 January 2005
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The Federal Democratic Republic of Ethiopia: 2004 Article IV Consultation and Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Statement; and Public Information Notice and Press Release on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2004 Article IV consultation with The Federal Democratic Republic of Ethiopia and sixth review under the three-year arrangement under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the combined 2004 Article IV consultation and sixth review under the three-year arrangement under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on June 25, 2004, 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 August 18, 2004. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of September 13, 2004 updating information on recent economic developments.

- a Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its September 13, 2004, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

The documents listed below have been or will be separately released.

Debt Sustainability Analysis
Ex Post Assessment of Long-Term Fund Engagement
Letter of Intent sent to the IMF by the authorities of The Federal Democratic Republic of Ethiopia*
Selected Issues Paper and Statistical Appendix
*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

Staff Report for the 2004 Article IV Consultation and Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Prepared by the African Department

(In consultation with the Finance, Fiscal Affairs, Legal, Monetary and Financial Systems, Policy Development and Review, and Statistics Departments)

Approved by Siddharth Tiwari and Matthew Fisher

August 18, 2004

- **A mission visited Addis Ababa during June 10-25, 2004 to conduct the 2004 Article IV Consultations, the sixth (and final) review of the PRGF, and to discuss the preliminary ex post assessment of Fund-supported programs in Ethiopia.** The team consisted of Mr. Basu (head), Mr. Powell, Mr. Erasmus, Mr. Yamauchi (all AFR), Mr. Sobolev (PDR), Mr. Mattina (FAD), Mr. Olafsson (MFD) and Ms. Pereira-Isaev (Senior Administrative Assistant, AFR). Mr. Kyei, the Fund's Resident Representative, participated in the work of the mission. Mr. Daniel (FAD), the head of the ex post assessment team, traveled to Addis Ababa on June 22-24 for discussions on the draft ex post assessment report. In the attached letter (Appendix I), the authorities request disbursement of the final disbursement under the PRGF arrangement.

- **The last Article IV consultation with Ethiopia was completed on September 23, 2002.** On that occasion, Executive Directors encouraged the authorities to implement decisively structural reforms that would enhance the efficiency and competitiveness of the economy. They urged the authorities to persevere with their cautious expenditure policy, and stressed the need to improve the planning, tracking, and reporting of public spending. They also urged a strengthening of the financial sector.

- **On February 27, 2004, the Executive Board concluded the fifth review under the PRGF arrangement and endorsed the first annual progress report (APR) of the PRSP.** Executive Directors commended the authorities for their strong performance under the program, despite the negative impact on the economy of the drought of 2001/02 and 2002/03. Directors stressed that it would be crucial to implement all elements of the Commercial Bank of Ethiopia (CBE) restructuring plan. They also underscored the importance of persevering with the other elements of the structural reform agenda, including privatization, capacity building, the promotion of non-traditional exports, and support for the private sector.

- **Subsequently, on April 20, 2004, the Executive Boards of the IMF and IDA agreed that Ethiopia had met the conditions for reaching the completion point under the enhanced HIPC Initiative**. Directors also agreed that exceptional additional HIPC Initiative assistance should be granted to reduce Ethiopia's NPV of debt-to-exports ratio at end 2002/03 to the HIPC Initiative threshold of 150 percent, if sufficient indications of participation are obtained from other creditors.

- Relations with the Fund are presented in Appendix II; relations with the World Bank are described in Appendix III; statistical issues are reviewed in Appendix IV, the authorities' reactions to the ex post assessment are detailed in Appendix V; and Appendix VI provides an alternative "Doubled Aid" scenario.

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EXECUTIVE SUMMARY

The issue of the border demarcation between Eritrea and Ethiopia remains unresolved. The Development Assistance Group (DAG) of donor ambassadors in Ethiopia has underscored the need to avoid escalating defense expenditures.

The PRGF program remains on track. All the quantitative performance criteria under the PRGF for end-March 2004, the structural performance criteria for end-June 2004, as well as all the benchmarks for these test dates have been met. In particular, the implementation of the Commercial Bank of Ethiopia (CBE) restructuring plan has progressed as planned.

Ethiopia's real GDP growth rebounded strongly (to 11.6 percent) during 2003/04. The average annual inflation rate (about 11 percent as of May 2004) has fallen much less sharply than earlier projected, mainly because food prices have declined at slower rates than earlier expected. The nonfood inflation rate (4.2 percent) is also higher, mainly because of the rise in import prices of selected inputs and the pass-through effects of a nominal effective depreciation of the birr in the wake of the National Bank of Ethiopia's (NBE's) policy of closely tracking the dollar.

Following last year's recovery, growth is expected to revert to trend. The staff project lower real GDP growth (about 5.7 percent) in 2004/05 based on an assumption of normal rains. This is about one percentage point below the authorities' projection, a difference fully explained by the staff's more cautious assumption for the growth of agricultural yields. The external current account deficit (including official transfers) is expected to widen in 2004/05 (to 8.7 percent of GDP), reflecting substantially lower official transfers.

The 2004/05 federal budget requires substantial domestic financing as spending initiatives outpace revenue growth. The planned doubling of domestic resources allocated to the Food Security Program (FSP) underlies the increase in total expenditures. In the absence of higher grants, additional measures are required to reduce the deficit by about 2 percent of GDP to bring domestic borrowing requirement to a level consistent with achieving the government's inflation target.

The staff prepared two illustrative medium-term fiscal projections: the "double aid" scenario (with higher public spending and growth) and a baseline scenario reflecting recent trends more closely. In addition to higher external assistance, achieving the higher growth objectives and absorbing the higher assistance required for achieving the Millennium Development Goals (MDGs) will require an accelerated and determined implementation of structural reforms to support rural and private sector development.

The authorities welcomed the ex post assessment as providing an opportunity to revisit their performance over the last decade and to enhance their future policies. They were concerned, however, that the report showed a lack of new thinking by the Fund, which was still applying the "old paradigm" of the "Washington Consensus." In their view, in the future, the Fund's seal of approval would be more important than the level of access.

I. Introduction

1. On July 14, 2004, the IMF Executive Board extended through October 31, 2004 the arrangement under the Poverty Reduction and Growth Facility (PRGF) approved on March 22, 2001, to allow time for the completion of the sixth review under the arrangement. The attached letter from the Minister of Finance and Economic Development of Ethiopia and the Governor of National Bank of Ethiopia (NBE), dated August 12, 2004 (Appendix I), indicates that the performance criteria under the third annual program (covering fiscal year July 8, 2003-July 7, 2004) supported by the PRGF arrangement were achieved, and requests the final disbursement under the arrangement.

2. The Article IV consultation discussions focused on the conclusions of the draft ex post assessment report (EPA) and on the authorities' macroeconomic policies and structural reform strategy to achieve an acceleration of economic growth and the Millennium Development Goals (MDGs). During these discussions, in line with the conclusions of the EPA, the staff strongly encouraged the authorities to pursue a more ambitious reform strategy than in the past. Section II describes economic performance in 2003/04. Section III reports on the discussions, and Section IV presents the staff appraisal.

3. Ethiopia continues to face political uncertainties, which are partly related to the unresolved dispute with Eritrea on boundary demarcation and partly to the preparations for the June 2005 elections. The Eritrea-Ethiopia Boundary Commission ruling (April 2002) that the town of Badme would be located within Eritrea has ignited strong opposition to it in Ethiopia, leading to protracted delays in the official demarcation of the border. However, the Ethiopian government has said it will not go to war over Badme. The international community's efforts, including a recent U.N. initiative, have not succeeded so far in resolving the impasse. Meanwhile, the Development Assistance Group (DAG) in Ethiopia has underscored that the Government of Ethiopia should avoid escalating defense expenditures while the border dispute remains unresolved. The DAG ambassadors have also encouraged the Ethiopian authorities to invite international observers to the upcoming June 2005 election, and allow all political parties to participate on an equal footing in the public debate prior to the election.

4. Ethiopia ranks towards the bottom (170 out of 177 countries) in the 2004 Human Development Index ranking, an assessment combining life expectancy, adult literacy, primary school enrollment, and per capita income. The poverty reduction strategy paper (PRSP) indicates that the poverty headcount index was 44.2 percent in 1999/2000 for the country as a whole, down from 45.5 percent in 1995/96

II. Economic Performance in 2003/04

Selected Indicators, 2001/02-2003/04 1/

	2001/02	2002/03	2003/04
	(Annual growth, in percent)		
Real GDP	1.6	-3.9	11.6
CPI	-7.2	15.1	9.6
Exports	-2.2	6.7	14.4
Imports (excl. aircrafts)	8.9	14.4	24.5
	(In percent of GDP)		
Gross domestic saving	2.5	1.0	1.3
of which private savings	1.7	0.6	0.3
Gross domestic investment	20.5	20.5	20.6
of which private investment	9.0	10.0	9.4
Resource gap	-17.9	-19.4	-19.4
Current account(excl. official transfers)	-12.9	-12.8	-13.0

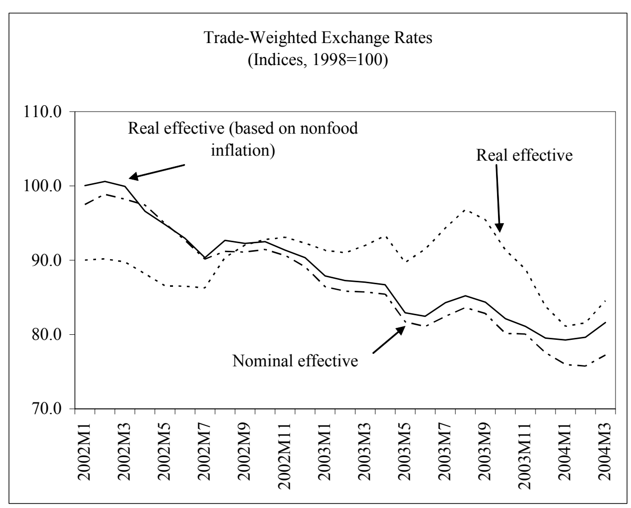
Sources: Ethiopian authorities; and staff projections

1/ Fiscal year ending July 7.

5. **Ethiopia's real GDP growth rebounded strongly (to 11.6 percent) during 2003/04, as agricultural production recovered fully from the drought-affected levels of 2001/02-2002/03.** Growth in the nonagricultural sectors was also stronger (6.8 percent) than earlier estimated, primarily reflecting the impact of higher agricultural output on industrial production and services activities.

6. **The average annual inflation rate (about 11 percent as of May 2004) has fallen much less sharply than earlier projected (5.5 percent), mainly because both food and nonfood prices have declined at slower rates than expected.** The announcement of floor prices for cereals under the cereal price support scheme operated by the Ethiopian Grain Trading Enterprise (EGTE) is likely to have had a signaling impact on the prices at which cereals have been traded in the markets, and in addition, a shift by some local aid agencies from imports to domestic purchases of cereals may also have prevented food prices from falling in line with earlier seasonal patterns. The introduction of warehousing facilities for farmers, moreover, has allowed them to store a part of their crop after the harvest instead of having to sell it when prices are subject to downward pressures. The nonfood inflation rate (4.2 percent in May 2004) is higher than earlier expected, mainly because of the nominal effective depreciation of the birr on the exchange market, as well as the rise in import prices of selected inputs.

Exchange Rate Developments, January 2002-March 2004



Sources: Ethiopian authorities; and staff calculations

7. **Although the exchange rate vis-à-vis the U.S. dollar has remained highly stable through 2003/04 declining only slightly from Birr/$ 8.60 in June 2003 to 8.63 in May 2004, the exchange rate has depreciated in nominal and real effective terms quite noticeably (by about 8 percent and 5 percent, respectively through end-March 2004).** Consistent with their policy of avoiding a real appreciation, the authorities indicated that they have been content to follow the U.S. dollar and allow the birr to depreciate against the euro. As a result, the nominal and real effective exchange rates of the birr also depreciated. Given the challenge of stimulating more rapid growth, the authorities indicated that the depreciation of the real

effective exchange rate was appropriate[1]. This policy has allowed the NBE to build up its net foreign asset position above the programmed level to take advantage of a normal harvest year and establish a stronger reserve cushion for coping with future exogenous shocks.

8. **The expansion of broad money through end-March 2004 (7.2 percent) was considerably less than programmed (12.4 percent).** Since the Government reduced its net indebtedness to the banking system much more than programmed, the NBE was able to reduce its net domestic assets (NDA) well below the program estimate and overall NDA of the banking system recorded a small decline. As the NBE did not fully offset the decline in its NDA with its buildup of net foreign assets (NFA), it was able to sharply limit the increase in reserve money. Reflecting the economic recovery, bank credit to the nongovernment sectors expanded strongly, both to the public enterprises (in telecommunications and power) and the private sector. The NBE also allowed the commercial banks to reduce their excess reserves by a modest amount to support this credit expansion. In the last quarter of the fiscal year, the authorities indicated that they expect the full use of programmed domestic credit which, combined with stronger than programmed growth in NFA, leads to projected broad money growth for 2003/04 beyond the programmed level.

