INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/18

January 2018

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

In the context of the 2017 Article IV Consultation, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** for the 2017 Article IV Consultation, prepared by a staff team of the IMF for the Executive Board's consideration on January 12, 2018, following discussions that ended on September 26, 2017, with the officials of The Federal Democratic Republic of Ethiopia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 12, 2017.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for The Federal Democratic Republic of Ethiopia.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

Press Release No. 18/06
FOR IMMEDIATE RELEASE
January 17, 2018

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2017 Article IV Consultation with the Federal Democratic Republic of Ethiopia

On January 12, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Federal Democratic Republic of Ethiopia.

Ethiopia has recorded annual average GDP growth of about ten percent in the last decade, driven by public investments in agriculture and infrastructure. The poverty rate has fallen from 44 percent in 2000 to 23.5 percent in 2015/16. In 2016/17 GDP growth is estimated at 9 percent, as agriculture rebounded from severe drought conditions in 2015/16. Industrial activity expanded, with continued investments in infrastructure and manufacturing. The current account deficit declined in 2016/17 to 8.2 percent of GDP from 9.1 percent the previous year, reflecting lower drought-related imports and lower public sector capital goods imports. However, export revenues were largely unchanged despite significant volume growth, as global agricultural commodity prices remained low. Foreign direct investment (FDI) growth, was 27.6 percent due to investments in the new industrial parks and privatization inflows. International reserves at end-2016/17 stood at US$3.2 billion (1.8 months of prospective imports cover).

In October 2017, the National Bank of Ethiopia (NBE) devalued the birr by 15 percent relative to the U.S. dollar, thereby reducing overvaluation and enhancing competitiveness. Simultaneously, the NBE increased interest rates and adopted a restrictive stance to minimize adverse effects on inflation—which was 13.6 percent in November 2017. Since October 2016, the Ministry of Finance and Economic Cooperation (MOFEC) implemented further cuts in external borrowing by the government and public enterprises (SOEs), and reduced outstanding non-concessional commercial debt. The general government deficit outturn in 2016/17 was 3.4 percent of GDP (including privatization) and the 2017/18 budget speech

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

announced additional consolidation policies, with the budget deficit projected at 2.5 percent of GDP.

Growth is expected to stay high in 2017/18, at 8.5 percent, supported by continued recovery from droughts and export expansion as new manufacturing facilities and infrastructure come online—offsetting the potentially dampening impact of restrictive macroeconomic policies. Over the medium term, growth is expected to remain around 8 percent, supported by sustained expansion in exports and investment. The authorities' policies envisaged under the second Growth and Transformation Plan (GTP II) are expected to underpin domestic private sector development and FDI. The GTP II also envisages allocating significant resources to poverty alleviation and the social safety net, while efforts to strengthen financial inclusion are underway.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended Ethiopia's impressive record of human development improvements and output growth over the last decade, and the effective policy response to the recent drought. They noted that the preconditions for an export expansion and transition to private sector-led growth—including investments in trade-enhancing infrastructure—are in place, and private direct investment is growing strongly. However, they underlined that external imbalances and inadequate reserve buffers remain a key risk, and urged the authorities to maintain determined policy actions to control external borrowing.

Directors stressed the need to continue determined implementation of policies to reduce external imbalances. They commended the restrictive public sector borrowing policy to contain external debt and imports while protecting pro-poor spending, the devaluation of the currency to regain competitiveness, and the tight monetary policy to rein in inflation. They agreed that these policies should address most of the birr's prior overvaluation, while ongoing reforms to strengthen the business environment will help preserve competitiveness gains. Directors welcomed the authorities' readiness to tighten policies further if inflationary pressures do not abate in coming months. They noted that a more flexible exchange rate would help preserve competitiveness and foster export diversification, and recommended eliminating exchange restrictions.

Directors supported the authorities' goal to strengthen domestic revenue mobilization and urged them to accelerate ongoing tax administration reforms. They welcomed plans to improve the management and oversight of public enterprises, including undertaking audits for some large state-owned enterprises (SOEs). Public-private partnerships (PPPs), long-term

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

concessions, and privatization of SOEs could offer opportunities to fund critical infrastructure. Directors welcomed the progress in strengthening the legal framework for PPPs and urged the authorities to ensure that their use strikes the appropriate balance between boosting private sector participation and minimizing fiscal risks. Continued efforts to improve the business climate, promote financial inclusion, and improve governance will also be important.

Directors welcomed plans to develop a broader range of indirect monetary policy instruments and promote an active inter-bank market, which would deepen financial markets and improve savings allocation. They encouraged the authorities to continue to monitor the NPLs of the national development bank and to shift its current funding mechanism to a less distortive system. Directors also urged implementation of the action plan to further strengthen the AML/CFT framework.

Directors welcomed ongoing efforts to strengthen the compilation and dissemination of economic statistics. They urged the authorities to adopt international standards for budgetary, monetary, and financial statistics and decisively address remaining data weaknesses in national accounts and public sector financial reporting.

It is expected that the next Article IV consultation with The Federal Democratic Republic of Ethiopia will be held on the standard 12-month cycle.

Federal Democratic Republic of Ethiopia: Selected Economic and Financial Indicators, 2013/14–2021/22

Social Indicators

GDP		**Poverty indicators in 2015/16 (national definitions)**	
Nominal GDP (2016, billions of U.S. dollars)	72.5	Poverty headcount ratio (percent of population)	23.5
GNI per capita, Atlas method (2015, current US$)	590	Food poverty (percent of population)	24.8
Population characteristics		**Income distribution, 2010**	
Total (2016, million)	91.2	Income shared by highest 10 percent of population	27.4
Urban population (2015)	19.5	Income shared by lowest 20 percent of population	8.0
Life expectancy at birth (2014, years)	64.0	GINI index	30.0

Economic Indicators

	2013/14 Act.	2014/15 Act.	2015/16 Act.	2016/17 IMF Staff Est.	2017/18 IMF Staff Proj.	2018/19 IMF Staff Proj.	2019/20 IMF Staff Proj.	2020/21 IMF Staff Proj.	2021/22 IMF Staff Proj.
	(Annual percentage change)								
National income and prices									
GDP at constant prices (at factor cost)	10.3	10.4	8.0	9.0	8.5	8.3	8.1	8.0	8.0
GDP deflator	11.0	10.8	9.5	8.9	11.7	8.6	8.6	8.3	8.2
Consumer prices (period average)	8.1	7.7	9.7	7.2	11.5	8.1	8.0	8.0	8.0
Consumer prices (end period)	8.5	10.4	7.5	8.8	12.0	8.0	8.0	8.0	8.0
External sector									
Exports of goods and services (U.S. dollars, f.o.b.)	8.7	-2.6	-3.5	2.9	12.9	13.4	13.9	14.2	14.2
Imports of goods and services (U.S. dollars, c.i.f.)	14.0	25.1	2.9	-4.8	7.4	7.6	7.9	8.2	8.6
Export volume (goods)	6.4	-2.7	4.9	-1.4	13.9	12.0	13.6	14.6	15.0
Import volume (goods)	17.9	32.5	12.9	-5.4	3.9	5.6	6.2	7.2	7.6
Nominal effective exchange rate (end of period)	-2.8	2.7	-2.3	0.8	...	...	...	...	...
Real effective exchange rate (end of period)	2.6	10.1	2.6	...	...	...	...	...	...
	(Percent of beginning-period stock of broad money, unless otherwise indicated)								
Money and credit									
Change in net foreign assets	0.5	-3.2	-3.7	3.4	1.2	3.8	3.2	3.4	2.5
Change in net domestic assets (including other items net)	26.4	27.5	24.0	25.3	18.9	15.1	16.0	17.3	18.6
Broad money	26.9	24.2	20.4	28.8	20.1	18.9	19.2	20.7	21.1
Base money (annual percentage change)	18.7	15.2	16.3	22.7	16.5	16.5	16.5	16.5	16.5
Velocity (GDP/broad money)	3.56	3.51	3.43	3.12	3.15	3.12	3.06	2.97	2.87
	(Percent of GDP, unless otherwise indicated)								
Financial balances[1]									
Gross domestic savings	20.5	21.9	22.4	20.4	20.4	21.5	21.4	22.7	22.1
Public savings	5.0	3.8	3.9	1.8	1.6	1.6	1.6	1.6	1.7
Private savings	15.6	18.1	18.5	18.6	18.8	19.9	19.8	21.1	20.4
Gross domestic investment	38.0	39.4	38.5	36.6	36.4	37.7	36.9	37.5	36.3
Public investment	17.0	17.6	17.2	14.9	13.8	14.4	13.1	11.9	14.9
Private investment	21.0	21.8	21.3	21.7	22.6	23.3	23.8	25.7	21.4
Resource gap	-17.5	-17.5	-16.1	-16.2	-16.0	-16.2	-15.4	-14.8	-14.2
External current account balance, including official transfers	-6.4	-10.2	-9.1	-8.2	-7.7	-7.5	-6.8	-6.1	-5.5
Government finances									
Revenue	13.8	14.4	15.2	14.4	14.7	15.1	15.5	15.8	16.3
Tax revenue	12.5	12.7	12.5	11.8	12.4	13.0	13.4	13.9	14.5
Nontax revenue	1.2	1.6	2.7	2.6	2.3	2.2	2.0	1.9	1.8
External grants	1.1	1.0	0.9	0.7	0.8	0.7	0.6	0.5	0.4
Expenditure and net lending	17.5	17.3	18.4	18.5	18.0	18.3	18.4	18.6	18.9
Fiscal balance, excluding grants (cash basis)	-3.7	-3.0	-3.2	-4.1	-3.3	-3.2	-2.9	-2.7	-2.6
Fiscal balance, including grants (cash basis)	-2.6	-1.9	-2.4	-3.4	-2.5	-2.5	-2.3	-2.2	-2.1
Total financing (including residuals)	2.6	1.9	2.4	3.4	2.5	2.5	2.3	2.2	2.1
External financing	1.9	1.0	1.7	1.6	0.7	0.9	0.7	0.6	0.5
Domestic financing	1.3	1.4	1.6	1.9	1.7	1.6	1.6	1.6	1.6
Public debt[2]	46.8	54.0	55.4	56.9	59.0	58.1	55.5	53.1	50.7
Domestic debt	21.0	23.8	24.8	26.5	25.9	26.1	25.6	25.1	24.8
External debt (including to the IMF)	25.8	30.3	30.7	30.4	33.1	31.9	29.9	27.9	26.0
Overall balance of payments (in millions of U.S. dollars)	-97	-521	-831	658	477	688	602	742	580
Gross official reserves (in millions of U.S. dollars)	2,496	3,248	3,402	3,197	3,673	4,361	4,963	5,705	6,286
(months of imports of goods and nonfactor services of following year)	1.5	1.9	2.1	1.9	2.0	2.2	2.3	2.4	2.5
GDP at current market prices (billions of birr)	1,061	1,298	1,528	1,786	2,167				

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] Based on data from Central Statistical Agency (CSA), except for the current account balance, which is based on BOP data from National Bank of Ethiopia (NBE).

[2] Non-financial public sector debt.

December 12, 2017

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

KEY ISSUES

Context. Ethiopia has an impressive record of human development improvements and output growth—averaging about 10 percent in the last decade—underpinned by public investment and productivity gains. However, over the last three years, droughts and weak international prices for agricultural commodities dampened growth and opened an external imbalance. Ethiopia is now experiencing a growth recovery after the 2015/16 drought. The authorities' determined actions to control public borrowing and imports has reduced the current account deficit; and foreign direct investment is rising fast. However, exports remained stagnant in 2016/17 and drought conditions lingered in some areas.

Outlook and risks. Growth is envisaged to remain high and exports to pick up over the medium term, but the current account deficit will decline only gradually. Notwithstanding recent policy restraint, external risks have increased and the updated Debt Sustainability Analysis (DSA) suggests that Ethiopia is at high risk of debt distress.

Key policies and recommendations. The authorities have recently implemented a 15 percent devaluation of the birr and a tighter monetary policy stance—appropriately complementing the restrictive fiscal stance announced in the 2017/18 budget speech. It is critical that implementation of public projects with large import and external borrowing components be slowed down. A more flexible exchange rate that reflects inflation differentials and the strength of the U.S. dollar relative to trading partners, and a tight monetary stance will help preserve competitiveness gains while reining in inflation.

To minimize adverse growth effects, policies that share investment funding with the private sector and promote its development—public-private partnerships (with adequate safeguards), private concessions, and privatizations—will be key. Mobilizing domestic resources, enhancing financial intermediation and deepening, and improving the investment environment are appropriately among the authorities' top priorities.

Approved By
Michael Atingi Ego (AFR) and Kevin Fletcher (SPR)

Discussions were held in Addis Ababa during September 13–26, 2017. The mission met with Prime Minister Hailemariam Desalegn, National Bank of Ethiopia Governor Teklewold Atnafu, Minister of Finance and Economic Cooperation Abraham Tekeste, officials of ministries and government agencies, representatives of public enterprises and the private sector, and development partners. The staff team comprised Mr. Escolano (head), Mr. Raman, Ms. Aivazova (all AFR), Ms. Marinkov (FAD), Mr. Pham (LEG) and Mr. Ouedraogo (STA). Mr. Atingi Ego (AFR) joined the mission for two days and held discussions with senior policymakers. Mr. Nakunyada (OED) also attended the mission's meetings with the authorities.

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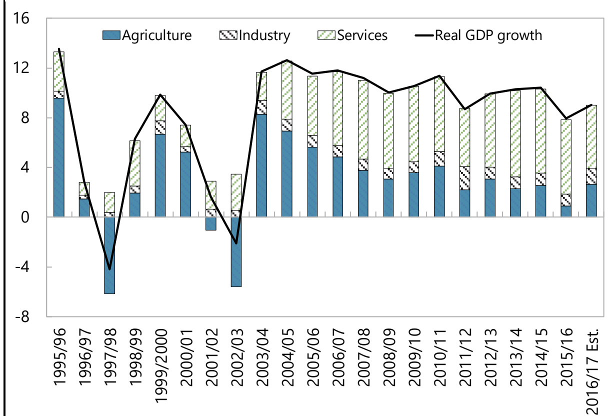
BACKGROUND AND RECENT DEVELOPMENTS

1. **Growth was resilient in 2016/17[1] amid continued weak global prices for commodities and re-emergence of drought in pastoral regions.** Output is estimated to have grown 9 percent (Figure 1)[2], owing to the recovery in the agriculture sector and 16 percent industry growth (power generation, construction), amid strong investment in infrastructure and manufacturing. Improved rainfall in the major Meher season saw agricultural production expand strongly by 8.8 percent, offsetting below-average rainfalls in the Belg season. The re-emergence of drought in the south and east did not halt the recovery: their GDP contribution is small and substantial past investments have enhanced the productivity and resilience of agriculture. However, the drought's budgetary and social costs remained high with 8.5 million people requiring food assistance.

Figure 1. Real GDP Growth and Contribution by Sector

(Percent)



Sources: Ethiopian authorities; and IMF staff calculations.

2. **The 2016/17 external current account deficit narrowed due to lower imports, but exports remained stagnant.** The current account deficit fell by one percentage point of GDP to 8.2 percent of GDP in 2016/17 as imports of goods and services declined, driven by lower drought-related food and public sector capital imports. The latter reflects the authorities' policy actions aimed at reducing external imbalances and ensuring debt sustainability, consistent with Fund advice. However, export revenue rose only 2.9 percent, well below expectations, reflecting delays in key export-oriented projects—now completed or near completion (Hawassa industrial zone, Djibouti railway, power transmission). On the upside, coffee export volumes surged after recent supply-enhancing market reforms. Foreign Direct Investment (FDI) grew strongly by 27.6 percent, driven by investor interest in new industrial parks and privatization proceeds. Overall, international reserves declined to US$3.2 billion, equivalent to 1.8 months of prospective imports of goods and services (2.5 months on the authorities' preferred measure[3]).

3. **In October 2017, the National Bank of Ethiopia (NBE) devalued the birr by 15 percent to improve competitiveness and substantially tightened monetary policy—broadly in line with Fund advice.** The interest rate floors on time and savings deposits were increased from 5 to 7 percent, and planned base money growth (the NBE's main monetary policy instrument) was

[1] The fiscal year runs July-June.

[2] Historical GDP data published by the IMF are those issued by Ethiopia's Central Statistical Agency. Staff notes that GDP measurement continues to be affected by source data issues as identified by STA TA that are still not resolved (see paragraph 35).

[3] Excluding food aid and franco valuta imports.

lowered from 22 percent to 16 percent. The NBE also liberalized some exchange control regulations, allowing exporters to access foreign credit and to retain up to 30 percent of their export proceeds in foreign currency (previously 10 percent), which, should lessen difficulties in procuring foreign exchange when needed for their inputs and capital imports. These measures are intended to address the external imbalances by supporting net exports and alleviating foreign exchange shortages, while minimizing potential inflationary effects from the devaluation. Prior to the devaluation, there had been an upward drift in inflation which exceeded the authorities target of about 8 percent, driven by food inflation; and significant growth in monetary and credit aggregates in 2016/17 (Figure 2 and Table 4). Inflation was 13.6 percent in November 2017, partly reflecting inflation momentum and the impact of the devaluation.

4. Since October 2016, the authorities appropriately adopted a restrictive stance on both government and public enterprises (SOEs) borrowing policies. The 2016/17 general government budget deficit was 3.4 percent of GDP including the supplementary budget, slightly below the budgeted 3.5 percent of GDP. While expenditure remained unchanged relative to 2015/16 (in percent of GDP), revenue underperformed (Table 1) mainly due to a shortfall in import levies. The January 2017 supplementary budget (1.1 percent of GDP) allowed for a moderate increase in public wages to increase retention, as suggested by a World Bank (WB) study, and social assistance, including drought-related spending. However, the supplementary budget was funded without additional borrowing by privatization receipts and fuel price stabilization fund surpluses. Also from October 2016, the Ministry of Finance and Economic Cooperation (MOFEC) implemented strong controls on external borrowing by public enterprises. As a result, the NPV of outstanding external obligations stabilized, and non-concessional commercial borrowing was reduced substantially.

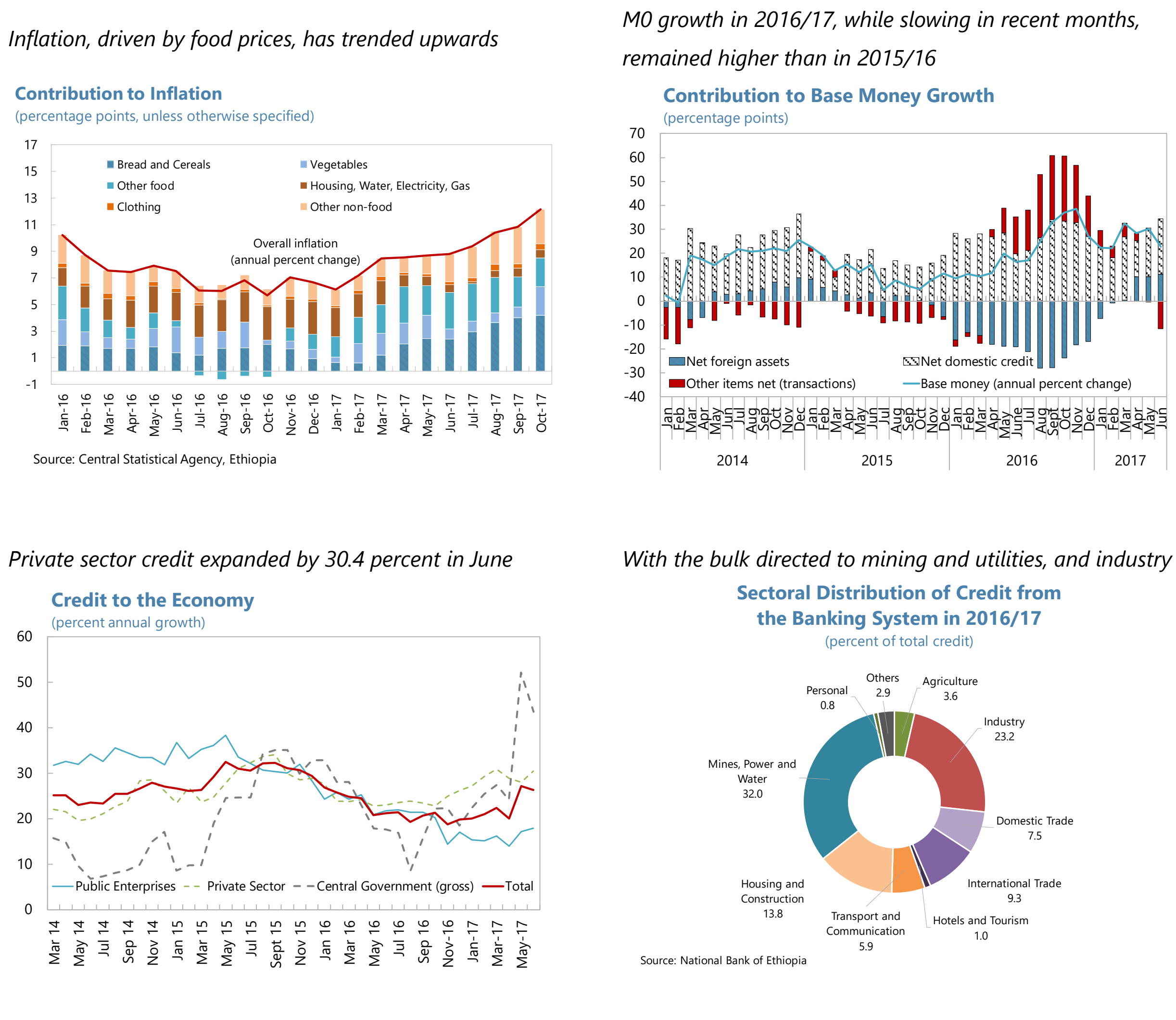
Table 1. Ethiopia: Fiscal Operations, 2015/16-2016/17
(Millions of birr, unless otherwise specified)

	2015/16	2016/17		2016/17	
	Year, actual	Budget	Year, preliminary	*Diff. w.r.t. 2015/16 (percent of GDP)*	*Percent of budget*
Revenue and grants	**244,819**	**283,798**	**269,151**	***-1.0***	***94.8***
Tax	190,520	226,894	210,173	*-0.7*	*92.6*
Non-tax	41,285	40,795	46,502	*-0.1*	*114.0*
Grants	13,014	16,108	12,477	*-0.2*	*77.5*
Expenditure and transfers	**280,893**	**346,448**	**329,658**	***0.0***	***95.2***
Recurrent expenditure	136,709	169,724	176,635	*0.9*	*104.1*
Capital expenditure	144,184	176,724	153,023	*-0.9*	*86.6*
Fiscal balance	**-36,073**	**-62,650**	**-60,507**	***-1.0***	***96.6***
Percent of GDP	***-2.4***	***-3.5***	***-3.4***		

5. Political context. Civil unrest since early-2015, rooted on regional and ethnic tensions, led to the introduction in October 2016 of a 9-month state of emergency, now lifted. The economic fallout, which affected mainly horticulture, tourism, and investor sentiment, seems to have been limited and short-lived. After the initially stern security response, the authorities took steps to enhance inclusiveness and compensated private investors for damages. However, instances of civil unrest continue. In October 2016, the cabinet was reshuffled, including appointment of a new

Minister of Finance and Economic Cooperation and other senior economic policymakers. The new cabinet has substantially intensified implementation of GTP II[4] policies aiming to increase privatization and private sector participation in the economy, introduction of a modern Public-Private Partnerships (PPPs) legal framework, and State-Owned Enterprises (SOEs) financial and governance reform.

Figure 2. Inflation, Monetary and Credit Developments



Source: Ethiopian authorities.

[4] Second five-year Growth and Transformation Plan (2015/16-2019/20).

OUTLOOK AND RISKS

6. **Output growth is expected to remain high at 8.5 percent in 2017/18, and only slowly decelerate over the medium term (Table 2).** In the short term, ongoing recovery from droughts and the expected pick-up in exports are expected to offset the impact of the restrictive macroeconomic policy stance announced by the authorities. Medium-term real GDP growth is expected to converge to 8 percent, supported by strong private investment, continuing investment in infrastructure, and improving productivity—as FDI and export-oriented industries expand. In the immediate term, inflation is likely to remain above the 8 percent target due to price momentum from earlier months and the pass-through from devaluation. Nevertheless, the announced restrictive monetary and fiscal policy stances should bring inflation back to target in 2018/19.

7. **Export growth is expected to pick up as key supporting projects come online, but the current account deficit will only gradually decline (Tables 5a and 5b).** Exports of goods and services are envisaged to pick up substantially in the medium term, reflecting the completion of key infrastructure (electricity generation and transmission, railway to Djibouti and other logistics, industrial parks) and pay-offs from domestic investment and greenfield FDI. Nevertheless, this pick-up is unlikely to reach its full extent immediately: time may be needed for testing, installation and training of newly-hired industrial workers before production facilities can operate at full capacity. Import growth will remain moderate in 2017/18, premised on continued public sector restraint, as announced in the recent budget speech. However, imports will gradually accelerate over the medium term since expanding manufacturing activities will entail substantial importation of inputs until alternative local sourcing, where feasible, develops. Thus, the current account deficit is projected to remain wide and decline only gradually.

8. **Medium-term policies will remain framed by the GTP II strategic objectives.** The GTP II allocates a major role to the public sector for public goods provision and anti-poverty and developmental programs. However, the strategy emphasizes private sector development and FDI, particularly in export-oriented manufacturing, through wide-ranging structural reforms and infrastructure improvements.

