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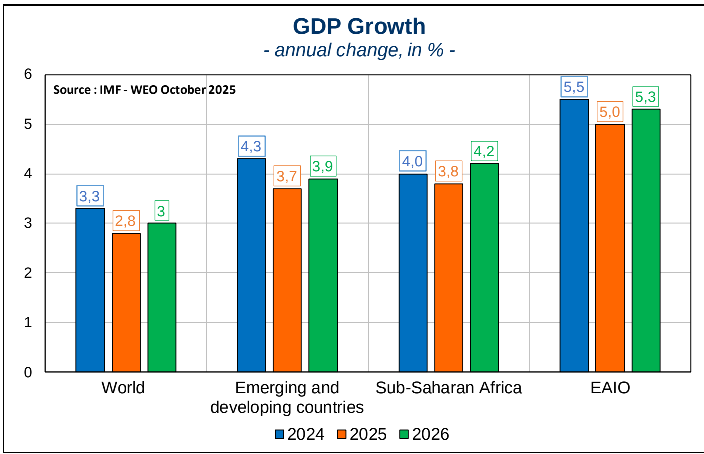
Regional economic and financial situation: resilient growth and persistent vulnerabilities

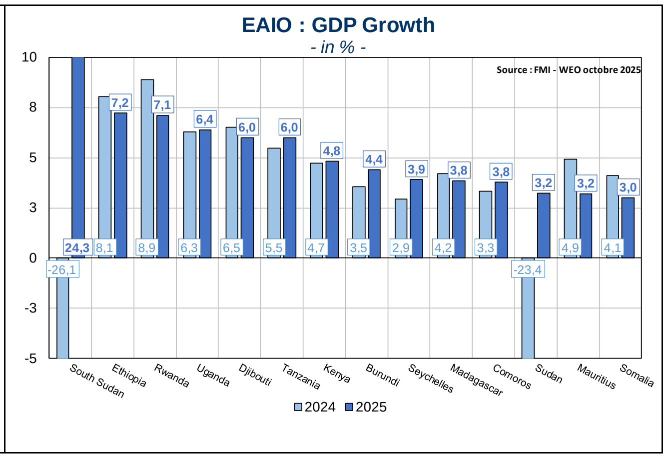
East Africa and the Indian Ocean region displays overall resilient regional growth, underpinned by improved agricultural output, buoyant services activity, and continued infrastructure investment, despite a constrained international environment. In the short term, the outlook remains broadly favorable but uneven: the main economies of East Africa and the Horn of Africa are expected to sustain robust growth, while more fragile or landlocked countries remain exposed to uncertain recovery trajectories. Inflation has generally eased, allowing for monetary policy easing in several countries, but remains elevated where deep-seated monetary imbalances persist. Financial systems remain resilient but insufficiently deep, with rising exposure to sovereign risk. The main macroeconomic risks stem from persistent fiscal and external vulnerabilities, reflected in high debt levels, a partial withdrawal of development partners, and still-fragile external positions.

Overall resilient regional growth, driven by heterogeneous growth engines but exposed to structural vulnerabilities

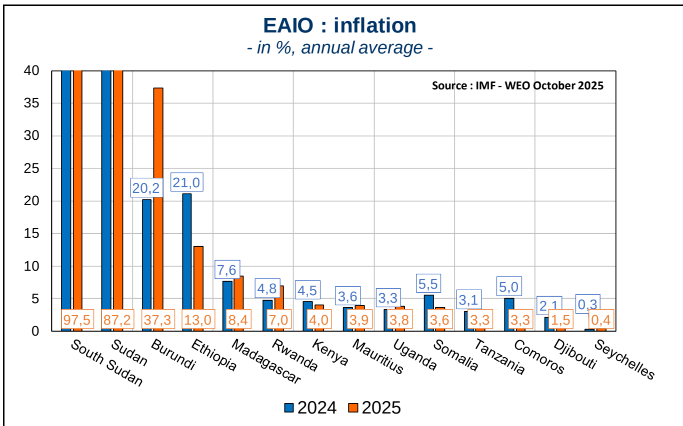
East Africa and the Indian Ocean (EAIO) continues to post overall robust growth momentum, despite an international environment marked by still-tight financial conditions, persistent volatility in commodity prices, and heightened geopolitical tensions. The region continues to benefit from a still-tangible post-COVID-19 rebound, driven by the recovery of the services sector, solid agricultural performance in several countries, and, in some cases, large-scale infrastructure investments.

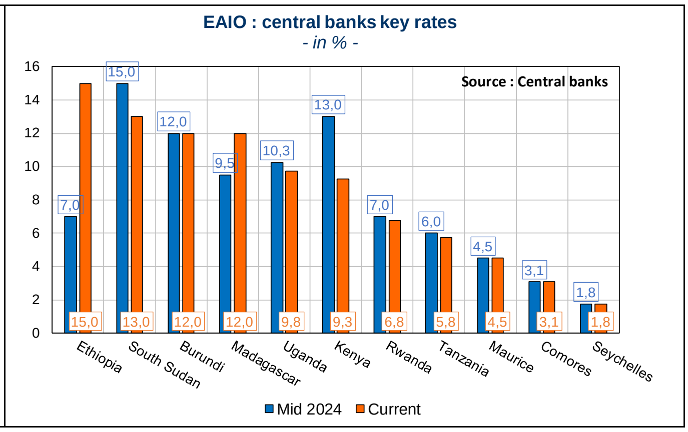
In the short term, growth prospects in the EAIO region remain broadly favourable but uneven across geographical sub-regions. East African economies (Kenya, Uganda, Rwanda and Tanzania) are expected to continue recording strong growth rates, generally above 5.0%, driven by solid agricultural performance, buoyant services activity, and the continuation of public and private investment. By contrast, more fragile or landlocked countries, such as Burundi and South Sudan, remain on slow and uncertain recovery paths, heavily dependent on climatic, security and financial conditions. In the Horn of Africa, the short-term outlook is similarly mixed: Djibouti benefits from momentum linked to its role as a regional logistics hub, particularly in the context of ongoing disruptions to Red Sea maritime routes, while Ethiopia is experiencing robust growth dynamics, supported by the recovery of agriculture, services and trade. Indian Ocean economies (Comoros, Madagascar, Mauritius and Seychelles) display more moderate short-term prospects, as activity is mainly driven by services—notably tourism, financial activities and external transfers—and remains exposed to climate shocks, volatility in international demand, and financing constraints.