Monetary Survey, 2001/02-March 2004
(Percentage change since the end of the previous fiscal year)

	2001/02 July 7	2002/03 July 7	2004 Mar. Rev. Prog.	2004 Mar. Act.
Net foreign assets	70.6	36.1	13.7	23.0
Net domestic assets	-2.1	-0.6	11.6	-2.0
Net claims on government	4.7	9.8	-2.3	-11.2
Claims on non-government	-7.1	-7.7	22.1	20.3
Other items (net)	3.3	10.0	3.6	5.6
Broad money	12.3	10.4	12.4	7.2
Money	12.2	8.8	9.9	5.2
Quasi-money	12.4	12.5	15.4	9.7
Memorandum items:				
Interest rates (in percent; end-period; saving-lending rate range)	3-13	3-13	...	3-14
Treasury-bill rate (in percent; end-period; 91-days)	0.24	1.30	...	0.51
Excess reserves (in percent of deposits)	8.1	12.8	...	8.4

Sources: Ethiopian authorities; staff projections.

9. **The structure of interest rates has remained unchanged during 2003/04.** The NBE's monetary policy committee considered increasing the minimum saving deposit rate, which is the only interest rate directly set by the NBE, in line with core inflation. However, it decided to postpone a decision on this matter to later in the year, when it would have a clearer picture of whether or not the pick up in nonfood inflation is temporary. The yield on 91-day Treasury bills has remained low, reflecting the excess liquidity in the banking system, and liquidity

Interest Rate Structure, 2001/02-March 2004
(In percent; end of period)

	2001/02 July 7	2002/03 July 7	2003 Sep.	2003 Dec.	2004 Mar.
Interest rates					
Savings deposits (minimum rate)	3.0	3.0	3.0	3.0	3.0
Time deposits (range of various maturities)	3.3-3.6	3.4-3.8	3.4-3.9	3.4-3.8	3.4-3.8
Lending rates (minimum-maximum rate range)	7.5-13.0	7.5-13.0	7.5-14.0	7.0-14.0	7.0-14.0
Treasury-bill rate (91-day maturity)	0.24	1.30	1.05	0.67	0.51

Source: Ethiopian authorities.

[1] The staff would characterize the current exchange rate regime as a tightly managed float.

management remains a major challenge for the authorities due to the underdeveloped nature of domestic financial markets[2].

10. **Based on updated estimates, in 2003/04 the fiscal deficit (including grants) is likely to be lower (4.8 percent of GDP) than targeted (7.1 percent of GDP) reflecting lower external project loans as donors shifted to grant financing given the vulnerable debt situation.** Relative to GDP, the deficit excluding grants (12.6 percent) was also below the program target (14.1 percent) as the share of recurrent expenditure was contained below that of domestic revenue. In nominal terms, revenue surpassed the program target because of strong indirect tax receipts stemming from buoyant import growth and improved customs administration, which more than offset lower-than-programmed direct taxes that reflected weak corporate profits following the drought of 2002/03. However, the tax base could not keep pace with the unexpectedly strong rebound in GDP, which was driven by the lightly taxed agricultural sector. Consequently, tax revenue fell short of the program target by 0.7 percent of revised GDP. Similarly, recurrent and capital spending were largely in line with the nominal program targets, but fell short as a share of GDP. Defense spending (Br. 2.4 billion) is expected to be held to the nominal program estimate, while poverty-reducing expenditure is anticipated to slightly exceed the nominal target owing to higher-than-planned capital spending in the education sector. The government has also implemented most of the planned expenditure for food security, without recourse to any domestic credit in the first nine months of 2003/04. However, the authorities anticipate a decompression of expenditures in the final quarter that will fully utilize the available domestic credit under the program.

General Government Operations, 2001/02-2003/04 1/
(In percent of GDP)

	2001/02	2002/03	2003/04	
			5th Review	Rev. Prog.
Total revenue and grants	24.7	27.5	26.6	26.4
Revenue	20.0	19.5	19.5	18.6
Grants	4.7	8.0	7.1	7.8
Total expenditure and net lending (cash basis) 2/	34.0	35.9	33.6	31.2
Recurrent expenditure 3/	20.3	23.7	19.8	18.3
Capital expenditure 3/	11.8	11.1	13.0	12.0
Special programs	1.9	1.1	0.8	0.9
Overall balance, including grants	-9.3	-9.7	-7.1	-4.8
Overall balance, excluding grants	-13.9	-17.7	-14.1	-12.6
Financing	9.3	9.7	7.1	4.8
External (net)	9.4	6.8	5.1	3.1
Domestic (net)	0.6	2.9	1.8	1.7
Privatization	0.1	0.0	0.2	0.0

Sources: Ethiopian authorities; and staff estimates and projections.

1/ Fiscal year ending July 7.
2/ Including special programs (demobilization and reconstruction).
3/ Excluding special programs (demobilization and reconstruction).

11. **The external current account deficit (including grants) is estimated to show a smaller deficit than earlier projected,** due to higher net inflows of official and private transfers and a larger surplus in nonfactor services. The additional official grants reflected a shift away from long-term lending by donors. In the capital account, although there was a shortfall in disbursements of official long-term loans, this was offset by other unclassified

[2] Although there exists a discount window, there is no demand for accommodation by the central bank.

inflows (recorded under net errors and omissions), and net capital inflows were broadly in line with the program estimate. Thus, the lower-than-programmed external current account deficit was the primary factor contributing to an overall surplus in the balance of payments. Under these circumstances, the NBE was able to build up its foreign reserves beyond the program level.

12. All the quantitative performance criteria for end-March 2004, the structural performance criteria for end-June 2004, as well as all the benchmarks for these test dates have been met, as shown in Appendix I, Tables 1 and 2.

13. The implementation of the restructuring plan for the NBE was begun in January 2004. Most of the recommendations made by KPMG, which covered all aspects of the restructuring plan except job grading, salary scales, and review of manuals for policies and procedures, were approved by the Board of the NBE. However, a number of key recommendations aimed at increasing the autonomy of the central bank were rejected by the NBE Board. [3]

14. Almost all the recommendations under the safeguard assessments have been implemented. The suggestion to strengthen the internal control system is planned to be completed as part of the overall organizational restructuring, in particular, of the internal audit department.

III. Report on Discussions

15. Since the Fund emphasized the need for structural reforms to support sustainable growth and poverty reduction in previous Article IV consultations, the discussions also covered key areas of such reforms including liberalization of the external sector and interest rates, the reorientation of spending to poverty alleviation, the speeding up of tax reform, privatization, and the strengthening of the financial sector, including by removing barriers to foreign bank entry (see sections IIB-IIIE below). Most of the immediate and distortionary policies identified in previous consultations have been gradually overhauled, but the authorities have remained cautious of greater market orientation in some key areas (see EPA section II). In particular the authorities continue to believe that allowing foreign bank entry would be premature (see paragraph 33 below). On the macroeconomic front, the authorities have, on the whole, pursued fiscal, monetary, and exchange rate policies that have been prudent and broadly in line with the Fund's advice.

[3] The following recommendations were rejected by the NBE Board: (a) limiting the overruling of the Board's decisions by the government to exceptional circumstances; (b) limiting the removal of the Board members from office to their noncompliance with qualifications; (c) granting tenure longer than the election cycle (six years); (d) setting qualifications of Board members, including no conflict of interest; and (e) requiring the governor to report annually to parliament.

16. **The discussions focused on the staff's EPA and on its implications for developing a sound framework of macroeconomic policies and structural reforms that could help to achieve the MDGs by 2015**. The EPA calls for the adoption of prudent debt management; realistic projections for real growth, government revenues and foreign grants in developing macroeconomic programs; more ambitious structural reforms; and programs that explicitly incorporate policies to help cope with exogenous shocks.

17. **In responding to the conclusions of the EPA, the authorities welcomed the opportunity to revisit performance under past programs.** They suggested, however, that the report should give greater recognition to significant recent reforms (e.g. in civil service reform and agriculture). They also considered it important for the Fund to give thought to alternative approaches to achieving development, and to avoid overemphasizing "liberalization". They acknowledged that Fund programs had been beneficial, and that without them the outcomes would have been different. Looking forward, they indicated that they would continue to take appropriately sequenced measures at their own pace, and based on their own concrete analysis. They recognized that to make better progress towards the MDGs and ensure that both the public sector and the private sector contributed to higher growth, it would be important to focus not only on strengthening public expenditure management and external aid mobilization efforts, but equally strongly concentrate on supportive macroeconomic policies, and institutional and structural reforms.

18. **In line with the recommendations of the EPA, the staff developed a baseline medium-term scenario based on recent trends and/or realistic projections of external assistance and real GDP growth.** At the authorities' request, the staff also prepared a more ambitious "Doubled Aid" scenario, which projected significantly higher external aid flows and somewhat higher GDP growth than under the staff's baseline. Regarding any future arrangement, the authorities noted that while they considered high access to be appropriate, Fund financing was relatively minor, and the key benefit of a Fund-supported program was the policy framework and the seal of approval.

A. Achieving Higher Growth and the MDGs

19. **The baseline scenario for 2004/05 and beyond takes into account four basic objectives.** First, the projections for the real GDP growth rate (5.7 percent in 2004/05 and an average of 5.3 percent per year for the period up to 2015) are somewhat less ambitious than that of the authorities' projections, because the projected increases in the ratios of investment and savings to GDP, and agricultural productivity, and the pace at which these gains would be realized are relatively more cautious than those of the authorities (Box 1)[4]. Second, the

[4] In response to the concerns expressed in the EPA regarding optimistic growth projections, the staff's baseline growth projections are lower by about 0.5 percentage points than the base projections presented in the completion point document (See HIPC Enhanced Initiative for Heavily Indebted Poor Countries – Completion Point Document).

annual inflation rate would be contained to 3 percent consistent with the base case of the APR of the PRSP. Third, foreign reserves would be maintained at a level that covers at least four months of imports. Fourth, the ratio of total (domestic and foreign) debt to GDP would be reduced gradually over time. To achieve these objectives, the targeted path of fiscal deficits and the accompanying policies would play a central role in achieving the necessary degree of monetary restraint, containing pressures on the price level and the external current account, and achieving debt sustainability.

20. **In contrast, under the doubled aid scenario, the authorities expect a marked acceleration of real GDP growth that is needed to achieve the income poverty goal of halving the number of people living in poverty by 2015.** To this end, based on estimates of the income elasticity of poverty and strong implementation of their reform program, the authorities are targeting an average annual growth rate of about 7 percent, compared with 4.0 percent achieved during 1991/92-2003/04. This would require significant increases in agricultural productivity, and the ratios of savings and investment to GDP. The authorities, however, expect that as a result of the envisaged intensity and implementation of supporting structural and institutional reforms, these critical variables would increase well above historical trends.

21. **The path of annual fiscal deficits (excluding grants) under the baseline would need to be contained to about 10 percent of GDP over the medium term,** based on recent trends in official aid receipts (9 percent of GDP) and on a policy of containing new domestic borrowing as a share of GDP (to about 1 percent of GDP). Over the longer term, the ratio of revenues to GDP is expected to rise gradually, reflecting ongoing capacity building and improved revenue buoyancy as non-agricultural growth picks up, allowing scope for increasing the ratio of total expenditures to GDP, and eventually for reducing the dependence on aid. Under this fiscal scenario, the government would be able to reduce gradually the currently high ratios of its domestic and foreign debt to GDP to more sustainable levels. Moreover, by limiting its domestic borrowing, it would provide scope for adequate annual increases in bank credit to the nongovernment sector within annual targets for monetary expansion that are consistent with holding the annual inflation rate at about 3 percent. A significant risk in successfully implementing the baseline scenario is the reoccurrence of a severe drought, which strikes about every third year on average, as noted in the ex post assessment discussion.

22. **The baseline scenario assumes new external borrowing over the medium term to be limited consistent with the baseline scenario presented at the HIPC initiative completion point,** with increased grants allowing total assistance to remain broadly at their current levels as a share of GDP. While the envisaged lending program will keep the debt stock elevated for some time, the debt-service ratios are projected to remain manageable over the projection horizon reflecting the long maturity periods on existing debt and projected future financing.

23. In contrast to the baseline, the "doubled aid" scenario entails a rapid expansion in poverty-reducing expenditure financed by an inflow of external grants (Box 2).[5] The budget deficit (excluding grants) would balloon to over 20 percent of GDP to finance higher poverty-reducing spending by 15 percent of GDP by 2015/16. In contrast, the deficit including grants would decline gradually to just 2.3 percent of GDP by 2015/16 as domestic fiscal effort steadily improves[6]. Expenditure would need to focus on recurrent items in light of the high wage component of addressing the shortage of teachers and medical staff that will be essential for achieving the MDGs in health and education[7]. Consequently, the government sector wage bill would increase by 4½ percent of GDP by 2015/16. The domestic public debt would decline and inflation would be contained (to 6 percent) by limited recourse to domestic financing at less than 1 percent of GDP per annum[8]. However, assumed donor assistance would increase by $5 billion per annum by 2015/16, before shifting to a downward trend. Under this scenario, the staff stressed the importance of containing any emerging wage pressures and maintaining adequate monetary restraint consistent with the inflation target, and noted that the scaling up of aid inflows also required aid coordination efforts to ensure predictability and firm forward-looking commitments from donors, as well as simplification and harmonization of donor conditionality and aid delivery practices.