9. **The external debt and debt service burden pose the main identifiable risk to macroeconomic stability (Annex I and Debt Sustainability Analysis, DSA).** In particular, liabilities acquired in past years (Figure 4) coupled with export supply delays have resulted in a deterioration of DSA indicators, warranting a reclassification to high risk of debt distress. Under the baseline, both the net present value (NPV) of public and publicly guaranteed external debt and debt service ratios relative to exports breach the standard cross-country thresholds calling for reclassification to high risk of debt distress. Current debt service is becoming significant: Ethiopia faces about US$1.5 billion in external public debt service payments[5] coming due during 2017/18 and significant obligations over the medium term. Given thin reserves (Annex II) and uncertainty in the timing and profile of the export pick-up, adverse shocks could pose debt servicing risks. This in turn, could force an undesirably abrupt import compression and undermine confidence, potentially compromising, at

[5] This estimate includes public enterprises.

least temporarily, Ethiopia's successful growth trajectory. In addition, further delays in the export take-off could also put growth projections at risk. The authorities have adopted appropriate decisive policy initiatives to forestall the emergence of debt stress episodes. These include restrictive public sector external borrowing policies, devaluation of the birr, a tight policy stance to increase domestic savings and contain demand spillovers through the balance of payments, and fast-track adoption of initiatives to mobilize private sector resources for infrastructure and public goods provision. Ethiopia remains vulnerable to climate-related risks, including droughts. The authorities have strengthened their safety net and humanitarian response mechanisms, which have been commended by donors, and are developing plans for preventive mitigation with assistance from the WB.

Authorities' Views

10. The authorities have placed the highest priority on policies to correct external imbalances and curb the debt burden, but disagreed with the change in DSA assessment to high risk of debt distress. There was no disagreement of substance between the authorities and staff as to the appropriate policy response, which the authorities are decisively implementing. The authorities considered the recent increase in the debt burden relative to exports as temporary, resulting from an unexpected delayed response of exports, and being effectively addressed by current policies. Also, they expressed concern that a DSA reclassification to high risk could hinder remedial policies by limiting their capacity to tap concessional financing (to replace commercial loans) and negatively affecting investor sentiment and public perceptions of the reform efforts.

POLICY DISCUSSIONS

11. There was agreement that after more than a decade of sustained public sector-led growth, the lead needs to be transferred now to the private sector—as envisaged in the authorities' GTP II strategy. Should the public sector continue undertaking on its own a broad array of public projects, even if highly productive in the long term, it would risk aggravating external imbalances in the short term. These imbalances in turn would undermine the very objective of the public projects: the development of a vibrant private sector and dynamic markets able to lead the economy into its next growth phase. Thus, the timing and sequence of public investment and other public sector activities needs to be reprofiled to a pace commensurate with actual export revenue increases, and with progress in mobilizing domestic savings. In 2016/17, the authorities appropriately curbed accumulation of external debt, but the protracted export supply response to past investment requires additional actions. Thus, the more restrictive macroeconomic policy stance adopted by the authorities, including after the birr devaluation, is appropriate. Staff also supports the reforms in tax administration and financial management of SOEs—which will enhance domestic resources and their effective use. The envisaged private sector development reforms, such as the roll-out of a financial market and improvements in the business climate should be accelerated. Use of PPPs (with adequate safeguards), private concessions, and privatizations, as envisaged by the authorities, will preserve public resources while helping private sector development.

A. Fiscal Policy

12. Budget implementation in 2017/18 is expected to remain appropriately restrictive. Staff projects a below-budget government deficit outturn of 2.5 percent of GDP (Table 3b), based on the strict borrowing policies announced in the budget speech, particularly on capital projects financed by external loans. That said, social needs remain large, and staff supports the authorities' intention to protect pro-poor spending. In this area, the social safety net is well-designed and has proven effective in delivering timely assistance to drought victims (Box 1). Continued progress on investment efficiency would also create fiscal room—staff encouraged participation in a Fund-WB Public Investment Management Assessment (PIMA).

Box 1. The Social Safety Net in Ethiopia

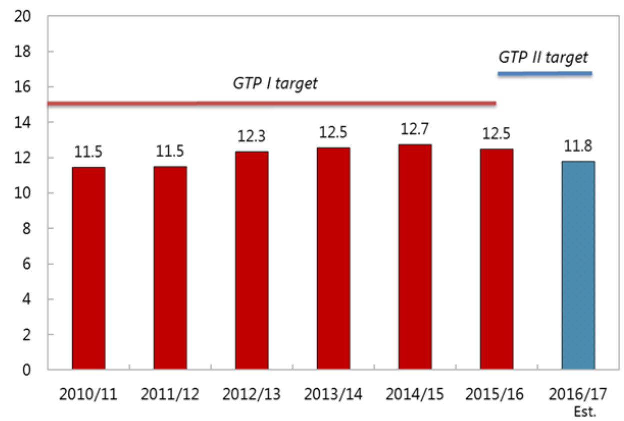
Ethiopia has dealt with multiple droughts since the 1980s that have resulted in significant social costs. The most recent drought in 2015/16 was managed through organized and coordinated action by the government with support from development partners. In addition to pledges from donors, the government mobilized reserve resources through drought recovery schemes. These mitigate the effects of the drought through imports and distribution of wheat and edible oil, and distribution of cattle feed to drought-stricken areas. The government's goal is to reduce dependence on donor funding and assume greater responsibility for its social safety net system.

Since 2005, the Productive Safety Net Program (PSNP) has been assisting rural families facing chronic food insecurity. The program, now in its fourth phase, is funded by the budget and multiple donors. It reaches about 8 million beneficiaries, about half of whom are in drought-affected areas. Since the PSNP's inception, the government has progressively increased its support, pledging US$500 million for the fourth phase. Of this. US$285 million constitutes cash grants, with the remainder offered as in-kind contributions (office space, employees, etc.). The PSNP aims to contain the negative effects of food shortages, support the rural transformation process, encourage families to engage in production and investment, and increase their purchasing power. Able-bodied beneficiaries must participate in productive activities aimed at uplifting community infrastructure and rehabilitating water and land resources. Participation (attendance) is recorded in the Urban Payroll Attendance Sheet System (UPASS), based on which PSNP beneficiaries receive food allocations or cash payments, the latter transferred into individuals' bank accounts. Participants are also encouraged to save and can be referred to microfinance institutions to finance business ventures upon graduation from the PSNP.

To reduce urban poverty, the Urban Productive Safety Net Project (UPSNP) was established with support from the World Bank. The UPSNP is a 5-year project targeting some 604,000 people living below the poverty line in 11 urban centers. The total allocation to the program is US$450 million, with the government contributing US$150 million through cash and in-kind transfers. The project applies PSNP mechanisms that have proven to be effective in the past, combining direct support with engagement in public work, and relies on community-based targeting for nomination of beneficiaries, all of whom are registered in UPASS and receive payments through their bank accounts. UPSNP beneficiaries are also encouraged to save a portion of their earnings. After a period of three years, they can graduate from the program and receive a lump sum to establish their own small-scale enterprises, with assistance from microfinance institutions.

13. Stepping up revenue mobilization is urgent (Figure 3). Staff welcomed initiatives to expedite tax administration reforms with technical assistance (TA) from development partners, including the Fund (Box 2). Additionally, staff encouraged steps to reduce the scope for tax officials' discretion and opportunities for rent-seeking. Staff suggested banking-intermediated payments and small-taxpayer taxation based on standardized presumptive-income indicators (e.g., shop surface) indexed to inflation. A stocktaking of existing tax incentives is near completion, with WB and Fund support. As a subsequent step, staff recommended establishing a regular cost-effectiveness review of existing incentives—a tax expenditure report—as part of the budget cycle.

Figure 3. Tax Revenue
(Percent of GDP)



14. SOEs governance reform and privatization aim at improving efficiency in public delivery while alleviating financing constraints. The recent National Tobacco Company privatization, divestment plans of non-strategic SOEs, and the ongoing audit of Ethio-Telecom are important steps. They should be accompanied by strengthened public oversight, based on timely audited International Financial Reporting Standards (IFRS) compliant financial statements for all public companies, and financial disclosure.

15. Improvements in fiscal reporting would facilitate macroeconomic policy formulation and accountability. Adoption of current Government Finance Statistics Manual (GFSM) standards remains an urgent task (Annex IV). Public debt reporting is accurate and comprehensive, and other public indicators from MOFEC and NBE are also appropriate. However, adherence to different methodologies make them difficult to integrate and result in inconsistencies. Policymaking and public understanding of policies would benefit from a more consistent and comprehensive fiscal reporting, encompassing extra-budgetary accounts. Also, a budget annex with the non-financial public sector summary consolidated accounts would allow monitoring of the broader financial and macroeconomic implications of public policies.

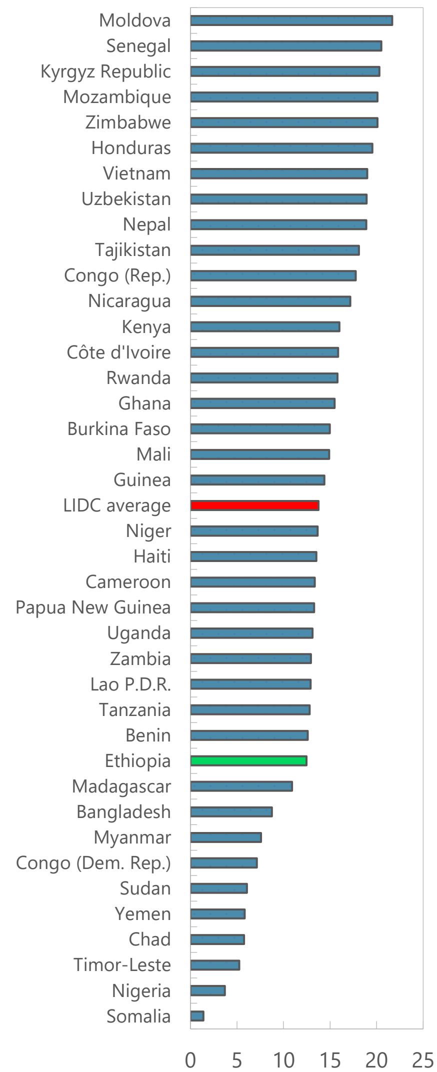
Box 2. Domestic Revenue Mobilization in Ethiopia

Ethiopia has a low tax ratio compared to other low-income countries. Administrative bottlenecks and weak tax compliance have been the main obstacles to revenue administration. Given the current low collection rate, achieving the target of 17.2 percent of GDP by 2019/20 will be challenging. Some countries in the region have successfully implemented reform programs aimed at improving tax compliance and strengthening effectiveness and efficiency in revenue administration (e.g. Mozambique, Congo Republic, Cabo Verde and Liberia). Reforms have focused on strengthening core operational processes, improving organizational structures, better use of data and information technology, and enhanced human resource management.

The authorities are pursuing an ambitious revenue administration reform agenda. The income tax and tax administration laws approved in 2016 aimed at improving tax collection, broadening the tax base and setting up a more efficient tax system overall. The authorities designed the strategy in collaboration with development partners and established a Tax Policy Directorate under the MOFEC. Also, the Ethiopian Revenue and Customs Authority is implementing strategic measures in human resources, data management, large-taxpayers' compliance, tax auditing, arrears, automation, and public outreach.

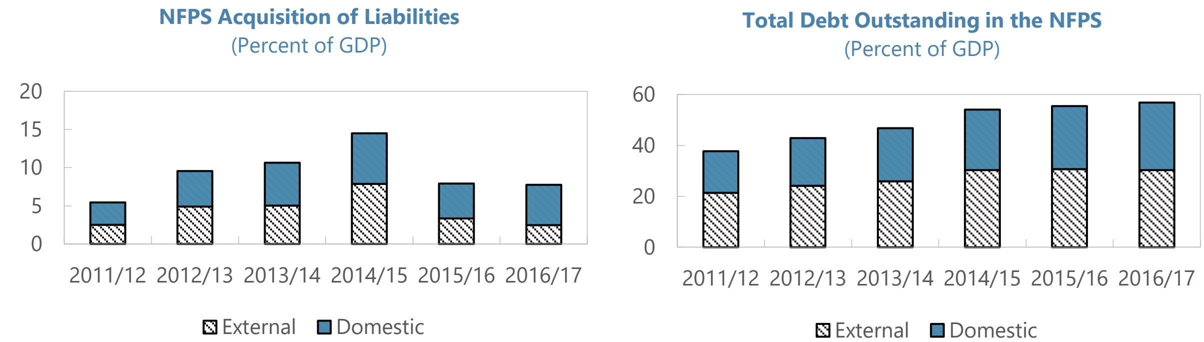
Although some progress has been achieved to date, much more remains to be done. Reforms have strengthened integrity and enforcement, with significant improvements in taxpayer assistance and service. However, compliance risk management improvements are slow. The authorities plan to clean up the taxpayer register and strengthen monitoring and management of exemptions with Fund assistance. An updated Integrated Tax Administration System software is also needed. Further legal reforms may be required to support revenue mobilization. A review of the Ethiopian tax system would also be useful in this regard, particularly as it could shed light on the underlying causes of the recent poor VAT performance.

Tax Revenue in LIDCs
(2016, percent of GDP, general government)



Source: WEO, Fiscal Monitor
Note: LIDC (low income developing countries) average weighs individual country by annual nominal GDP converted to US dollars at average market exchange rates as a share of the group GDP.

Figure 4. Net Accumulation of Liabilities and Debt Outstanding of the Non-Financial Public Sector



Source: Ethiopian authorities.

Authorities' Views

16. There was agreement on the need to continue the tight policies and control on external borrowing implemented by the authorities during 2016/17, aiming at reducing the debt burden. While the authorities project substantially higher export and output growth than staff, there was also agreement that strong policies would need to be maintained until actual export performance improves. On structural fiscal reforms, including domestic revenue mobilization (Box 2), the authorities intend to continue intense technical assistance collaboration with development partners, stressing that this support is an important component in implementing their reform agenda. The authorities intend to continue strengthening the oversight of public enterprises with a view to improving their performance and, where appropriate, exploring options for strategic divestment.

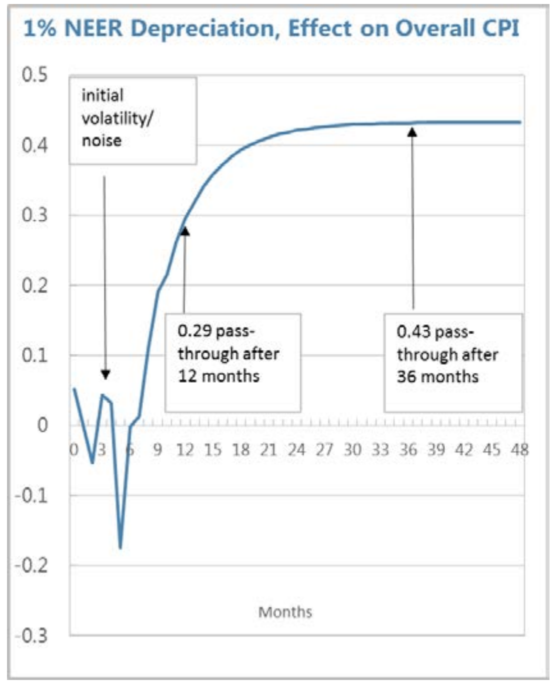
B. Exchange Rate, Monetary, and Financial Sector Policies

17. In recent years, the exchange rate has been rigidly managed to achieve a nominal depreciation path of 5–6 percent annually relative to the U.S. dollar, which resulted in an overvaluation of the real exchange rate (Annex II). This exchange rate policy implicitly aimed at maintaining the real effective exchange rate stable, assuming that the inflation differential with trading partners was about 5–6 percentage points and the U.S. dollar value remained stable relative to Ethiopia's trading partners' currencies. However, the birr became increasingly overvalued in real effective terms after the strengthening of the U.S. dollar in 2014–15. In addition, persistently higher-than-expected inflation differentials with trading partners added to the overvaluation—even when allowing for high productivity gains in Ethiopia. While the predictable depreciation path reduced uncertainty, the increasing overvaluation encouraged import demand, hampered export diversification into higher-value export lines,[6] exacerbated foreign exchange scarcity in the market.

[6] 2016 Article IV Consultations with Ethiopia (IMF Country Report No. 16/322).

Box 3. Exchange Rate Pass-Through in Ethiopia

Inflation pass-through in Ethiopia has historically been significant, but not complete. Staff's analytical work has sought to explore empirically the exchange rate pass-through from the nominal effective exchange rate (NEER) to domestic prices. A univariate vector autoregression model was estimated using 2003–2017 data. The model controls for international oil and food prices, but it was statistically unfeasible to control for policy variables. Thus, results must be interpreted as applying when policy settings are at their (generally accommodative) historical levels for earlier depreciations.



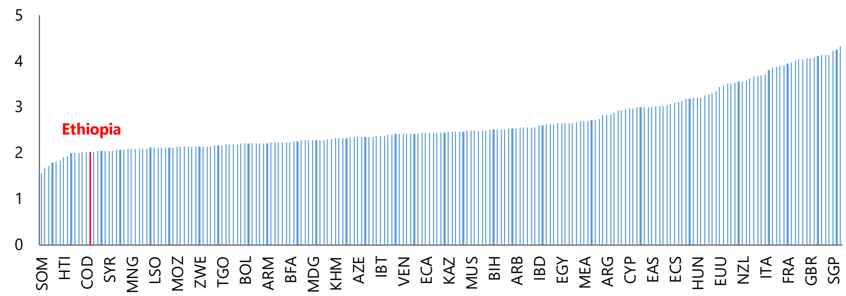
The results show that a 1 percent movement in the NEER has historically been associated with a cumulative 0.43 percent movement in the Consumer Price Index (CPI) over 3 years, with most of the impact occurring within the first 18 months. A smaller effect is observed with the food basket in the CPI where a 1 percent NEER depreciation is expected to produce a cumulative increase of 0.23 percent in food prices over 3 years. These results suggest that, with policies at their historical settings, the recent 13-percent devaluation (measured in USD/birr) should raise domestic prices by approximately 5.6 percent over the next 18 months, or roughly 3.7 percent in the first year. Alternative estimation methodologies yielded broadly similar results. These should be interpreted as an upper bound: the restrictive policies announced by the NBE can be expected to result in substantially smaller pass-through.

Box 4. Infrastructure Investment, Exchange Rate Policies, and Export Diversification: Cross-Country Analysis

Ethiopia has a small export base—its exports-to-GDP ratio in 2015 was the fifth lowest in the world—highly concentrated in primary products. This raises two risks: (i) Ethiopia lacks the export diversification needed to raise growth through a broad base of production technologies,[1] spreading risk and reducing aggregate output volatility;[2] and (ii) primary products are vulnerable to global price volatility and weather-related shocks. The GTP II aims to increase both the level and diversification of exports to support resilient growth.

Quality of Trade and Transport-related Infrastructure, 2015

(1 = Low; 5 = High)



Source: World Development Indicators, World Bank

Efforts to diversify exports are ongoing. Two key obstacles identified in surveys are the paucity of trade-related infrastructure, and the overvaluation of the exchange rate and associated shortages of foreign exchange.

Cross-country analysis validates these perceptions: an overvalued real exchange rate hinders export diversification, while good infrastructure improves it. A real depreciation of 20 percent (in line with the 2016/17 estimated misalignment, Annex II) is associated with an export diversification of 6 percent (to Ghana's level) holding all other factors constant. Similarly, an improvement in the quality of trade-related infrastructure by 25 percent (to Chile's level) is associated with an export diversification shift of 31 percent (to Russia's level). Moreover, the analysis shows that diversification is associated with higher growth and structural transformation, two key strategic goals of the Ethiopian authorities. Export diversification is associated with value added, particularly in manufacturing and services. These results reinforce the conclusions of earlier analyses[3] showing cost considerations are critical in entering new markets, particularly for manufactures.

Export Concentration, Real Exchange Rate and Growth

VARIABLES	(1) Export concentration	(2) Agriculture	(3) Manufacture	(4) Services
RER	2.4303***			
	(0.558)			
Quality of infrastructure	-1.0244***			
	(0.225)			
Log(PPP per capita)	-0.1714**			
	(0.077)			
Exports concentration		-0.0526	-0.2794***	-0.1950***
		(0.039)	(0.077)	(0.066)
Natural rents	0.0392***	0.0044	0.0051	0.0127*
	(0.006)	(0.004)	(0.008)	(0.007)
Quality of the regulatory system	0.0015	0.0059***	0.0363***	0.0381***
	(0.004)	(0.002)	(0.004)	(0.003)
Log(population)		1.0262***	0.9529***	0.8630***
		(0.023)	(0.046)	(0.039)
Constant	4.3837***	18.9636***	18.2415***	19.5695***
	(0.692)	(0.195)	(0.382)	(0.327)
Observations	218	218	218	218
R-squared	0.376	0.910	0.756	0.781

Estimates based on a seemingly unrelated regression model using a cross-country panel of 42 African countries between 1995-2015. The results are robust even after controlling for trade openness, FDI, public investment, public debt and political stability.

Standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1.

RER is real exchange rate.

PPP GDP per capita is Purchasing Power Parity GDP per capita.

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1 Romer, P. M., 1990, *Endogenous Technological Change*, Journal of Political Economy, Vol. (98)5, pp. 71–102.

2 Acemoglu, D. and F. Zilibotti, 1997, *Was Prometheus Unbound by Chance? Risk Diversification and Growth*, Journal of Political Economy, Vol. 105(4), pp. 709–751.

3 2016 Article IV Consultations with Ethiopia (IMF Country Report No. 16/322).

18. The October 2017 devaluation of the birr and subsequent monetary tightening will help address exchange rate overvaluation. Staff estimates that the real effective exchange rate was overvalued by about 20 percent during 2016/17 based on a variety of approaches (Annex II)—resulting in widespread foreign exchange shortages. Thus, the October devaluation eliminated on impact most of the accumulated overvaluation, leaving it at about 7 percent.[7] The substantial reduction in base and broad money growth targets for 2017/18 are appropriate to contain second-round and pass-through inflationary effects (Box 3). Going forward however it will be key to maintain a flexible exchange rate to preserve competitiveness and facilitate export diversification (Box 4). Staff advised against an excessively rigid birr-USD depreciation path and argued for making it more responsive than in the past to the evolution of the USD and inflation differentials relative to trading partners.

19. The ongoing financial deepening calls for a strategic approach to reforming the monetary policy framework to ensure its continued effectiveness. Direct monetary instruments may be appropriate at an early stage of financial development.[8] However, over time, base money is expected to shrink relative to overall monetary aggregates as the financial sector deepens. In such a case, direct monetary instruments lose their effectiveness as the relationship between base and broader money aggregates weakens. Thus, the NBE should gradually move towards indirect monetary policy instruments and reduce direct budget financing, letting other financial agents and markets play a larger role. The role of the market in setting interest rates will become important, including to promote secondary market trading. Although real rates remain negative, the recent increase in interest rates is a positive step. Also, the rapid process of financial inclusion and deepening suggests that over the medium term, a slower expansion of base money than currently targeted by the NBE would be more consistent with a neutral monetary stance.

20. The obligation for banks to purchase NBE bills equivalent to 27 percent of their loan issuance remains in place. The proceeds are used to fund the Development Bank of Ethiopia (DBE). Staff argued that the current system penalizes short-term working capital financing; and that the bills' low remuneration (3 percent) makes them unsuitable for trading in the planned secondary market. Instead, DBE expansion could be funded through retained profits. If additional funding were deemed necessary, raising market financing or direct budgetary capitalization would be preferable on governance, accountability, and transparency grounds. While the current system may have initially spurred banks' deposit expansion, as the authorities argued, this objective would be better served by increasing competition through the (possibly initially limited) presence of international banks, which would result in know-how and technological spillovers.

21. Financial stability indicators do not indicate emerging vulnerabilities (Table 6). In June 2017, system-wide non-performing loans (NPLs), at 2.59 percent, remain below the statutory ceiling

[7] Measured in USD per birr, consistent with the overvaluation measurement, the devaluation was 13.04 percent.

[8] The NBE's main operational instrument is base money growth. In the current framework, interest rates do not play a significant role in the monetary transmission mechanism, but addressing negative real rates would be crucial to developing functioning financial markets. The recent increase in interest rates is expected to move the real interest rates closer to zero or positive values over time as inflation declines.

of 5 percent, while banks overall appear profitable, well-capitalized, and liquid. Nevertheless, rapid credit growth merits vigilance by banks and the NBE. In contrast, NPLs in the DBE have increased substantially to well above their separate statutory limit (15 percent). While the DBE is not a deposit-taking institution (and hence not part of the commercial banking system), the high NPL level constitutes a contingent fiscal liability. Staff welcomed plans to address this issue, including by taking decisive recovery measures, such as foreclosing and seizing collateral on NPLs related to projects that are not viable. An objective assessment of future viability of the affected loans is crucial to ensure that only profitable projects are supported.

22. Difficulties in maintaining reliable correspondent banking relationships (CBRs) by smaller non-systemic banks raises concerns. The CBR losses appear related to high compliance costs for the correspondent banks and small business volume. The NBE, together with the Financial Intelligence Center, is making progress in strengthening Ethiopia's Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework, and implementing the action plan agreed with the Financial Action Task Force (FATF), which could help forestall additional CBR losses. Also, the NBE is encouraged to examine additional options, including encouraging banks to expand or consolidate, and engage home supervisors of the correspondent banks.

Authorities' Views

23. The NBE largely agreed with staff's assessment on the exchange rate and monetary policy stance, and has taken decisive actions consistent with Fund advice. The authorities are considering staff's advice on a more flexible depreciation path. They are also taking actions to address bad loans in the DBE. Regarding the banks' obligatory purchase of NBE bills, the authorities consider that it has provided crucial incentives for banks to expand deposits and branches, without any detrimental effects on profitability—while providing the DBE with cost-effective funding and draining prior excess liquidity from the system.

C. Supporting the Emerging Private Sector

24. Efforts to spur industrialization are showing positive results. The strategic orientation of industrialization policy—a focus on labor intensive light manufacturing such as in leather, apparel, textiles, agro-processing and electricity—capitalizes on Ethiopia's competitive advantages. This is buttressed by the promotion of industrial parks, which circumvent business climate impediments through simplified procedures, tax advantages, and easy access to financial services. Wider reforms aim at addressing other bottlenecks, most notably power supply and transport links. In this regard, the imminent start of operations of key projects such as the railway to Djibouti and transmission lines from Gibe III are welcome developments. Staff encouraged the authorities to expedite the process of World Trade Organization (WTO) accession to enhance export prospects.