Inflation has broadly receded across the region, following the peaks recorded between 2022 and 2023. This decline reflects lower food and energy prices, favorable base effects, and, in some countries, early implementation of restrictive monetary policies. However, conditions remain heterogeneous: inflation is now largely under control in Kenya, Uganda, Rwanda and Tanzania, while it remains very high in economies characterized by deep-seated monetary imbalances (notably Burundi and South Sudan). Exchange rate regimes play a key role, whether through fixed pegs (Djibouti, Eritrea) or gradual depreciations used as external adjustment mechanisms (Rwanda, Tanzania).

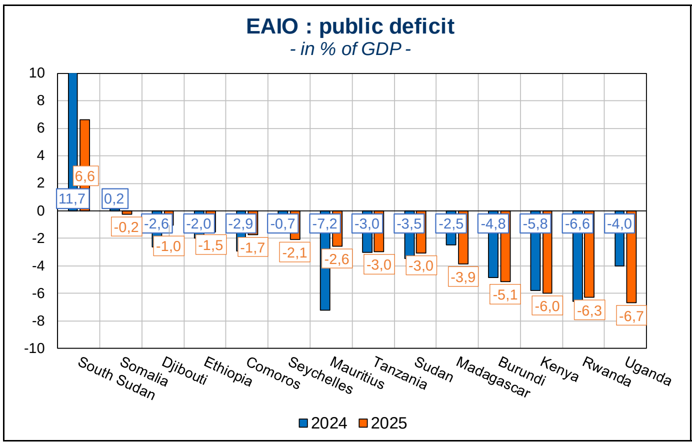


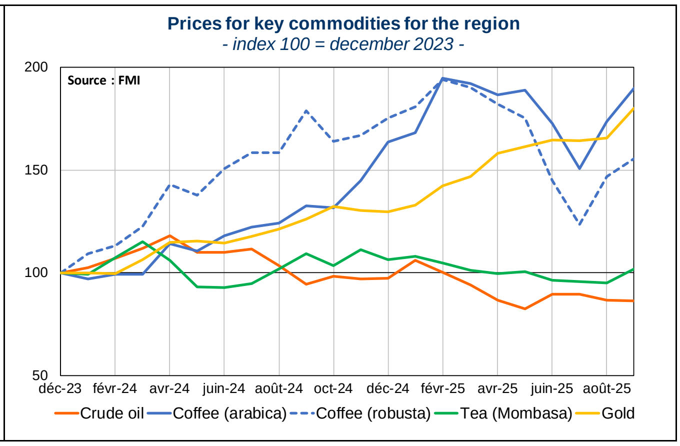


Regional financial sectors appear broadly resilient, well capitalized and liquid, but remain of limited size. Financial intermediation is still insufficient to fully support the private sector, while rising exposure to sovereign risk constitutes a shared vulnerability, particularly in countries that rely heavily on domestic financing.

Macroeconomic balances under pressure: persistent fiscal and external vulnerabilities

Public finances are the main source of vulnerability in the region. Budget deficits remain high in several countries, driven by a combination of still-insufficient revenue mobilization, sustained investment spending, and, above all, a rapidly rising debt service burden. In this context, public debt is on an upward trajectory in most EAIO countries. While some states maintain debt levels considered sustainable in the short term (notably Tanzania and Somalia), others are classified as high-risk for over-indebtedness, or even in distress (Kenya, Djibouti, South Sudan, Eritrea). Debt structure is a central issue: in several countries, the share of domestic debt is increasing, exposing public finances to high interest costs and crowding out the private sector. Conversely, external debt, generally concessional, remains predominant in the most aid-dependent economies, although its share is declining in some cases (notably Kenya and Uganda). These countries face suspension of commitments from some multilateral donors or delays in disbursements, amid requirements for fiscal consolidation, governance, and structural reforms. This situation has increased reliance on more costly domestic and market-based financing, as well as innovative instruments still largely untested, thereby reducing fiscal space and weighing on social and development spending.





External positions show cyclical improvement but remain fragile. Current account deficits remain high in most economies, reflecting strong dependence on imports of capital goods, energy, and food products. Recent increases in the prices of certain export commodities, notably coffee and gold (Ethiopia, Uganda, Tanzania), as well as declines in crude oil prices, have partially alleviated short-term external imbalances by boosting export revenues and reducing energy bills in several countries. Diaspora remittances play an important stabilizing role (particularly in Comoros, South Sudan, and Somalia), though they do not fully offset external imbalances. Foreign exchange reserves have generally been rebuilt in the main regional economies, but remain low or very low in the most fragile countries, limiting their capacity to absorb external shocks. In this context, persistent pressures in foreign exchange markets continue to be a major constraint on macroeconomic stabilization in several countries.