-September 2009 (MEFP ¶38).	Structural benchmark for end-December 2009	The procurement process for the study will begin as soon as the financial resources have been identified.
7 • Competitiveness and private sector investment: Submit the new Commercial Code, prepared with the assistance of the European Union, to the National Assembly (MEFP ¶37).	Structural benchmark for end-June 2009	The new Commercial Code is prepared, but submission to the National Assembly has been delayed due to its bundling with the Intellectual Property and Competition Laws. Moreover, a period of time has been dedicated for consultation with the private sector.
8 • National accounts: Conduct a survey of economic activities--with a view to including its results in the estimates of the national accounts, with the support of our development partners (MEFP ¶42).	Structural benchmark for end-September 2009	The full population census was launched on February 28, 2009. The date for its finalization is expected to be at the end of June 2009; the survey of poverty and economic activities will be ready before end-September 2009.

APPENDIX II

SUPPLEMENTARY TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This attachment contains the changes to the definitions of quantitative performance criteria and benchmarks agreed during the first review of the program supported by the Poverty Reduction and Growth Facility (PRGF), reflected in Tables 1 and 2 of the revised Letter of Intent (LOI)/Memorandum on Economic and Financial Policies (MEFP); and to the scope and frequency of data to be provided for program monitoring purposes. Except for the changes included in this supplementary Technical Memorandum of Understanding (TMU), all other definitions in the previous TMU remain applicable.

PERFORMANCE CRITERION

2. Domestic arrears' original definition (¶3 TMU) should continue to apply to all payments falling due (principal or interest) on the domestic debt or on obligations contracted or guaranteed by the central government or the BCD, with the exceptions of salaries and wages to public sector employees and the contributions to pension funds of public employees. For salaries and wages to public sector employees, the ceiling on flow accumulation of new domestic arrears would be considered met if the current practice of delaying monthly payments by one month is continued for each month alone (paid in full for each month). For the government's contributions to pension funds for its public employees, the ceiling should be met with a delay no longer than one quarter (paid in full for each quarter).

REPORTING OBLIGATIONS

3. In addition of the provisions of ¶21 of the original TMU, the authorities will provide the IMF with domestic arrears data related to the current month reported as monthly flows of new accumulations for all categories, including public sector employees' salaries and wages and pension contributions, as a memorandum item to the table of fiscal operations (TOFE).

Statement by the IMF Staff Representative on Djibouti

Executive Board Meeting for the First Review Under PRGF Arrangement

June 17, 2009

1. This statement provides additional information that became available after the staff report for the first review under PRGF arrangement with Djibouti (EBS/09/72, 5/19/09) was circulated to Executive Directors. The new information does not alter the thrust of the staff appraisal.

2. **Recent performance suggests that Djibouti is on track to meet the program's continuous quantitative performance criteria (QPC) and structural benchmarks (SB) through end-March**, with the exception of the ceiling on domestic arrears. Based on preliminary information, program performance is broadly in line with all the other fiscal, monetary and external sector quantitative targets. The SB on the introduction of a single treasury account was implemented by end-May, 2009, as agreed, and the authorities have confirmed that all external debt repayments vis-à-vis multilateral creditors have been made on time and that no new accumulation of external arrears has occurred. Bilateral agreements to implement the Paris Club debt rescheduling agreement of October 2008 have been concluded with some creditors and are being negotiated with the rest. The authorities continue to seek comparable treatment by non-Paris Club creditors. In this regard, negotiations with Saudi Arabia are well advanced.

3. **End-April monetary data are broadly consistent with program projections**. Inflation continued its downward trend, reaching 3.5 percent year-on-year. Official reserves have increased to $187 million, equivalent to a currency board cover of 127 percent and 2.6 months of prospective imports. Private sector credit growth decelerated but remains strong at 23 percent year-on-year.

4. **Budget execution data up to end-March 2009 are also broadly in line with projections.** The revenue performance was on target, but indirect taxation was weaker than projected on account of softening economic activity, lower import commodity prices, and low efficiency of the recently introduced VAT. Direct taxes, grants, and leasing fees from the foreign military bases held up well, and nontax domestic revenues were stronger than programmed. Total expenditure was in line with program projections, mainly due to the containment of wages, outlays on goods and services, and investment spending. Overall, the fiscal stance tightened in the first quarter of 2009 vis-à-vis the same period of 2008, with an overall fiscal deficit (including grants) of 0.9 percent of GDP, compared with 1.3 percent in the first quarter of 2008. The deficit was largely financed by concessional external borrowing.