25. Other reforms to the business climate are necessary to elicit increased investment. Businesses consider foreign exchange shortages and onerous tax administration and licensing requirements the main impediments to investment. The package of measures around the October 2017 birr devaluation discussed above will help in this regard. The authorities' commitment to improving key business environment rankings (e.g., WB's Doing Business, World Economic Forum's

Competitiveness Index) is a positive step. The Financial Inclusion Strategy has the potential to ease the cost of doing business and support domestic investment. The authorities have intensified anti-corruption initiatives, which resulted in a number of high-profile arrests and legal prosecutions. Progress in strengthening the anti-corruption regime will also contribute to improve the investment environment.

26. New PPP legislation, with the appropriate fiscal safeguards, can help private sector development and fund public infrastructure. The Council of Ministers recently endorsed PPP legislation, soon to be approved by parliament. The creation of a PPP Directorate within MOFEC tasked with the centralized management and oversight of PPPs is welcome. Staff encouraged the authorities to work with development partners on the implementation of a PPP framework that strikes the appropriate balance between eliciting private participation and minimizing fiscal risks.

27. Ethiopia is leveraging participation in the G20's Compact with Africa to make progress on reforms and attract FDI. The authorities have integrated their strategic goals, as outlined in the GTP II, with policy commitments aimed at maintaining macroeconomic stability, strengthening domestic revenue mobilization, upgrading public investment management, and improving the business climate.

OTHER ISSUES

28. With participation of the IMF Legal Department, staff assessed the operation of Ethiopia's foreign exchange system, including the foreign exchange legal framework and market practices, against Article VIII, Sections 2(a), 3 and 4 of the IMF's Articles of Agreement. Staff has assessed that one of the four exchange restrictions in existence in 2002 (when the last assessment was conducted) has been eliminated, while the scope of another restriction has been expanded. Also, the recent bank regulations on foreign exchange prioritization and rationing give rise to a new exchange restriction.[9] Staff encouraged the authorities to remove these restrictions and recommended moving toward eventual acceptance of obligations under Article VIII. The authorities' view is that all existing restrictions affect exclusively the capital account, and that there are no exchange restrictions on current account payments; consequently, they do not intend to request their approval.

29. The NBE continues to address recommendations in the 2009 Safeguards Assessment. Following changes on the NBE board, a new audit committee has been formed, and a Risk Management Unit has started operations. A full set of audited financial statements has now been published on the NBE's website, in accordance with the safeguards policy. The NBE is also soliciting bids from consultants to transition to IFRS. Notwithstanding these developments, some recommendations focused on strengthening the external audit process, and legal amendments to address safeguards weakness in the Central Bank Law remain outstanding. The NBE did not see its full legal independence as a pressing issue, noting that it was already operationally independent in

[9] Following the recent devaluation and measures taken by the authorities, an assessment has been initiated to ascertain whether a significant spread between the parallel market cash rate and the official market exchange rate, or any other feature of Ethiopia's exchange system, may give rise to a multiple currency practice.

practice. They stressed that the NBE's monetary policy goals informed its operational decisions, including on the amount of credit extended to the government, and annual limits on the latter were strictly observed. The NBE also did not consider the distribution to the government of unrealized gains on foreign assets to be a significant risk in the context of predictable nominal birr depreciation (Informational Annex).

30. Improvement of economic statistics would strengthen policymaking and support investors' confidence. The authorities are rebasing the national accounts, which is expected to yield a significant improvement in the accuracy of estimates. Nevertheless, the national accounts remain confined to the supply side complemented by a few expenditure-side aggregates. Sectoral and income accounts or higher frequency indicators are not produced. Further, Ethiopia does not provide monetary and financial data in the Standardized Report Forms. Improvements in economic statistics and their upgrading to current international standards are urgent tasks. This would yield high returns by informing the policymaking process as well as by minimizing investors' uncertainty and enhancing the public understanding of policies.

31. The Fund's TA strategy is aligned with the identified structural reform priorities (Annex III). Capacity building efforts are especially focused on strengthening domestic revenue mobilization, upgrading the quality of economic and financial statistics, introducing secondary financial markets, modernizing monetary policy implementation, and strengthening financial supervision.

STAFF APPRAISAL

32. The preconditions for an export take-off and associated transition to private sector-led growth are in place. Ethiopia has invested in trade-enhancing infrastructure, and private investors are responding positively to these efforts. With key projects coming online, a significant improvement in exports is expected over the medium term. The ongoing shift from traditional activities to higher value added tradeable products can support continued strong growth, offsetting fiscal and monetary restraint.

33. Stagnant exports in 2016/17 have raised debt sustainability risks, but the authorities have taken decisive actions to address the underlying external imbalances. The DSA now indicates that the risk of debt distress has increased from "moderate" to "high". Staff advised steadfast implementation of ongoing policies, especially strong control of public external non-concessional borrowing, to lessen the chance of adverse outcomes. As the export take-off becomes entrenched, risks should subside, providing scope to revisit external financing of critical future projects. In the meantime, creating more room for private sector participation in investment projects is advised. Staff assesses the external position to be moderately weaker than the level consistent with medium-term fundamentals and desirable policies.

34. The October devaluation and adoption of a tighter monetary policy stance will help to reduce the external current account deficit and associated risks, while the budget execution needs to be tightened this year. Monetary policy however may need further tightening if inflationary pressure does not abate over the next few months, including further interest rate hikes.

Tight budget implementation as announced in the budget speech, targeting a return of the budget deficit to 2½ percent of GDP, and stringent monetary targets will help contain import demand and inflation. Staff supports the October devaluation of the birr which corrected a large part of its overvaluation. Going forward, adopting a more flexible exchange rate policy that responds to movements in the U.S. dollar and actual inflation differentials with respect to trading partners will be key to retain the achieved competitiveness gains and ease foreign exchange shortages. The authorities did not request and staff does not recommend approval of the exchange rate restrictions maintained inconsistently with Article VIII obligations.

35. Pressing ahead with key structural reforms is key to medium-term growth prospects. The authorities' emphasis on improving the efficiency of revenue administration and policy is crucial to create fiscal room and improve the business climate. Rolling out, as planned, a secondary market for government securities will deepen financial intermediation and improve savings allocation. It will require, however, higher real interest rates and public savings to accommodate the attendant financing costs. It will also require reforms to the compulsory purchase by banks of low-yielding NBE bills to fund the DBE.

36. Data are broadly adequate for surveillance, but further efforts to address gaps and delays would improve the policymaking process and transparency. Efforts to improve economic, fiscal, and financial statistics are welcome but there remain weaknesses in accuracy, coverage, and adoption of current standards. The upcoming national accounts rebasing is an opportunity to step up collaboration with international experts to improve the quality of statistics. The adoption of Standardized Report Forms for monetary and financial statistics is also an urgent task. Greater transparency on granular financial stability indicators and SOEs financial reporting would enhance policymaking and transparency. Staff encourages the authorities to implement the enhanced General Data Dissemination System (e-GDDS).

37. Staff recommends that the next Article IV consultation with Ethiopia be held on the standard 12-month consultation cycle.

Table 2. Ethiopia: Selected Economic and Financial Indicators, 2013/14–2021/22

Social Indicators

GDP		**Poverty indicators in 2015/16 (national definitions)**	
Nominal GDP (2016, billions of U.S. dollars)	72.5	Poverty headcount ratio (percent of population)	23.5
GNI per capita, Atlas method (2015, current US$)	590	Food poverty (percent of population)	24.8
Population characteristics		**Income distribution, 2010**	
Total (2016, million)	91.2	Income shared by highest 10 percent of population	27.4
Urban population (2015)	19.5	Income shared by lowest 20 percent of population	8.0
Life expectancy at birth (2014, years)	64.0	GINI index	30.0

Economic Indicators

	2013/14 Act.	2014/15 Act.	2015/16 Act.	2016/17 IMF Staff Est.	2017/18 IMF Staff Proj.	2018/19 IMF Staff Proj.	2019/20 IMF Staff Proj.	2020/21 IMF Staff Proj.	2021/22 IMF Staff Proj.
	(Annual percentage change)								
National income and prices									
GDP at constant prices (at factor cost)	10.3	10.4	8.0	9.0	8.5	8.3	8.1	8.0	8.0
GDP deflator	11.0	10.8	9.5	8.9	11.7	8.6	8.6	8.3	8.2
Consumer prices (period average)	8.1	7.7	9.7	7.2	11.5	8.1	8.0	8.0	8.0
Consumer prices (end period)	8.5	10.4	7.5	8.8	12.0	8.0	8.0	8.0	8.0
External sector									
Exports of goods and services (U.S. dollars, f.o.b.)	8.7	-2.6	-3.5	2.9	12.9	13.4	13.9	14.2	14.2
Imports of goods and services (U.S. dollars, c.i.f.)	14.0	25.1	2.9	-4.8	7.4	7.6	7.9	8.2	8.6
Export volume (goods)	6.4	-2.7	4.9	-1.4	13.9	12.0	13.6	14.6	15.0
Import volume (goods)	17.9	32.5	12.9	-5.4	3.9	5.6	6.2	7.2	7.6
Nominal effective exchange rate (end of period)	-2.8	2.7	-2.3	0.8	…	…	…	…	…
Real effective exchange rate (end of period)	2.6	10.1	2.6	…	…	…	…	…	…
	(Percent of beginning-period stock of broad money, unless otherwise indicated)								
Money and credit									
Change in net foreign assets	0.5	-3.2	-3.7	3.4	1.2	3.8	3.2	3.4	2.5
Change in net domestic assets (including other items net)	26.4	27.5	24.0	25.3	18.9	15.1	16.0	17.3	18.6
Broad money	26.9	24.2	20.4	28.8	20.1	18.9	19.2	20.7	21.1
Base money (annual percentage change)	18.7	15.2	16.3	22.7	16.5	16.5	16.5	16.5	16.5
Velocity (GDP/broad money)	3.56	3.51	3.43	3.12	3.15	3.12	3.06	2.97	2.87
	(Percent of GDP, unless otherwise indicated)								
Financial balances[1]									
Gross domestic savings	20.5	21.9	22.4	20.4	20.4	21.5	21.4	22.7	22.1
Public savings	5.0	3.8	3.9	1.8	1.6	1.6	1.6	1.6	1.7
Private savings	15.6	18.1	18.5	18.6	18.8	19.9	19.8	21.1	20.4
Gross domestic investment	38.0	39.4	38.5	36.6	36.4	37.7	36.9	37.5	36.3
Public investment	17.0	17.6	17.2	14.9	13.8	14.4	13.1	11.9	14.9
Private investment	21.0	21.8	21.3	21.7	22.6	23.3	23.8	25.7	21.4
Resource gap	-17.5	-17.5	-16.1	-16.2	-16.0	-16.2	-15.4	-14.8	-14.2
External current account balance, including official transfers	-6.4	-10.2	-9.1	-8.2	-7.7	-7.5	-6.8	-6.1	-5.5
Government finances									
Revenue	13.8	14.4	15.2	14.4	14.7	15.1	15.5	15.8	16.3
Tax revenue	12.5	12.7	12.5	11.8	12.4	13.0	13.4	13.9	14.5
Nontax revenue	1.2	1.6	2.7	2.6	2.3	2.2	2.0	1.9	1.8
External grants	1.1	1.0	0.9	0.7	0.8	0.7	0.6	0.5	0.4
Expenditure and net lending	17.5	17.3	18.4	18.5	18.0	18.3	18.4	18.6	18.9
Fiscal balance, excluding grants (cash basis)	-3.7	-3.0	-3.2	-4.1	-3.3	-3.2	-2.9	-2.7	-2.6
Fiscal balance, including grants (cash basis)	-2.6	-1.9	-2.4	-3.4	-2.5	-2.5	-2.3	-2.2	-2.1
Total financing (including residuals)	2.6	1.9	2.4	3.4	2.5	2.5	2.3	2.2	2.1
External financing	1.9	1.0	1.7	1.6	0.7	0.9	0.7	0.6	0.5
Domestic financing	1.3	1.4	1.6	1.9	1.7	1.6	1.6	1.6	1.6
Public debt[2]	46.8	54.0	55.4	56.9	59.0	58.1	55.5	53.1	50.7
Domestic debt	21.0	23.8	24.8	26.5	25.9	26.1	25.6	25.1	24.8
External debt (including to the IMF)	25.8	30.3	30.7	30.4	33.1	31.9	29.9	27.9	26.0
Overall balance of payments (in millions of U.S. dollars)	-97	-521	-831	658	477	688	602	742	580
Gross official reserves (in millions of U.S. dollars)	2,496	3,248	3,402	3,197	3,673	4,361	4,963	5,705	6,286
(months of imports of goods and nonfactor services of following year)	1.5	1.9	2.1	1.9	2.0	2.2	2.3	2.4	2.5
GDP at current market prices (billions of birr)	1,061	1,298	1,528	1,786	2,167				

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] Based on data from Central Statistical Agency (CSA), except for the current account balance, which is based on BOP data from National Bank of Ethiopia (NBE).

[2] Non-financial public sector debt.

Table 3a. Ethiopia: General Government Operations, 2013/14–2021/22[1]

(Millions of birr)

	2013/14 Act.	2014/15 Act.	2015/16 Act.	2016/17 IMF Staff Est.	2017/18 IMF Staff Proj.	2018/19 IMF Staff Proj.	2019/20 IMF Staff Proj.	2020/21 IMF Staff Proj.	2021/22 IMF Staff Proj.
Total revenue and grants	158,078	199,609	244,819	269,151	336,421	405,367	481,630	571,150	686,268
Revenue	146,174	186,589	231,805	256,674	318,144	386,443	462,992	552,760	668,098
Tax revenue	133,119	165,277	190,520	210,173	268,161	331,127	401,867	485,209	593,321
Direct taxes	47,021	60,149	71,844	81,417	106,117	132,933	165,363	205,102	254,778
Indirect taxes	86,098	105,129	118,676	128,757	162,045	198,196	236,505	280,109	338,545
Domestic indirect taxes	40,499	52,339	55,953	62,553	76,495	92,800	111,897	136,469	166,673
Import duties and taxes	45,599	52,790	62,723	66,202	85,549	105,395	124,607	143,638	171,870
Nontax revenue	13,055	21,312	41,285	46,502	49,983	55,316	61,125	67,551	74,777
Grants	11,904	13,020	13,014	12,477	18,277	18,923	18,637	18,389	18,170
Program grants	2,510	2,866	291	588	2,140	1,528	1,790	2,093	2,449
Project grants	9,394	10,154	12,724	11,889	16,137	17,395	16,847	16,297	15,721
Total expenditure and net lending (cash basis)	185,472	224,881	280,893	329,658	389,800	468,195	550,625	648,365	773,662
Recurrent expenditure [2]	78,087	107,198	136,709	176,635	210,705	245,905	292,520	343,899	407,087
Defense spending	7,489	8,814	9,498	11,940	12,300	15,000	17,572	20,541	24,038
Poverty-reducing expenditure [3]	38,141	55,674	71,690	89,918	109,829	129,338	155,780	182,673	216,497
Interest payments	3,794	5,338	7,232	8,248	11,391	13,172	15,613	19,638	24,897
Domestic interest and charges	2,290	2,835	3,639	4,126	6,546	7,781	9,457	12,659	17,030
External interest payments [4]	1,504	2,502	3,593	4,122	4,845	5,391	6,156	6,979	7,866
Other recurrent expenditure	28,663	37,373	48,289	66,529	77,185	88,396	103,555	121,047	141,655
Capital expenditure	107,385	117,683	144,184	153,023	179,095	222,290	258,105	304,466	366,575
Central treasury	82,175	92,424	109,236	115,772	151,439	185,860	223,438	271,059	333,250
External project grants	9,394	10,154	12,724	11,889	16,137	17,395	16,847	16,297	15,721
External project loans	15,816	15,105	22,225	25,362	11,519	19,036	17,820	17,110	17,604
Overall balance									
Including grants	-27,394	-25,272	-36,073	-60,507	-53,379	-62,829	-68,995	-77,216	-87,394
Excluding grants	-39,298	-38,293	-49,088	-72,984	-71,656	-81,752	-87,633	-95,605	-105,564
Financing	33,384	32,106	51,238	73,140	53,379	62,829	68,995	77,216	87,394
Net external financing	19,874	13,155	26,034	28,953	15,479	22,761	21,758	21,300	21,958
Gross borrowing	21,258	15,105	28,223	31,621	18,508	26,716	26,817	27,627	29,912
Project loans	15,816	15,105	22,225	25,362	11,519	19,036	17,820	17,110	17,604
Protection of Basic Services (PBS)	5,442	0	5,999	6,259	6,989	7,680	8,997	10,517	12,307
Amortization	-1,424	-1,950	-2,190	-2,669	-3,029	-3,954	-5,059	-6,327	-7,954
Domestic (net)	13,510	18,466	24,704	33,304	37,900	40,067	47,238	55,916	65,436
Memorandum items:									
Total poverty-reducing expenditure	126,782	148,493	184,576	204,284	248,045	291,597	345,567	404,268	475,077
Primary fiscal balance, including grants	-23,600	-19,934	-28,842	-52,259	-41,988	-49,657	-53,382	-57,578	-62,497

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] Government financial statistics are reported by the authorities based on GFSM 1986.

[2] Excluding special programs (demobilization and reconstruction).

[3] Poverty-reducing spending is defined to include total spending on health, education, agriculture, roads, and food security.

[4] External interest and amortization are presented after HIPC debt relief from the World Bank and the African Development Bank.

Table 3b. Ethiopia: General Government Operations, 2013/14–2021/22[1]
(Percent of GDP)

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	Act.	Act.	Act.	IMF Staff Est.	IMF Staff Proj.	IMF Staff Proj.	IMF Staff Proj.	IMF Staff Proj.	IMF Staff Proj.
Total revenue and grants	14.9	15.4	16.0	15.1	15.5	15.9	16.1	16.3	16.8
Revenue	13.8	14.4	15.2	14.4	14.7	15.1	15.5	15.8	16.3
Tax revenue	12.5	12.7	12.5	11.8	12.4	13.0	13.4	13.9	14.5
Direct taxes	4.4	4.6	4.7	4.6	4.9	5.2	5.5	5.9	6.2
Indirect taxes	8.1	8.1	7.8	7.2	7.5	7.8	7.9	8.0	8.3
Domestic indirect taxes	3.8	4.0	3.7	3.5	3.5	3.6	3.7	3.9	4.1
Import duties and taxes	4.3	4.1	4.1	3.7	3.9	4.1	4.2	4.1	4.2
Nontax revenue	1.2	1.6	2.7	2.6	2.3	2.2	2.0	1.9	1.8
Grants	1.1	1.0	0.9	0.7	0.8	0.7	0.6	0.5	0.4
Program grants	0.2	0.2	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Project grants	0.9	0.8	0.8	0.7	0.7	0.7	0.6	0.5	0.4
Total expenditure and net lending (cash basis)	17.5	17.3	18.4	18.5	18.0	18.3	18.4	18.6	18.9
Recurrent expenditure [2]	7.4	8.3	8.9	9.9	9.7	9.6	9.8	9.8	10.0
Defense spending	0.7	0.7	0.6	0.7	0.6	0.6	0.6	0.6	0.6
Poverty-reducing expenditure [3]	3.6	4.3	4.7	5.0	5.1	5.1	5.2	5.2	5.3
Interest payments	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.6	0.6
Domestic interest and charges	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.4	0.4
External interest payments [4]	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other recurrent expenditure	2.7	2.9	3.2	3.7	3.6	3.5	3.5	3.5	3.5
Capital expenditure	10.1	9.1	9.4	8.6	8.3	8.7	8.6	8.7	9.0
Central treasury	7.7	7.1	7.1	6.5	7.0	7.3	7.5	7.8	8.1
External project grants	0.9	0.8	0.8	0.7	0.7	0.7	0.6	0.5	0.4
External project loans	1.5	1.2	1.5	1.4	0.5	0.7	0.6	0.5	0.4
Overall balance									
Including grants	-2.6	-1.9	-2.4	-3.4	-2.5	-2.5	-2.3	-2.2	-2.1
Excluding grants	-3.7	-3.0	-3.2	-4.1	-3.3	-3.2	-2.9	-2.7	-2.6
Financing	3.1	2.5	3.4	4.1	2.5	2.5	2.3	2.2	2.1
Net external financing	1.9	1.0	1.7	1.6	0.7	0.9	0.7	0.6	0.5
Gross borrowing	2.0	1.2	1.8	1.8	0.9	1.0	0.9	0.8	0.7
Project loans	1.5	1.2	1.5	1.4	0.5	0.7	0.6	0.5	0.4
Protection of Basic Services (PBS)	0.5	0.0	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Amortization	-0.1	-0.2	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2
Domestic (net)	1.3	1.4	1.6	1.9	1.7	1.6	1.6	1.6	1.6
Memorandum items:									
Poverty-reducing expenditure	12.0	11.4	12.1	11.4	11.4	11.4	11.6	11.6	11.6
Primary fiscal balance, including grants	-2.2	-1.5	-1.9	-2.9	-1.9	-1.9	-1.8	-1.6	-1.5

Sources: Ethiopian authorities and IMF staff estimates and projections. The Ethiopian fiscal year ends July 7.

[1] Government financial statistics are reported by the authorities based on GFSM 1986.

[2] Excluding special programs (demobilization and reconstruction).

[3] Poverty-reducing spending is defined to include total spending on health, education, agriculture, roads, and food security.

[4] External interest and amortization are presented after HIPC debt relief from the World Bank and African Development Bank.

Table 4. Ethiopia: Monetary Survey and Central Bank Accounts, 2013/14–2021/22

	2013/14 Act	2014/15 Act.	2015/16 Act.	2016/17 Act.	2017/18 IMF Staff Proj.	2018/19 IMF Staff Proj.	2019/20 IMF Staff Proj.	2020/21 IMF Staff Proj.	2021/22 IMF Staff Proj.
	(Millions of birr, unless otherwise indicated)								
Monetary survey									
Net foreign assets	46,014	36,410	22,800	38,035	44,936	71,419	97,420	130,492	160,415
Central bank	26,821	29,973	10,506	23,977	27,848	53,135	77,856	109,558	138,016
Commercial banks	19,193	6,436	12,293	14,058	17,088	18,284	19,564	20,934	22,399
Net domestic assets	251,585	333,337	422,249	535,022	643,217	747,110	878,321	1,047,290	1,266,049
Domestic credit	300,472	394,072	491,375	627,282	698,733	837,152	977,197	1,165,235	1,411,285
Claims on government (net)[1]	26,630	30,725	47,638	85,442	103,572	123,458	146,927	174,733	207,299
Claims on nongovernment	273,842	363,348	443,736	541,840	595,161	713,695	830,271	990,502	1,203,986
Public enterprises	181,900	242,927	295,639	348,672	377,060	446,024	504,301	591,290	830,392
Private sector	91,942	120,421	148,097	193,168	218,101	267,671	325,969	399,212	373,594
Broad money	297,599	369,747	445,049	573,057	688,153	818,529	975,741	1,177,782	1,426,465
Money	133,916	153,179	178,392	216,443	270,860	314,141	361,421	433,505	520,066
Currency outside banks	53,161	60,496	66,686	73,918	89,252	104,871	126,545	148,944	173,519
Demand deposits	80,755	92,683	111,706	142,525	181,608	209,270	234,875	284,562	346,547
Quasi money	163,683	216,568	266,657	356,614	417,293	504,388	614,321	744,276	906,399
Savings deposits	136,334	174,699	217,034	293,432	338,747	403,655	485,965	578,479	691,957
Time deposits	27,349	41,869	49,622	63,183	78,546	100,733	128,356	165,797	214,442
Central bank									
Net foreign assets	26,821	29,973	10,506	23,977	27,848	53,135	77,856	109,558	138,016
Foreign assets	48,216	66,818	74,157	73,874	87,253	107,918	127,266	152,772	174,131
Foreign liabilities	21,395	36,844	63,650	49,897	59,405	54,783	49,410	43,214	36,115
Net domestic assets	62,130	72,494	108,658	122,281	142,608	145,446	153,491	159,961	175,974
Domestic credit	84,469	100,434	120,645	148,117	165,405	180,686	195,037	208,462	220,964
Government (net)	64,212	77,077	95,038	120,891	136,817	150,669	163,520	175,368	186,216
Other items (net)	-22,339	-27,939	-11,987	-25,836	-22,796	-35,240	-41,546	-48,501	-44,990
Base money	88,951	102,468	119,165	146,258	170,456	198,581	231,347	269,519	313,990
Currency outside banks	53,161	60,496	66,686	73,918	89,252	104,871	126,545	148,944	173,519
Commercial bank reserves	35,790	41,971	52,479	72,340	81,204	93,710	104,802	120,576	140,471
Cash in vault	11,179	14,744	15,907	20,328	30,151	31,046	27,384	31,506	36,704
Reserve deposit	24,611	27,227	36,572	52,012	51,053	62,664	77,418	89,070	103,766
	(Annual percentage change, unless otherwise indicated)								
Monetary survey									
Net foreign assets	2.6	-20.9	-37.4	66.8	18.1	58.9	36.4	33.9	22.9
Net domestic assets	32.6	32.5	26.7	26.7	20.2	16.2	17.6	19.2	20.9
Domestic credit	28.3	31.2	24.7	27.7	11.4	19.8	16.7	19.2	21.1
Claims on government (net)	21.2	15.4	55.0	79.4	21.2	19.2	19.0	18.9	18.6
Claims on nongovernment	29.0	32.7	22.1	22.1	9.8	19.9	16.3	19.3	21.6
Public enterprises	34.2	33.5	21.7	17.9	8.1	18.3	13.1	17.2	40.4
Private sector	19.9	31.0	23.0	30.4	12.9	22.7	21.8	22.5	-6.4
Broad money	26.9	24.2	20.4	28.8	20.1	18.9	19.2	20.7	21.1
Money	17.5	14.4	16.5	21.3	25.1	16.0	15.1	19.9	20.0
Quasi money	35.8	32.3	23.1	33.7	17.0	20.9	21.8	21.2	21.8
Memorandum items:									
Base money growth	18.7	15.2	16.3	22.7	16.5	16.5	16.5	16.5	16.5
Excess reserve deposit (billions of birr)	9,905	8,615	11,416	25,456	18,237	24,110	32,086	34,756	38,247
Percent of deposits	3.5	2.4	3.0	5.1	3.0	3.4	3.8	3.4	3.1
Money multiplier (broad money/reserve money)	3.35	3.61	3.73	3.92	4.04	4.12	4.22	4.37	4.54
Velocity (GDP/broad money)	3.56	3.51	3.43	3.12	3.15	3.12	3.06	2.97	2.87
Currency-deposit ratio	0.217	0.196	0.176	0.148	0.149	0.147	0.149	0.145	0.138
Gross official foreign reserves (millions of U.S. dollars)	2,496	3,248	3,402	3,197	3,673	4,361	4,963	5,705	6,286
Birr per U.S. dollar (end of period)	19.6	20.6	21.6	…	…	…	…	…	…
Nominal GDP (millions of birr)	1,060,825	1,297,961	1,528,044	1,786,210	2,167,121	2,552,066	2,989,715	3,494,741	4,089,722

Sources: NBE and IMF staff estimates and projections.

