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EXECUTIVE SUMMARY ECONOMIC LETTER OF EAST AFRICA AND THE INDIAN OCEAN (EAIO)

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Public debt in EAIO

Key facts

- **Public debt in EAIO countries has followed an upward – albeit erratic – trajectory since 2012**, rising from 34.0% to 51.5% of GDP between 2012 and 2024. Sudan, in a context of severe currency depreciation, and Rwanda, which has heavily invested in public infrastructure, have recorded the sharpest increases. Conversely, Somalia's debt has been significantly reduced following the country's attainment of the Completion Point under the Heavily Indebted Poor Countries (HIPC) Initiative.
- **Debt in the region is predominantly external**, accounting for 65.8% of total public debt in 2023. External debt is largely concessional for countries such as Rwanda and Madagascar, while others – such as Djibouti – rely on non-concessional financing.
- **China has emerged as the region's leading bilateral creditor**, primarily funding infrastructure projects, particularly in the transport sector. By contrast, the share of Paris Club creditors has declined significantly.
- **Numerous challenges remain to ensure debt sustainability in the region**, especially for countries like Djibouti and Ethiopia, whose debt is considered unsustainable, while Seychelles and Tanzania face a moderate risk of debt distress.

In summary...

Public debt in the East African and the Indian Ocean region

The level of public debt in the countries of East Africa and the Indian Ocean (EAIO) remains relatively contained (51.5% of GDP in 2024 – excluding Eritrea, Somalia, and Sudan – compared to 61.0% in Sub-Saharan Africa). **)** *Nevertheless, debt levels have risen sharply since 2011 (34.7% of GDP), driven by substantial infrastructure investments, successive crises (health, geopolitical, climate-related), and rising borrowing costs. Rwanda, Kenya, and Djibouti stand out with higher debt levels, exceeding 65% of GDP. Overall, EAIO countries share certain common vulnerabilities (exposure to external shocks, low domestic revenue mobilization), but also present significant disparities in debt structures and access to financing. For instance, while domestic debt is well developed*

in Kenya, Ethiopia, and Uganda, it remains very limited – or even non-existent – in Djibouti, Rwanda, South Sudan, or Somalia. Moreover, the composition of external debt is heterogeneous: multilateral creditors hold the bulk of it in Madagascar, Rwanda, Uganda, and Tanzania, whereas bilateral lenders dominate in Somalia, Djibouti, and the Comoros. China is by far the leading bilateral lender in the region, particularly in Djibouti, Uganda, the Comoros, Kenya, and Ethiopia. Finally, debt sustainability levels vary widely across countries: while Seychelles and Tanzania face moderate debt distress risk, Ethiopia and Djibouti are assessed by the IMF to have unsustainable debt levels. In this context, most countries in the region are engaged in fiscal consolidation processes, which weigh on economic activity.

In detail…

Public debt in EAIO countries has followed an upward – though erratic – trajectory since 2012, rising from 34.0% to 51.5% of GDP between 2012 and 2024. This dynamic reflects the accumulation of primary deficits due to successive shocks affecting the region (COVID-19, the war in Ukraine, political instability), which is also highly exposed to climate hazards. Some countries in the region have experienced particularly sharp changes in public debt levels. Sudan (+180.5 percentage points of GDP), in a context of severe currency depreciation, and Rwanda (+44.7 pts since 2011), due to large-scale public infrastructure investments, recorded the highest increases. Conversely, Somalia's debt decreased by -101.8 pts since 2019, after reaching the Completion Point of the HIPC Initiative (see box below).

Box: The Heavily Indebted Poor Countries (HIPC) Initiative

The HIPC Initiative, launched in 1996 under the aegis of the IMF and the World Bank, was created to provide deep debt relief to poor and heavily indebted countries from the international financial community (IFIs, bilateral official creditors, and private lenders). It was designed as a comprehensive solution to repeated debt crises affecting these countries. Today, the initiative is nearing completion: only two countries – both in EAIO, Eritrea and Sudan – out of the 39 originally eligible, can still benefit from the mechanism.

The initiative consists of two main stages:

1. **The Decision Point**, for which a country must meet four conditions: (i) be eligible for concessional assistance from the International Development Association (IDA) and the IMF's Poverty Reduction and Growth Trust (PRGT); (ii) face an unsustainable debt situation that cannot be resolved through traditional debt relief mechanisms; (iii) have implemented sound reform programs supported by the IMF and the World Bank; and (iv) have prepared a Poverty Reduction Strategy Paper (PRSP) through a participatory process.

2. **The Completion Point**, which unlocks full debt relief under the initiative, once the country has: (i) maintained strong performance under IMF and World Bank-supported programs; (ii) satisfactorily implemented key reforms agreed at the Decision Point; and (iii) adopted and implemented its poverty reduction strategy for at least one year.