[5] The scenario assumes a doubling of the ratio of on-budget receipts of foreign grants and loans to GDP from 11 percent in 2003/04 to 22 percent in 2015/16.

[6] External borrowing in the "doubled aid" scenario is limited to be consistent with the high case scenario presented at the time of the completion point in April 2004, when the projected debt burden was considered to be sufficiently high as to warrant topping-up of HIPC Initiative assistance.

[7] Attracting and retaining sufficient health personnel to deliver required health services could demand significant increases in wages. Containing more generalized wage inflation pressures in the rest of the economy would be important for protecting private investment and employment.

[8] Under the doubled aid scenario money velocity is assumed to decline slightly from the current level of 1.87 to about 1.78 by 2015, while broad money grows by about 13-15 percent per annum.

Box 1. Assumptions Underlying the Medium-Term Growth Projections

Ethiopia's PRSP (the SDPRP) indicates that real GDP growth should average about 6 percent per year in order to achieve the MDG income poverty goal of halving the number of people living in poverty. The authorities believe that average annual real GDP growth of 7.0 percent could be achieved over the medium term.

Achieving growth of this magnitude on a sustainable basis would, however, require a significant improvement on the experience of the past 13 years. Annual real GDP growth during 1991/92-2003/04 averaged 4.0 percent, while potential growth is estimated at about 4.4 percent (Table 1). The staff's baseline scenario assumes implementation of a reform program and higher agricultural productivity than in the past, which yields higher GDP growth, averaging about 5.5 percent annually.

The following are the main differences between the staff baseline projection and that of the authorities:

- the authorities' projection is based on a doubling of official aid flows as a share of GDP;
- regarding agricultural production, the staff projects crop yields to improve by an average of 4 percent per year, compared with the authorities' projection of 9 percent – this compares with an average increase of 1.4 percent per year during 1993/94-2003/04;
- applying a growth accounting framework, and taking into account projections for gross domestic investment and labor, the staff's projection implies a contribution from total factor productivity (TFP) of 1.1 percentage points; in the authorities' projection, this would imply a TFP contribution of 1.7 percentage points; and
- the authorities' projection implies a further substantial increase in the ratio of investment to GDP. Compared with the staff's projection of an increase in the ratio to an average of 22 percent during 2004/05-2020/21, the authorities' growth projection implies a ratio of 31.4 percent of GDP. The staff projects an improvement in gross domestic savings to about 8 percent of GDP from 2.3 percent during 1991/92-2003/04, compared with the authorities' projection of about 11 percent of GDP. The authorities' projections thus imply a significant resource gap, averaging about 23 percent of GDP during 2004/05-2020/21.

Table 1. Potential Real GDP Growth and Sources of Growth

	Actual	Revised Baseline	Authorities Projection
	1991/92-2003/04	2004/05-2020/21	
Real GDP at factor cost	4.0	5.5	7.0
Agriculture	2.2	3.3	7.5
Non-agriculture	5.8	6.6	6.6
Real per capita GDP	1.1	3.1	4.2
Growth accounting			
Real GDP at factor cost	4.0	5.4	7.0
Capital stock	1.4	2.1	3.0
Labor	2.0	2.3	2.3
Total factor productivity	0.7	1.1	1.7
Potential GDP growth			
HP filter 1/	4.5		
Production function 2/	4.4		
Capital-Output ratio 3/	4.4		

Source: Authorities; and staff estimates and projections.

1/ Hodrick-Prescott Filter
2/ This approach models output as a function of capital, labor, and total factor productivity.
3/ This approach models output as a function of the capital stock based on an assumption that output in developing countries is fundamentally constrained by a lack of infrastructure and capital.

Box 2. Achieving the Millennium Development Goals (MDGs) in Ethiopia.

Ethiopia is confronting pressing social deficits with respect to achieving universal primary education, addressing gender disparity, enhancing basic health care coverage, and reversing the spread of major diseases.

Health: Only 62 percent of the population enjoy access to basic health care services, while the prevalence of HIV/AIDS is estimated to impact about 2 million people;
Education: Completion rates in primary education are low with over half of students dropping out by grade 3, while enrollment in secondary schools is only 14 percent;
Population dynamics: Large investments will be required just to maintain the currently low level and quality of public service given an estimated fertility rate of 5.9 children per woman of childbearing age that will boost the population by 50 percent within 20 years;
Water: Just one quarter of the population has access to safe drinking water, and only 15 percent has access to sanitation services; and
Transport, telecommunications and power: Ethiopia has low road density at just 27 km/1000km[3], compared to 50 in sub-Saharan Africa (SSA). Telecommunications and internet connectivity are also low with just 4 telephone lines per 1,000 people, compared to an average of 14 in SSA.

Achieving the MDGs will require a substantial increase in donor assistance. Aid flows presently amount to just $13 per capita compared to the SSA average of $23. In light of this, and guided by the pattern of expenditure in the "extended PRSP" scenario detailed in the World Bank's Public Expenditure Review, the fiscal impact of doubling foreign assistance as a share of GDP is assessed relative to a baseline scenario that incorporates prudent revenue forecasts, existing expenditure priorities and current trends in donor support. The "doubled aid" scenario assumes that the increase in required resources over the baseline is disbursed in the form of higher grants, reflecting Ethiopia's tight external debt position. Consistent with this scenario, donor support would increase gradually through 2015/16 to reach about $6 billion, enabling poverty-reducing spending to attain $78 per capita compared to just $20 in 2003/04. The wage bill also increases significantly as higher social spending is allocated to recurrent spending needs in education and health care, which entail large wage components. The budget deficit excluding grants increases sharply to over 20 percent of GDP by 2015/16, raising concerns about the sustainability of donor financing after 2015/16.

	2003/04	2015/16	
	Actual	Baseline	Doubled Aid
Revenue excluding grants (percent of GDP)	18.6	19.6	19.6
Poverty spending (percent of GDP)	16.3	16.7	31.1
per capita spending in U.S. dollar	$19.50	$34.50	$78.40
Public expenditure (percent of GDP)	31.2	28.8	42.4
Wage bill	7.8	7.8	12.3
External financing and grants (percent of GDP)	11.0	8.2	22.0
U.S. dollar (millions)	$1,107	$1,614	$5,973

[3] Statistics are from the World Bank's 2002/03 Public Expenditure Review and CAS.

B. The 2004/05 Budget

24. **The authorities' 2004/05 federal budget requires substantial domestic financing as spending outpaces revenue growth**. Although the consolidated government budget will not be available until September, the staff project a slight decline in the general government fiscal deficit by 0.1 percent of GDP, assuming that the authorities secure additional grant financing or undertake fiscal measures totaling 2 percent of GDP to fill the gap. In the absence of higher grant financing, or new measures, the authorities will require domestic financing of 3.5 percent of GDP to finance a general government deficit that would rise to 6.7 percent, jeopardizing a sustained decline in both the inflation rate and the ratio of public debt to GDP.

General Government Operations, 2003/04-2005/06 1/
(In percent of GDP)

	2003/04	2004/05		2005/06
	Est.	Auth.	Rev. Proj.	Rev. Proj.
Total revenue and grants	26.4	24.1	24.3	25.2
Revenue	18.6	19.0	18.4	18.3
Grants	7.8	5.1	5.8	7.0
Total expenditure and net lending (cash basis)2/	31.2	31.9	31.0	28.7
Recurrent expenditure 3/ 4/	18.3	18.1	17.8	16.7
Capital expenditure 3/	12.0	12.8	12.2	11.6
Special programs	0.9	1.0	0.9	0.5
Overall balance, including grants	-4.8	-7.8	-6.7	-3.5
Financing 5/	4.8	7.8	6.7	3.5
External (net)	3.1	5.7	3.2	2.3
Domestic (net)	1.7	2.1	1.5	1.2
Financing gap	...	...	2.0	...

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

1/ Fiscal year ending July 7.
2/ Including special program (demobilization and reconstruction).
3/ Excluding special programs (demobilization and reconstruction).
4/ Authorities' expenditure is higher by 0.9 percent as external interest is presented gross of HIPC relief.
5/ Total financing in 2004/05 and 2005/06 is consistent with the staff's baseline scenario, thus leaving a gap to be financed either through higher domestic financing, or measures to be identified.

25. **With respect to the revenue projections for 2004/05, nongrant revenue is projected by staff to decrease by 0.2 percent of GDP after incorporating prudent projections for receipts from corporate profit taxes and indirect taxes on imports, and recognizing the authorities' envisioned downward path in nontax revenue**. The former was based on a less substantial jump than assumed by the authorities and the previous staff projection, which reflects a more cautious forecast in the recovery of financial and industrial sector profits from currently depressed levels. In the staff's estimates, the large overperformance in import duties during 2003/04 is only partially carried forward into the 2004/05 projection, reflecting lower projected import growth.[9] The authorities explained that they had taken into account the full-year impact of the revenue measures implemented in the course of 2003/04, notably those relating to the strengthening of both customs administration and tax enforcement procedures.

26. **The authorities project higher spending in 2004/05 by 0.6 percent of GDP, led by a doubling of the Food Security Program (FSP) and higher defense and poverty-reducing expenditure.** The authorities envision defense expenditure returning to the

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[9] Another concern stems from the published federal budget, which includes a more optimistic forecast of nontax revenue than discussed during the mission.

nominal level (Br. 3 billion) initially budgeted in 2003/04 after compressing military spending this year in light of an expected revenue shortfall. Poverty reducing expenditures increase as a share of GDP (to 18.4 percent). The staffs' revised projection entails lower recurrent spending on "other" items to contain spending growth, as the authorities expressed optimism that a switch to performance-based budgeting in 2004/05 would contribute to securing additional savings in this area. The mission also suggested that the scaling-up of FSP outlays be phased in with concurrent steps to ensure greater accountability in the use of transfers by regional governments, preferably through more timely external audits of achieved outcomes. There is also a need to address the lack of capacity to absorb additional FSP transfers in several regions. The staff also noted that these efforts to contain spending in light of tighter financing could be facilitated if the authorities reconsidered the proposed increase in defense spending as a share of GDP.

27. **Taking into account the expected net foreign financing, the staff urged the authorities to limit the government's domestic borrowing requirement to 1.5 percent of GDP in 2004/05, with a view to achieving a decline in the inflation rate and in the ratio of domestic debt to GDP.** Additional measures to reduce the deficit by about 2 percent of GDP would be required to bring the domestic borrowing requirement to a level consistent with achieving the objective of reducing the public debt, and containing monetary expansion in line with the government's inflation target[10]. In view of this and the expected near term deterioration of the external debt situation, the strategy should be to significantly reduce domestic debt as a share of GDP, and set total public debt on a downward path over the medium term. To this end, the staff stressed the importance of developing and publicizing a comprehensive debt management strategy covering all public debt (both domestic and external). The strategy should articulate clear limits to the acceptable level of borrowing with appropriate steps to ensure that all government borrowing decisions are only approved if consistent with its public debt strategy.

28. **The authorities considered the staff's tax revenue projections to be too cautious.** They agreed, however, that it was important to continue to seek additional donor grants to support the expansion of the food security program. They stressed that they would continue to monitor budget developments closely ensuring that government borrowing remained consistent with medium-term sustainability, and that private borrowing and investment was not crowded out.

29. **Structural fiscal reforms in tax and customs administration will continue after making significant progress during 2003/04.** Tax collection and enforcement procedures are being improved by putting in place effective tools to collect tax arrears, including

[10] The ratio of the NPV of public debt to GDP remains large—about 55 percent—at end-2003/04, using the methodology of the new low income country (LIC) debt template (See Debt Sustainability in Low-Income Countries – Proposal for an Operational Framework and Policy Implications).

applying liens on property and account balances, and preparing auctions for seized property next year (the non-filing rate has improved from over 35 percent of taxpayers to under 20 percent since the new procedures were established this fiscal year). Customs administration is also being substantially improved by recruiting college graduates to bolster human capital, providing enhanced training and streamlining clearing procedures for goods and facilitating collections. As the authorities' attention shifts increasingly to revenue administration from tax policy, the mission suggested making efforts to improve the value-added tax (VAT) refund mechanism in light of low refund requests by international standards, possibly as a result of overly stringent auditing and enforcement procedures.

30. **Reform priorities in public expenditure management in 2004/05 will focus on bolstering local government capacity after two waves of major fiscal decentralization.** The authorities identified reform priorities for 2004/05 consistent with the key recommendations of the second Assessment and Action Plan (AAP) for tracking poverty-reducing spending, which include (i) improving budget reporting to facilitate timely general government consolidation by revising and extending the chart of accounts to all regions; (ii) automating budget accounting systems, networking regional governments and rolling out double-entry cash accounting to all regions; (iii) clearing the backlog of unaudited accounts to under one year from over five years; (iv) continuing the civil service overhaul; (v) enhancing cash management; and (vi) improving budget formulation and reporting by reaching agreement with donors on a standardized reporting form to more accurately estimate all inflows and their destination, including grant-financed project spending.