[1] Claims on the general government by the banking system less deposits of the general government with the banking system.

Table 5a. Ethiopia: Balance of Payments, 2013/14–2021/22
(Millions of U.S. dollars)

	2013/14 Act.	2014/15 Act.	2015/16 Act.	2016/17 Act.	2017/18 IMF Staff Proj.	2018/19 IMF Staff Proj.	2019/20 IMF Staff Proj.	2020/21 IMF Staff Proj.	2021/22 IMF Staff Proj.
	(Millions of U.S. dollars, unless otherwise indicated)								
Current account balance	-3,576	-6,579	-6,574	-6,551	-6,497	-6,613	-6,526	-6,430	-6,367
(Percent of GDP)	-6.4	-10.2	-9.1	-8.2	-7.7	-7.5	-6.8	-6.1	-5.5
Current account balance, excl. official transfers	-5,255	-8,087	-7965	-7979	-8023	-8188	-8148	-8133	-8142
(Percent of GDP)	-9.5	-12.5	-11.0	-10.0	-9.5	-9.3	-8.5	-7.7	-7.1
Trade balance	-9,929	-13,439	-13,857	-12,895	-13,582	-14,358	-15,174	-16,068	-17,062
Exports of goods	3,277	3,019	2,868	2,908	3,343	3,834	4,455	5,190	6,045
Coffee	714	780	723	882	973	1,119	1,273	1,396	1,484
Oil seeds	652	510	477	350	404	478	525	573	600
Gold	456	319	291	209	232	271	276	281	285
Other	1,454	1,410	1,377	1,465	1,734	1,966	2,381	2,941	3,676
Imports of goods	-13,206	-16,459	-16,725	-15,803	-16,924	-18,192	-19,629	-21,258	-23,108
Services (net)	712	124	-246	-61	15	158	325	536	774
Exports	3,174	3,264	3,196	3,331	3,703	4,155	4,645	5,202	5,821
Imports	-2,462	-3,140	-3,442	-3,393	-3,688	-3,997	-4,320	-4,666	-5,047
Income (net)	-153	-262	-290	-508	-545	-625	-665	-705	-443
Private transfers (net)	4,115	5,490	6,429	5,485	6,089	6,637	7,367	8,103	8,590
Official transfers (net)	1,679	1,508	1,391	1,428	1,526	1,575	1,622	1,703	1,775
Capital account balance	3,950	7,381	7,530	6,688	6,974	7,301	7,128	7,172	6,948
Foreign direct investment (net)	1,467	2,202	3,268	4,171	4,913	5,446	6,155	6,829	7,124
Other investment (net)	2,483	5,179	4,262	2,517	2,061	1,855	973	344	-176
Federal government	2,084	2,567	1,567	1,388	1,565	1,567	1,611	1,600	1,444
Disbursements	2,214	2,654	1,675	1,499	1,353	1,334	1,354	1,297	1,111
Amortization	-130	-87	-108	-112	-212	-232	-257	-303	-333
Other public sector long term (net) [1]	373	2,228	2,146	626	505	75	-141	-485	-780
Private sector borrowing (net)	0	350	451	503	487	750	17	-274	-309
Other (net)	27	34	98	0	-496	-537	-513	-498	-532
Errors and omissions	-471	-1,323	-1,787	521	0	0	0	0	0
Overall balance	-97	-521	-831	658	477	688	602	742	580
Financing	97	521	831	-658	-477	-688	-602	-742	-580
Central bank (net; increase –)	-46	-93	976	-555	-477	-688	-602	-742	-580
Commercial banks (net; increase –)	143	614	-145	-103	0	0	0	0	0
	(Annual percentage change, unless otherwise indicated)								
Memorandum items:									
Exports of goods	6.4	-7.9	-5.0	1.4	15.0	14.7	16.2	16.5	16.5
Imports of goods	15.2	24.6	1.6	-5.5	7.1	7.5	7.9	8.3	8.7
Services exports	11.3	2.8	-2.1	4.2	11.2	12.2	11.8	12.0	11.9
Services imports	7.9	27.5	9.6	-1.4	8.7	8.4	8.1	8.0	8.2
Exports of goods and services (percent of GDP)	11.6	9.7	8.4	7.8	8.3	9.1	9.5	9.9	10.3
Imports of goods and services (percent of GDP)	-28.2	-30.3	-27.8	-24.0	-24.3	-25.3	-24.9	-24.7	-24.5
Trade balance (percent of GDP)	-17.9	-20.8	-19.1	-16.1	-16.0	-16.3	-15.8	-15.3	-14.8
Private transfers (net, percent of GDP)	7.4	8.5	8.9	6.9	7.2	7.6	7.7	7.7	7.5
Gross official reserves (millions U.S. dollars)	2,496	3,248	3,402	3,197	3,673	4,361	4,963	5,705	6,286
(Months of following year imports of goods and services)	1.5	1.9	2.1	1.9	2.0	2.2	2.3	2.4	2.5
(Months of imports -- authorities' definition) [2]	1.9	2.8	3.0	2.6	2.7	2.9	3.0	3.1	3.1
GDP (millions of U.S. dollars)	55,512	64,683	72,523	79,958	84,707	87,834	96,165	105,056	114,899

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] Includes net borrowing by state-owned enterprises and NBE time deposits

[2] The NBE definition for import coverage excludes food-aid and franco-valuta imports.

Table 5b. Ethiopia: Balance of Payments, 2013/14–2021/22

(Percent of GDP)

	2013/14 Act.	2014/15 Act.	2015/16 Act.	2016/17 Act.	2017/18 IMF Staff Proj.	2018/19 IMF Staff Proj.	2019/20 IMF Staff Proj.	2020/21 IMF Staff Proj.	2021/22 IMF Staff Proj.
				(Percent of GDP)					
Current account balance	-6.4	-10.2	-9.1	-8.2	-7.7	-7.5	-6.8	-6.1	-5.5
Current account balance, excl. official transfers	-9.5	-12.5	-11.0	-10.0	-9.5	-9.3	-8.5	-7.7	-7.1
Trade balance	-17.9	-20.8	-19.1	-16.1	-16.0	-16.3	-15.8	-15.3	-14.8
Exports of goods	5.9	4.7	4.0	3.6	3.9	4.4	4.6	4.9	5.3
Coffee	1.3	1.2	1.0	1.1	1.1	1.3	1.3	1.3	1.3
Oil seeds	1.2	0.8	0.7	0.4	0.5	0.5	0.5	0.5	0.5
Gold	0.8	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.2
Other	2.6	2.2	1.9	1.8	2.0	2.2	2.5	2.8	3.2
Imports of goods	-23.8	-25.4	-23.1	-19.8	-20.0	-20.7	-20.4	-20.2	-20.1
Services (net)	1.3	0.2	-0.3	-0.1	0.0	0.2	0.3	0.5	0.7
Exports	5.7	5.0	4.4	4.2	4.4	4.7	4.8	5.0	5.1
Imports	-4.4	-4.9	-4.7	-4.2	-4.4	-4.6	-4.5	-4.4	-4.4
Income (net)	-0.3	-0.4	-0.4	-0.6	-0.6	-0.7	-0.7	-0.7	-0.4
Private transfers (net)	7.4	8.5	8.9	6.9	7.2	7.6	7.7	7.7	7.5
Official transfers (net)	3.0	2.3	1.9	1.8	1.8	1.8	1.7	1.6	1.5
Capital account balance	7.1	11.4	10.4	8.4	8.2	8.3	7.4	6.8	6.0
Foreign direct investment (net)	2.6	3.4	4.5	5.2	5.8	6.2	6.4	6.5	6.2
Other investment (net)	4.5	8.0	5.9	3.1	2.4	2.1	1.0	0.3	-0.2
Federal government	3.8	4.0	2.2	1.7	1.8	1.8	1.7	1.5	1.3
Disbursements	4.0	4.1	2.3	1.9	1.6	1.5	1.4	1.2	1.0
Amortization	-0.2	-0.1	-0.1	-0.1	-0.3	-0.3	-0.3	-0.3	-0.3
Other public sector long term (net) [1]	0.7	3.4	3.0	0.8	0.6	0.1	-0.1	-0.5	-0.7
Private sector borrowing (net)	0.0	0.5	0.6	0.6	0.6	0.9	0.0	-0.3	-0.3
Other (net)	0.0	0.1	0.1	0.0	-0.6	-0.6	-0.5	-0.5	-0.5
Errors and omissions	-0.8	-2.0	-2.5	0.7	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.2	-0.8	-1.1	0.8	0.6	0.8	0.6	0.7	0.5
Financing	0.2	0.8	1.1	-0.8	-0.6	-0.8	-0.6	-0.7	-0.5
Central bank (net; increase –)	-0.1	-0.1	1.3	-0.7	-0.6	-0.8	-0.6	-0.7	-0.5
Commercial banks (net; increase –)	0.3	0.9	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0
Gross official reserves	4.5	5.0	4.7	4.0	4.3	5.0	5.2	5.4	5.5
GDP (millions of U.S. dollars)	55,512	64,683	72,523	79,958	84,707	87,834	96,165	105,056	114,899

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] Includes net borrowing by state-owned enterprises and NBE time deposits

Table 6. Ethiopia: Financial Stability Indicators of the Commercial Banking Sector, 2012–17
(In percent, unless otherwise indicated)

	Jun-12	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17
Capital adequacy						
Capital to Risk-Weighted Assets	13.4	17.9	17.4	16.4	14.7	21.5
Regulatory Capital Tier I to Risk-Weighted Assets	13.4	17.9	17.4	16.4	14.7	21.5
Capital to Assets	6.7	7.2	7.0	6.6	6.5	9.6
Asset quality						
NPLs to Total Loans	1.4	2.5	2.0	2.1	2.9	2.6
NPLs Net of Provisions to Capital	-5.6	-0.5	-2.3	-1.1	2.9	2.1
Earning and profitability						
Return on Assets	3.9	3.2	3.1	3.1	2.7	2.4
Return on Equity[1]	55.7	48.0	44.9	47.4	43.0	29.6
Gross Interest Income to Total Income [2]	56.8	64.9	62.8	67.9	73.9	74.9
Interest Margin to Gross Income	39.1	45.1	42.3	46.1	49.9	48.4
Non-interest Expenses to Gross Income [3]	22.9	26.9	32.7	32.1	33.1	34.2
Personnel Expenses to Non-interest Expenses	42.2	43.3	43.7	47.4	48.2	51.3
Liquidity						
Liquid Assets to Total Assets	20.6	23.2	16.2	11.7	11.9	12.9
Liquid Assets to Short-term liabilities	26.7	30.1	20.8	14.8	15.6	17.0
Total Loans and Bonds to Total Deposits [4]	94.0	93.9	100.6	105.0	107.2	107.3

Source: National Bank of Ethiopia

[1]The average capital used to calculate the ROE execludes retained earning and profit & loss.

[2] Total income comprises gross interest income and gross non-interest income.

[3]Gross income comprises net interest income and total non-interest income.

[4]Customer deposit includes time, current and saving deposits.

Annex I. Risk Assessment Matrix (RAM)[1]

Source of Risk	Relative Likelihood	Impact if realized	Policy Response
Domestic Risks			
Insufficient progress in reprofiling public investment program in line with export outcomes or the availability of financing that does not increase public sector external debt.	**M/H**	H. With thin reserves, any shocks to debt service or meeting other financial obligations risks could result an undesirable import compression, withdrawal of private financing, including FDI, and a derailing of Ethiopia's growth momentum.	Continue to maintain strict control over external borrowing of the public sector. Limit domestic credit to reduce pressures on the exchange rate. Exchange rate flexibility could also help alleviate pressures by reducing domestic demand for FX.
Slow progress in reforms enhancing export competitiveness.	**H**	H. Underperformance of exports, decreased foreign currency availability and lower capital goods imports. Slowdown in investment and growth. Weaker debt sustainability.	Implement structural reforms to enhance competitiveness, support export diversification, and address corruption. Allow greater exchange rate flexibility to support export competitiveness. Postpone some investment to reduce public sector borrowing and avoid deterioration in debt sustainability.
Slow implementation of tax administration and tax law reforms, hindering achieving targets in GTP II.	**H**	H. Fewer resources for investment, slower growth and less progress on poverty reduction.	Prioritize investment adequately to growing country's capacity to generate taxes. Accelerate tax administration and tax policy reforms to strengthen fiscal revenues.
Deterioration in asset quality in banks to due poor financial performance of SOEs.	**L**	H. Higher fiscal costs related to an increase in contingent liabilities, either directed at bailing out SOEs or recapitalizing banks, which could divert resources from investment. Loan write-offs could lead to credit curbs, further weakening growth.	Strengthen oversight of SOEs' performance. Prioritize large-scale investment to ensure efficient use of scarce domestic resources. Strengthen bank supervision and enforce prudential limits.
Climate change. Increased frequency of drought conditions,	**M**	H. Food price shock leading to a higher food inflation. Adverse social impact, and stalled progress in poverty reduction. Lower agricultural exports, higher social spending, higher spending in remedial measures (food and fertilizer imports, animal feed, etc.). Underperformance in hydro-power generation leading to lower supply for domestic consumption and lower exports.	Increase food assistance. Tighten monetary policy if second-round effects are significant. Slow SOE imports and increase fiscal expenditure for social and medical protection. Develop medium-term strategies to diversify energy mix.
Social/political unrest.	**L**	L/M. Further social unrest or prolonged maintenance of emergency security measures	Accelerate reforms to improve the business environment and private

		could impact growth, foreign direct investment, and the tourism sector.	sector development, to reassure domestic and foreign investors.
External Risks			
Tighter global financial conditions (including leading to an appreciation of the U.S. dollar and euro)	**H**	H. Rising cost of external financing and higher risk premia on frontier markets like Ethiopia. If the birr is not allowed to adjust, further real appreciation, adversely affecting exports and the external deficit. Deterioration of the external debt position.	Reduce need for external financing by improving domestic revenue performance and prioritizing externally-financed capital projects. Accelerate reforms enhancing export competitiveness. Adopt a more flexible exchange rate policy. Prioritize investment projects to ensure debt levels remain manageable.
Retreat from cross-border integration.	**H**	H. Lower demand for Ethiopia's main exports leading to widening trade deficit and weaker debt sustainability. Reduction in remittances from diaspora.	Accelerate reforms enhancing export competitiveness. Adopt a more flexible exchange rate policy.
Reduced financial services by correspondent banks ("de-risking").	**M**	H. Reduction in availability of foreign exchange to private banks, increase in cost of cross-border transactions, including remittances. Higher current account deficit and lower growth. Lower capacity of banks to finance economic activity.	Swiftly address AML/CFT deficiencies and avoid further action by the FATF. Closely monitor status of CBR and effectively communicate respondent banks' AML/CFT compliance efforts to correspondent banks. Explore opportunities for banking sector consolidation.
Weaker-than-expected global growth	**L/M**	H. Lower demand for Ethiopia's main exports leading to widening trade deficit and weaker debt sustainability.	Accelerate reforms enhancing export competitiveness. Adopt a more flexible exchange rate policy.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of Fund staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities.

Annex II. External Sector Assessment

Based on data as at June 2017, the external position was assessed to be moderately weaker than the level consistent with medium-term fundamentals and desirable policies. The exchange rate was found to be overvalued by about 20 percent, while international reserves were found to be below model-based optimal benchmarks. To address external imbalances and strengthen competitiveness, the authorities devalued the currency and tightened monetary policy in October 2017. The magnitude of these changes likely largely addressed the estimated currency overvaluation. However, the final impact will depend on the pass-through of exchange rate changes into domestic prices. The tight monetary stance should help preserve a significant part of the competitiveness gains, support net exports and strengthen foreign reserves.

1. Until the devaluation of the exchange rate in October 2017, the National Bank of Ethiopia's framework on managing its exchange rate had remained unchanged since the 2016 Article IV Consultation. The official exchange rate against the U.S. dollar depreciated by 5.8 percent in 2016/17, similar to the 6 percent depreciation observed in 2015/16. Data on the parallel market rate also showed a widening of the margin. On a trade-weighted basis, the birr depreciated by a smaller magnitude, 2.8 percent in 2016/17, reflecting the strengthening of the U.S. dollar against other currencies which partly offset the depreciation in the bilateral rate. As a result of this and Ethiopia's relatively high inflation rate relative to its trade partners, the real effective exchange rate appreciated by 3.3 percent over the same period.

2. Since the staff mission took place, the NBE has taken significant actions to address external imbalances. The birr was devalued by 15 percent against the U.S. dollar in October 2017. Also, to contain inflationary pressures, the NBE has tightened monetary policy. The floor on deposit rates was raised from 5 to 7 percent, while the NBE's reserve money target was lowered from 22 percent to 16 percent. Staff expects that while some pass through from the exchange rate to domestic prices will occur, the tightening of policies will help preserve a significant part of the gains in competitiveness and thus reduce the overvaluation going forward.

3. Before taking the devaluation into account, the real exchange rate was higher than warranted by productivity levels. Some of the observed real appreciation could arise in equilibrium as a result of Ethiopia's strong per capita GDP growth (an indicator of productivity growth) due to the Balassa-Samuelson-Penn effect. However, even when taking this effect into account, the real exchange rate in 2016 was elevated in a cross-country context. Staff used a variant of the approach in Rodrik (2009),[1] and fitted a log-linear model of real exchange rates against per capita GDP (both measured relative to the annual sample average, and with time dummies) in a large sample of countries for 2000–2016. Fuel and commodity exporters as well as small and micro-states were excluded from the sample. Comparing the actual real exchange rate with the level estimated by the fitted curve, the birr was found to be overvalued by 20.8 percent in 2016. This is smaller than the

[1] Rodrik, D., 2009, *The Real Exchange Rate and Economic Growth*, Brookings Papers on Economic Activity (Washington, DC: Brookings Institution Press), March 30.

36 percent estimated using Rodrik's original methodology (which provided a poorer statistical fit) for 2015 in the last staff report.

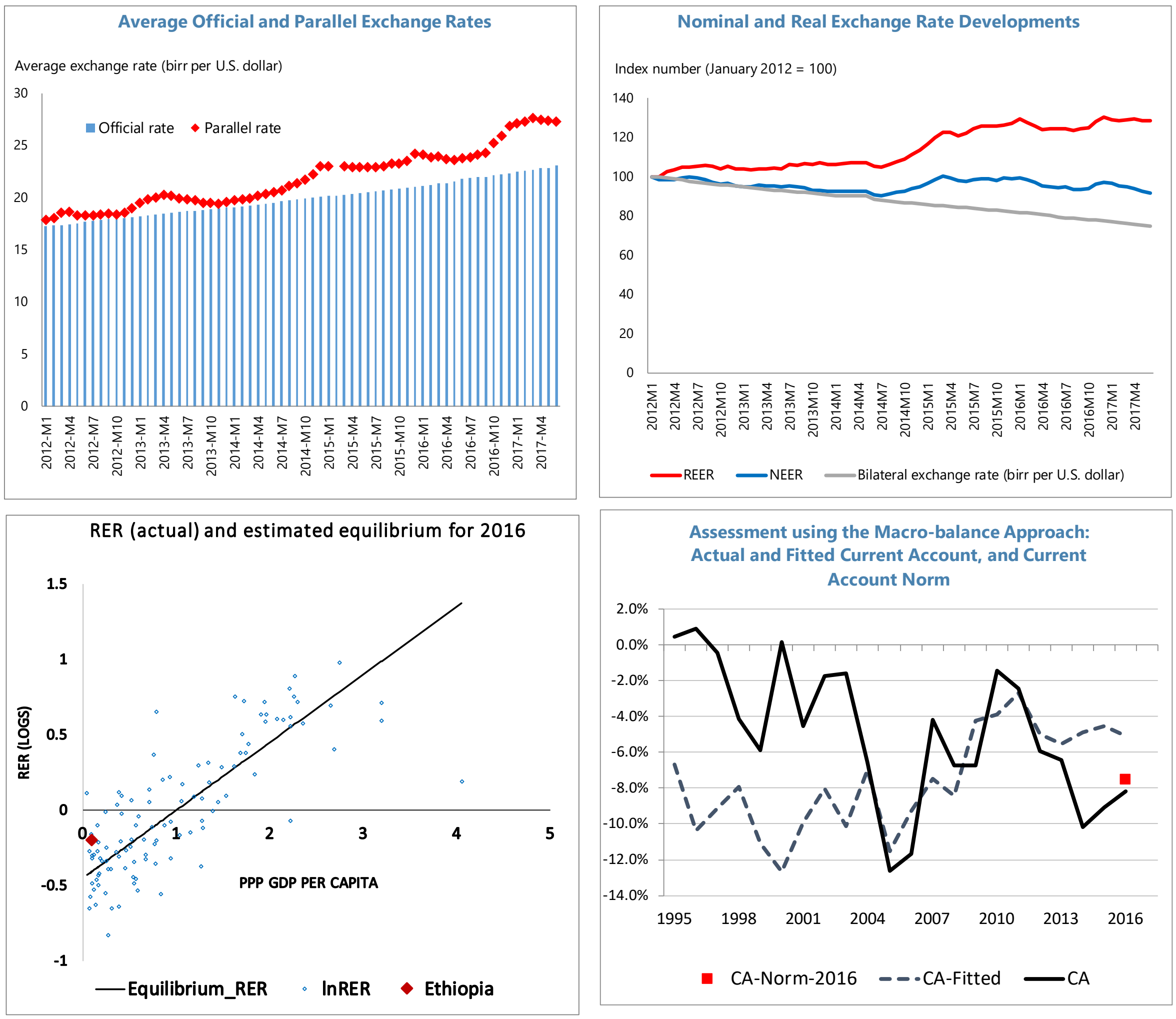
4. The current account model of the Fund's EBA-lite methodology[2] pointed to a similar magnitude of overvaluation of around 22 percent in 2016/17—thus, also before the recent devaluation. The current account deficit for 2016/17 was 8.2 percent of GDP, whereas the fitted current account deficit—consistent with Ethiopia's economic and demographic fundamentals—is 5.1 percent, a gap of 3.1 percentage points. Decomposing this gap into a policy gap (the contribution of policies to the divergence), and the norm (the residual, including cyclical factors), we find that policies had reduced the gap by 1.3 percentage points due to a private credit-to-GDP ratio below the long-run level, though this is partly offset by the lower-than-adequate level of international reserves (see Figure II.2). The other policy variables—the fiscal deficit and degree of capital and financial account openness—were near their assumed long-run values and therefore broadly neutral on the gap. Once imports arising from public sector-driven investment were excluded,[3] the remaining gap amounted to 0.7 percentage point. Applying the updated export and import elasticities in the current account EBA-lite template, we derived an overvaluation of 21.9 percent for 2016/17, lower than the 33.2 percent in the last staff report.

5. The October 2017 devaluation likely reduced the estimated overvaluation substantially. The immediate impact of the devaluation was a commensurate depreciation of the real exchange rate of around 13 percent (measured as USD per birr), which brought the estimated overvaluation to around 7 percent. However, the full final impact will depend on the magnitude of the pass-through effects of the devaluation on domestic inflation. Steadfast implementation of the strong monetary policy response announced by the NBE would help contain inflation after an initial increase and ensure that the gains to competitiveness are largely preserved. Subsequently, the NBE should also stand ready to adopt a more flexible exchange rate determination to ensure that inflation differentials vis-à-vis major trade partners and fluctuations of the USD against trading partners' currencies (which are unrelated to Ethiopia's economic conditions) do not erode the regained competitiveness.

[2] Methodological Note on EBA-lite (IMF Policy Paper, February 2016).

[3] Similar to the approach taken in the 2016 staff report, we adjusted the norm for part of the imports related to public investment, amounting to 1.2 percent of GDP, arising from public investment spending, based on customs data for 2016/17.

Figure II.1. Exchange Rate Developments and Assessment



Sources: Ethiopian Authorities and IMF staff calculations.

6. **Foreign reserves have declined in 2016/17.** The National Bank of Ethiopia received an inflow of US$1 billion from an official bilateral creditor at the end of 2015, which was mainly used to finance imports, primarily foodstuffs, to alleviate the adverse impact of drought. As at March 2017, the level of reserves stood at US$3.2 billion, sufficient to finance 1.8 months of prospective imports

of goods and services, down from 2.1 months in June 2016. According to the NBE's own measure, [4] reserves amounted to 2.5 months at the end of June 2017.

7. Balance of payments developments could put pressure on international reserves. Data for the H1 2016/17 showed a narrowing of the external current account deficit on account of a decline in imports of goods and non-factor services that more than offset lower private transfers. Current projections suggest the deficit will remain large at 8.2 percent of GDP in 2016/17. Given the central bank's policy of smooth and predictable depreciation at about 6 percent annually, pressures on international reserves may emerge. Shortages of foreign exchange have persisted. The unofficial (parallel) exchange rate, previously published by the NBE, is no longer being disclosed publicly. However, based on the NBE's latest surveys, the average parallel market exchange rate for June 2017 was 18.2 percent more depreciated than the average official exchange rate.