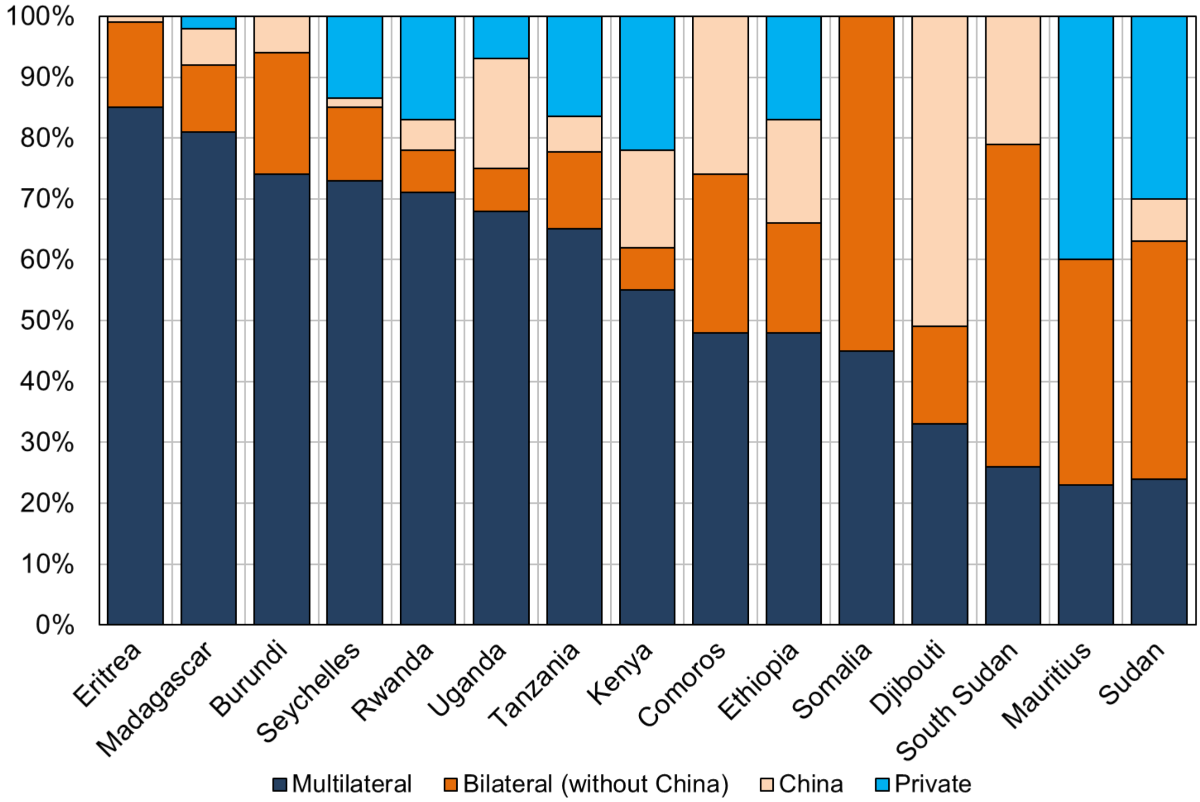
While Sudan reached its Decision Point in June 2021, Somalia was the most recent EAIO country to reach its Completion Point in December 2023. Eritrea, though eligible, has yet to initiate the process.

Public debt in the EAIO region is predominantly external, accounting for 65.8% of total debt in 2023. This debt is mainly concessional in countries like Rwanda and Madagascar, whereas others – such as Djibouti, whose debt is entirely external – rely on non-concessional financing, characterized by higher interest rates and shorter maturities, which increase their vulnerability and exposure to debt distress.

- **Multilateral creditors account for nearly half of this external debt (51.8% in 2023)**, enabling many countries in the region to benefit from highly favorable terms. The World Bank remains a major actor in the region, alongside the IMF, which is engaged through its ECF, EFF, RCF, and RSF programs (see glossary) in nine countries (Burundi, Comoros, Ethiopia, Kenya, Madagascar, Uganda, Rwanda, Seychelles, and Tanzania).
- **Bilateral creditors, particularly China, hold a significant share of external debt (33.4% in 2023).** While the Paris Club's share has been declining, China has become the region's top bilateral creditor, primarily funding infrastructure projects, especially in the transport sector. For example, it financed Kenya's Standard Gauge Railway (SGR), linking the capital Nairobi to the port city of Mombasa. However, bilateral loans often come with less concessional terms than multilateral ones, involving higher interest rates and shorter maturities. This has led to a higher debt service burden, worsening debt sustainability in several countries across the region.
- **Private creditors represent a smaller share of external debt (14.1% in 2023).** This category is primarily composed of sovereign bondholders (Eurobonds) and commercial banks, which are often associated with more stringent financing terms.