C. Monetary Policy and Financial Sector Reforms

31. **The authorities have targeted monetary expansion to be in line with their projection of nominal GDP growth.** This assumes a somewhat higher GDP growth than the staff projection and a small decline in the income velocity of money that is not assumed in the staff projection. The staff explained that in the present environment of stronger inflationary pressures and financially weak banks, it would be prudent to avoid projecting a decline in velocity. As the authorities plan to build up foreign reserves at a slower pace than last year, their monetary target for 2004/05 allows for a substantial increase in credit to the nongovernment sector in addition to the planned increase in credit to government. The staff explained that such a stance of monetary policy carried serious risks of magnifying the current inflationary pressures. To avoid this risk, the staff recommended the adoption of more moderate targets for the expansion of money and credit to the government.

32. **While progress is being made to address the restructuring needs of financial institutions, further efforts are needed to resolve the structural problems facing the CBE, the CBB and the DBE, and to strengthen the capacity for bank supervision.[11]** The

[11] The CBE is Commercial Bank of Ethiopia, the CBB is Construction and Business Bank and the DBE is the Development Bank of Ethiopia.

staff noted that by exploiting the restructuring and reform of state-owned banks and ensuring that they become financially viable, they would be better able to expand their financial intermediation role. While the implementation of the CBE restructuring plan has progressed as planned (Box 3), a continued full implementation of the plan is essential in 2004/05. As the privatization of the CBB has been postponed again due to a delay in preparing up-to-date audited accounts, completing this task as quickly as possible would help move the privatization process forward. Since the financial situation of the DBE has remained weak despite the financial restructuring implemented in 2003, a comprehensive audit will need to be conducted to provide the basis for developing a new financial restructuring plan for the DBE. The staff noted that the supervision department of the NBE had conducted on-site inspections (30 in total) and developed corrective actions that the banks subsequently implemented. Nonetheless, since the inspections have not been as frequent as required (once in every year), and the supervision department has suffered from a loss of experienced staff, due in particular to insufficient remuneration, the mission suggested that steps be taken to address these issues.

Box 3. Restructuring of the Commercial Bank of Ethiopia (CBE)—Update

Restructuring of the CBE has been implemented as planned so far. A comprehensive financial restructuring of the CBE started in November 2003 with a view for the CBE to becoming a sound and profitable bank. The CBE instituted a policy to limit rescheduling/renewal of nonperforming loans (NPLs) to two iterations in January 2004, as a prior action of the PRGF fifth review, and two structural performance criteria for end-June 2004 have been implemented: (i) removal of the maximum annual write-off limit of Br.100 million in May 2004 through the approval of a revised write-off policy by the CBE Board; and (ii) transfer of cofinanced loans (Br .1,029 million) in June 2004 from the CBE to the DBE in exchange for a government-guaranteed bond (Br.392 million) with discount factor equivalent to the amount of the provisions already constituted on these loans (Br.637 million). According to the Memorandum of Understanding (MOU) co-signed by the CBE, the DBE, and the MOFED in June 2004, the government-guaranteed bond will be repaid out of state dividends by the CBE during 2003/04-2004/05 (projected to be Birr 189 million in 2003/04 and Br.524 million in 2004/05). Following the removal of the annual write-off limit, the authority to write-off loans was transferred in June 2004 from the Board of the CBE to management.

From end-June 2003 through end-March 2004, NPLs declined, while capital increased. The ratio of NPLs to total loans at end-March 2004 declined to 46 percent (including the Djibouti branch loans) from 54 percent at end-June 2003 through a combination of cash collection, rescheduling/renewals, and foreclosures. The ratio is estimated to have declined further by end-June 2004, with the transfer of cofinanced loans to the DBE and the write-off by Br.20 million already implemented as planned. The capital adequacy ratio rose to 13.2 percent at end-March 2004 (before state dividend payment) from 10 percent at end-June 2003. The financial restructuring plan envisages the NPLs to decline to 37 percent of total loans by end-June 2004, while the risk-weighted capital adequacy ratio will remain above 10 percent. Audited accounts are expected to become available in October 2004

33. **The staff believes that financial sector reform should be accelerated.** Over the medium term, financial sector reforms should aim at promoting financial intermediation and the growth of savings and investment, and at providing the NBE with the necessary

instruments for actively controlling reserve money and influencing market-determined interest rates. The staff noted that by allowing foreign bank entry and addressing the near monopoly status of the CBE, competition in the banking sector and efficiency could be enhanced. By ensuring that access to financial services—savings and credit—is fully extended to the rural sector, a significant constraint to agricultural production could be alleviated. To meet the credit needs of small- and medium-size enterprises, it would help to extend the range of lending instruments beyond short-term, collateral-based credit. The savings mobilization effort could be strengthened by introducing appropriate savings instruments that carry positive real interest rates. The staff also stressed that prudent monetary policies would have to be pursued by containing any inflationary domestic bank financing to the government, and when necessary, by sterilizing the monetary impact of any excessive external inflows and contain inflationary pressures. The authorities indicated that they will continue their efforts to enhance efficiency in the financial sector. They consider, however, that they are not yet ready to allow foreign banks to enter the financial sector, and that priority should continue to be given to strengthening the domestic banks and enhancing supervision by the NBE. The staff and the authorities agreed on the importance of fostering microfinance institutions.

D. Other Structural Reforms

34. As noted in the EPA, accelerating growth will require an accelerated implementation of structural reforms in collaboration with the World Bank. While the authorities have made significant progress during the past year with the implementation of such reforms in support of rural and private sector development, a number of important challenges remain.

- The staff stressed that significantly accelerating **growth in agricultural production** would require rapid progress in improving (a) the functioning of input and output markets, (b) access to rural financing, (c) security of land tenure, (d) technical support and capacity building, and (e) the pursuit of vigorous risk management mechanisms.

- With regard to **private sector development**, it would be important to achieve significant progress in privatizing the remaining public enterprises, removing the impediments to private sector development and foreign trade identified in the Diagnostic Trade Integration Study (DTIS).[12] Equally important would be

[12] Ethiopia scores 6 (moderately restrictive) on the Fund's Trade Restrictiveness Index. Major reforms recommended by the DTIS include (i) reducing the anti-export bias of the tariff policy; (ii) encouraging export diversification; (iii) strengthening export promotion services; (iv) developing the export potential of agriculture, manufacturing and tourism; (v) strengthening the institutions for formulating trade policy, and analyzing trade-related issues; (vi) strengthened customs administration; (vii) ensuring WTO accession; (viii) improving access to infrastructure services; and (ix) improving the legal and regulatory environment.

implementing the Industrial Development Strategy and current initiatives to integrate Ethiopia's economy into the global economy (including accession to the WTO, participation in the COMESA FTA, and the EU EPA).

- Finally, the authorities were also encouraged to press ahead with their ongoing efforts to enhance the efficiency of the Customs Authority, revise the federal urban land lease law, revise the recently adopted Competition Policy to clarify that regulations are intended only to limit anti-competitive behavior, further strengthen dialogue with the private sector, and to improve access to telecommunications services, including through the partial liberalization of the sector.

E. External Projections and Policies

35. **Over the period 2004/05–2006/07, the external current account deficit (excluding official grants) is projected to narrow progressively as a percent of GDP**. With export volume growing more strongly than import volume and some improvement in the terms of trade over the outer years, the trade deficit is also forecast to narrow somewhat. Despite the recent expansion of Ethiopian Air Lines' (EAL) fleet of aircrafts, the net inflows of services as well as private transfers are projected to decline relative to the exceptionally high levels of 2003/04. Nonetheless, this weakening in the balance on services and private transfers is not expected to offset the improvement in the trade balance. However, with the projected decline in inflows of official transfers, the current account deficit (including grants) is likely to widen over the projection period. As a result, despite a substantial increase in net capital inflows (largely long-term loan disbursements) in 2004/05 and lower debt service payments resulting from recent debt relief under the HIPC Initiative and bilateral debt cancellations, the overall balance of payments is expected to shift to a large deficit. Moreover, as the capital account surplus is projected to decline over the outer years, the overall balance will continue to be in substantial deficit. Consequently, the foreign reserves cover of imports is likely to decline, though remaining within a comfortable range of 4.5-5 months of imports.

Medium-Term Balance of Payments

	2004/05	2005/06	2006/07
External current account deficit (excl. official transfers) (percent of GDP)	-12.6	-12.1	-10.1
External current account deficit (incl. official transfers) (percent of GDP)	-8.7	-7.4	-3.5
Gross official reserves (in months of following year imports)	4.7	4.5	4.8
Exports volume	4.7	6.0	6.2
Imports volume	-4.9	3.8	0.7

Source: Staff projections

1/ Fiscal year ending July 7.

36. **The current level of the exchange rate does not suggest a competitiveness problem.** Services and noncoffee exports have been growing strongly and coffee export volume has also risen over the past year, despite a decline in prices. Nonetheless in the staff's view, a significant real appreciation should be avoided going forward. The speedy implementation of measures to (i) further liberalize the foreign trade regime, (ii) eliminate

any remaining exchange restrictions,[13] (iii) streamline customs procedures, (iv) improve access to credit, land availability, competition policies, and infrastructure would go a long way towards achieving this objective.[14] Moreover, the suggested stance of monetary restraint and the implementation of proposed measures that increase productivity and cost efficiency would help to strengthen competitiveness further. With the increased openness of the economy to foreign trade and monetary policy geared towards achieving the inflation objective, the staff recommended that the exchange rate be allowed to be fully market-determined, with NBE's interventions in the foreign exchange market being limited only to smoothing out fluctuations and reducing the volatility of the exchange rate. While broadly agreeing with this approach, the authorities noted that that they intend to avoid any real appreciation of the currency. They furthermore noted that while they have implemented a number of the structural reforms to improve competitiveness, they were at this stage not considering further trade liberalization as this might adversely affect domestic industries.

37. The authorities indicated that they are negotiating with Paris Club creditors the bilateral agreements resulting from the recent agreement to provide debt relief, including topping-up at the completion point under the HIPC Initiative (Box 4). They will also seek comparable treatment from all other official bilateral and commercial creditors. They indicated that they are preparing, with the help of the World Bank and Debt Relief International (DRI), a public debt strategy that will cover both external and domestic debt, although they expressed a view that the focus of external debt sustainability should be on expanding exports rather than constraining borrowing. Similarly, on domestic debt, they noted that the burden on the budget was low (due to low or negative real interest rates), and that they would rely on future revenue growth to contain it, particularly if domestic interest rates were to rise to positive levels in real terms.

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[13] The remaining restrictions include (a) the tax certification requirement for repatriation of investment income; (b) restrictions on repayment of legally entered into external loans and supplies and foreign partner's credits; (c) rules for issuance of import permits; and (d) the requirement to provide a clearance certificate from NBE to obtain import permits.

[14] The recently completed DTIS and recommendations of the Technical Committee also provides appropriate guidance on these issues.

Box 4. Summary of the Paris Club Agreement on the Provision of Debt Relief Under the Enhanced HIPC Initiative

The representatives of the Paris Club creditor countries met in May 2004 and agreed (with one creditor still in the process of taking the necessary legislative steps to join the consensus) on a recommendation to their governments to implement their share of the debt relief effort (including topping-up) approved by the Boards of IMF and IDA at the completion point under the enhanced HIPC initiative. According to the terms of the agreement, the following principal amounts will be cancelled: (i) 100 percent of non-ODA pre-cutoff government and government-guaranteed debt; (ii) 100 percent of the consolidated loans from the 1992 and 1997 Paris Club consolidation agreements; (iii) 22 percent of non-ODA consolidated loans under the Debt Reduction option from the 2001 consolidation agreement (as amended in 2002; and (iv) (74 minus eDR13/05/04) percent of non-ODA consolidated loans under the Debt Service Reduction option from the 2001 consolidation agreement (as amended in 2002) where eDR13/05/04 is a ratio calculated to achieve a comparable debt reduction between creditors who chose the Debt Reduction option and creditors who chose the Debt Service Reduction option in the previous consolidation agreements. The terms of the agreement are therefore more favorable than assumed by the staff under the completion point, and will provide Ethiopia with debt relief of about $83 million more in NPV terms than assumed by the staff. In addition to the agreed terms of treatment, most of the Paris Club creditors committed on a bilateral basis to grant additional cancellations of up to 100 percent of their claims.

F. PRSP Process

38. In May 2004, a multiagency mission of major donors, assessed progress with SDPRP actions and indicators as the basis for providing new financing for SDPRP implementation. The agencies intending to provide direct budget support (DBS) indicated an intention to streamline and harmonize the budget support process. During discussions, the authorities indicated the intention to prepare a second annual progress report (APR) by December 2004 and to take into account the issues raised by the staff in the joint staff assessment of the first APR.

G. Statistics and Technical Assistance

39. **The authorities continued to make progress with the implementation of initiatives to improve the quality and comprehensiveness of macroeconomic data, and the timeliness of dissemination.** While the Medium-Term National Statistical Plan (MTNSP) has not yet been approved by the Office of the Prime Minister, the Central Statistical Authority (CSA) has started implementation of initiatives aimed at broadening the coverage of macroeconomic data.[15] To this end, the CSA conducted a Census of Economic Establishments in March 2004, and technical assistance was requested through the GDDS

[15] The MTNSP consists of three main objectives, namely enhancing the legal status of the CSA, expanding the capacity of the CSA, and improving the coverage and dissemination of data.