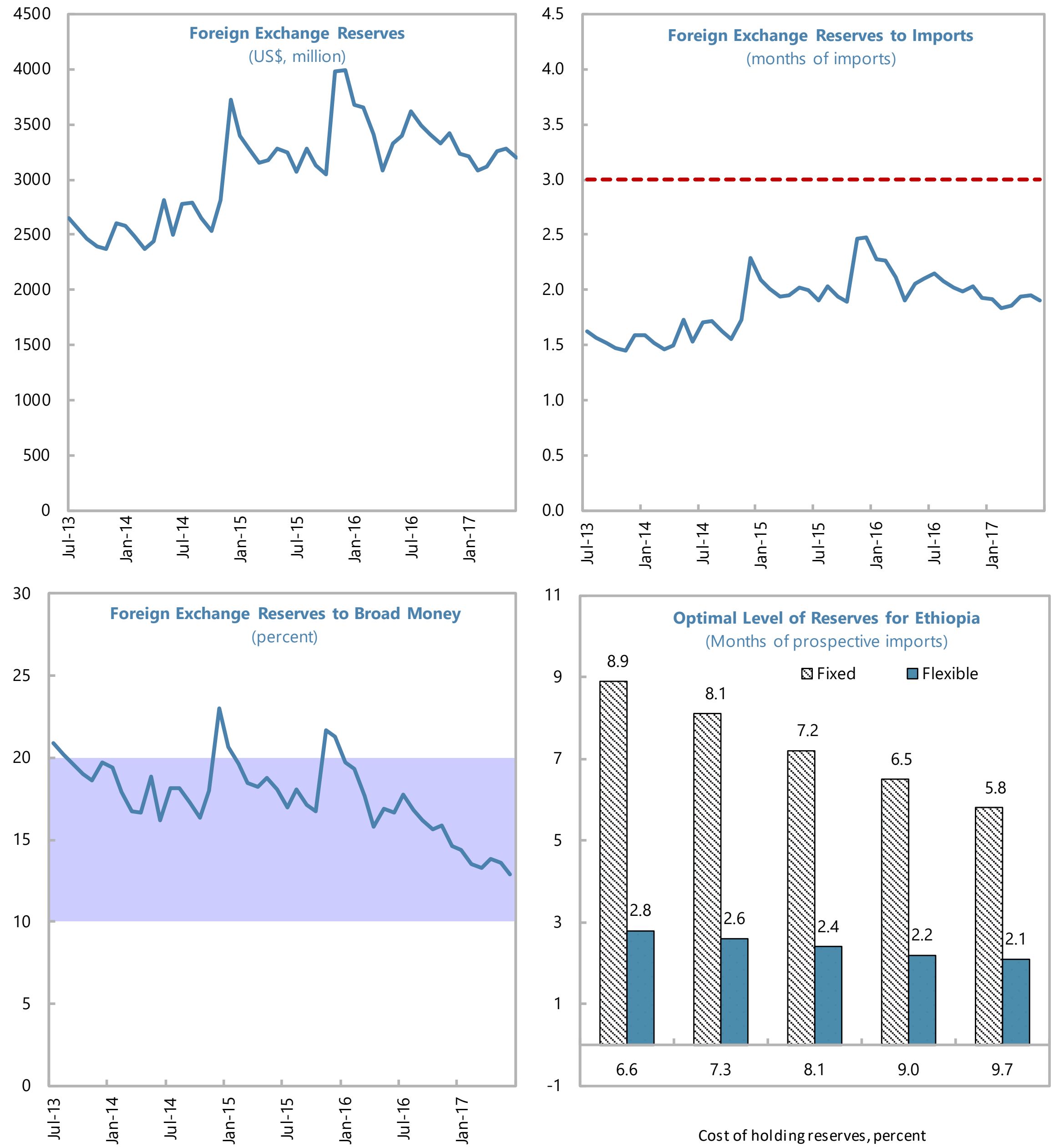
8. Evaluated using data for June 2017, Ethiopia's foreign reserves are below model-based optimal benchmarks. While the reserves-to-broad money ratio shows reasonable coverage around 10–20 percent, other indicators are raise concerns. A formal reserve adequacy assessment based on a cost-benefit analysis for a credit-constrained low income country[5] gives a range of estimates for adequate reserve levels, depending on the assumptions on the costs of maintaining reserves. The model evaluates shocks in external demand, terms of trade, foreign direct investment and aid flows, based on an updated panel regression. The model also assesses reserve adequacy based on the exchange rate regime, with a fixed rate regime calling for higher reserves. Ethiopia maintains a crawl-like arrangement,[6] with the authorities aiming for a smooth depreciation of the birr against the U.S. dollar. Therefore, the model's assessment for a country with a fixed exchange rate suggests that the optimal reserve coverage should lie between 5.8 and 8.9 months of prospective imports for plausible costs of reserves (proxied here by the range of yields observed on Ethiopia's sovereign 10-year Eurobond between July 2015 to June 2017). In the floating rate case, adequate reserves are assessed as between 2.1 to 2.8 months. The model results underscore the need for further reserve accumulation.

[4] Ethiopian authorities calculate the reserve coverage by deducting food aid and franco-valuta imports from total imports. The reserve target of 3 months of import coverage under the national definition translates into an import coverage slightly above 2 months under the standard definition.

[5] Based on proposals for assessing reserve adequacy contained in the 2015 staff report on Assessing Reserve Adequacy (SM/14/334) and the June 2015 guidance note.

[6] See the 2015 Annual Report Exchange Arrangements and Exchange Restrictions.

Figure II.2. Reserve Adequacy Analysis



Sources: Ethiopian Authorities and IMF staff calculations.

Annex III. Capacity Development Strategy for FY 2018–20

1. **Ethiopia is the second largest country in sub-Saharan Africa (SSA) in terms of population and about the fifth largest economy.** The country is undergoing significant structural and economic reforms, and experiencing high growth. However, it is still among the lowest income countries. In the short term, the recent civil unrest and subsequent state of emergency poses risks to the ambitious private sector development reforms envisaged in the GTP II, both because of political economy pressures and the potential adverse effect on investment. A recent cabinet reshuffle has resulted in a more technocratic and reform-oriented economic policy team being put in place.

2. **In this context, TA intensity from the HQ is relatively low, and most of the TA is provided through the regional center in East Africa.** In Financial Year (FY) 2016 Ethiopia received TA equivalent to 1.9 FTEs, ranking 24th among 45 SSA TA recipients. Ongoing and planned HQ TA focuses on tax administration reforms, PFM, resource revenue modeling, and production of quarterly national accounts. In 2016, Ethiopia started to benefit from the advice of a Long-term Technical Assistance Expert (LTX) (on the development of the secondary market for government securities) funded by DFID. Recently, the authorities have requested Fund TA on the issue of quantifying and assessing tax expenditures and incentives. In addition to the TA topics flagged above, the areas of support could be expanded by including PIMA, an in-depth general assessment of tax policy, advice on strengthening correspondent bank relationships and the AML/CFT framework, improving the reliability and comprehensiveness of national statistics, and advice on strengthening supervision and regulation and benchmarking supervisory processes against international standards.

3. **In support of these policy priorities, the proposed strategy for IMF TA FY18–20 is as follows:**

Priorities	**Objectives**
Domestic Revenue Mobilization	Increase tax revenue to GDP ratio.
PFM and Budget Efficiency	Strengthen the public finance management.
Correspondent Banking Relationships and AML/CFT	Address the risk of potential and actual loss of CBR and strengthen the AML/CFT framework.
Liquidity Forecasting and Management, and Development of the Interbank Money Market	Enhance liquidity forecasting by developing a viable framework for liquidity forecasting and management, and a well-functioning interbank money market.
Data quality and statistics	Enhance the coverage, timeliness, reliability and integrity of economic statistics.
Strengthen risk-based supervision, supervisory review processes and market discipline (Basel II implementation)	Address current gaps in supervisory and regulatory processes.

4. **To achieve these objectives, it is expected that FAD, MCM, and STA will provide TA, supported by AFRITAC East.** Depending on the authorities' readiness and availability of resources, LEG's support in strengthening the AML/CFT framework could be provided in the context of pressures on CBRs.

5. **The main risks to the impact of the TA in FY18 include capacity constraints, including the insufficient number of staff working on key capacity development issues in the various agencies, a lack of coordination between agencies involved in various TA interventions, and commitment and ownership of the authorities in implementing TA recommendations.** These risks could be mitigated by stronger selection of TA projects to ensure greater ownership by the authorities, earmarking dedicated staff in government agencies to implement the reforms, and close coordination with Fund surveillance activity to ensure macro-critical projects are given priority.

Authorities' Views

6. **The authorities have reviewed this Capacity Development Summary and provided suggestions and comments to clarify their strategy.** These comments have been incorporated.

Annex IV. Authorities' Response to Past IMF Policy Recommendations

1. **Addressing external imbalances.** Staff previously advised the authorities to align import and borrowing plans to actual export performance. Various steps were taken in this direction since the 2016 consultations: low priority fiscal expenditure was deferred or canceled, resulting in a lower-than-budgeted fiscal deficit; and a directive to strictly control external borrowing by public enterprises, especially non-concessional borrowing was issued in October 2016. Consequently, both imports and the pace of accumulation of external non-concessional borrowing were curtailed significantly.

2. **Allowing greater flexibility in the exchange rate to address exchange rate overvaluation and improve competitiveness.** While the NBE continued to allow the birr to depreciate steadily by around 6 percent over the course of 2016/17, the appreciation of the U.S. dollar until end-2016 largely eroded those gains. In addition, the uptick in domestic inflation resulted in upward pressure on the real exchange rate, more than offsetting the gains from the nominal movement of the birr. The devaluation of the birr relative to the U.S. dollar announced in October 2017 helps address this gap. The NBE's tighter monetary stance to contain the possible impact on inflation should also help preserve the gains to competitiveness from the nominal exchange rate adjustment and bring the birr closer to its equilibrium.

3. **Step up domestic resource mobilization.** With the assistance of development partners (including the Fund), the authorities have advanced in some areas of the domestic revenue mobilization agenda (Box 2). Despite authorities' efforts, the revenue ratio declined from 15.2 to 14.4 percent of GDP between 2015/16 and 2016/17, suggesting additional efforts are necessary. On other key macro-fiscal reforms, there was progress on adopting reforms to the PPP framework, with a new PPP law expected to be passed by the Parliament in its next session. However, the authorities have not yet acted on the recommendation to participate in a joint WB-IMF Public Investment Management Assessment (PIMA).

4. **Facilitate modernization of the monetary framework and development of the financial system.** Staff recommendations on interest rates, exchange rate, and financial sector policies including: (i) allowing for flexible determination of the interest rates, (ii) improving market functioning and price setting mechanism for the exchange rate aimed at increasing exchange rate flexibility, and (iii) phasing out the requirement that private banks invest in NBE bonds a 27 percent of their credit (to finance the Development Bank of Ethiopia, DBE), have had mixed traction. The decision to raise the floor on the deposit interest rate from 5 to 7 percent announced in October 2017 begins the process of addressing negative real interest rates, though further steps are needed. The NBE has also announced its intention to allow secondary trading of government-issued securities during 2017/18, which would benefit from higher rates of return on papers. Non-performing loan (NPL) levels in the DBE have increased since the last consultations, and may call for more aggressive actions on the part of the regulator.

5. Address gaps in the quality and timeliness of economic statistics. Fund TA to improve data quality, especially for the compilation of the national accounts and balance of payments, has intensified, and work to re-base the national accounts is in train. However, TA experts have had limited access to both the primary data and methodological tools used in the compilation of the data. There has also been little progress on migrating to more recent GFSM fiscal reporting standards and summary consolidated accounts of the public enterprises are not produced.

Annex V. Millennium Development Goals

	Base Year 2015	Target by 2020
Goal 1: End poverty in all its forms everywhere		
National headcount poverty rate (measured as people leaving on less than $1.25 a day) (in %)	23.4	16.7
Share of resources allocated to poverty reduction (as expenditure to GDP) (in %)	12.3	15.4
Goal 2: End hunger, achieve food security and promote sustainable agriculture		
Productivity of major crops (quintal/hectare)	21.5	27.3
Number of smallholder farmers of agricultural extension service beneficiaries ('000)	14,014	16,776
Number of pastoralists of agricultural extension service beneficiaries ('000)	690	858
Quantity of chemical fertilizers supplied (in metric ton)	1,025,231	2,062,106
Quantity of improved seed supplied (in '000 quintals)	1,874	3,560
Land with community based water shade development program (mln hectares)	12.2	41.4
Land with modern small scale irrigation schemes (mln hectares)	2.3	4.1
Goal 3: Ensure healthy lives and promote well-being for all at all ages		
Maternal mortality ratio (%)	420	199
Under-five mortality rate (%)	64	30
Neonatal mortality rate (%)	28	10
Number of HIV infections (per 1,000 uninfected population)	0.03	0.01
Coverage of essential health services (i.e.: reproductive, maternal, newborn, and child health, infectious diseases, and others) (% of population)	98	100
Goal 4: Ensure inclusive and equitable quality education		
Primary school net enrolment rate (%)	96.9	100
Primary school completion rate (%)	52.2	74
Share of primary school certified teachers (%)	71.4	95
Share of secondary school certified teachers (%)	87.3	100
Adult education participation rate (%)	74.4	100
Undergraduate program admission capacity	755,244	1,106,287
Total number of students admitted to post graduate program	28,140	56,000
Goal 5: Achieve gender equality and empower all women and girls		
Proportion of seats held by women in national parliaments (%)	38.8	50
Share of decision-making role of women in the federal executive bodies (%)	9.2	40
Share of mobile phone owners (in million)	38.8	103
Goal 6: Ensure availability and sustainable management of water and sanitation		
Proportion of population using safely managed drinking water (%)	58	83
Goal 7: Ensure access to affordable and sustainable energy		
Proportion of population with access to electricity (%)	60	90
Consumption of green renewable electric power source in MW	4,091	16,699
Goal 8: Promote sustained, inclusive economic growth, full and productive employment		
Unemployment rate (%)	4.1	3.5
Number of jobs in tourism industry (million)	0.7	1.7
Number of commercial bank branches	2,868	5,736
Goal 9: Build resilient infrastructure, promote inclusive industrialization and foster innovation		
Share of rural population, who live within 5 km of an all-season road (%)	13.5	36.6
Micro and small manufacturing industry growth rate (%)	2.9	23.5
Micro and small manufacturing as share of GDP (%)	1.1	1.8
Research and development expenditure as a proportion of GDP (%)	0.61	1.0
Goal 10: Reduce inequality		
Per capita income in USD	691	1,177
Income distribution (GINI coefficient)	0.3	0.3
Goal 11: Take urgent action to combat climate change and its impacts		
Share of population living in slums and inadequate settlements (%)	…	…
Share of population that has access to public transport (%)	34	52
Other		
Number of new and amended legal documents promoting sound public procurement	…	4
Number of improved policies, strategies, rules, directives and guidelines	…	20
Share of children under 5, whose births have been registered with a civil authority (%)	…	50
Number of internet users ('000)	40,000	103,662
Forest coverage (%)	16	20

Source: The Ethiopian National Planning Commission

INTERNATIONAL MONETARY FUND

December 12, 2017

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

Approved By
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Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)

Stagnant exports in 2016/17, due to a weak external environment and delays in completing key export-oriented projects, and the maturing of non-concessional borrowing contracted in the last 5 years has resulted in a deterioration of the 2017 Debt Sustainability Analysis (DSA) indicators relative to 2016. As in the 2016 DSA, the net present value of external debt-to-exports (PVDE) breaches the threshold in the baseline. In addition, there is now a breach of the debt service-to-exports (DSE) indicator. That said, there is no breach of the debt service-to-exports-plus-remittances indicator. In 2016/17 there was also a decline in external reserves, and widespread foreign exchange shortages. As a result, the risk of external debt distress is now assessed as "high".

After the 2016 DSA discussions, and as exports underperformed, the authorities took decisive remedial actions consistent with staff advice. They curtailed import-intensive public projects to reduce external public borrowing and keep non-concessional borrowing (NCB) within the 2016 DSA envelope. They introduced strict control mechanisms on NCB by government and state-owned enterprises which resulted in the stabilization of the PV of external debt. The 2017/18 budget speech reaffirmed this restrictive fiscal stance. These policies were crucial in narrowing the external current account deficit by one percentage point of GDP to 8.2 percent in 2016/17 despite weak exports. In October 2017, following the 2017 Article IV Consultation and DSA discussions, the authorities devalued the birr by 15 percent and adopted a restrictive monetary stance to further reduce external imbalances and gain competitiveness.

With steadfast implementation of the announced policies, and the expected export take-off, risks are projected to diminish. However, policy slippages or further delays in export supply would keep risks elevated for an extended period. On the upside, faster-than-projected ramp up of exports—driven by recently completed projects—would strengthen debt sustainability. The projected baseline path of total public sector debt (external plus domestic) does not result in additional risks beyond those discussed for the external debt.

BACKGROUND AND RECENT DEVELOPMENTS

1. **Ethiopia's debt-financed public investments in infrastructure over recent years have boosted growth.** Ethiopia reached the completion point under the Heavily Indebted Poor Countries (HIPC) Initiative in 2004 and benefited from debt relief under the Multilateral Debt Relief Initiative (MDRI) in 2006.[1] Public and publicly guaranteed (PPG) external debt[2] fell in the years that followed, reaching a low of 18 percent of GDP in mid-2012. By end-2016/17,[3] it stood at 30.7 percent of GDP[4] and total (including domestic) public debt was at 57 percent. Since FY13,[5] IDA set non-concessional borrowing (NCB) ceilings for Ethiopia in cooperation with the authorities. The ceilings were initially set at US$1 billion in FY13, FY14, and FY15. While constant in absolute terms, in percent of GDP the ceilings imposed shrinking borrowing space for non-concessional financing over time (from 2.1 percent of GDP in FY13 to 1.6 percent of GDP in FY15). In response to a shift in the risk of debt distress rating from low to moderate, the NCB ceilings for FY16 and FY17 were further adjusted downward to 1.1 and 0.5 percent of GDP, respectively. Over the past three years, the authorities adhered to the agreed ceilings. The NCB ceiling for FY18 was set at $400 million or 0.5 percent of GDP.

2. **Ethiopia's risk of debt distress was assessed as "moderate" in the 2016 DSA, but risks have increased.** In the 2016 DSA, one indicator—the present value of debt to exports (PDVE)—breached the threshold under the baseline. Nevertheless, staffs of the Fund and IDA exercised judgment, as allowed by the guidelines, in reaffirming the moderate risk rating. This judgement was based on the mainly concessional composition of the debt and the official nature of most creditors, the virtual absence of tradeable debt, and strong restrictions on capital account transactions—all making unlikely a debt distress episode prompted by a disorderly market reaction. It was also considered that the debt had been devoted to investments with high expected growth return—thus increasing the capacity to repay—rather than to financing current spending. All these risk-mitigating factors remain in place. The 2016 DSA however also indicated that a continuation of export underperformance would materially deteriorate the debt sustainability prospects. In 2016/17, stagnant export revenue due to delays in coming on-stream of some export-oriented infrastructure projects, coupled

[1] Debt relief negotiations with a number of bilateral creditors (Bulgaria, Libya, Russia and FR Yugoslavia) and commercial creditors from Italy, the former Czechoslovakia, India, and FR Yugoslavia are ongoing. The total principal in arrears to these creditors amounted to US$355 million. Standard HPIC terms were assumed for this amount in the DSA.

[2] PPG debt includes the foreign debt of the National Bank of Ethiopia, the debt of the federal government, regional governments, all state-owned enterprises that borrow externally, except Ethiopian Airlines (EAL). EAL meets the criteria for exclusion set out in the 2013 Staff Guidance Note on the Debt Sustainability Framework for low-income countries (Annex 3) because it is run on commercial terms, has a sizeable profit margin (as reflected in audited accounts published annually), enjoys managerial independence, and borrows without government guarantee. The debt of Ethiopian Telecom (ETC), which also borrows without a government guarantee, does not meet these criteria and is therefore included in the DSA. In the past, the authorities have requested the exclusion of ETC, which would have a material impact on the results of the DSA. An important requirement in this context is the availability of independent annual financial audits and publicly available comprehensive annual reports.

[3]The DSA is based on the Ethiopian fiscal year, which runs from July–June.

[4] Including debt outstanding to the Fund.

[5] Financial years mentioned in this paragraph (prefixed by FY) refer to IDA NCB ceilings and correspond to financial years of the World Bank.

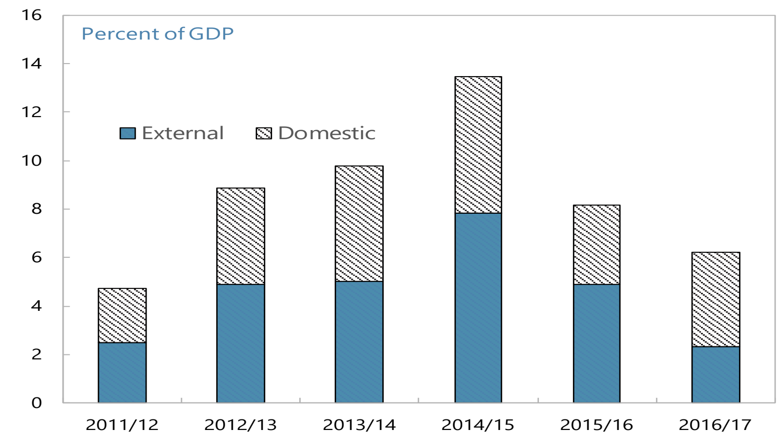
with a ratcheting up of debt service coming due as past obligations are starting to mature have resulted in a higher ratio of debt service to exports than envisaged in 2016.

3. **After the 2016 DSA discussions, the authorities appropriately took determined policy actions to address external risks**. In October 2016, the Ministry of Finance and Economic Cooperation (MOFEC) issued a directive establishing strict controls on contracting of new NCB by state-owned enterprises (SOEs) and oversaw a prudent implementation of the 2016/17 budget in order to cut NCB and import-intensive investment projects. As a result, public external borrowing has fallen drastically from the already reduced levels of 2015/16 (Text Figure 1), the stock of commercial borrowing outstanding has declined, and the PV of debt has been stabilized. The recently approved 2017/18 budget envisages a continued decline in external NCB as a percent of GDP,[6] commits to maintain NCB within the strict limits envisaged in the 2016 DSA during 2016/17, and appropriately sequence infrastructure projects.

4. **Subsequently, the authorities have taken additional steps in 2017/18 to reduce risks and elicit private sector participation in public projects.** In October 2017, the National Bank of Ethiopia (NBE) devalued the birr by 15 percent, aiming to improve competitiveness and address external imbalances. The NBE also tightened monetary policy by raising the floor on time and savings deposit rates from 5 to 7 percent, and reduced the 2017/18 target growth of base money (the NBE's operational target) from 22 percent to about 16 percent to contain the pass-through from the exchange rate into domestic prices. This restrictive monetary policy stance appropriately aims at dampening domestic absorption and preserving the achieved competitiveness gains. The NBE also loosened foreign exchange restrictions on exporters, allowing them to retain a larger proportion of their export earnings and access foreign borrowing, and restrictions on private sector external borrowing. The authorities have also indicated that options to encourage private sector participation in public projects such as Public-Private Partnerships (PPPs), the use of concessions, and privatization are being actively explored. A new PPP law has been approved by the Council of Ministers and is expected to be passed by Parliament early in the current session. To manage potential fiscal risks, the PPP framework will need to strike the appropriate balance between eliciting private participation and minimizing fiscal risks.

[6] The government has announced that the government budget for 2017/18 contains no external NCB. Public enterprises, however, may incur limited external NCB for their capital expenditures on ongoing projects, if authorized by the Ministry of Finance.

Text Figure 1. Net Financing Flows to the Non-Financial Public Sector

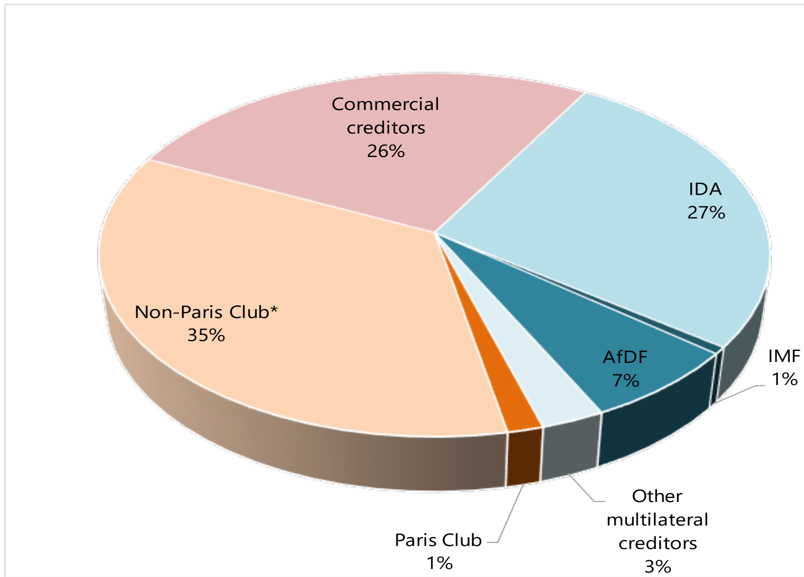


Source: Ethiopian authorities, IMF staff estimates. Includes the debt of EAL and external liabilities of the National Bank of Ethiopia.

