Last updated on April 3, 2013

DJIBOUTI—PROGRAM NOTE

Most recent IMF-Supported Program: Forty five-month US$20 million arrangement under the Extended Credit Facility (ECF) approved by the IMF's Executive Board on September 18, 2008. The Executive Board approved an augmentation of access of US$15 million (60 percent of quota) during the fifth review of the program on February 6, 2012. The sixth and final review of the program was completed on May 23, 2012.

Recent Developments

During the past several years, Djibouti has undergone a substantial transformation driven by a surge in foreign direct investment (FDI)—mainly from the Gulf Cooperation Council countries—at the country's two ports and in the construction and tourism sectors. However, being capital-intensive, the large investment in these sectors has not culminated in a reduction in poverty and unemployment. Moreover, extensive tax exemptions granted to FDI projects have undermined government revenue mobilization efforts.

Economic activity expanded in 2012. Real GDP growth rose from 4.5 percent in 2011 to 4.8 percent in 2012, driven by port activity, transit trade with Ethiopia, transshipment and construction activities. Some of these activities benefited from large FDI inflows. Inflation declined from 5.1 percent in 2011 to 3.7 percent in 2012, thanks to a stabilization of international food prices, and a welcome decline in electricity tariffs for low-threshold consumers, following the completion of the interconnection with the Ethiopian electricity grid. The current account deficit deteriorated from 12.6 percent of GDP in 2011 to 13.4 percent of GDP in 2011. Djibouti's economic outlook for 2013 is relatively favorable. Real GDP is expected to grow at a rate of about 5 percent, buoyed by port activity, trade with Ethiopia, construction, and FDI.

The Role of the IMF

The IMF has supported Djibouti's efforts to improve macroeconomic stability and growth since the mid–1990s. The most recent ECF arrangement was approved in September 2008 for 80 percent of quota, or SDR 12.72 million (about US$20 million), in support of Djibouti's poverty reduction strategy launched in January 2007. An augmentation of 60 percent of quota was approved during the fifth review of the program in February 2012 to meet the projected shortfall in external financing due to the drought in the Horn of Africa and the increase in global commodity prices. The ECF-supported program aimed at addressing poverty and growing social imbalances through enhanced macroeconomic stability and improved economic management. To complement the program, the IMF, together with other development partners, provided technical assistance in the areas of tax policy (value added tax), expenditure policy (subsidy reform), public financial management (medium-term budgetary framework and accounting classification), and monetary and financial sector development (banking supervision and regulation).

Performance under the Program

The program was extended to June 2012 to allow for a full disbursement of the credit line due to a delay in program implementation caused by a large fiscal slippage and the accumulation of arrears in 2009 driven by spending related to social and security pressures. The sixth and final review was therefore completed in May 2012. The authorities' short-term challenge continues to be maintaining price stability and budget discipline, despite increased spending pressures related to higher oil and food prices. The 2012 budget recorded a deficit of about 2.7 percent of GDP due to weak tax collection efforts, and higher expenditures linked to the February 2013 legislative elections. Improving the economy's competitiveness to promote private-sector development and foreign investment was a key objective of the program. To this end, the program supported the deepening of structural reforms, particularly measures to reduce energy costs, increasing the supply of water and lowering its cost, restructuring public enterprises, and expanding citizens' access to public services.The authorities have requested a new ECF arrangement.

Medium-Term Challenges

To tackle deep economic disparities, spread the benefits of growth among the population at large, and address the high unemployment currently estimated at about 50 percent, Djibouti should follow a multi-pronged strategy:

- To create room for much-needed social and development spending, and maintain macroeconomic stability (in the context of a currency board), the aim should be fiscal consolidation through an expansion of the revenue base and containment of current spending while protecting social expenditure and reducing domestic arrears. Bank financing of the budget deficit should be avoided to contain inflation and support competitiveness.

- Balance of payments sustainability must be supported by improving debt-management capacity and securing external financing on concessional terms.

- Reforms to strengthen financial sector soundness should focus on implementing the recommendations of the 2008 Financial Sector Assessment Program, including improving bank supervision and regulation, as well as enforcing the updated Anti-Money Laundering–Combating the Financing of Terrorism legislation.

- Structural reform, especially in the energy sector and the business environment, should be pursued to improve competitiveness and achieve broad-based growth.