Initiative for the compilation of a production price index and an index of manufacturing production. Regarding the rebasing of the national accounts, the authorities have decided to establish 1999/2000 as base year, rather than the previously planned 1995/96--the authorities expect this work to be finalized by August 2004. In the area of monetary data, a follow-up STA technical assistance (TA) mission is planned for September 2004 to continue efforts at improving the classification of the data.

40. **The government has made some progress in addressing the previously identified deficiencies in external debt management.** The Credit Administration Department of the Ministry of Finance is in the process of upgrading its debt management software and providing training to staff with the support of UNDP and UNCTAD. In addition, a Debt Management Committee is soon to be established at a technical level to strengthen the coordination among the various departments of the ministry and the NBE. Furthermore, to facilitate aid delivery and interagency coordination, the government is in the process of launching the centralized Aid Management Platform which would allow both the government (federal and regional) and donors to get a better grip on the amount of foreign assistance delivered and its timing, modalities, recipients, and end use.

41. Efforts aimed at improving data on poverty and social indicators include plans to conduct the Household Income, Consumption and Expenditure Survey (HICES), and Welfare Monitoring Survey during 2004/04–the latter also will include a number of indicators relating to HIV/AIDS.

IV. Staff Appraisal

42. **Performance under the three-year PRGF-supported program has been good.** Despite the impact of the recent drought, price stability has been maintained, and significant progress has been made with key structural reforms, in particular the commencement of the restructuring plan for CBE and the strengthening of public expenditure management. All the quantitative and structural performance criteria required for the completion of the final review have been achieved. Reaching the HIPC Initiative completion point has also allowed Ethiopia's external debt to be reduced and brought scheduled debt service obligations to more manageable levels.

43. **Ethiopia nonetheless remains highly vulnerable to external shocks, and poverty indicators continue to be among the highest in the world.** Achieving faster growth and the Millennium Development Goals will require higher levels of external aid, but also improvements in the capacity to effectively absorb and use such assistance through accelerated implementation of financial sector and other structural reforms (largely to support rural and private sector development). Higher inflows of external aid could be facilitated by a peaceful resolution of the border dispute with Eritrea and the continued reorientation of public resources to poverty related expenditures.

44. **Achieving the MDGs will require significantly greater levels of external assistance,** and this will need to be largely in the form of grants if debt sustainability is to be

maintained. It will be important for the authorities to develop a comprehensive and prudent public debt management strategy which clarifies the rules for containing future domestic and external borrowing to sustainable levels. Consistent with any scenario involving a significant increase in external assistance as a share of GDP, the authorities' medium-term fiscal framework needs to involve a rebalancing of expenditure to recurrent items, given large gaps in the required number of teachers and medical personnel. The staff strongly supports the authorities' plan to develop their own fiscal scenarios aimed at achieving the MDGs, but recommends continued close consultation with donors and the Fund, to identify the challenges early and mitigate any potential adverse effects on the broader macro framework arising from a substantial scaling-up of inflows of donor assistance. Significantly higher external assistance would necessarily imply a large deterioration in fiscal and external balances (excluding grants), leaving Ethiopia even more dependent on foreign aid than it is today.

45. **Fiscal policy should continue to focus on strengthening expenditure management and enhancing revenues, while containing inflationary domestic financing and reducing the public debt burden.** In view of the projected higher level of domestic borrowing needed to finance the 2004/05 budget and the recent pickup in nonfood inflation, however**,** it will be important to take additional measures to achieve the desired reductions in the debt and the inflation rate. While the staff welcomes the food security program, its implementation should be supported by adequate efforts to strengthen the capacity of local governments to absorb the substantially higher federal transfers, and seek additional donor grants. The latter could be facilitated if the authorities prepared timely external audits of the achieved outcomes. The staff would caution the authorities against institutionalizing the scheme to guarantee the minimum price for maize, wheat and sorghum, to avoid any direct budgetary costs resulting from the scheme, and instead to address the underlying causes of price volatility by improving performance in the agricultural sector and tackling market fragmentation.

46. **Significant progress has already been achieved with fiscal structural reforms.** Improving public expenditure management remains a critical priority, especially for bolstering the capacity of local governments, given their new expenditure mandates following fiscal decentralization. It is crucially important to continue to progress with consolidating the general government accounts in a timely manner, including regular reporting. Moreover, efforts to consolidate the gains made in improving customs administration should continue, and the VAT refund mechanism should be carefully reviewed along with other audit and enforcement guidelines, to avoid imposing an overly restrictive tax environment that discourages investment and growth.

47. **Monetary and exchange rate policies will need to focus on achieving the authorities' inflation and international reserve targets.** The case that the exchange rate should be weaker is not compelling. Nonetheless the staff considers that a significant real appreciation of the exchange rate going forward should be avoided. The authorities should seek to safeguard external competitiveness through structural reforms that improve productivity and efficiency. Measures to further liberalize foreign trade, eliminate remaining exchange restrictions, streamline customs procedures, and implement the recommendations

in the DTIS would support these objectives. Moreover, the exchange rate should be allowed to be fully market-determined, with NBE's interventions in the market being limited only to smoothing out fluctuations.

48. **In order to lay firm foundations for achieving a sustained increase in long-term growth compared with the recent past, it will be essential to expedite the implementation of the government's structural reform agenda**. Necessary reforms focus on agriculture (especially enhancing land tenure security), food security, capacity building, export promotion, privatization, and strengthening the legal and regulatory framework. In the financial sector, while progress has been made with strengthening bank supervision and implementing the restructuring plan of the CBE, it will be important to fully implement these initiatives. Regarding the NBE, the staff welcomes the commencement of the restructuring plan, but there is a need to work towards increasing the operational autonomy of the NBE, and the staff would urge the authorities to consider the recommendations of the consultants aimed at strengthening the NBE's independence. The staff also urges the authorities to open up more of the financial sector to the private sector, including by allowing foreign bank entry.

49. Data provision to the Fund remains adequate for surveillance purposes, and the staff welcomes the development of a comprehensive Medium-Term National Statistical Plan and efforts to improve data on poverty and social indicators.

50. The staff recommends that the final review under the PRGF be completed. It is proposed that the next Article IV consultation with Ethiopia be held within 24 months, subject to the provisions of Decision No. 127 94–(02/76) on Article IV consultation cycles, as amended.

Figure 1. Ethiopia: Selected Economic Indicators, 1999/2000-2006/07 1/

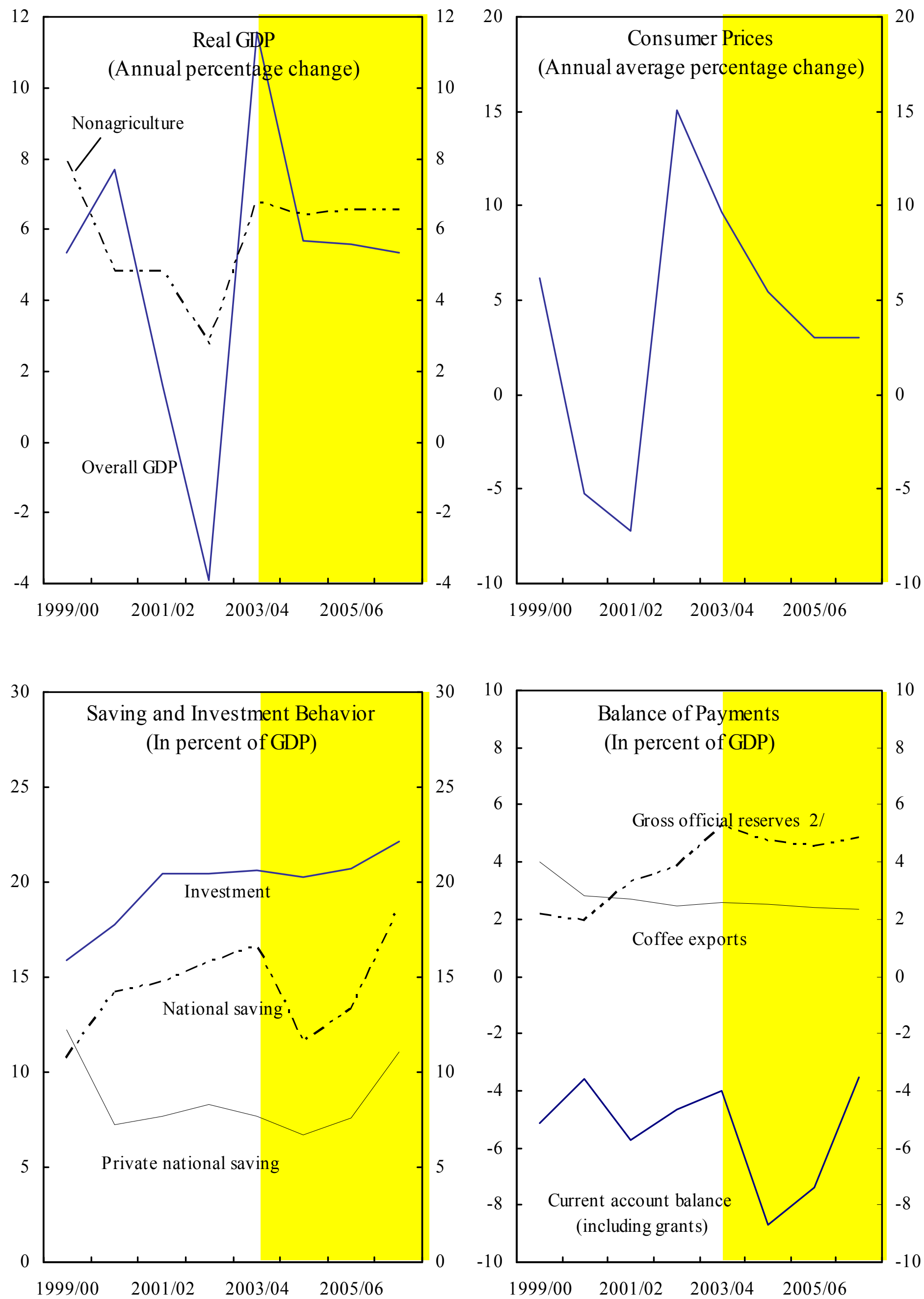
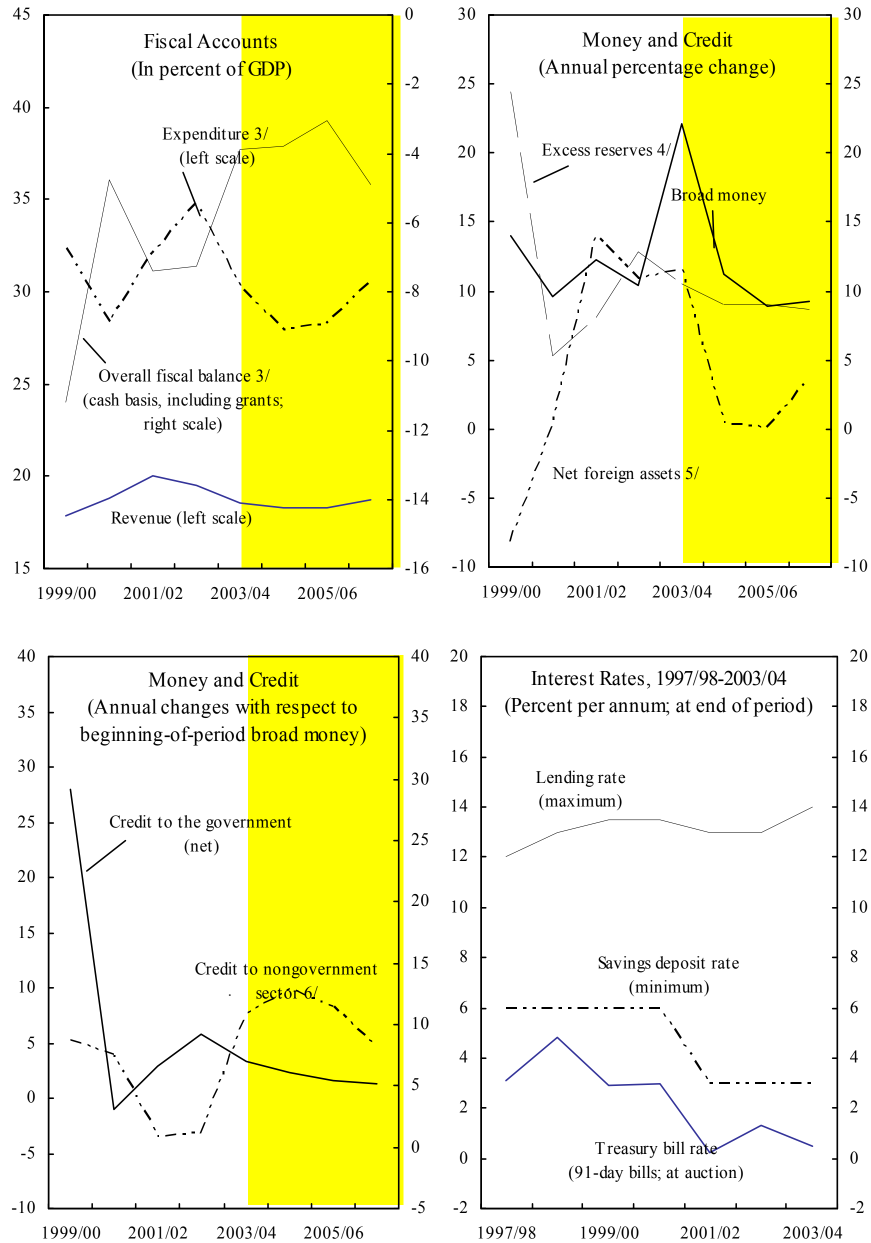