5. Growth in 2016/17 is estimated to have been strong, at 9 percent, sustained by a recovery in agriculture and expansion in industry. The re-emergence of drought in the pastoral regions in the south and east did not halt the recovery: their GDP contribution is small, government interventions were effective, and substantial past investments have enhanced the productivity and resilience of agriculture. Exports of goods and services rose by 2.9 percent in 2016/17, underperforming expectations, as merchandise exports were nearly flat during the year. On the other hand, imports fell by 4.8 percent in 2016/17 due to lower imports of food and capital goods imported by the public sector. Thus, the current account deficit narrowed significantly to 8.2 percent of GDP (from 9.1 percent in 2015/16).

6. The main sources of external financing in 2016/17 were foreign direct investment (FDI), and public sector borrowing, mainly in the form of project loans, largely concessional. Net FDI increased significantly from US$4.2 billion in 2015/16 to US$4.9 billion in 2016/17, driven by the newly-opened industrial parks. In addition, a stake in the National Tobacco Company, the state-owned tobacco monopoly, was sold to foreign investors during the year. New public external loans signed in 2016/17 (including loans not guaranteed by the government) amounted to US$2.8 billion. About half of the new commitments were concessional loans from multilateral development agencies and institutions. Of the remainder, close to half were at below-market rates with a roughly 30 percent grant element from EXIM Bank of China. Some of these loans were used together with IDA resources for the financing of the water and sanitation infrastructure as well as for the rehabilitation of the power infrastructure. New loan commitments from private creditors on commercial creditors were small, amounting to US$97.3 million, and used for power rehabilitation projects in the power and transmission sector.

Text Figure 2. Ethiopia: Composition of Public and Publicly-Guaranteed External Debt
(As at June 30, 2017)



Source: Ethiopian authorities, IMF staff calculations.
*Includes external liabilities of the National Bank of Ethiopia.

7. **Ethiopia has adhered to the US$400 million ceiling on contracting new NCB in 2016/17 set by IDA.** Based on end-2016/17 debt stock data, the stock of external loans from commercial lenders declined by US$261 million, suggesting the bulk of NCB disbursements were from official lenders at below-market rates. This reflects a deliberate policy by the government to avoid further deterioration in debt sustainability.

OUTLOOK AND KEY ASSUMPTIONS

8. **The revised macroeconomic assumptions incorporate the lower-than-expected export performance in 2016/17 (Box 1 and Text Table 1).** The main fiscal assumptions assume a sustained fiscal consolidation effort, based on announced policies and the government's record of prudent budget implementation. However, export performance in the immediate term were revised downward to reflect the more gradual improvement in exports in light of recent data. The export performance projections incorporate the positive impact from the new industrial parks, especially the Hawassa Industrial Park where activities have started; the new railway line to Djibouti which has already been completed and is pending the finalization of operational and safety test runs; and hydropower facilities and electricity transmission lines gradually coming online in 2017 and over subsequent years (Box 2). The projections also build in gains in competitiveness due to the devaluation of the birr in October 2017. However, this medium-term outlook faces downside risks emanating from potential further delays in export-supporting infrastructure, slower-than-expected progress in implementing structural reforms to elicit investment, and shocks to the external market environment faced by Ethiopia's exports. Upside risks include a faster-than-projected recovery in exports—driven by faster ramp up of production in industrial parks or early completion of the power transmission lines to facilitate electricity exports to Kenya.

Box 1. Ethiopia: Macroeconomic Assumptions for the Baseline Scenario

Real GDP growth is projected to remain stable at around 8½ percent over the next two years before gradually stabilizing at 8 percent by 2021/22. Continuing investment in infrastructure, including by the private sector, and improving productivity, as FDI and export-oriented industries expand, should ensure the growth momentum is maintained going forward. Over the long term, growth is expected to converge to 5-6 percent as Ethiopia becomes a middle-income country. CPI inflation, which is expected to be elevated in the near term, is projected to converge to 8 percent in 2018/19 and remain at that level in the long run. The government primary deficit is projected to decline to about 1½ percent of GDP, with gradual progress in tax collection offsetting increased investment and social spending.

The external current account deficit (including official transfers) was 8.2 percent of GDP in 2016/17. Improved export performance, a moderate pick-up in capital goods imports, and steady inflows of remittances (although slowly declining as a ratio to GDP) will lead to a gradual improvement of the deficit over the longer term. Economic transformation is expected to ameliorate external imbalances, with more dynamic and diversified exports and a phase-down in imports of capital goods.

Exports of goods and services are estimated to have grown by 2.9 percent in 2016/17. A recovery in traditional exports and development of new exports will sustain growth at an average of 13.7 percent between 2017/18–2021/22. The commencement of the Addis-Djibouti railway line will improve trade logistics and reduce the transportation cost of moving goods in and out of the country. It will take only 10 hours for the new railway to take goods between Ethiopia and Djibouti, a significant improvement over the 3-4 days by truck currently. Further, the Hawassa Industrial Park and second phase of the Bole-Lemi Industrial Park have started operations and are set to increase manufacturing exports and contribute to the diversification of exports. Investments in hydro-power, industrial parks, export processing zones, and public policies to encourage FDI and private investment in light manufacturing industries are expected to support export growth and diversification. Imports of goods and services declined by 4.8 percent in 2016/17 as public sector investment was reprofiled to reduce imports. In addition, food imports, which doubled in 2015/16 in response to the drought, are also declined. Import growth is expected to gradually increase in the longer term due to demand for imported capital goods will remain strong during the remaining years of the GTP II implementation period. In the long run, imports are expected to grow in line with domestic output.

Private transfers declined by 14.7 percent in 2016/17, as inflows from non-governmental organizations declined sharply following the improvement in drought conditions. Remittances, however, remained stable after the sharp increase through 2014/15. Projections assume remittances will amount to about 3 percent of GDP by 2037/38.

FDI is projected to increase from US$4.9 billion in 2016/17 (5.2 percent of GDP) to US$7.1 billion by 2021/22, and is expected to average 6.2 percent of GDP over this period. This reflects improved competitiveness and ongoing policies to attract foreign investment.

9. The DSA assumes the amount of NCB disbursed over the medium term will decline significantly between 2017/18 and 2021/22. Actual NCB disbursed in 2016/17 (including disbursements to EAL) was around US$1.3 billion, consistent with what was assumed in the 2016 DSA. Going forward, the DSA assumes the level of non-concessional financing, mainly from official bilateral lenders at below-market rates, will decline substantially and amount to between US$300-650 million annually until 2021/22. The DSA also incorporates US$1.8 billion in concessional lending from donors in 2017/18, the bulk of which (US$1.3 billion) is from IDA. Going forward, concessional lending will remain stable at US$1.5-1.8 billion annually until 2021/22 on the back of new IDA commitments before declining gradually as Ethiopia gets closer to graduating to middle-income status and relying more on IBRD and other sources of financing. As a result, new disbursements of medium- and long-term external borrowing is assumed to remain largely concessional, with an average interest rate of 1.3 percent, maturity of 30.3 years and grace period of 5.7 years. In considering the stress tests, the DSA assumes that the marginal debt required to cover any financing gaps that may occur under the stress scenario would be evenly split between domestic and external borrowing, maintaining the current split for debt outstanding.

10. Ethiopia's capacity to carry debt is assessed as "medium". The 3-year average of the Country Policy and Institutional Assessment Ratings (CPIA) scores for 2014-16, which is used to classify countries based on their debt-carrying capacity, stood at 3.48, within the 3.25–3.75 range for medium capacity countries. The score for 2016 was 3.47.

Text Table 1. Ethiopia: Underlying Macroeconomic and Debt Assumptions

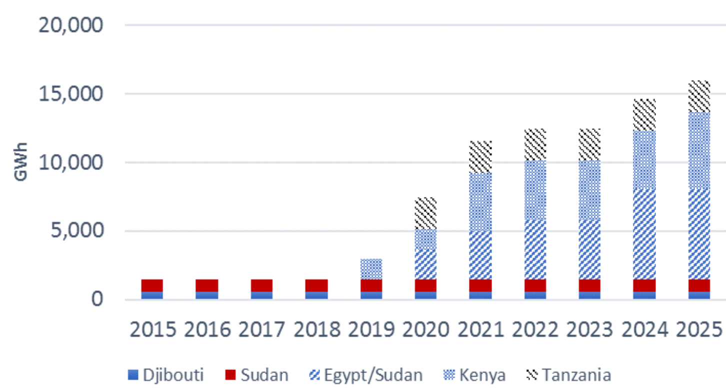
Fiscal year ending June	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2025/26	2035/36	2036/37	2037/38
		Projections								
Selected indicators from the macro-frame and debt data										
Grant Element of New External Borrowing										
2017DSA	29.8	29.8	46.3	48.6	50.3	50.2	58.9	31.8	31.6	31.4
2016DSA	31.9	36.9	45.0	41.6	38.1	41.3	42.3	43.9	n.a.	n.a.
New Commercial Loan Disbursements (billions of U.S. dollars)										
2017DSA	2.612	1.213	0.654	0.452	0.388	0.292	0.000	1.250	1.250	1.250
2016DSA	2.612	1.745	1.303	0.828	0.772	0.947	0.856	0.750	n.a.	n.a.
Real GDP Growth (annual percent change)										
2017DSA	9.0	9.0	8.5	8.3	8.1	8.0	6.5	5.5	5.0	5.0
2016DSA	7.5	7.5	7.5	7.4	7.3	7.3	6.3	6.0	n.a.	n.a.
Current Account Balance (percent of GDP)										
2017DSA	-8.2	-7.7	-7.5	-6.8	-6.1	-5.5	-5.1	-3.7	-3.3	-3.0
2016DSA	-10.7	-9.3	-8.9	-8.2	-8.1	-7.8	-6.0	-3.7	n.a.	n.a.
Exports of goods and services (percent of GDP)										
2017DSA	8.3	8.3	9.1	9.5	9.9	10.3	11.4	12.9	13.3	13.5
2016DSA	8.9	9.2	9.4	9.7	10.0	10.0	10.9	14.7	n.a.	n.a.
Exports of goods and services (annual percent change)										
2017DSA	2.9	12.9	13.4	13.9	14.2	14.2	10.4	8.8	8.9	8.7
2016DSA	15.5	12.0	12.0	12.0	12.0	9.4	10.1	12.0	n.a.	n.a.
Fiscal balance (percent of GDP)										
2017DSA	-3.0	-2.5	-2.5	-2.3	-2.2	-2.1	-2.4	-1.9	-1.9	-1.9
2016DSA	-2.5	-3.0	-3.2	-3.0	-3.1	-3.1	-2.6	-2.0	n.a.	n.a.
International reserves (Billions of U.S. dollars)										
2017DSA	3.2	3.7	4.4	5.0	5.7	6.3	9.1	19.6	22.0	23.4
2016DSA	3.4	3.7	4.1	4.9	5.7	6.0	8.4	37.7	n.a.	n.a.

Sources: Ethiopian authorities; IMF and World Bank staff estimates and projections.

Box 2. The Take-off in Electricity Exports

Ethiopia's cost of supplying electricity is among the lowest in Sub-Saharan Africa, presenting unique export opportunities. According to World Bank estimates, Ethiopia will have over 9,000 MW of installed capacity by 2020 (estimated to be the second highest installed capacity available in the region). This would provide over 25,000 GWh of renewable energy that would be able to meet domestic and export demand for electricity. Over the next few years, therefore, Ethiopia is set to become a regional energy superpower and develop into the cornerstone of the regional power market and of the East African Power Pool (EAPP).

Ethiopia: Destination of Electricity Exports



Source: World Bank staff projections.

Electricity exports are set to double in 2019 to US$250 million and reach US$1 billion by 2023. Currently, Ethiopia's power exports are limited to Sudan and Djibouti. However, power transmission interconnection to Kenya (financed by the World Bank and other partners) is scheduled to be commissioned in the first half of calendar year 2019 (tower and stringing work is substantially advanced and the converter station is under construction). With this interconnection to Kenya, capable of over 2,000 MW of transfer capacity established, exports will be expanded to Tanzania and possible to other countries in the EAPP. Over the medium term, additional connections to Sudan and Egypt are also planned. In addition, envisaged EAPP interconnection to the Southern African Power Pool could further open the market for Ethiopian exports to Southern African countries. By 2023, Ethiopia could achieve roughly one-sixth of the export revenue from power as it does from coffee and oilseeds, which currently accounts for 42 percent of merchandise exports.

The acceleration in export revenues is a combination of the significant growth in export volumes and a relatively high export tariff. Based on signed Power Purchase Agreements (PPAs) between Ethiopia and Kenya, and Ethiopia and Tanzania (others are being planned and negotiated), the growth in exports is expected to rise ten-fold from 1,443 GWh in 2016 to 14,657 GWh in 2023. Thus far, the negotiated average price under the PPAs has been US$0.07/kWh, based on this, the value of exports is expected to increase from US$250 million in 2019 to US$1 billion in 2023 and US$1.2 billion in 2025.

Ethiopia: Projections of Electricity Exports, 2016—2025

Electricity exports	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Value of exports (US$ millions)	101	101	101	250	523	811	872	1,026	1,118	1,210
Price (U.S. dollar/kWh)[1]	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07
Volume (GWh)	1,443	1,443	1,443	3,571	7,471	11,586	12,457	14,657	15,971	17,286

Source: Ethiopian authorities and World Bank staff estimates.

[1] As per the Framework Agreement.

Projections are on a calendar year basis.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

A. Baseline Scenario

11. The baseline shows debt stock declining gradually from 2017/18 (Figure 1). Two of the indicators, the PV of debt-to-GDP (PVDG), and PV of debt-to-revenue (PVDR) reach 22.6 percent and 141.7 percent respectively, well below the thresholds (respectively 40 percent and 250 percent). However, as was the case in the 2016 DSA, the PVDE ratio starts significantly above the threshold at 271.9 percent in 2017/18 (121.9 percentage points above the threshold) before declining gradually. Based on current projections, the PVDE ratio will only fall below the 150-percent threshold in 2021/22, giving rise to a 5-year breach under the baseline. The magnitude and duration of the observed breaches are consistent with a "high" risk of debt distress rating in a cross-country context.

12. The profile of the debt service indicators reflects the maturity profile of NCB, with the debt service-to-exports ratio breaching its threshold in 2017/18–20/21. The start of principal repayments on non-concessional loans related to transportation and communications projects, and the start of principal repayments of a deposit from a bilateral creditor with the NBE[7] results in the debt service-to-exports (DSE) and debt service-to-revenue ratios peaking in 2019/20. In particular, the DSE ratio breaches the 20 percent threshold in 2017/18, and peaks at 22.7 percent in 2019/20 before declining back to below the threshold in 2021/22. The DSR ratio remains well below its threshold throughout the projection window.

B. Stress Tests and Additional Analysis

13. The ratios based on exports are the only indicators to exceed their thresholds under the stress test scenarios examined (Table 2). The PVDE ratio, already above the threshold in the baseline, exceeds the threshold under all alternative scenarios for 9 years, with the shock to exports having the largest impact. Similarly, the export shock results in the threshold for the DSE ratio being breached in 2017/18–2022/23 and again in 2024/25, with the largest breach coming in 2019/20.

14. Debt sustainability is substantially bolstered by consideration of remittances, yet the augmented PV of debt-to-exports ratio continues to breach its threshold (Figure 3). Remittances in Ethiopia are highly significant: 5.5 percent of GDP in 2016/17, well exceeding exports of goods (3.6 percent of GDP). The pattern of remittances, which come from a large diaspora with strong ties to Ethiopia, are reliable external receipts and exhibit a counter-cyclical pattern (such as during the recent drought). A recent joint study by the Ethiopian authorities and the World Bank to improve estimates of remittances confirms the significant size and stability of the flows.[8] Thus, an alternative scenario using remittance-augmented

[7] The assumption on the deposit's financing terms have changed from the 2016 to the 2017 DSA. The initial assumption of an 8-year maturity were changed into a 6-year maturity as the re-negotiation process with the depositor was not completed by the time the 2017 DSA was conducted. This change has important implications on the duration of the DSE breach and the magnitude of its peak in 2019/20.

[8] A recent IMF TA mission on BOP statistics confirmed these findings.

thresholds provides a useful picture of the debt sustainability situation in Ethiopia.[9] Under this approach, a significant breach was still observed in the PV of debt-to-exports-plus-remittances indicator, but it was smaller (41.6 percentage points of total exports plus remittances) and shorter (3 years) than using the standard approach. Further, there were no additional breaches of the thresholds for the other indicators. In particular, the debt service-to-exports-plus-remittances indicator, which presents a breach under the standard approach, does not breach the threshold when remittances are considered. All debt burden indicators under the probability approach also confirm that the solvency indicators as well as the debt service-to-exports ratio do not appear to raise concerns implied under the standard approach, remaining well below the relevant threshold throughout the projection period.

C. Assessment

15. The external DSA confirms that Ethiopia's vulnerabilities are associated with its narrow export base. Consistent with the results of recent DSAs, export concentration (agricultural commodities, air passenger transportation) and low export revenue from goods and services (about 7 percent of GDP) renders Ethiopia especially vulnerable to export shocks, as shown by the experience of weak commodity prices in 2015/16-2016/17. While external debt is not comparatively high as a percent of GDP (about 30 percent), it represents a high proportion of exports. Policies to reduce external vulnerabilities, including risks to external debt sustainability should remain focused on competitiveness (including through a more flexible exchange rate), and export diversification. In addition, there is a need to continue efforts at mobilizing domestic savings, curbing import-intensive projects, and seeking alternative funding sources for public goods such as concessions to private investors, PPPs (with adequate fiscal safeguards), and privatization proceeds. The authorities have implemented policies consistent with these conclusions and with the associated staffs' advice. The trajectories of debt stock ratios have not changed materially from last year, but debt service indicators have deteriorated. At its maximum, the PVDE ratio is about 17 percentage points higher than in the 2016 DSA, though the length of the breach declined from 7 to 5 years. However, the deterioration in the DSE ratio suggests liquidity risks have increased. As a result, staffs assess the risk of debt distress in Ethiopia is now "high" compared to the "moderate risk" rating assigned in the 2016 DSA. Furthermore, the authorities recognize the risks posed by export underperformance and, as advised in the 2016 DSA and continuously under IDA's NCBP, have put in place strong policies to restrain NCB and reduce external imbalances. These policies, if implemented steadfastly, could mitigate the risk of an external debt distress episode occurring. In addition, the structure of the debt is such that it is largely made up of concessional credit; there are few marketable instruments; existing exchange controls on birr convertibility and capital account minimize the occurrence of debt distress episode. As of now, even the Eurobond that constitutes the significant portfolio inflow has eight years to maturity.

[9] The staff guidance note on the application of the DSF allows in the use of the remittance-augmented scenario to inform the risk rating (paragraph 55) in cases where this is relevant, such as Ethiopia. The thresholds for the PV of debt-to-exports + remittances and debt service-to exports + remittances are 120 percent and 16 percent respectively.

Text Table 2. Ethiopia: Composition of External Public Debt

	As at end-June 2016			As at end-June 2017		
	USD, million	Percent of Total	Percent of GDP	USD, million	Percent of Total	Percent of GDP
Total[1]	**22,643**	**100.0**	**31.2**	**24,492**	**100.0**	**30.6**
Official Creditors[1]	**15,950**	**70.4**	**22.0**	**18,061**	**73.7**	**22.6**
Multilaterals	**7,720**	**34.1**	**10.6**	**9,067**	**37.0**	**11.3**
IDA	5,560	24.6	7.7	6,564	26.8	8.2
IMF	195	0.9	0.3	152	0.6	0.2
AfDF	1,495	6.6	2.1	1,684	6.9	2.1
Other multilateral creditors	470	2.1	0.6	667	2.7	0.8
Bilaterals[1]	**8,231**	**36.3**	**11.3**	**8,994**	**36.7**	**11.2**
Paris Club	390	1.7	0.5	380	1.6	0.5
Non-Paris Club[1]	7,840	34.6	10.8	8,614	35.2	10.8
Private Creditors	**6,692**	**29.6**	**9.2**	**6,431**	**26.3**	**8.0**
Of which: Bond and Notes Holders	1,000	4.4	1.4	1,000	4.1	1.2

Sources: Ethiopian authorities and IMF staff calculations.

[1] Includes external liabilities of the National Bank of Ethiopia.

16. **A continuation of the poor export performance or policy slippages would lead to a worsening of debt sustainability prospects.** The projected export growth, while based on well-identified projects with positive spillovers and the completion schedule of key infrastructure, could be affected by other vulnerabilities and risks materializing. And whereas world trade has recently rebounded, with prospects in place for a sustained export expansion, Ethiopia remains subject to international price volatility in a few agricultural commodities. Furthermore, the success in developing an export-based manufacturing industry will depend on the government's commitment to reforms that support private sector-led growth. Any significant increase in the contracting of new NCB while the export base is still narrow would weaken external debt sustainability.

Authorities' view

17. **The authorities did not concur with staffs' assessment that the risk of debt distress is "high".** The authorities noted that the concerns raised arise from the small export base, which is a temporary feature and biases the results. They drew attention to the fact that none of the other indicators in the DSA breached their respective thresholds, either in the baseline or in the stress tests. In their view, the appropriate action is to redouble efforts to expand the export base, which they are doing through a broad scope of policy initiatives, including provision of export-supporting infrastructure. The private sector has responded positively to these efforts, and exports from the new industrial zones are commencing. In the interim, policies have responded strongly to curb external borrowing going forward and reduce external imbalances. The authorities are confident these actions will safeguard debt sustainability until the export take-off becomes entrenched.

D. Public Debt Sustainability Analysis

18. External debt accounts for about 55 percent of total public and publicly guaranteed (PPG) debt (Text Table 3). As at end-June 2017, total PPG debt amounted to 57 percent of GDP (up from 56 percent in 2015/16). Domestic debt of the central government accounts for 23 percent of total debt, and the remainder (22.6 percent) is the domestic debt of SOEs. The bulk of the domestic debt of the central government is owed to banks, primarily the NBE, largely reflecting advances to finance the budget. The remainder mainly comprises Treasury bills. Domestic borrowing by the SOEs, whether through loans or bond issuance, was entirely from domestic banks.

Text Table 3. Ethiopia: Composition of Public and Publicly-Guaranteed Debt

	As at end-June 2016			As at end-June 2017		
	Billions of birr	Percent of Total	Percent of GDP	Billions of birr	Percent of total	Percent of GDP
Total [1]	**871.9**	**100.0**	**56.0**	**1038.9**	**100.0**	**57.0**
External [1]	**493.6**	**56.6**	**31.2**	**566.0**	**54.5**	**30.6**
Domestic	**378.2**	**43.4**	**24.8**	**472.9**	**45.5**	**26.4**
Central government	167.2	19.2	10.9	238.5	23.0	13.3
Banks	123.2	*14.1*	*8.1*	*178.4*	*17.2*	*10.0*
NBE	*109.1*	*12.5*	*7.1*	*135.6*	*13.1*	*7.6*
Other banks	*14.1*	*1.6*	*0.9*	*42.8*	*4.1*	*2.4*
Non-banks	*44.0*	*5.1*	*2.9*	*60.1*	*5.8*	*3.4*
SOEs	211.0	24.2	13.8	234.4	22.6	13.1

Source: Ethiopian authorities, IMF staff calculations.

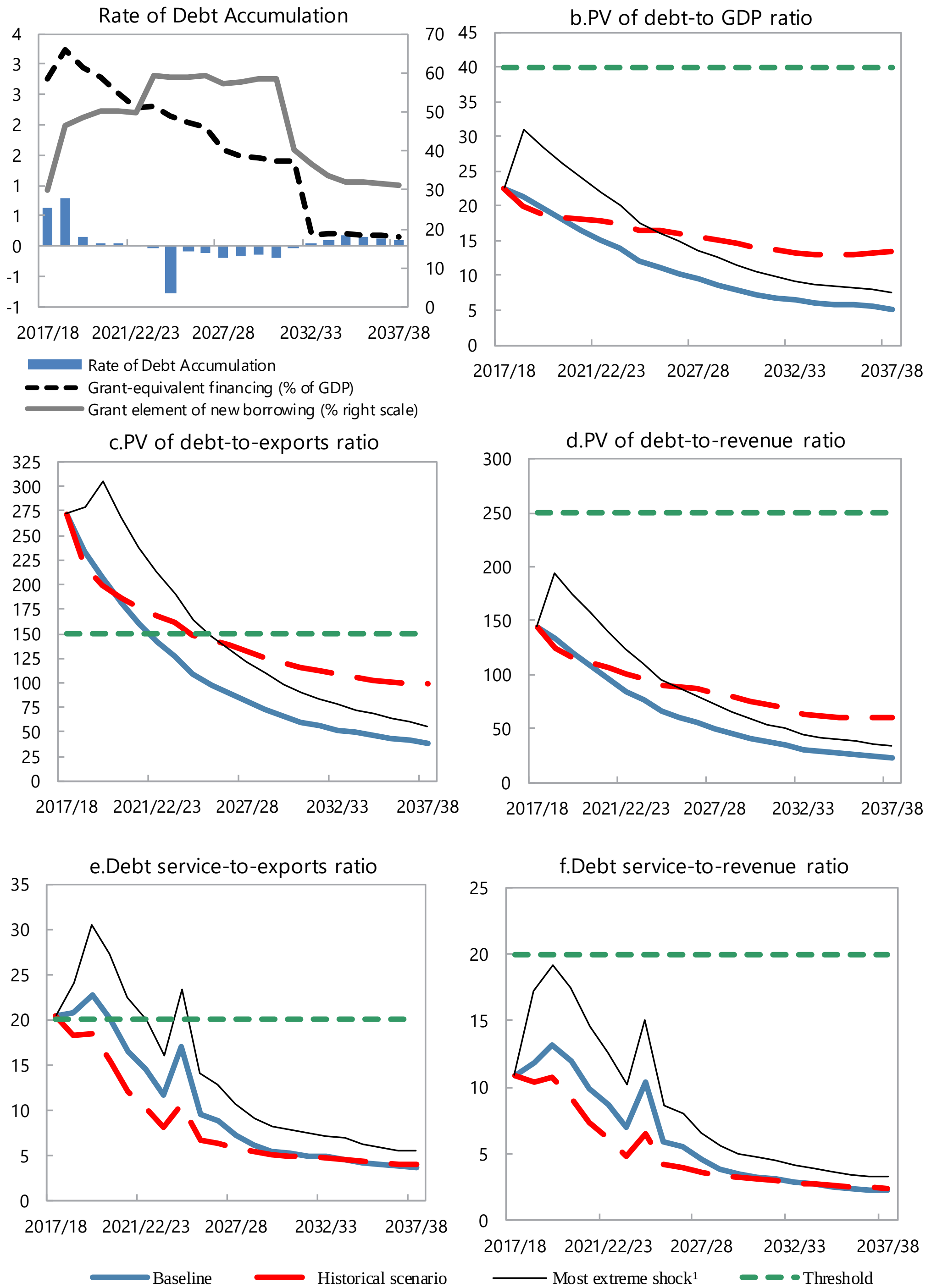
[1] Includes external liabilties of the National Bank of Ethiopia.