Djibouti: Summary of Central Government Fiscal Operations, 2008–09
(In percent of GDP)

	2008		2009		
	Est.	Q1	EBS/08/105	Prog.	Q1
Revenues and grants	42.3	8.3	34.8	36.0	8.6
Tax revenue	20.2	6.0	18.6	19.4	4.9
Direct taxes	9.1	2.0	8.2	8.4	1.8
Indirect and other taxes	11.2	3.0	10.4	11.0	1.8
Nontax domestic revenues	2.7	0.4	2.1	3.7	0.8
Nontax external revenues 1/	6.1	0.8	5.8	5.6	0.9
Grants	13.2	1.1	8.3	7.4	1.9
Total expenditure	41.0	9.6	36.6	37.8	9.5
Current expenditure	27.0	6.6	24.4	23.1	5.2
Of which:					
Wages and related expenditure	12.8	3.5	10.9	12.4	3.4
Goods and services	9.5	2.1	6.0	6.0	1.0
Investment expenditure	14.0	3.0	12.3	14.7	4.3
Overall balance (commitment basis, including grants)	1.3	-1.3	-1.8	-1.8	-0.9
Change in arrears (cash payments = -)	-3.3	-0.7	-1.3	-1.3	-0.3
Overall balance (cash basis)	-2.0	-2.0	-3.1	-3.1	-1.2

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

1/ Annual leasing fees from French (€30 million) and US ($30 million) military bases.

Press Release No. 09/216
FOR IMMEDIATE RELEASE
June 17, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes the First Review of Djibouti's PRGF and Approves US$ 2.3 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) completed today the first review under the three-year Poverty Reduction and Growth Facility (PRGF) arrangement with Djibouti (see Press Release 08/211). The completion of the review enables the immediate disbursement of SDR 1.476 million (about US$ 2.3 million), bringing the total amount disbursed under the program to SDR 5.34 million (US$ 8.2 million).

The Board also approved the authorities' request for four waivers of nonobservance of performance criteria, and modification of performance criteria. The waivers were approved because the non-observance was minor (for the delay in the submission of the VAT law), temporary (for the accumulation of external arrears), and on the grounds of implemented corrective actions. These include the implementation of a single treasury account and the strengthening of administrative procedures to avoid an accumulation of new arrears to domestic public and private providers (for the accumulation of domestic arrears), and preventive measures to reduce the vulnerability of electricity supply, including by strengthening the financial position of the electricity company through reducing public arrears.

Following the Executive Board discussion, Mr. Murilo Portugal, Deputy Managing Director and Acting Chairman, stated:

"The implementation of the main monetary and fiscal measures envisaged under the PRGF-supported program has helped Djibouti sustain high economic growth and bring down inflation to single digits. Nevertheless, program implementation has been hampered by, among other things, weaknesses in administrative capacity, and the authorities are giving high priority to addressing such weaknesses.

"Adherence to the program's medium-term macroeconomic policies will be crucial. Observance of the fiscal consolidation path is particularly important. In order to strengthen Djibouti's fiscal and debt sustainability, additional revenue and expenditure measures are being implemented in 2009. The introduction of a value added tax, the broadening of income taxation, the suspension of patent exemptions for foreign direct investment, and an increase in non-tax revenues related to the resumption of fees on imported oil will contribute to strengthen the country's revenue performance.

"The main expenditure measures—a freeze on public sector salaries and recruitment, except in health and education, and reinforced control of nonessential current expenditure—are necessary to achieve the necessary fiscal consolidation, while allowing for an increase in poverty-related spending. Every effort should also be made to improve the terms of the country's financing, including by concluding bilateral agreements with Paris Club and non-Paris club creditors, seeking highly concessional assistance, and strengthening current debt management practices.

"Financial stability will be further strengthened with the help of IMF technical assistance. The central bank plans to upgrade its banking supervision and crisis prevention capacity. Accelerating the implementation of structural reforms to lower production costs, strengthen public utilities, and improve the investment climate is also crucial to enhance Djibouti's competitiveness and reduce external vulnerabilities," Mr. Portugal said.

Statement by Laurean Rutayisire, Executive Director for Djibouti
June 17, 2009

I – Introduction

I would like to thank Management and Staff for the constructive policy dialogue held with my Djiboutian authorities within the context of the current review under the PRGF arrangement.

My Djiboutian authorities' program performances have been broadly in line with the set program criteria albeit temporary deviations. The net repayment of domestic arrears, the settlement of all external payment arrears, the accumulation of government deposits, the ceiling of non social wage bill, the currency board coverage at 121 percent and the accumulation of official reserves were all met. On the structural reform front, the Investment Code was revised before the agreed date in order to streamline tax exemptions and strengthen the procedure to monitor exempted projects. The audited accounts of the social security fund, the main public enterprises and fiscal operations of the state (TOFE) were published on the website of the Ministry of Economy, Finance and Planning.

Due to institutional and human capacity constrains, the performance criteria on external arrears, domestic arrears, nonconcessional borrowing and the submission of VAT law to the National Assembly were temporary missed. However, remedial measures have been put in place. Accordingly, my Djiboutian authorities request waivers for nonobservance of these performance criteria as well as the modification of the performance criteria on domestic arrears.