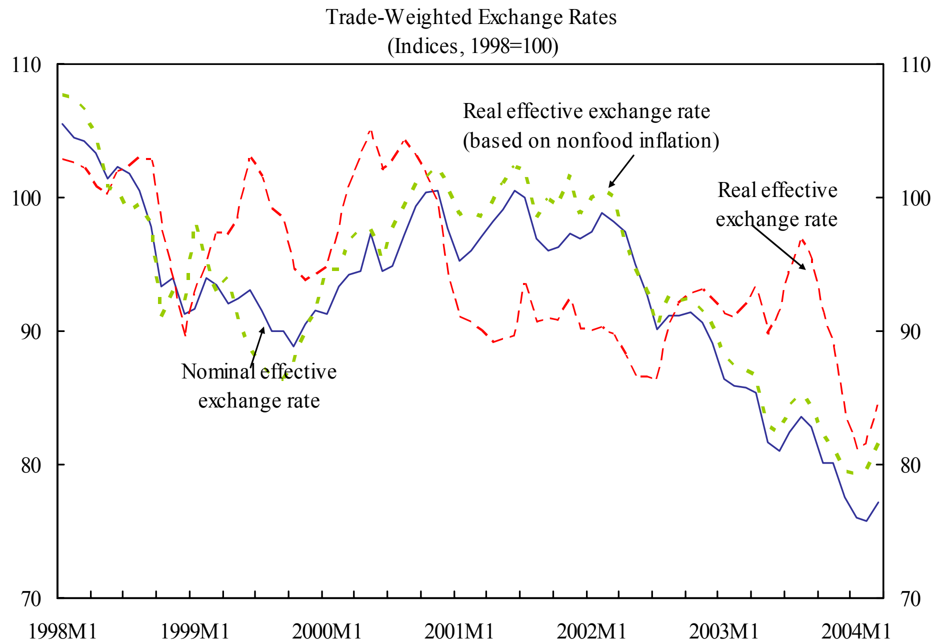
Figure 1. Ethiopia: Selected Economic Indicators, 1999/2000-2006/07 1/ (concluded)

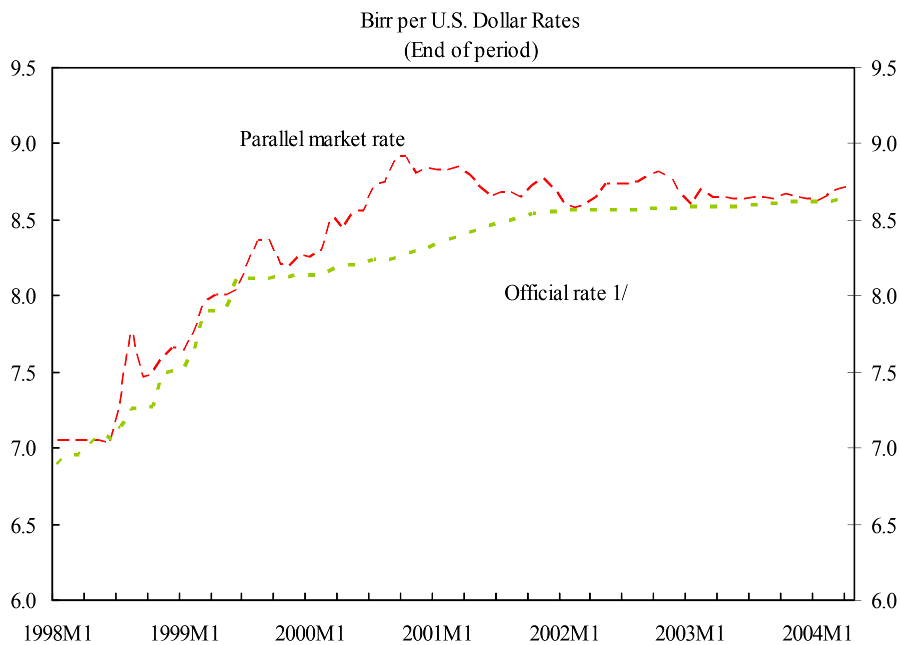


Sources: Ethiopian authorities; and staff estimates and projections.

1/ All data pertain to the period July 8-July 7. Shaded area indicates program period.
2/ In months of imports of goods and nonfactor services of the following year.
3/ Excluding special programs.
4/ In percent of deposits.
5/ Change in percent of beginning-of-period broad money.
6/ Includes credit to public enterprises and the private sector.

Figure 2. Ethiopia: Exchange Rate Developments, January 1998-March 2004





Sources: IMF, Information Notice System; National Bank of Ethiopia; and staff estimates.

1/ Until September 2001, the marginal rate at the foreign exchange auction conducted by the National Bank of Ethiopia; thereafter, the transaction-weighted foreign exchange interbank market rate.

Table 1. Ethiopia: Schedule of Disbursements and Repayments Under the PRGF Arrangement, 2004-05

	Position on December 31, 2003	2004		2005	
		Jan.-June	July-Dec.	Jan.-June	July-Dec.
		(In millions of SDRs)			
Net use of Fund resources					
Repayments 1/	…	4.4	3.7	2.7	2.7
Projected disbursements	…	10.4	10.4	0.0	0.0
Fund resources outstanding (end of period)	105.8	111.9	118.6	115.9	113.2
		(In percent of quota) 2/			
Net use of Fund resources					
Repayments	…	3.3	2.8	2.0	2.0
Projected disbursements	…	7.8	7.8	0.0	0.0
Fund resources outstanding (end of period)	79.2	83.7	88.7	86.7	84.7

Source: Fund staff calculations and projections.

1/ With Board-approved HIPC Initiative assistance
2/ Quota of SDR 133.7 million.

Table 2. Ethiopia: Proposed Schedule of Remaining Disbursements and Conditions for Disbursement Under the PRGF Arrangement, 2004

	Amount		Availability	Conditions Include:
	SDRs	Percent of quota		
	10,429,000	7.8	September 13, 2004	Completion of sixth review and observance of performance criteria through end-June 2004.
Total	10,429,000	7.8		

Table 3. Ethiopia: Selected Economic and Financial Indicators, 2002/03-2008/09 1/

	2002/03	2003/04		2004/05		2005/06		2006/07	2007/08	2008/09
		5th Review	Rev. Prog.	5th Review	Rev. Proj.	5th Review	Rev. Proj.			
					(Annual percentage change)					
National income and prices										
GDP at constant prices (at factor cost)	-3.9	6.7	11.6	6.4	5.7	6.1	5.6	5.3	5.1	5.1
GDP deflator	14.5	5.2	8.3	3.7	5.7	3.2	3.0	3.4	3.3	3.3
Consumer prices (period average)	15.1	5.5	9.6	3.0	5.4	3.0	3.0	3.0	3.0	3.0
External sector										
Exports, f.o.b.	6.7	7.3	14.4	11.5	10.2	9.5	6.0	9.1	8.6	8.2
Imports, c.i.f.	14.4	9.3	24.5	1.8	-0.9	1.3	3.4	0.6	6.1	5.7
Export volume	9.8	3.8	12.0	7.1	4.7	7.8	6.0	6.2	6.2	6.2
Import volume	6.8	2.9	13.2	1.7	-4.9	1.4	3.8	0.7	5.7	5.7
Terms of trade (deterioration -)	-10.0	-2.6	-7.9	4.2	1.5	1.6	0.3	3.0	2.0	2.0
Nominal effective exchange rate (end of period)	-12.5	...	...	...	...	...	...	...	...	...
Real effective exchange rate (end of period)	6.1	...	...	...	...	...	...	...	...	...
			(In percent of beginning-of period stock of broad money, unless otherwise indicated)							
Money and credit										
Net foreign assets	10.8	6.2	11.6	2.7	0.4	0.0	0.1	3.6	3.9	5.1
Net domestic assets	-0.4	7.2	10.4	8.0	10.8	9.1	8.8	5.6	4.8	4.7
Net claims on the government	5.7	3.3	3.3	0.0	2.4	0.0	1.6	1.3	1.3	1.3
Credit to the nongovernment sector	-3.2	5.8	7.5	8.6	9.9	9.5	8.3	4.6	3.8	3.8
Broad money	10.4	13.4	22.1	10.7	11.3	9.2	8.9	9.2	8.7	9.9
Velocity (GDP/broad money)	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.8
Interest rates (in percent at end of period)										
Savings deposits (minimum rate)	3.0	…	…	…	…	…	…	…	…	…
Lending rates (maximum rate)	13.0	…	…	…	…	…	…	…	…	…
Treasury bill (91-day maturity)	1.3	…	…	…	…	…	…	…	…	…
					(In percent of GDP, unless otherwise indicated)					
Financial balances										
Gross domestic saving	1.0	3.8	1.3	5.4	2.3	7.1	3.4	6.7	7.5	8.1
Government saving	0.4	0.5	1.0	2.7	1.3	4.1	1.6	1.5	1.5	1.4
Private saving	0.6	3.3	0.3	2.6	1.0	3.0	1.8	5.3	6.0	6.7
Gross domestic investment	20.5	23.3	20.6	23.1	20.3	22.9	20.7	22.2	22.4	22.4
Government investment	10.5	11.9	11.2	11.6	10.3	11.0	10.6	12.0	12.0	12.0
Private investment	10.0	11.4	9.4	11.5	10.0	11.9	10.1	10.2	10.4	10.4
Resource gap	-19.4	-19.5	-19.4	-17.7	-17.9	-15.8	-17.4	-15.4	-14.9	-14.3
External current account balance, including official transfers	-4.7	-7.9	-4.0	-7.4	-8.7	-6.2	-7.4	-3.5	-3.4	-2.2
Saving-investment (government)	-3.0	-6.4	-2.3	-4.8	-5.5	-3.5	-4.9	-4.4	-4.5	-3.7
Saving-investment (private)	-1.7	-1.5	-1.8	-2.5	-3.2	-2.8	-2.5	0.9	1.1	1.6
External current account balance, excluding official transfers	-12.8	-14.0	-13.0	-12.4	-12.6	-10.6	-12.1	-10.1	-9.9	-9.4
Government finances										
Revenue	19.5	19.5	18.6	20.1	18.4	20.4	18.3	18.7	18.7	19.0
Tax revenue	14.4	15.5	14.8	16.2	14.9	16.6	14.9	15.3	15.3	15.6
Nontax revenue	5.1	4.1	3.7	3.9	3.6	3.8	3.4	3.4	3.4	3.4
External grants	8.0	7.1	7.8	6.0	5.8	5.2	7.0	6.9	6.8	7.3
Expenditure and net lending 2/	34.8	32.8	30.3	30.7	30.0	29.2	28.3	30.5	30.4	30.7
Fiscal balance, excluding grants (cash basis)	-17.7	-14.2	-12.6	-11.6	-10.5	-9.1	-10.5	-11.8	-11.7	-11.7
Fiscal balance, including grants (cash basis)	-9.7	-7.1	-4.8	-5.6	-4.7	-3.9	-3.5	-4.9	-4.9	-4.4
Total financing	9.7	7.1	4.8	5.6	4.7	3.9	3.5	4.9	4.9	4.4
External financing	6.8	5.1	3.1	5.1	3.2	3.3	2.3	3.9	3.9	3.4
Domestic financing (including residual)	2.9	1.8	1.7	0.4	1.5	0.4	1.2	1.0	1.0	1.0
Privatization receipts	0.0	0.2	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Domestic debt 3/	39.0	36.4	33.6	33.3	31.7	30.7	30.3	28.7	27.5	26.3
External debt (including to Fund)	98.5	94.3	68.7	92.5	68.4	89.5	69.7	66.9	64.9	62.5
Net present value (NPV) of external debt-to-exports ratio (including to Fund) 4/	150.0	246.1	168.3	244.4	182.8	246.9	199.9	206.3	208.3	207.7
NPV of external debt-to-revenue ratio (including to Fund) 5/	119.3	188.1	130.4	184.7	144.9	181.5	161.7			
External debt-service ratio 6/	14.9	18.5	16.1	16.8	18.1	16.0	19.1	19.0	18.1	17.1
External debt-service ratio 7/	7.3	9.3	6.6	7.1	5.3	7.1	6.9	7.2	7.3	7.1
Overall balance of payments (in millions of U.S. dollars)	161	-121	105	-194	-251	-189	-253	-88	-80	23
Gross official reserves (in millions of U.S. dollars)	931	1,043	1,289	1,084	1,205	1,076	1,166	1315	1486	1741
(in months of imports of goods and nonfactor services of following year)	3.8	4.6	5.3	4.8	4.7	4.8	4.5	4.8	5.2	5.7
GDP at current market prices (in millions of birr)	57,077	64,277	69,708	71,197	77,559	78,177	84,486	92,282	100,136	108,691
Exchange rate (birr per U.S. dollar; period average rate)	8.58	...	...	...	...	...	...	...	...	...