19. Overall public debt does not flag additional risks (Figure 2). The present value of total public debt stays well below the indicative threshold of 56 percent of GDP in the baseline and under most scenarios considered throughout the projection period. The only alternative scenario where a breach occurs is under the assumption of a primary fiscal balance throughout the simulation horizon fixed at its 2017/18 level. However, the baseline assumes a gradual increase in domestic interest rates to achieve positive real interest rates by the end of the DSA projection window. As a result, the primary balance in the baseline increases gradually over time, as fiscal policy accommodates the increased financing costs. In contrast, the fixed primary balance scenario implies a gradual widening of the fiscal deficit, contrary to the authorities' policy intentions and past record of prudent budgetary policy. All indicators also show a declining trend after 2025/26 as public investment tapers off with the completion of the large projects planned under the GTP II, and with it, the need for new borrowing slows as well.

E. Conclusion

20. The deterioration in debt sustainability indicators results in Ethiopia's risk of external debt distress being raised to "high". Notwithstanding this, the authorities have taken strong measures to limit the further build-up of risks and reduce them over time. With the completion of key trade-enhancing infrastructure such as the railway line to Djibouti, industrial parks and power generation and transmission facilities, preconditions for the export take-off are largely in place. The private sector is also responding positively to these efforts and FDI has increased substantially. Further, the structure of external debt (mainly official credit, often concessional), limited marketable debt instruments, existing controls on birr convertibility and capital account reduce the risk of an external debt distress episode. The key is to maintain and build on the current implementation of prudent policies. The authorities have also indicated their intention to encourage private sector participation in the provision of public projects including PPPs, privatizations and concessions, to further reduce the public borrowing requirement. This would simultaneously ensure the necessary investment in critical projects while preserving public debt sustainability. The passage of the new PPP law will support the authorities' agenda in this regard. The authorities are encouraged to work with development partners on the implementation of the PPP framework to ensure that it strikes the appropriate balance between eliciting private participation and minimizing fiscal risks.

Figure 1. Ethiopia: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2017/18—37/38 1/



Sources: Ethiopian authorities and staff estimates and projections.
[1] The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to an Exports shock; in d. to a One-time depreciation shock; in e. to an Exports shock and in figure f. to a One-time depreciation shock.

Table 1. Ethiopia: External Debt Sustainability Framework, Baseline Scenario, 2014/15-37/38 1/

	Actual			Historical 6/	Standard 6/	Projections									
				Average	Deviation							2017/18-2022/23			2023/24-2037/38
	2014/1	2015/1	2016/17			2017/1	2018/1	2019/2	2020/21	2021/2	2022/23	Average	2027/2	2037/38	Average
External debt (nominal) 1/	**35.1**	**35.6**	**31.6**			**32.9**	**31.9**	**29.9**	**27.8**	**25.8**	**23.7**		**17.1**	**10.5**	
of which: public and publicly guaranteed (PPG)	31.4	32.5	29.4			31.3	30.2	28.6	27.0	25.3	23.5		16.8	8.9	
Change in external debt	5.1	0.4	-4.0			1.3	-1.1	-2.0	-2.1	-2.1	-2.0		-1.3	-0.6	
Identified net debt-creating flows	3.6	0.1	-3.8			0.1	0.2	-2.4	-2.9	-3.0	-2.6		-1.3	-1.0	
Non-interest current account deficit	**11.4**	**9.6**	**7.7**	**6.8**	**3.1**	**7.1**	**6.9**	**6.2**	**5.6**	**5.1**	**5.2**		**4.7**	**2.8**	4.3
Deficit in balance of goods and services	24.0	21.8	16.2			16.0	16.2	15.4	14.8	14.2	13.6		11.0	6.7	
Exports	11.3	9.4	7.8			8.3	9.1	9.5	9.9	10.3	10.6		11.8	13.5	
Imports	35.3	31.2	24.0			24.3	25.3	24.9	24.7	24.5	24.1		22.7	20.2	
Net current transfers (negative = inflow)	-12.6	-12.1	-8.6	-13.7	2.9	-9.0	-9.3	-9.3	-9.3	-9.0	-8.4		-6.3	-3.9	-5.6
of which: official	-2.7	-2.2	-1.8			-1.8	-1.8	-1.7	-1.6	-1.5	-1.5		-1.3	0.0	
Other current account flows (negative = net inflow)	0.0	-0.1	0.1			0.0	0.1	0.1	0.2	0.0	0.0		0.0	0.1	
Net FDI (negative = inflow)	**-4.0**	**-5.1**	**-5.2**	**-3.8**	**0.8**	**-5.8**	**-6.2**	**-6.4**	**-6.5**	**-6.2**	**-5.9**		**-4.9**	**-3.3**	-4.4
Endogenous debt dynamics 2/	**-3.8**	**-4.4**	**-6.3**			**-1.1**	**-0.5**	**-2.2**	**-2.0**	**-1.9**	**-1.9**		**-1.0**	**-0.6**	
Contribution from nominal interest rate	0.5	0.6	0.5			0.6	0.7	0.6	0.5	0.4	0.4		0.2	0.2	
Contribution from real GDP growth	-2.7	-3.1	-2.3			-2.7	-2.7	-2.4	-2.2	-2.0	-1.9		-1.0	-0.5	
Contribution from price and exchange rate changes	-1.6	-1.8	-4.5			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**1.5**	**0.3**	**-0.2**			**1.2**	**-1.3**	**0.4**	**0.8**	**1.0**	**0.6**		**0.0**	**0.4**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	24.1			24.3	23.0	20.9	18.8	17.0	15.2		9.8	6.8	
In percent of exports	...	...	308.9			291.9	252.5	220.8	190.4	164.2	144.5		83.3	50.3	
PV of PPG external debt	**...**	**...**	**21.9**			**22.6**	**21.3**	**19.6**	**18.0**	**16.5**	**15.1**		**9.5**	**5.2**	
In percent of exports	**...**	**...**	**280.9**			**271.9**	**234.4**	**207.2**	**182.0**	**159.8**	**142.7**		**80.3**	**38.7**	
In percent of government revenues	**...**	**...**	**143.9**			**144.4**	**133.1**	**120.0**	**108.3**	**96.4**	**84.7**		**50.3**	**23.5**	
Debt service-to-exports ratio (in percent)	**15.5**	**19.5**	**22.2**			**27.9**	**27.2**	**28.1**	**24.8**	**20.5**	**17.5**		**7.8**	**4.2**	
PPG debt service-to-exports ratio (in percent)	**9.8**	**14.6**	**17.8**			**20.5**	**20.9**	**22.7**	**20.1**	**16.5**	**14.6**		**7.3**	**3.8**	
PPG debt service-to-revenue ratio (in percent)	**6.0**	**7.2**	**9.1**			**10.9**	**11.9**	**13.2**	**12.0**	**10.0**	**8.7**		**4.6**	**2.3**	
Total gross financing need (Billions of U.S. dollars)	5.1	4.1	3.4			3.0	2.8	2.4	1.7	1.2	1.4		1.2	0.4	
Non-interest current account deficit that stabilizes debt ratio	6.3	9.2	11.7			5.7	8.0	8.2	7.7	7.2	7.2		6.0	3.4	
Key macroeconomic assumptions															
Real GDP growth (in percent)	10.3	10.4	8.0	10.2	1.2	9.0	8.5	8.3	8.1	8.0	8.0	8.3	6.0	5.0	6.0
GDP deflator in US dollar terms (change in percent)	5.6	5.5	14.5	7.7	12.4	-2.9	-4.5	1.1	1.1	1.3	1.6	-0.4	1.1	2.0	1.0
Effective interest rate (percent) 5/	1.8	1.8	1.8	1.4	0.3	2.1	2.1	1.9	1.8	1.7	1.6	1.9	1.2	1.7	1.4
Growth of exports of G&S (US dollar terms, in percent)	-2.6	-3.5	2.9	10.2	11.7	12.9	13.4	13.9	14.2	14.2	12.1	13.4	9.0	8.7	8.8
Growth of imports of G&S (US dollar terms, in percent)	25.1	2.9	-4.8	12.6	13.9	7.4	7.6	7.9	8.2	8.6	8.0	8.0	6.0	5.6	5.8
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	29.8	46.3	48.6	50.3	50.2	49.7	45.8	57.3	31.4	47.0
Government revenues (excluding grants, in percent of GDP)	18.5	19.0	15.2			15.7	16.0	16.3	16.6	17.1	17.8		18.8	22.1	19.9
Aid flows (in Billions of US dollars) 7/	2.7	2.5	2.5			3.3	3.4	3.4	3.5	3.5	3.4		3.3	0.5	
of which: Grants	1.5	1.4	1.4			1.5	1.6	1.6	1.7	1.8	1.9		2.4	0.0	
of which: Concessional loans	1.2	1.2	1.0			1.8	1.8	1.8	1.8	1.7	1.5		0.9	0.5	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			2.8	3.2	3.0	2.8	2.5	2.3		1.6	0.2	1.1
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			55.1	66.0	68.8	70.8	72.4	73.6		88.1	31.4	64.4
Memorandum items:															
Nominal GDP (Billions of US dollars)	55.5	64.7	80.0			84.7	87.8	96.2	105.1	114.9	126.0		182.3	351.5	
Nominal dollar GDP growth	16.5	16.5	23.6			5.9	3.7	9.5	9.2	9.4	9.7	7.9	7.1	7.1	7.1
PV of PPG external debt (in Billions of US dollars)			17.0			17.5	18.1	18.2	18.3	18.3	18.3		16.7	17.7	
(PVt-PVt-1)/GDPt-1 (in percent)						0.6	0.8	0.1	0.1	0.0	0.0	0.3	-0.2	0.1	-0.1
Gross workers' remittances (Billions of US dollars)	4.4	4.4	4.4			4.8	5.2	5.6	6.1	6.6	5.7		6.2	7.3	
PV of PPG external debt (in percent of GDP + remittances)	...	...	20.8			21.4	20.1	18.5	17.0	15.6	14.4		9.1	5.1	
PV of PPG external debt (in percent of exports + remittances)	...	...	164.3			161.6	142.1	128.0	114.8	102.7	99.7		62.3	33.5	
Debt service of PPG external debt (in percent of exports + remittanc	...	...	10.4			12.2	12.7	14.0	12.7	10.6	10.2		5.7	3.3	

Sources: Ethiopian authorities; and IMF staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Ethiopia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017/18–37/38 1/

(In percent)

	Projections							
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	**2027/28**	2037/38
PV of debt-to GDP ratio								
Baseline	23	21	20	18	17	15	**9**	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	23	20	19	18	18	18	**16**	13
A2. New public sector loans on less favorable terms in 2018-2038 2	23	22	21	20	19	18	**14**	10
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	23	21	19	18	16	15	**9**	5
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	23	22	22	20	18	17	**11**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	23	21	21	19	17	16	**10**	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	23	22	22	20	18	17	**11**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	23	20	18	16	15	14	**8**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	23	31	29	26	24	22	**14**	8
PV of debt-to-exports ratio								
Baseline	272	234	207	182	160	143	**80**	39
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	272	219	199	186	176	168	**133**	99
A2. New public sector loans on less favorable terms in 2018-2038 2	272	244	225	206	187	173	**119**	73
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	272	234	207	181	159	142	**80**	38
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	272	279	306	269	237	213	**121**	56
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	272	234	207	181	159	142	**80**	38
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	272	245	229	202	178	160	**91**	42
B5. Combination of B1-B4 using one-half standard deviation shocks	272	250	242	212	186	166	**93**	45
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	272	234	207	181	159	142	**80**	38
PV of debt-to-revenue ratio								
Baseline	144	133	120	108	96	85	**50**	24
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	144	124	116	111	106	100	**83**	60
A2. New public sector loans on less favorable terms in 2018-2038 2	144	139	131	122	113	103	**74**	45
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	144	132	118	107	95	83	**49**	23
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	144	137	133	120	107	95	**57**	25
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	144	133	127	115	102	90	**53**	25
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	144	139	133	120	107	95	**57**	25
B5. Combination of B1-B4 using one-half standard deviation shocks	144	122	108	98	87	76	**45**	21
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	144	194	175	157	140	123	**73**	34

Table 2. Ethiopia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017/18–37/38 (continued)

(In percent)

				Debt service-to-exports ratio				
Baseline	21	21	23	20	17	15	**7**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	21	18	19	15	12	10	**6**	4
A2. New public sector loans on less favorable terms in 2018-2038 2	21	21	23	21	17	15	**9**	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	21	21	23	20	17	15	**7**	4
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	21	24	30	27	23	20	**11**	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	21	21	23	20	17	15	**7**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	21	21	23	21	17	15	**8**	4
B5. Combination of B1-B4 using one-half standard deviation shocks	21	23	27	24	20	17	**9**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	21	21	23	20	17	15	**7**	4
				Debt service-to-revenue ratio				
Baseline	11	12	13	12	10	9	**5**	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	11	10	11	9	7	6	**4**	2
A2. New public sector loans on less favorable terms in 2018-2038 2	11	12	13	12	10	9	**6**	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	11	12	13	12	10	9	**4**	2
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	11	12	13	12	10	9	**5**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	11	12	14	13	11	9	**5**	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	11	12	13	12	10	9	**5**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	11	11	12	11	9	8	**4**	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	11	17	19	17	15	13	**7**	3
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	41	41	41	41	41	41	**41**	41

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

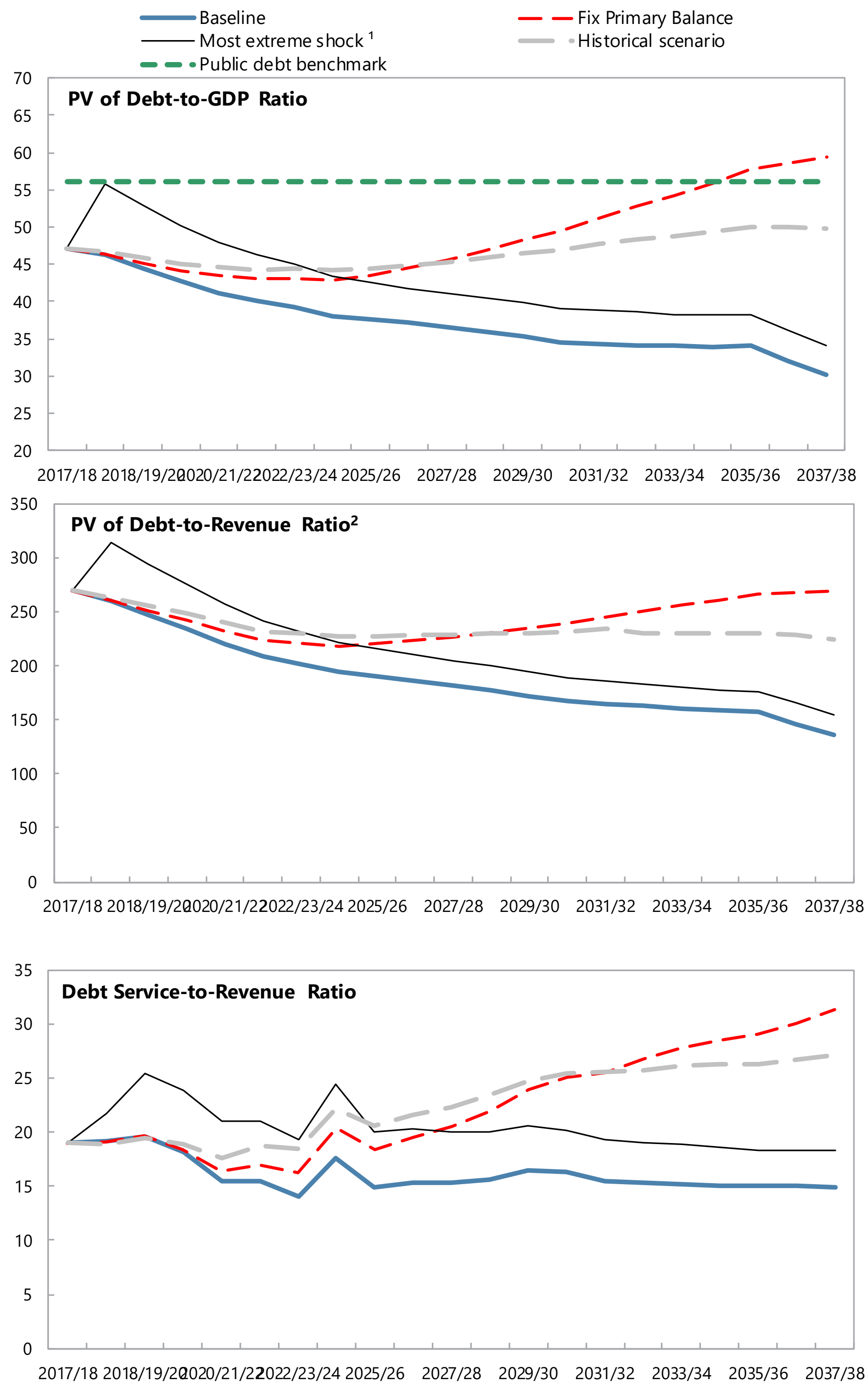
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 2. Ethiopia: Indicators of Public Debt Under Alternative Scenarios, 2017/18–37/38 1/



Sources: Ethiopian authorities; and staff estimates and projections.

[1] The most extreme stress test is the test that yields the highest ratio on or before 2025. It corresponds to a one-time depreciation shock.

[2] Revenues are defined inclusive of grants.

Table 3. Ethiopia: Ethiopia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2014/15–37/38

(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2014/15	2015/16	2016/17			2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2017/18-2022/23 Average	2027/28	2037/38	2023/24-2037/38 Average
Public sector debt 1/	61.2	59.6	53.8			55.7	55.2	53.4	51.7	50.0	48.6		43.8	33.9	
of which: foreign-currency denominated	31.4	32.5	29.4			31.3	30.2	28.6	27.0	25.3	23.5		16.8	8.9	
Change in public sector debt	10.0	-1.6	-5.8			1.8	-0.5	-1.8	-1.7	-1.8	-1.4		-1.1	-2.2	
Identified debt-creating flows	2.5	-2.7	-7.6			1.4	-1.0	-1.6	-1.5	-1.7	-1.2		-0.7	-2.1	
Primary deficit	9.5	5.9	5.2	5.8	2.9	4.4	4.4	3.6	3.5	3.2	3.3	3.7	1.7	-0.9	1.2
Revenue and grants	21.2	21.2	17.0			17.5	17.8	18.0	18.2	18.7	19.2		20.1	22.1	
of which: grants	2.7	2.2	1.8			1.8	1.8	1.7	1.6	1.5	1.5		1.3	0.0	
Primary (noninterest) expenditure	30.7	27.0	22.2			21.9	22.2	21.6	21.7	21.9	22.6		21.8	21.2	
Automatic debt dynamics	-7.0	-8.6	-12.2			-3.0	-5.4	-5.2	-5.0	-4.9	-4.5		-2.4	-1.2	
Contribution from interest rate/growth differential	-6.3	-7.5	-9.2			-6.0	-5.5	-5.4	-5.2	-5.1	-4.6		-2.6	-1.2	
of which: contribution from average real interest rate	-1.5	-1.7	-4.8			-1.6	-1.1	-1.2	-1.2	-1.2	-0.9		0.0	0.6	
of which: contribution from real GDP growth	-4.8	-5.8	-4.4			-4.5	-4.4	-4.2	-4.0	-3.8	-3.7		-2.5	-1.7	
Contribution from real exchange rate depreciation	-0.7	-1.1	-3.1			3.1	0.1	0.2	0.2	0.2	0.1		...	...	
Other identified debt-creating flows	0.0	0.0	-0.6			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	-0.6			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	7.5	1.1	1.8			0.4	0.5	-0.2	-0.2	-0.1	-0.2		-0.4	-0.1	
Other Sustainability Indicators															
PV of public sector debt	...	...	46.3			47.0	46.3	44.4	42.7	41.2	40.1		36.5	30.1	
of which: foreign-currency denominated	...	...	21.9			22.6	21.3	19.6	18.0	16.5	15.1		9.5	5.2	
of which: external	...	...	21.9			22.6	21.3	19.6	18.0	16.5	15.1		9.5	5.2	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	12.3	9.4	8.4			7.7	7.8	7.1	6.8	6.1	6.3		4.8	2.4	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	272.4			269.4	259.9	246.5	234.3	220.5	208.5		181.8	136.1	
PV of public sector debt-to-revenue ratio (in percent)	...	...	304.3			300.4	289.0	272.0	257.2	240.4	225.9		194.4	136.1	
of which: external 3/	...	...	143.9			144.4	133.1	120.0	108.3	96.4	84.7		50.3	23.5	
Debt service-to-revenue and grants ratio (in percent) 4/	13.4	16.5	18.5			19.0	19.1	19.7	18.2	15.5	15.4		15.3	14.9	
Debt service-to-revenue ratio (in percent) 4/	15.3	18.4	20.7			21.2	21.3	21.7	19.9	16.9	16.7		16.4	14.9	
Primary deficit that stabilizes the debt-to-GDP ratio	-0.5	7.5	11.0			2.6	4.8	5.4	5.2	5.0	4.7		2.9	1.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	10.3	10.4	8.0	10.2	1.2	9.0	8.5	8.3	8.1	8.0	8.0	8.3	6.0	5.0	6.0
Average nominal interest rate on forex debt (in percent)	1.6	1.8	1.8	1.2	0.4	2.1	2.1	1.9	1.8	1.7	1.7	1.9	1.1	1.2	1.1
Average real interest rate on domestic debt (in percent)	-5.7	-6.6	-18.8	-11.3	7.9	-7.3	-5.3	-5.2	-5.2	-5.3	-3.6	-5.3	0.4	2.5	1.2
Real exchange rate depreciation (in percent, + indicates depreciation	-2.9	-3.7	-10.2	-3.5	11.0	11.3	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	10.9	10.8	27.5	18.1	10.4	11.3	8.5	8.2	8.1	8.3	8.7	8.9	8.2	9.1	8.1
Growth of real primary spending (deflated by GDP deflator, in percer	16.3	-2.9	-11.2	0.3	6.7	7.3	9.9	5.6	8.6	8.9	11.4	8.6	5.0	6.1	5.6
Grant element of new external borrowing (in percent)	...	...	...	...	...	29.8	46.3	48.6	50.3	50.2	49.7	45.8	57.3	31.4	...

Sources: Ethiopian authorities and staff estimates and projections.