My Djiboutian authorities are fully aware of the challenges ahead notably the need to widen the base for sustained growth and poverty reduction. Policies laid out in their MEFP for the rest of 2009 and the PRGF program are designed to address these challenges.

II – 2009 Program Policies and Objectives

My Djiboutian authorities are strongly committed to consolidate progress made under the PRGF-supported program and speed up structural reforms in order to sustain economic growth, improve competitiveness, create jobs and reduce poverty.

In the fiscal sector, the authorities' efforts to further improve fiscal management will be intensified. Fiscal policy will continue to aim at a gradual narrowing of the overall deficit, on a commitment basis. For 2009, an overall deficit of about 1.8 percent of GDP is projected and the authorities remain committed to take needed actions to achieve a balanced fiscal position by 2011. To this end, additional measures to reduce non-social current expenditure including the wage bill will be identified and implemented. Control of current expenditure through freezing recruitment in the public sector, except for health, education and tax administration will be enhanced. In their efforts to fight poverty, the authorities remain also committed to increase social expenditures at about 10.6 percent of GDP. The reduction of the stock of domestic arrears in line with the program's target will be pursued. To avoid any further accumulation of new domestic arrears, the principles governing the budgetary accounts will be amended including a strict compliance with the definition of arrears in the IMF's Government Finance Statistics Manual of 2001. To this end, FAD technical assistance will be requested. On the revenue side, the introduction of the VAT, VAT enforcement in the free trade zone, and the amended investment code will help enlarge the revenue base and streamline the exemptions. Efforts to establish a single treasury account have also been intensified and a new treasury management was set up.

As regards monetary and financial polices, the authorities will continue containing inflation, increasing the level of international reserves to sustain the currency board arrangement and further improving financial intermediation. In this context, efforts to strengthen liquidity management will be accelerated with the establishment of reserves requirements for which Fund technical assistance has been requested. In order to create conducive environment for the implementation of reserves requirements, the banking law will be amended in consultation with the banking sector and Fund staff by end-August and presented to the National Assembly by end-December 2009. Therefore, the authorities have requested the amendment of this structural performance criterion to allow the legal process to be fully implemented. Based on the recommendations of the recent Financial Sector Stability Assessment, the authorities will formulate by end-September 2009 an action plan to revise the Banking Law and the banking regulations to make them consistent with international best practices, create an unit with the central bank fully devoted to banking supervision, strengthen licensing requirement, gradually raise the capital adequacy ratio, and upgrade bank inspections. The authorities plan also to increase the minimum capital requirement and introduce the needed amendments in their efforts to further strengthen the legislation creating the currency board. As regards anti-money laundering, the AML/CFT law incorporating recommendations made by the Fund's Legal Department will be submitted to the national Assembly by end-December 2009.

On structural reforms and competitiveness, the authorities are strongly committed to sustaining the implementation of their reform agenda. Efforts to further improve the environment for more FDI and sustain competitiveness will be accelerated. In regard to the electricity supply and the need to reduce its costs, an agreement to connect Djibouti's electricity grid to Ethiopia's grid has been signed. A nonconcessional loan to supplement the 2006 concessional loan was contracted with the OPEC Fund to purchase machinery critical to the production of electricity in order to avoid economic disruption in Djibouti. With the support of the World Bank, a study aiming at the reduction of personnel at the *Electricité de Djibouti* (EDD) will be conducted and finalized by end-September 2009. Efforts to strengthen the coordination of the national investment promotion agency with the Ministry of Finance are also underway. The authorities remain committed to liberalize the labor market. In order to fully implement the *Initiative Nationale pour le Développement Social* (INDS), a population census was launched last February and the ensuing poverty and economic assessments will be completed by next September. The authorities plan to prepare an annual progress report on their PRGF implementation by end-September 2009.

In order to further enhance the monitoring of the program and ensure the coordination, the authorities will establish a high level committee to review implementation of program measures including the payment of domestic and external debt. The authorities are also mindful on the need to further improve the quality of statistical data for the monitoring of the program.

On Debt Sustainability and Debt Management, the authorities have reached agreement with Paris Club creditors to reschedule Djibouti's external debt under Houston terms. Negotiations with non Paris Club bilateral creditors will continue. The authorities intend to organize a donors' conference to mobilize highly concessional financing for the poverty reduction strategy. The authorities will also request technical assistance from the Fund to improve current debt management practices.

III - Conclusion

My Djiboutian authorities remain strongly determined to pursue implementing prudent macroeconomic policies and structural reforms under the PRGF arrangement. In this context, they will continue working with the Fund and other development partners. I will appreciate Board approval of my authorities' completion of the first review under the PRGF-supported program, waivers of temporary non observance of performance criteria and modification of performance criteria.