DJIBOUTI

Economic growth remains strong in 2017, fueled mainly by construction and rising transit trade and transshipment for Ethiopia with improved port and transport infrastructure. Although fiscal and external positions are improving gradually, debt and fiscal sustainability risks remain. With more than a fifth living in extreme poverty and nearly 40 percent of the labor force unemployed, reforms to make growth more inclusive, with increased job creation and improved productivity and human capital will be critical.

Recent developments

GDP growth is projected at 7.1 percent in 2017 reflecting an acceleration from the estimated 6.5 percent in 2016. Growth is mainly driven by construction and rising transit trade and transshipment for Ethiopia with improved port and transport infrastructure. Inflation is expected to remain at 3.5 percent, driven mainly by demand for housing and services. The latest official unemployment rates show weak links between growth and employment generation: the rate was 39 percent in 2015, with women (49 percent) and rural areas (59 percent) showing higher rates. Meanwhile, the labor force participation rate is less than 25 percent.

The fiscal deficit is projected to significantly narrow to 3.8 percent of GDP in 2017, from an estimated 15.2 percent in 2016, given that mega-infrastructure projects for port development and railways construction, which triggered large capital expenditure, have ended. The external deficit is also projected to improve to 15.4 percent of GDP in 2017 from 22.2 percent in 2016, as capital imports wind down. FDI is expected to rise to 10.8 percent of GDP in 2017 from 9.1 percent in 2016, stimulated by ongoing US$4 billion gas pipeline construction between Ethiopia and Djibouti, due for completion in 2019, industrial development in the new free zone in Djibouti City, operations of the newly constructed Djibouti-Addis railway, and the construction of the "Hassan Gouled Aptidon International Airport", 25 km south-west of Djibouti City, expected for completion in 2018.

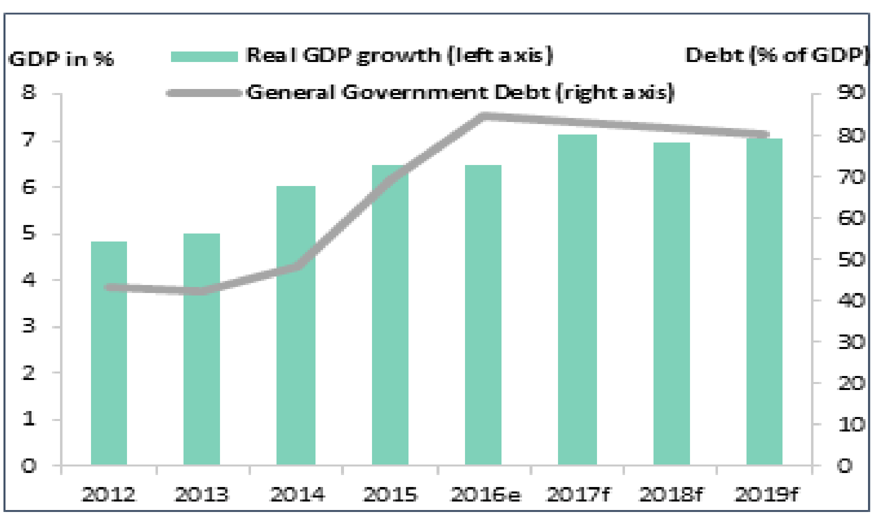
Foreign exchange reserves are projected to remain sufficient for coverage of broad money and currency board at 3.4 months of imports. The Real Effective Exchange Rate is expected to further appreciate, reflecting the combined effects of the supply side constraints and the relatively high consumer prices. The banking sector remains weak with deteriorating loan portfolio of commercial banks and rising nonperforming loans (NPLs). The ratio of NPLs to total loans increased from 14 percent in 2013 to 23 percent in 2016. The authorities attribute this increase to the introduction of stricter loan classification requirements.

Monitoring of welfare and poverty in the country has been somewhat limited. The statistical office has conducted one household survey on living conditions in the last ten years, but failed to incorporate households from the nomadic population—a group highly vulnerable to drought—that represented 20 percent of the population in 2009.

Outlook

The medium-term outlook remains favorable with the expectation that debt-financed mega-infrastructures are efficiently managed to generate sufficient revenues for debt servicing. The fiscal deficit is projected to gradually improve, narrowing to low single digits in 2017-19. This would materialize with rationaliza-

FIGURE 1 Djibouti / Growth and public debt



Sources: World Bank staff estimates.

tion of expenditures and effective implementation of tax reform to enlarge the tax base and increase revenues from activities generated by megaprojects. The current account deficit is projected to decline to 12.3 percent of GDP by 2018 and further down to 10.2 percent in 2019, with a gradual pick up in exports growth over imports. FDI inflows and capital transfers should continue to finance the deficit. Reserves are expected to sustain the peg of the Djibouti Franc to the US Dollar at 177.72. Inflation is projected to remain at 3.5 percent in 2017-18, furthering pressure on competitiveness.

With infrastructure-led growth and corresponding demand for foreign labor, megaprojects on their own are not likely to have a significant positive spillover on job creation and poverty reduction. Stronger monitoring of welfare is expected in the future as a new National Strategy for Development of Statistics is being developed, and the first results of a nationally representative household consumption survey are expected to be available in the Fall of 2017.

Risks and challenges

Economic diversification for job creation, strengthening institutional capacity for macroeconomic management and better quality of public services delivery, and governance system reform to improve accountability, rule of law, government effectiveness and citizens' engagement remain the top challenges of the Government. Addressing these challenges remain imperative to solve the country's entrenched issues of poverty, unemployment, and low human capital quality, and to put the macro fundamentals on a sustainable path. Macroeconomic stability remains subject to high risks, including debt distress and vulnerability to trade and finance shocks. Social discontent over growing poverty, unemployment and inequality as well as regional instability and acute climate challenges pose additional risks to the growth prospects.

TABLE 2 **Djibouti** / Macro outlook indicators (annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	6.0	6.5	6.5	7.1	7.0	7.0
Private Consumption	6.4	7.1	6.0	7.8	7.7	7.9
Government Consumption	1.6	5.7	5.8	6.5	2.3	1.7
Gross Fixed Capital Investment	19.3	32.9	-24.2	-9.3	-0.4	0.5
Exports, Goods and Services	5.4	17.6	4.5	6.5	8.0	8.1
Imports, Goods and Services	11.9	28.9	-5.0	-2.0	2.3	3.0
Real GDP growth, at constant factor prices	6.4	6.5	6.5	7.1	7.0	7.0
Agriculture	3.0	3.0	2.1	2.5	3.0	3.0
Industry	5.4	5.4	5.5	5.8	6.0	6.1
Services	6.8	6.9	6.9	7.6	7.4	7.4
Inflation (Consumer Price Index)	2.9	2.2	3.5	3.5	3.5	3.1
Current Account Balance (% of GDP)	-25.2	-30.4	-22.2	-15.4	-12.3	-10.2
Fiscal Balance (% of GDP)	-10.7	-20.7	-15.2	-3.8	-2.6	-1.4
Debt (% of GDP)	48.5	69.4	84.8	83.4	81.9	80.5
Primary Balance (% of GDP)	-10.4	-19.1	-13.4	-1.7	-0.4	0.9

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: e = estimate, f = forecast.