1/ Reffers to nonfinancial public sector gross debt.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4. Ethiopia: Sensitivity Analysis for Key Indicators of Public Debt, 2017/18–37/38

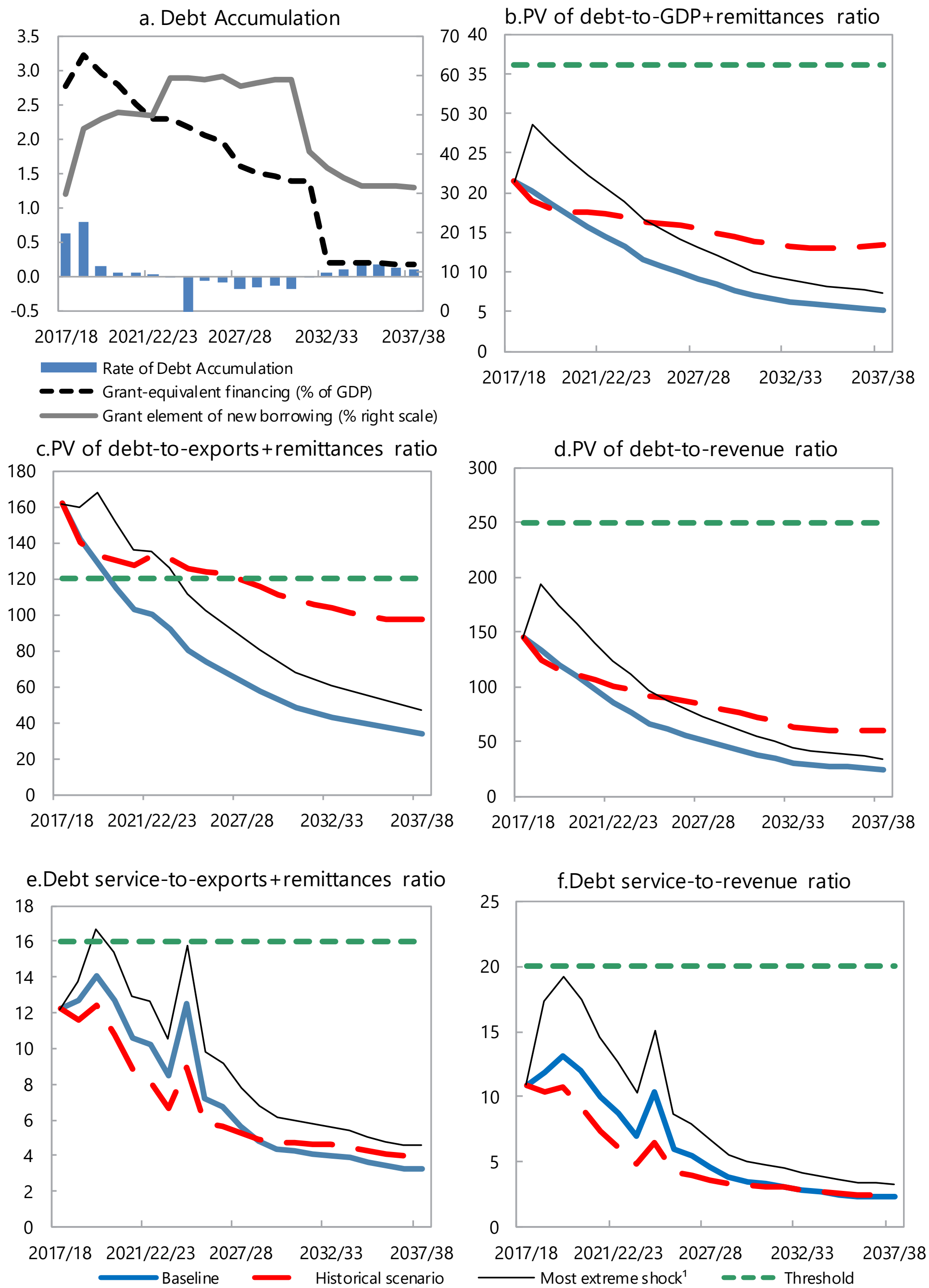
	Projections							
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2027/28	2037/38
PV of Debt-to-GDP Ratio								
Baseline	47	46	44	43	41	40	37	30
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	47	47	46	45	45	44	45	50
A2. Primary balance is unchanged from 2018	47	46	45	44	43	43	46	59
A3. Permanently lower GDP growth 1/	47	46	45	43	42	41	39	38
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-20	47	46	44	42	40	39	35	28
B2. Primary balance is at historical average minus one standard deviations in 2019-202	47	50	52	49	47	46	40	33
B3. Combination of B1-B2 using one half standard deviation shocks	47	48	48	46	44	42	37	27
B4. One-time 30 percent real depreciation in 2019	47	56	53	50	48	46	41	34
B5. 10 percent of GDP increase in other debt-creating flows in 2019	47	54	52	49	47	46	41	33
PV of Debt-to-Revenue Ratio 2/								
Baseline	269	260	247	234	220	209	182	136
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	269	263	255	248	240	232	229	225
A2. Primary balance is unchanged from 2018	269	260	250	242	232	224	227	268
A3. Permanently lower GDP growth 1/	269	261	248	237	224	213	194	170
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-20	269	258	243	230	216	203	174	125
B2. Primary balance is at historical average minus one standard deviations in 2019-202	269	279	286	270	252	237	201	147
B3. Combination of B1-B2 using one half standard deviation shocks	269	270	269	253	235	220	182	123
B4. One-time 30 percent real depreciation in 2019	269	314	293	276	257	241	205	154
B5. 10 percent of GDP increase in other debt-creating flows in 2019	269	304	287	270	253	237	202	148
Debt Service-to-Revenue Ratio 2/								
Baseline	19	19	20	18	16	15	15	15
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	19	19	19	19	18	19	22	27
A2. Primary balance is unchanged from 2018	19	19	20	18	16	17	20	31
A3. Permanently lower GDP growth 1/	19	19	20	18	16	16	17	19
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-20	19	19	19	18	15	15	14	13
B2. Primary balance is at historical average minus one standard deviations in 2019-202	19	19	21	23	22	21	18	16
B3. Combination of B1-B2 using one half standard deviation shocks	19	19	20	21	20	19	15	13
B4. One-time 30 percent real depreciation in 2019	19	22	25	24	21	21	20	18
B5. 10 percent of GDP increase in other debt-creating flows in 2019	19	19	22	25	22	21	18	16

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

Figure 3. Ethiopia: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios and Remittances, 2017/18—37/38 1/



Sources: Ethiopian authorities and staff estimates and projections.

[1] The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a one-time depreciation shock; in c. to an exports shock; in d. to a one-time depreciation shock; in e. to an exports shock and in figure f. to a one-time depreciation shock.

INTERNATIONAL MONETARY FUND

December 12, 2017

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by

The African Department
(In collaboration with other departments)

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RELATIONS WITH THE FUND

(As of October 31, 2017)

Membership Status: Joined: December 27, 1945 Article XIV

General Resources Account:	**SDR Million**	**% Quota**
Quota	300.70	100.00
IMF's holdings of currency (holdings rate)	293.31	97.54
Reserve Tranche Position	7.51	2.50

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	127.93	100.00
Holdings	1.20	0.94

Outstanding Purchases and Loans:	**SDR Million**	**% Quota**
ESF Arrangement	81.56	27.12
ESF RAC Loan	10.03	3.33

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ESF	Aug 26, 2009	Nov 22, 2010	153.76	153.76
ECF [1]	Mar 22, 2001	Oct 31, 2004	100.28	100.28
ECF [1]	Oct 11, 1996	Oct 22, 1999	88.47	29.49

Overdue Obligations and Projected Payments to Fund [2]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2017	2018	2019	2020	2021
Principal	8.02	37.44	34.09	12.03	
Charges/Interest	0.18	0.80	0.88	0.82	0.80
Total	8.20	38.24	34.97	12.85	0.80

Implementation of HIPC Initiative:	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	November 2001

[1] Formerly PRGF

[2] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

(continued)

Assistance committed	
by all creditors (US$ million)[3]	1,982.20
of which: IMF assistance (US$ million)	60.85
(SDR equivalent in millions)	45.12
Completion point date	April 2004
Disbursement of IMF assistance (SDR million)	
Assistance disbursed to the member	45.12
Interim assistance	10.28
Completion point balance	34.84
Additional disbursement of interest income[4]	1.54
Total disbursements	46.66

Implementation of Multilateral Debt Relief Initiative (MDRI):

I. MDRI-eligible debt (SDR million)[5]	112.07
Financed by: MDRI Trust	79.66
Remaining HIPC resources	32.41
II. Debt Relief by Facility (SDR million)	

		Eligible Debt	
Delivery Date	**GRA**	**PRGT**	**Total**
January 2006	N/A	112.07	112.07

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

As of February 4, 2015, the post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

Exchange Rate Arrangement

The de-facto exchange rate arrangement is classified as a crawl-like arrangement. The authorities describe their exchange rate regime as a managed float with no predetermined path for the exchange rate. The pace of depreciation of the nominal exchange rate, however, has been stable. The NBE continues to supply foreign exchange to the interbank market based on plans prepared at the beginning of each fiscal year, which take into account estimates of supply and demand. The transaction-weighted average interbank market exchange rate as of November 29, 2017, is Br 27.1657 = US$1.

[3] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence, these two amounts cannot be added.

[4] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

[5] The MDRI provided 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

Ethiopia maintains four restrictions on payments and transfers for current international transactions, which relate to: (i) the tax certification requirement for repatriation of dividend and other investment income; (ii) restrictions on repayment of legal external loans and suppliers of foreign partners credits; (iii) the prioritization and rationing of foreign exchange to certain imports of goods and services, debt payments and invisibles, and (iv) the requirement to provide a clearance certificate from the NBE to obtain import permits. These restrictions are inconsistent with Article VIII, Section 2(a), of the IMF's Articles of Agreement and remain unapproved. In addition, staff is in the process of assessing whether a significant spread between the parallel market cash rate and the official market exchange rate, or any other feature of Ethiopia's exchange system, may give rise to a multiple currency practice.

Safeguards Assessment

The National Bank of Ethiopia (NBE) was subject to an update safeguards assessment in 2009 (previous assessment was completed in 2001). The updated assessment found improved financial reporting and internal audit practices. Notwithstanding these developments, the assessment noted significant weaknesses. Recommendations focused on strengthening oversight of risks and controls, improving accounting records and the external audit process, and legal amendments to address safeguards weaknesses in the Central Bank Law. Since then, some progress has been reported on the outstanding safeguards recommendations, particularly the establishment of an audit committee, and capacity building for the internal audit function. Staff has recently received audited financial statements for the previous years together with the management letters issued by the NBE's external auditor. A full set of audited financial statements has now been published on the NBE's website.

Article IV Consultation

Ethiopia is on the standard 12-month consultation cycle, in accordance with the Decision on Article IV Consultation Cycles (Decision No, 14747-(10/96), 9/28/2010). The last consultation was concluded on September 26, 2016.

Technical Assistance (2016–present)

TA intensity from the HQ is relatively low, and most of the TA is provided through the regional center in East Africa. In FY 2017 Ethiopia received TA equivalent to 2.2 FTEs, ranking 15th among 45 SSA TA recipients. Ongoing and planned HQ TA focuses on tax administration reforms, PFM, resource revenue modeling, and production of quarterly national accounts. In 2016, Ethiopia received an LTX (on the development of the secondary market for government securities) funded by DFID, however little progress was made by the authorities and the contract was terminated early. The authorities, the Fund and the donor are reviewing the outcome of the experience before deciding how to proceed. Recently, the authorities have requested Fund TA on quantifying and assessing tax expenditures and incentives. Future TA could also address weaknesses in data reporting to the fund, with a particular focus on improving the reliability and comprehensiveness of national accounts, fiscal data, and monetary and financial statistics.

Table 1. The Federal Democratic Republic of Ethiopia: Fund Technical Assistance

Department	Purpose	Time of Delivery
STA	Balance of Payments Statistics	January 2016
FAD, AFE	Medium Term Budgetary Framework	January 2016
AFE	Strengthening Crisis Management Framework	February 2016
FAD	Overcoming Challenges in Tax Administration	February 2016
AFE	Strengthening Cash Management	February 2016
FAD, AFE	Strengthening Revenue Mobilization and Tax Administration	March 2016
STA	National Accounts and Price Statistics	April 2016
MCM	Domestic Debt Market Development	June 2016
STA	External Sector Statistics	September 2016
FAD	Compliance Risk Management in Tax Administration	September 2016
FAD	Resource Revenue Modeling	September 2016
AFE	Government Finance	October 2016
MCM	Improving the Bank Resolution and Crisis Management Framework	October 2016
FAD	Tax Administration	January 2017
MCM/AFE	Establishing a Deposit Insurance System	March 2017
AFE	Enhancing Risk-Based Supervision Framework for Insurers	March 2017
FAD	Revenue Administration	April 2017
FAD	Reviewing the PFM Reform Strategy	May 2017
STA	External Sector Statistics	October 2017
FAD	Revenue Administration	November 2017
STA/AFE	Government Finance Statistics	November 2017

Resident Representative

The IMF had a resident representative in Addis Ababa since 1993 to October 2015, when the term of the last Resident Representative ended. Since then, the office has been staffed by local employees.

JOINT MANAGEMENT ACTION PLAN, JULY 2017–JUNE 2018

(As of October 31, 2017)

Title	Products	Provisional and actual timing of missions	Expected and actual delivery date
A. Mutual information on relevant work program			
The World Bank work program in the next 12 months	**Economic policy analysis and advice**		
	• Ethiopia Economic Update (annually)	July 2017-June 2018	Q1 2018
	• Policy dialogue on economic reform	July 2017-June 2018	Ongoing
	• Analytical work on structural change	July 2017-June 2018	Q2 2018
	• Tax studies	July 2017-June 2018	Q4 2017
	Technical assistance		
	• Strengthen SOE management and fiscal risk	July 2017-June 2018	Q1-Q2 2018
	• Deepen debt management capacity	July 2017-June 2018	Q1-Q2 2018
The Fund work program in the next 12 months	**Macroeconomic policy analysis and advice**		
	• Article IV consultation	May/June 2018	June 2018
	Technical assistance		
	• Revenue administration	November 2017	November 2017
	• External sector statistics	October 2017	October 2017
	• Government finance statistics	November 2017	November 2017
	• National accounts statistics		
	• Debt Sustainability Framework	January 2018	January 2018
B. Mutual information on relevant work program			
Fund request to Bank	• Periodic update on all TA activities • Macroeconomic and financial data to be shared regularly • Participating in reviews of key analytical work	Ongoing	Ongoing
Bank request to Fund	• Periodic update on all TA activities • Macroeconomic and financial data to be shared regularly	Ongoing	Ongoing
C. Agreement on joint products and missions			
Joint products in the next 12 months	• Debt Sustainability Analysis (DSA)		May/June 2018

STATISTICAL ISSUES

(As of November 7, 2017)

I. Assessment of Data Adequacy for Surveillance

General: Data provision is broadly adequate for surveillance. However, in 2016/17 some data reported to the Fund were subject to considerable delays and revisions. The existing data weaknesses reflect capacity constraints and the authorities are seeking to address them through technical assistance (TA).

National Accounts: Deficiencies in the source data and compilation practices affect the accuracy and reliability of the GDP statistics, and issues identified by an STA TA report from 2012 have not yet been addressed. Weaknesses are particularly evident in respect to the estimation of output in key sectors, including agricultural production, and in private consumption, saving, investment, and fixed capital formation. The statistical discrepancies between the expenditure categories and output remain significant. Information provided to the Fund is subject to discrepancies. Policymaking and surveillance would benefit from improving national accounts statistics. The authorities have been receiving TA in this area from STA and AFRITAC East.

Government finance statistics: Despite some improvements, the government fiscal statistics continue to be affected by shortcomings in terms of coverage and outdated reporting standards. Data for the general government are based on Government Finance Statistics Manual (GFSM) 1986. Establishing a framework for compiling and disseminating Government Finance Statistics (GFS) and public sector debt statistics that meet GFSM 2001 is an urgent task (the authorities are receiving TA in this area from AFRITAC East). Lack of consolidation of extra-budgetary funds into comprehensive fiscal reporting hinder proper assessment of the Government's fiscal stance, savings, and borrowing requirement. Current financial statements of public enterprises and other information on their operations is not available.

Monetary statistics: Monetary and financial statistics (MFS) have not been reported to STA since 2010. The authorities have not yet reported MFS using the Standardized Report Forms (SRFs) and existing MFS data are compiled with deviations from the recommended methodology, such as lack of detailed currency and sectoral breakdown of financial instruments. Data for Other Financial Corporations are not reported. Monetary survey data for both the central bank and commercial banks are subject to frequent delays in reporting for surveillance. Data from commercial banks is subject to significant revisions. Financial Access Survey data have not been reported since 2012.

Financial statistics: Aggregate set of Financial Soundness Indicators (FSIs) neglect many core indicators. In addition, information gaps, e.g.: commercial banks' income statements, information on distribution of non-performing loans (NPLs) by sector, NPL provisions, maturity of credit, net open position, have implications for conducting an assessment of financial sector risks.

Balance of payments: Balance of payments data require improvements in coverage, valuation, timing, and classification of current account transactions. Financial and capital account transactions are also incompletely covered. Data on FDI is based on an estimation method developed by the NBE. An exploratory survey needs to be conducted to verify the actual investment made in Ethiopia and to establish the universe of the enterprises with private cross border capital. A survey on cross-border financial flows and stocks for the private sector should also be undertaken. Full implementation of BPM6 methodology is recommended.

II. Data Standards and Quality

Ethiopia participates in the General Data Dissemination System (GDDS) and metadata were partially updated in early 2008. No Report on the Observance of Standards and Codes has been completed.

Table 1. The Federal Democratic Republic of Ethiopia: Table of Common Indicators Required for Surveillance
(As of November 17, 2017)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange rates	11/29/2017	11/29/2017	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1/]	6/30/2017	9/13/2017	M	M	M
Reserve/base money	6/30/2017	9/13/2017	M	M	M
Broad money	6/30/2017	9/13/2017	M	M	M
Central bank balance sheet	6/30/2017	9/13/2017	M	M	M
Consolidated balance sheet of the banking system[2/]	6/30/2017	9/13/2017	M	M	Q
Interest rates[3/]	6/30/2017	9/13/2017	M	M	M
Consumer price index	9/30/2017	10/6/2017	M	M	M
Revenue, expenditure, balance, and composition of financing[4/] – central government	6/30/2017	11/17/2017	M	M	M
Revenue, expenditure, balance, and composition of financing[4/] – general government[5/]	6/30/2017	11/17/2017	Q	Q	A
Stocks of central government and central government-guaranteed debt[6/]	6/30/2017	8/4/2017	Q	Q	Q
External current account balance	6/30/2017	9/14/2017	M/Q	Q	Q
Exports and imports of goods and services	8/31/2017	9/22/2017	M	M	M
GDP/GNP	6/30/2017		A	A	A
Gross external debt	…	…	Q	Q	Q
International investment position[7/]	…	…	N/A	N/A	N/A

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] The authorities provide aggregate balance sheet items but not detailed enough for proper financial stability analysis.
[3] Both market-based and officially determined, including discount rates, money market rates, and rates on treasury bills, notes, and bonds.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The general government consists of the central government and local governments.
[6] Including currency and maturity composition.
[7] Reflecting capacity constraints which the authorities are addressing through technical assistance.

Statement by the Executive Director, Mr. Maxwell M. Mkwezalamba, by the Senior Advisor of the Executive Director, Ms. Gloria Gasasira-Manzi, and by the Advisor of the Executive Director, Mr. Willie Nakunyada on The Federal Democratic Republic of Ethiopia
January 12, 2018

Introduction

Our Ethiopian authorities appreciate the constructive and fruitful engagement with staff during the recent Article IV mission. Broadly, they agree with staff's assessment of underlying challenges and key policy recommendations, but raise concerns regarding the DSA assessment.

Economic performance in Ethiopia has remained robust, largely benefiting from the authorities' strong commitment to implement sound macroeconomic policies that support rapid growth and poverty reduction. This notwithstanding, growth prospects remain subject to weather related and commodity price shocks, rising inflation, and the temporary debt challenges. Against this background, the authorities have intensified drought mitigation measures, tightened monetary policy, maintained a strict fiscal policy, and curtailed public borrowing. Moreover, the authorities have intensified efforts to promote rapid industrialization and structural transformation, as articulated in the second Growth and Transformation Plan[1] (GTP II), to unleash export potential, foster economic diversification and ensure debt sustainability.

Recent Economic Developments and Outlook

Economic activity rebounded in 2016/17, with GDP growth at 10.9 percent from 8 percent recorded in FY2015/16, according to actual data recently released by the authorities. The upturn in economic activity was underpinned by recovery in agriculture; and expansion in the construction, tourism, and manufacturing sectors; increased power generation; and substantial increase in foreign direct investment (FDI) inflows. Looking ahead, the completion of flagship investment projects, notably the electricity generation and transmission, the railway line to Djibouti, and the development of industrial parks, is expected to lay a solid foundation for strong economic performance. Importantly, potential up-side risks emanating from the recovery in international commodity prices and improved export performance could strengthen Ethiopia's position as one of the fastest growing and dynamic economies in Africa.

Despite the recent rise in inflation spurred by firming food prices, the tightening of monetary policy in October 2017 is expected to dampen inflation towards the authorities' 8 percent

[1] The second phase of the Growth and Transformation Plan (GTP) outlines the country's successor 5-year development strategy (based on sectoral policies) covering the period 2015/16 to 2019/20.

target. On the other hand, the decline in food imports in FY2016/17 in response to improved agricultural output and the slow-down in public sector capital imports compressed the import bill. Against this backdrop, the external current account deficit, improved in FY2016/17.

Fiscal Policy and Debt Sustainability

The authorities remain steadfast in maintaining a tight fiscal policy stance. Accordingly, the budget deficit for 2016/17 remained below the 3.5 percent of GDP target. Moreover, the authorities continue to implement a productive budget that is characterized by elevated capital expenditures, while protecting priority social spending to cushion the vulnerable. Consequently, a robust safety net system has benefitted poor families in both the rural and urban areas and delivered tremendous social gains. At the same time, the authorities are stepping up efforts to increase fiscal revenues through strengthening tax administration and public financial management, including by automation, broadening the tax base, intensifying tax education and enforcement measures, promoting use of the banking system for all government payments, and finalizing the establishment of a Treasury Single Account. Further, a cost - benefit analysis on the tax incentive structure is being undertaken, in collaboration with the Word Bank and the IMF, to ascertain scope for rationalization.

Considering the impact of the delayed export take-off and the rise in debt obligations, the authorities have taken decisive remedial measures to improve debt sustainability. Within this context, they imposed stringent controls on non-concessional borrowing by state owned enterprises (SOEs) and the government, consistent with the new centralized external debt directive. The authorities are also finalizing the legal framework that governs Public Private Partnership (PPP) arrangements to reduce the burden of project financing from the public sector. In the meantime, they remain current in the settlement of all external debt obligations.

In addition, the authorities are pressing ahead with policy efforts to support rapid industrialization and economic diversification to raise export earnings, boost growth prospects, and improve debt sustainability. In this context, new investments in industrial parks, cluster developments, and power generation are expected to unlock additional export revenues. Besides current power exports to Sudan and Djibouti, the country will soon supply electricity to Kenya, once construction of the transmission line is finalized. More importantly, the commencement of operations on the Addis Ababa-Djibouti railway line on January 3, 2018 is expected to significantly reduce transportation and logistics costs and enhance export competitiveness.

Overall, Ethiopia’s economy remains sound, characterized by robust growth performance and improved living conditions. All loans contracted over the years have been invested in productive and growth-enhancing infrastructure, and the authorities have continued to take appropriate measures to contain borrowing, and firmly establish a strong export base. These investments have set the stage for the private sector to drive the next phase of development. Against this background, the authorities had expected that the assessment of Ethiopia’s debt situation would have attached greater weight to country specifics, including the expected take off in export, significant FDI and remittance inflows, and far-reaching corrective policy actions.

Monetary and Financial Sector Policy Measures

The authorities have maintained a reserve money targeting framework to contain inflation at low and stable levels. Within this context, the National Bank of Ethiopia (NBE) continues to exercise restraint by confining advances to the government within strict reserve money targets and ensuring congruency between fiscal and monetary policies. Further, significant progress has been made towards establishing a secondary market for government securities. In this regard, Technical Assistance (TA) from the Fund is expected to help operationalize the secondary market and pave the way for the gradual adoption of indirect monetary policy instruments.

Consistent with Fund advice, the authorities devalued the Ethiopian birr by 15 percent in October 2017 to address underlying current account imbalances, and tightened monetary policy by raising the minimum deposit rates from 5 to 7 percent to dampen incipient inflationary pressures. Further, the NBE lowered the planned base money growth from 22 to 16 percent. Looking ahead, the authorities are committed to ensure that the exchange rate remains supportive of export competitiveness. To counter the inflationary effects of the exchange rate devaluation, the NBE stands ready to further tighten monetary policy going forward.

More generally, the banking sector remains safe and sound, characterized by well capitalized and profitable institutions with low non-performing loans (NPLs) estimated at 2.6 percent in June 2017. This notwithstanding, the NBE continues to vigilantly monitor the Development Bank of Ethiopia's (DBE) asset quality. This follows the rise in the DBE's NPLs occasioned by the slow up-tick in manufactured exports. The expected increase in export earnings attributed to completion of industrial park development projects financed by the DBE is expected to improve the bank's loan collection efforts and the eventual reduction in NPLs. Moreover, the DBE has made adequate provisioning for the impaired loans, and is currently intensifying loan recovery efforts. As such, the authorities view the DBE's NPLs as a short-term phenomenon, which will be resolved once export performance picks up.

The banking sector is aggressively mobilizing deposits through outreach programs in previously un-banked segments of the population. Against the background of these financial inclusion efforts, the branch network expanded by 33 percent in FY2016/17 to 44,257 branches. The rapid expansion of bank branches and deposit base have been accompanied by increased use of electronic money as well as mobile and agent banking services. To mitigate potential risks arising from increased use of these new products, the NBE has strengthened its surveillance and monitoring toolkit. More importantly, the launch of the National Financial Inclusion Strategy (NFS) in October 2017 is envisaged to provide further impetus to efforts aimed to integrate the unbanked segments of the population.

Notable progress has been made in efforts to strengthen the AML/CFT framework to halt further loss of correspondent banking relationships (CBRs). To this end, the authorities have made significant strides in addressing remaining deficiencies through the development of a National Action Plan (NAP) in line with Financial Action Task Force (FATF) recommendations, and accepted by the Africa/Middle East Joint Group (JG). To operationalize the NAP, and timely address the remaining deficiencies, various committees that focus on the completion of key time bound activities have been established.

Structural Reforms

The authorities are advancing reforms to improve the business climate and enhance competitiveness. In this respect, substantial resources have been deployed towards development of road, rail, dry ports, air transport, energy, telecommunications, water, and irrigation infrastructure to reduce the cost of doing business, and improve productivity. Consequently, the country recorded over US$4 billion in FDI inflows in 2017. Additional measures include joint venture and PPP arrangements between government and the private sector in the development of industrial parks and supportive infrastructure, to exploit the country's comparative advantages.

At the same time, the authorities have intensified efforts to reform SOEs with a view to enhance commercial viability and strengthen governance practices. In this regard, they are undertaking comprehensive public enterprise reforms, including privatization of ten out of the remaining twenty SOEs that fall under the purview of the Ministry of Public Enterprises (MPE). The privatization of key SOEs is expected to lessen the burden on government in the near term, and create additional fiscal head-room. Furthermore, the authorities are undertaking reforms aimed at improving corporate governance, upgrading financial systems, and developing capacity in business leadership among SOEs. Significant strides have also been made in the finalization of audited financial statements of SOEs to align them with international standards. The few SOEs that are yet to finalize their financial statements are well on course to meet the set deadlines.

Regarding data, the authorities look forward to continued collaboration with the Fund and development partners in the provision of further TA to improve the quality and reliability of macroeconomic statistics. Going forward, the planned work stream to rebase the national accounts is envisaged to help further refine the quality of statistics in line with best international standards.

Conclusion

Our Ethiopian authorities remain steadfast in the implementation of prudent macroeconomic policies required to sustain robust economic performance and ensure debt sustainability.

They view the current debt situation as temporary and are taking bold measures to boost investment and exports, and contain public borrowing. Against this background, the authorities remain concerned with the DSA assessment, given the unique country circumstances. This notwithstanding, our authorities remain optimistic that implementation of the private sector and export-oriented industrialization strategy remains integral to reducing debt sustainability risks, and propelling Ethiopia into lower middle income status by 2025. That said, they remain committed to engagement with the IMF, and appreciate Fund advice and technical assistance.