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

1/ Data pertain to the period July 8-July 7.
2/ Excluding special programs.
3/ Whole series was revised.
4/ After enhanced HIPC Initiative relief. Exports of goods and services used.
5/ After enhanced HIPC Initiative relief. Revenues exclude grants.
6/ Before debt relief; on an accrual basis; in percent of exports of goods and nonfactor services.
7/ After enhanced HIPC Initiative relief.

Table 4. Ethiopia: General Government Operations, 2002/03-2008/09 1/
(In millions of birr)

	2002/03	2003/04		2004/05		2005/06	2006/07	2007/08	2008/09
		5th Review	Est.	Auth.	Rev. Proj. 2/	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	15,702	17,084	18,413	18,802	18,810	21,331	23,599	25,521	28,570
Revenue	11,149	12,542	12,950	14,796	14,305	15,438	17,257	18,725	20,651
Tax revenue (incl. measures)	8,244	9,932	10,340	12,041	11,550	12,604	14,119	15,321	16,956
Direct taxes	3,010	3,673	3,294	4,389	3,912	4,259	4,799	5,207	5,978
Indirect taxes	5,233	6,259	7,045	7,651	7,638	8,345	9,321	10,114	10,978
Domestic indirect taxes	1,668	2,150	2,151	2,626	2,457	2,769	3,230	3,505	3,804
Import duties and taxes	3,564	4,109	4,895	5,026	5,181	5,576	6,091	6,609	7,174
Nontax revenue	2,906	2,610	2,610	2,756	2,756	2,834	3,138	3,405	3,695
Grants 5/	4,553	4,542	5,463	4,005	4,505	5,892	6,343	6,795	7,918
Total expenditure and net lending (cash basis) 3/	19,840	21,093	21,118	24,098	23,284	23,900	28,126	30,464	33,367
Recurrent expenditure 3/	13,527	12,752	12,750	14,123	13,790	14,128	15,847	17,129	18,926
Defense spending	2,341	2,400	2,400	3,000	3,000	2,600	3,000	3,000	3,000
Poverty-targeted expenditure	3,672	4,446	4,446	5,088	5,088	5,784	6,536	7,336	8,624
Education	2,276	2,513	2,513	2,923	2,923	3,178	3,690	4,004	4,620
Health	526	711	711	810	810	954	1,042	1,230	1,444
Agriculture	730	1,038	1,038	1,139	1,139	1,406	1,535	1,666	2,026
Roads	139	183	183	217	217	246	269	435	534
Interest payments (after traditional debt-relief mechanism)	1,219	1,447	1,474	1,567	940	959	1,243	1,352	1,465
Domestic interest and charges	625	773	773	739	739	738	995	1,074	1,160
External interest payments (after traditional debt-relief mechanism) 6/	594	675	702	828	201	221	248	278	305
Emergency assistance (food and other emergency aid) 5/	2,890	874	874	901	880	901	910	918	927
Other recurrent expenditure	3,406	3,583	3,556	3,567	3,883	3,884	4,157	4,522	4,910
Net lending	0	0	0	0	0	0	0	0	0
Capital expenditure 3/	6,313	8,341	8,368	9,975	9,494	9,772	12,280	13,335	14,440
Central treasury	3,265	4,442	4,922	6,392	6,392	5,891	7,232	7,842	8,621
External assistance 5/	1,196	1,326	2,295	1,593	1,673	2,150	2,871	3,110	3,589
External loans 5/	1,852	2,574	1,152	1,990	1,429	1,732	2,176	2,383	2,230
Of which: poverty-targeted expenditure	4,921	6,841	6,917	9,203	9,203	8,100	8,663	9,252	10,019
Special programs 4/	655	535	642	767	734	384	0	0	0
Unidentified financing or measures to be identified 7/	-733	0	0	0	1,546	0	0	0	0
Overall balance									
Including grants	-5,526	-4,544	-3,347	-6,063	-3,662	-2,953	-4,527	-4,943	-4,797
Excluding grants 8/	-10,079	-9,086	-8,811	-10,069	-8,167	-8,846	-10,870	-11,738	-12,715
Financing	5,526	4,545	3,347	6,065	3,662	2,953	4,527	4,943	4,797
External (net)	3,865	3,283	2,171	4,416	2,474	1,951	3,595	3,931	3,699
Gross borrowing 5/	3,608	3,336	2,048	4,507	2,620	2,116	3,764	4,113	3,862
HIPC Initiative relief 6/	531	695	934	713	0	0	0	0	0
Unpaid debt under negotiation	283	0	0	0	0	0	0	0	0
Amortization repayment (after traditional debt-relief mechanism)	-557	-748	-811	-804	-146	-165	-169	-182	-163
Total domestic financing	1,661	1,262	1,176	1,649	1,188	1,003	932	1,012	1,099
Domestic (net)	1,653	1,162	1,162	1,649	1,188	1,003	932	1,012	1,099
Banking system	1,651	1,000	1,000	1,649	888	676	575	625	678
Nonbank sources	2	162	162	0	300	327	357	387	420
Privatization	8	100	14	0	0	0	0	0	0
Memorandum items:									
Poverty-targeted expenditure	8,592	11,287	11,363	14,291	14,291	13,884	15,199	16,588	18,643
Wages and salaries	4,452	4,925	5,437	...	6,050	6,590	7,198	7,733	8,309
HIPC Initiative relief on interest 6/	286	339	403	...	...	...	...	...	...
HIPC Initiative relief on amortization 6/	245	298	532	...	...	...	...	...	...
Gross domestic product	57,077	64,277	69,708	78,044	77,559	84,486	92,282	100,136	108,691

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

1/ Fiscal year ending July 7.
2/ The revised projection is based on current policies and identified financing. The medium-term baseline reflects staff-recommended adjustment based on identified financing consistent with the inflation target and sustainable public debt.
3/ Excluding special programs (demobilization and reconstruction).
4/ Demobilization and reconstruction.
5/ Figures for external financing and grants are provided by donors, and differ in some cases from government estimates.
6/ External interest payments are presented after traditional debt relief up to 2003/04, but following the completion point in 2003/04 are presented after HIPC Initiative relief starting in 2004/05. HIPC Initiative relief below the line becomes zero beginning in 2004/05 following the completion point. The authorities after 2003/04 continue to provide figures gross of debt relief.
7/ Unidentified financing is assumed to be filled from above the line, either as additional grant financing or through measures to be identified.
8/ In cases of unidentified financing, the balance excluding grants is calculated assuming that additional measures are taken to close the gap, rather than higher grants.

Table 5. Ethiopia: General Government Operations, 2002/03-2008/09 1/
(In percent of GDP)

	2002/03	2003/04		2004/05		2005/06	2006/07	2007/08	2008/09
	Act.	5th Review	Est.	Authorities	Rev. Proj. 2/	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	27.5	26.6	26.4	24.1	24.3	25.2	25.6	25.5	26.3
Revenue	19.5	19.5	18.6	19.0	18.4	18.3	18.7	18.7	19.0
Tax revenue (incl. measures)	14.4	15.5	14.8	15.4	14.9	14.9	15.3	15.3	15.6
Direct taxes	5.3	5.7	4.7	5.6	5.0	5.0	5.2	5.2	5.5
Indirect taxes	9.2	9.7	10.1	9.8	9.8	9.9	10.1	10.1	10.1
Domestic indirect taxes	2.9	3.3	3.1	3.4	3.2	3.3	3.5	3.5	3.5
Import duties and taxes	6.2	6.4	7.0	6.4	6.7	6.6	6.6	6.6	6.6
Export taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenue	5.1	4.1	3.7	3.5	3.6	3.4	3.4	3.4	3.4
Grants 5/	8.0	7.1	7.8	5.1	5.8	7.0	6.9	6.8	7.3
Total expenditure and net lending (cash basis) 3/	34.8	32.8	30.3	30.9	30.0	28.3	30.5	30.4	30.7
Recurrent expenditure 3/	23.7	19.8	18.3	18.1	17.8	16.7	17.2	17.1	17.4
Defense spending	4.1	3.7	3.4	3.8	3.9	3.1	3.3	3.0	2.8
Poverty-targeted expenditure	6.4	6.9	6.4	6.5	6.6	6.8	7.1	7.3	7.9
Education	4.0	3.9	3.6	3.7	3.8	3.8	4.0	4.0	4.3
Health	0.9	1.1	1.0	1.0	1.0	1.1	1.1	1.2	1.3
Agriculture	1.3	1.6	1.5	1.5	1.5	1.7	1.7	1.7	1.9
Roads	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.5
Interest payments (after traditional debt-relief mechanism)	2.1	2.3	2.1	2.0	1.2	1.1	1.3	1.4	1.3
Domestic interest and charges	1.1	1.2	1.1	0.9	1.0	0.9	1.1	1.1	1.1
External interest payments (after traditional debt-relief mechanism) 6/	1.0	1.0	1.0	1.1	0.3	0.3	0.3	0.3	0.3
Emergency assistance (food and other emergency aid) 5/	5.1	1.4	1.3	1.2	1.1	1.1	1.0	0.9	0.9
Other recurrent expenditure	6.0	5.6	5.1	6.0	5.0	4.5	4.5	4.5	4.5
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure 3/	11.1	13.0	12.0	12.8	12.2	11.6	13.3	13.3	13.3
Central Treasury	5.7	6.9	7.1	8.2	8.2	7.0	7.8	7.8	7.9
External assistance 5/	2.1	2.1	3.3	2.0	2.2	2.5	3.1	3.1	3.3
External loans 5/	3.2	4.0	1.7	2.5	1.8	2.0	2.4	2.4	2.1
Of which: poverty-targeted expenditure	8.6	10.6	9.9	11.8	11.9	9.6	9.4	9.2	9.2
Special programs 4/	1.1	0.8	0.9	1.0	0.9	0.5	0.0	0.0	0.0
Unidentified financing or measures to be identified 7/	-1.3	0.0	0.0	0.0	2.0	0.0	0.0	0.0	0.0
Overall balance									
Including grants	-9.7	-7.1	-4.8	-7.8	-4.7	-3.5	-4.9	-4.9	-4.4
Excluding grants 8/	-17.7	-14.1	-12.6	-12.9	-10.5	-10.5	-11.8	-11.7	-11.7
Financing	9.7	7.1	4.8	7.8	4.7	3.5	4.9	4.9	4.4
External (net)	6.8	5.1	3.1	5.7	3.2	2.3	3.9	3.9	3.4
Gross borrowing 5/	6.3	5.2	2.9	5.8	3.4	2.5	4.1	4.1	3.6
HIPC Initiative relief 6/	0.9	1.1	1.3	0.9	0.0	0.0	0.0	0.0	0.0
Unpaid debt under negotiation	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization repayment (after traditional debt-relief mechanism)	-1.0	-1.2	-1.2	-1.0	-0.2	-0.2	-0.2	-0.2	-0.2
Total domestic financing	2.9	2.0	1.7	2.1	1.5	1.2	1.0	0.0	0.0
Domestic (net)	2.9	1.8	1.7	2.1	1.5	1.2	1.0	1.0	1.0
Banking system	2.9	1.6	1.4	2.1	1.1	0.8	0.6	0.6	0.6
Nonbank sources	0.0	0.3	0.2	0.0	0.4	0.4	0.4	0.4	0.4
Privatization	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Poverty-targeted expenditure	15.1	17.6	16.3	18.3	18.4	16.4	16.5	16.6	17.2
Wages and salaries	7.8	7.8	7.8	...	7.8	7.8	7.8	7.7	7.6
HIPC Initiative relief on interest 6/	0.5	0.5	0.6	...	...	...	...	...	...
HIPC Initiative relief on amortization 6/	0.4	0.7	0.8	...	...	...	...	...	...

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

1/ Fiscal year ending July 7.
2/ The revised projection is based on current policies and identified financing. The medium-term baseline reflects staff recommended adjustment based on identified financing consistent with the inflation target and sustainable public debt.
3/ Excluding special programs (demobilization and reconstruction).
4/ Demobilization and reconstruction.
5/ Figures for external financing and grants are provided by donors, and differ in some cases from government estimates.
6/ External interest payments are presented after traditional debt relief up to 2003/04, but following the completion point in 2003/04 are presented after HIPC Initiative relief starting in 2004/05. HIPC Initiative relief below the line becomes zero beginning in 2004/05 following the completion point. The authorities after 2003/04 continue to provide figures gross of debt relief.
7/ Unidentified financing is assumed to be filled from above the line, either as additional grant financing or through measures to be identified.
8/ In cases of unidentified financing, the balance excluding grants is calculated assuming that additional measures are taken to close the gap, rather than higher grants.

