

DJIBOUTI—PROGRAM NOTE

Current IMF-Supported Program: Forty five-month US\$20 million arrangement under the Poverty Reduction and Growth Facility—now renamed the Extended Credit Facility (ECF), approved by the IMF’s Executive Board on September 18, 2008. The Executive Board approved the fifth review of the program and an augmentation of access of US\$15 million (60 percent of quota) on February 6, 2012. The sixth and final review of the program is tentatively scheduled for 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, the large investment in these sectors has not culminated in a reduction in poverty and unemployment because the investment has been capital intensive. Furthermore, extensive tax exemptions granted to FDI projects have undermined government revenue mobilization efforts.

The macroeconomic environment remained mixed in 2011. Real GDP growth rose from 3.5 percent in 2010 to 4.5 percent in 2011, thanks to the recovery of transshipment activity and transit trade with Ethiopia. Inflation, which stood at 4 percent in 2010, increased to roughly 5 percent in 2011, driven by the rebound in international food and commodity prices. The current account deficit deteriorated from 5.8 percent of GDP in 2010 to 12.6 percent of GDP in 2011. Djibouti’s economic outlook for 2012 is relatively favorable. Real GDP is expected to grow at a rate of about 4.8 percent, buoyed by port activity, trade with Ethiopia, construction, and FDI. The interconnection with the Ethiopian electricity grid was completed in 2011, resulting in a reduction in tariffs for low-income consumers.

The Role of the IMF

The IMF has supported Djibouti’s efforts to improve macroeconomic stability and growth since the mid-1990s. The latest 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 Horn of Africa drought and the increase in global commodity prices. The ECF-supported program aims to address poverty and growing social imbalances through enhanced macroeconomic stability and improved economic management. To complement the program, the IMF, together with other development partners, has been providing 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 first review of the program was concluded in June 2009. The second and third reviews were completed in January 2011, after a significant delay caused by a large fiscal slippage and the accumulation of arrears in 2009 driven by spending related to social and security pressures. The fourth review was completed in July 2011, and the fifth review in February 2012. The program was extended to June 2012 to allow for a full disbursement of the credit line. The short-term challenge continues to be maintaining price stability and budget discipline, despite increased spending pressures relating to higher oil and food prices. The 2012 budget envisages a surplus of about 0.5 percent of GDP, reflecting a strengthening of tax revenue and tight control of expenditure. In 2012, the program also focuses on the reduction of outstanding domestic arrears and the avoidance of new arrears through increased spending controls; increased budget transparency and sound fiscal management, particularly in regard to subsidies; and strengthened bank supervision and financial sector development, including access to financial services. Improving the economy's competitiveness to promote private-sector development and foreign investment remains a key objective of the program. To this end, the program envisages 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.

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 60 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 (AML–CFT) legislation.
- Structural reform, especially in the energy sector and business environment, should be pursued to improve competitiveness and achieve broad-based growth.