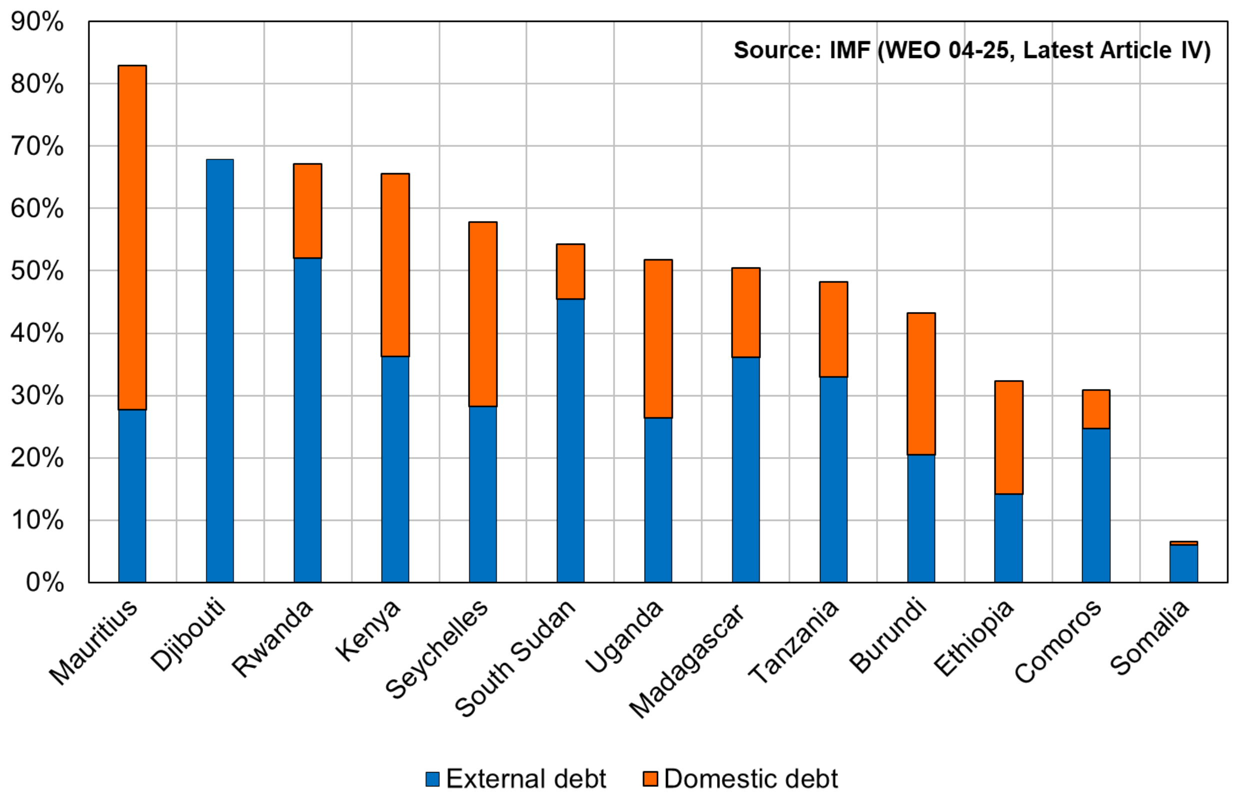
Figure: External debt composition in EAIO

- 2023, in % of total -



In contrast, domestic debt is less developed in the region, accounting for only 34.2% of total public debt. Eritrea stands out as an exception, with 80% of its debt denominated in local currency, mainly due to international sanctions and restricted access to external markets. To a lesser extent, Uganda, Kenya, and Ethiopia also distinguish themselves by the relative development of their domestic debt markets. However, such financing often remains more expensive due to higher interest rates and underdeveloped financial markets across the region. For instance, in Kenya, 10-year sovereign bond yields averaged 13.5% in 2024, peaking as high as 18.6% in March.

Figure: Public debt composition in EAIO
- 2023, in % GDP –



Rising debt levels, combined with increasing debt service costs, have weakened public debt sustainability in the region, prompting the IMF to classify the debt of Djibouti and Ethiopia as unsustainable. In response, several countries – including Rwanda, Kenya, Ethiopia, and Tanzania – have launched fiscal consolidation processes aimed at increasing domestic revenue mobilization and improving control over public expenditure. These efforts have led to a gradual reduction in fiscal deficits, which fell from a peak of -6.2% of GDP in 2020 during the COVID-19 crisis to -3.6% of GDP in 2024.However, the gap with the primary deficit (which stood at -1.6% of GDP in 2024) highlights the significant weight of interest payments in national budgets across the region – particularly in Uganda, Ethiopia, and Kenya.

Over the medium term, public debt levels are projected to decline across the region, reaching 47.4% of GDP by 2029 according to the IMF. This expected decline is largely driven by ongoing IMF- supported programs in nine countries of the region (see above), with particularly large reductions anticipated for Seychelles (-10.3 percentage points between 2024 and 2029) and Burundi (-7.2 points). Nonetheless, this trajectory remains constrained by deep structural challenges. Extremely high informality – estimated at around 80% of employment in the region (excluding Seychelles and Mauritius) – severely limits governments' ability to broaden the tax base. At the same time, social and security-related expenditures remain high and difficult to curtail. These challenges are compounded by persistent corruption and strong exposure to climate shocks, generating additional public spending needs – both for adaptation and mitigation. In this context, dependence on external financing increases the vulnerability of countries in the region. Currency depreciations significantly raise the burden of public debt when the latter is mostly external, thereby exacerbating fiscal pressures. Agriculture, a cornerstone of EAIO economies, remains highly vulnerable to both climate and geopolitical shocks. As a result, the IMF recommends economic diversification, particularly toward sectors less exposed to external shocks.