Table 6. Ethiopia: Monetary Survey, 2002/03-2008/09 - Baseline Scenario 1/

	2002/03	2003/04		2004/05	2005/06	2006/07	2007/08	2008/09
		5th Review	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In millions of birr)							
Net foreign assets	11,290	13,168	14,833	14,991	15,020	16,654	18,575	21,310
National Bank of Ethiopia (NBE)	6,273	7,395	9,262	8,813	8,917	10,492	12,359	15,039
Assets	8,003	9,333	11,132	10,787	10,560	12,027	13,705	16,198
Liabilities	1,731	1,938	1,870	1,974	1,643	1,535	1,346	1,159
Commercial banks	5,018	5,773	5,570	6,178	6,104	6,162	6,216	6,271
Assets	6,731	7,556	7,290	7,961	8,197	8,276	8,349	8,422
Liabilities	1,713	1,783	1,720	1,783	2,094	2,114	2,132	2,151
Net domestic assets	19,216	21,424	22,402	26,437	30,090	32,602	34,943	37,484
Domestic credit	28,332	31,094	31,633	36,207	40,307	42,970	45,465	48,180
Claims on government (net) 2/	17,855	18,855	18,855	19,743	20,419	20,994	21,619	22,297
NBE	9,804	10,804	10,804	11,248	11,586	11,873	12,185	12,524
Commercial banks	8,052	8,052	8,052	8,496	8,833	9,121	9,433	9,772
Claims on nongovernment	10,477	12,239	12,778	16,464	19,888	21,976	23,846	25,884
NBE	114	114	114	0	0	0	0	0
Commercial banks	10,364	12,125	12,664	16,464	19,888	21,976	23,846	25,884
Other items (net)	-9,117	-9,671	-9,231	-9,769	-10,217	-10,368	-10,522	-10,696
Broad money	30,506	34,592	37,235	41,428	45,110	49,256	53,518	58,794
Money	16,815	19,591	21,838	22,974	24,013	25,414	26,943	28,773
Currency outside banks	7,726	10,001	11,993	11,175	10,524	12,003	13,853	16,511
Demand deposits	9,089	9,591	9,844	11,799	13,489	13,411	13,090	12,262
Quasi-money	13,691	15,001	15,397	18,455	21,098	23,842	26,576	30,021
Savings deposits	12,529	13,771	14,135	16,942	19,368	21,979	24,593	27,907
Time deposits	1,162	1,230	1,262	1,513	1,729	1,863	1,983	2,114
	(Annual change in percent of beginning-of period broad money; unless otherwise indicated)							
Net foreign assets	10.8	6.2	11.6	0.4	0.1	3.6	3.9	5.1
Net domestic assets	-0.4	7.2	10.4	10.8	8.8	5.6	4.8	4.7
Domestic credit	2.6	9.1	10.8	12.3	9.9	5.9	5.1	5.1
Claims on government (net)	5.7	3.3	3.3	2.4	1.6	1.3	1.3	1.3
Claims on nongovernment	-3.2	5.8	7.5	9.9	8.3	4.6	3.8	3.8
Broad money	10.4	13.4	22.1	11.3	8.9	9.2	8.7	9.9
Money	4.9	9.1	16.5	3.1	2.5	3.1	3.1	3.4
Quasi money	5.5	4.3	5.6	8.2	6.4	6.1	5.6	6.4
Memorandum items:								
Reserve money growth	26.9	14.5	31.2	-2.7	0.4	10.9	11.6	14.4
Money multiplier	2.41	2.39	2.24	2.56	2.78	2.74	2.67	2.56
Velocity (GDP/broad money)	1.87	1.86	1.87	1.87	1.87	1.87	1.87	1.85
Gross official foreign reserves (in millions of U.S. dollars)	931	1,043	1,289	1,205	1,166	1,315	1,486	1,741
Net foreign assets of the banking system (in millions of U.S. dollars	1,313	1,471	1,717	1,674	1,658	1,821	2,014	2,290
Excess reserves (in percent of deposits)	12.8	10.6	10.6	9.0	9.0	8.7	8.3	8.0

Sources: National Bank of Ethiopia; and Fund staff estimates and projections.

1/ Year ending July 7.
2/ Claims on general government (federal and regional governments and other public agencies) by the banking system less deposits of the general government with the banking system.

Table 7. Ethiopia: Balance of Payments, 2002/03-2008/09 - Baseline Scenario 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2002/03	2003/04		2004/05	2005/06	2006/07	2007/08	2008/09
		5th Review	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Trade balance	-1,458	-1,602	-1,863	-1,785	-1,831	-1,787	-1,878	-1,965
Exports of goods	483	518	552	609	645	704	765	828
Coffee	165	167	208	221	225	236	246	265
Other	318	351	344	388	421	468	518	563
Imports of goods	1,940	2,120	2,415	2,394	2,477	2,492	2,643	2,793
Fuel	288	305	329	327	319	320	328	356
Cereals	273	120	180	110	80	60	60	60
Aircraft	17	117	117	117	117	0		
Imports excl. fuel,cereals,aircraft	1,362	1,578	1,789	1,840	1,960	2,112	2,255	2,377
Nonfactor services (net)	167	169	298	203	203	223	259	287
Exports of nonfactor services	657	650	817	752	784	828	883	938
Imports of nonfactor services	490	481	519	549	582	605	624	651
Income (net)	-55	-49	-77	-22	-26	0	10	22
Of which : gross official interest payments 2/	-72	-80	-83	-41	-50	-50	-51	-51
Private transfers (net)	495	454	592	490	522	537	531	550
Current account balance, excl. official transfers	-850	-1,028	-1,049	-1,114	-1,133	-1,027	-1,078	-1,106
(in percent of GDP)	-12.8	-14.0	-13.0	-12.6	-12.1	-10.1	-9.9	-9.4
excluding EAL imports		-12.4	-11.5	-11.3	-10.8	-10.1		
Official transfers (net)	540	449	724	349	441	669	706	851
Current account balance, incl. official transfers	-310	-579	-325	-765	-692	-357	-372	-255
(in percent of GDP)	-4.7	-7.9	-4.0	-8.7	-7.4	-3.5	-3.4	-2.2
excluding EAL imports		-6.3	-2.6	-7.3	-6.1	-3.5		
Capital account balance (incl. errors and omissions)	472	459	429	514	439	269	292	278
Foreign direct investment (net)	14	20	0	50	70	70	74	79
Other investment (net)	349	439	248	464	369	199	218	200
Official long-term loans	353	456	281	465	372	203	222	204
Disbursements	443	562	387	482	403	239	260	241
EAL loan	0	117	117	117	117	0	0	0
Amortization 2/	90	106	106	17	31	36	37	37
Other public sector long-term loans (net) 3/	-4	-17	-17	-2	-3	-4	-4	-4
Other (net)	0	0	-16	0	0	0	0	0
Errors and omissions	108	0	198	0	0	0	0	0
Overall balance	161	-121	105	-251	-253	-88	-80	23
Financing	-161	121	-105	251	253	88	80	-23
Central bank (net; increase -)	-236	-97	-343	88	30	-163	-192	-276
Reserves (increase -)	-266	-112	-358	84	39	-149	-170	-255
Liabilities (increase +)	30	15	15	4	-8	-14	-22	-21
Fund credit (net)	4	15	15	4	-8	-14	-22	-21
Commercial banks (net; increase -)	-108	-62	-62	-45	16	0	0	0
Changes in arrears	0	0	0	0	0	0	0	0
Debt relief (Paris Club II and III, Naples terms) 4/	183	25	0	0	0	0	0	0
Financing gap	0	254	284	208	206	251	272	253
Exceptional financing 5/	0	146	153	208	206	251	272	253
Traditional debt relief	0	27	21	0	0	0	0	0
HIPC Initiative relief	0	81	109	0	0	0	0	0
Residual gap	0	0	0	0	0	0	0	0
Memorandum items:								
Exports of goods (percent change)	6.7	7.3	14.4	10.2	6.0	9.1	8.6	8.2
Export price index (percent change)	-3.1	3.4	2.4	5.6	0.0	3.0	2.4	2.0
Export volume index (percent change)	9.8	3.8	12.0	4.7	6.0	6.2	6.2	6.2
Total imports of goods (percent change)	14.4	9.3	24.5	-0.9	3.4	0.6	6.1	5.7
Import price index (percent change)	7.6	6.2	11.2	4.0	-0.4	-0.1	0.4	0.0
Import volume index (percent change)	6.8	2.9	13.2	-4.9	3.8	0.7	5.7	5.7
Import volume index (excluding cereals, aircraft) (percent change)	0.3	8.0	17.1	-1.7	5.6	6.7	5.8	5.8
Gross official reserves	931	1,043	1,289	1,205	1,166	1,315	1,486	1,741
(in months of imports of goods and nonfactor services of following year)	3.8	4.6	5.3	4.7	4.5	4.8	5.2	5.7
Terms of trade index percent change (1996/97 = 100)	-10.0	-2.6	-7.9	1.5	0.3	3.0	2.0	2.0

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

1/ Data pertain to the period July 8-July 7.
2/ From 2004/05, incorporates debt relief under HIPC Initiative (including topping up) and additional bilateral voluntary cancellations.
3/ Ethiopian Airlines and other public enterprises.
4/ Includes 1997 and 2001 Paris Club rescheduling agreements (including Russia) under Naples terms, 2002 Paris Club topping up to Cologne terms, and HIPC Initiative interim relief including estimates of relief beyond HIPC Initiative & relief on non-Paris Club debt under negotiation
5/ Balance of payments support from the World Bank (PRSC) and AfDB (SAL)

Table 8. Ethiopia: Projected Payments to the Fund, 2003/04-2013/14 1/
(In millions of SDRs, unless otherwise indicated)

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Obligations from existing drawings 2/	9.5	7.4	6.1	7.1	10.5	12.0	11.1	14.0	8.8	1.3	0.3
PRGF/ESAF/SAF repayments	8.8	6.4	5.4	6.5	9.9	11.6	10.7	13.7	8.5	1.0	0.0
Charges and interest	0.7	1.0	0.7	0.7	0.6	0.5	0.4	0.3	0.3	0.3	0.3
Obligations from prospective drawings	0.1	0.1	0.1	0.1	0.1	0.1	4.0	5.8	5.8	5.8	5.8
PRGF/ESAF/SAF repayments	0.0	0.0	0.0	0.0	0.0	0.0	3.8	5.7	5.7	5.7	5.7
Charges and interest	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Total obligations	9.6	7.6	6.3	7.3	10.6	12.2	15.1	19.8	14.6	7.1	6.0
PRGF/ESAF/SAF repayments	8.8	6.4	5.4	6.5	9.9	11.6	14.5	19.4	14.2	6.8	5.7
Charges and interest	0.8	1.1	0.8	0.8	0.7	0.6	0.5	0.4	0.4	0.3	0.3
Outstanding Fund credit	111.9	115.9	110.5	104.0	94.1	82.6	68.0	48.6	34.4	27.6	21.9
In percent of:											
Exports of goods and nonfactor services	11.7	12.6	11.4	10.1	8.5	6.9	5.3	3.5	2.3	1.7	1.3
External public debt	2.9	2.8	2.5	2.3	2.0	1.7	1.3	0.9	0.6	0.5	0.4
Gross official reserves	12.5	14.2	14.0	11.7	9.4	7.0	5.1	3.2	2.1	1.6	1.2
GDP	2.0	1.9	1.7	1.5	1.3	1.0	0.8	0.5	0.3	0.3	0.2
Quota	83.7	86.7	82.6	77.8	70.4	61.7	50.9	36.4	25.7	20.6	16.4
Total obligations	9.6	7.6	6.3	7.3	10.6	12.2	15.1	19.8	14.6	7.1	6.0
In percent of:											
Exports of goods and nonfactor services	1.0	0.8	0.6	0.7	1.0	1.0	1.2	1.4	1.0	0.4	0.4
External public debt	0.2	0.2	0.1	0.2	0.2	0.2	0.3	0.4	0.3	0.1	0.1
Gross official reserves	1.1	0.9	0.8	0.8	1.1	1.0	1.1	1.3	0.9	0.4	0.3
GDP	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.1
Quota	7.2	5.7	4.7	5.4	7.9	9.1	11.3	14.8	10.9	5.3	4.5
Memorandum item:											
Projected disbursements	10.4	10.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Fund staff estimates and projections.

1/ Year ending July 7.
2/ With Board-approved HIPC Initiative assistance

Table 9. Ethiopia: Social Indicators

	Latest Single Year 1970-75	1980-85	1993-2001	Sub-Saharan Africa	Low-Income Countries
Population					
Total population, midyear (millions)	33.0	43.4	65.8	673.9	2,505.8
Growth rate (percent; annual average)	2.6	2.8	2.3	2.3	1.8
Urban population (percent of population)	9.5	11.7	15.9	32.3	30.8
Total fertility rate (births per woman)	5.9	7.0	5.6	5.1	3.5
Income					
Gross National Income (GNI) per capita (U.S. dollars)	...	120	100	460	430
Consumer price index (1995/96 (July 8-July 7) =100)	17	51	100	288	380
Food price index (1995/96 (July 8-July 7) =100)	...	52	47	...	...
Income/consumption distribution					
Gini index 1/	...	...	57.2	...	...
Lowest quintile (percent of income or consumption) 1/	...	8.6	2.5	...	...
Highest quintile (percent of income or consumption) 1/	...	41.3	60.8	...	...
Public expenditure					
Health (percent of GDP) 1/	...	...	1.8	2.5	1.1
Education (percent of GDP) 1/	...	3.0	4.8	3.4 2/	2.8
Social security and welfare (percent of GDP)	...	1.4	...	...	...
Net primary school enrollment rate (percent of age group)					
Total 1/	...	29	47	...	...
Male	...	33	53	...	...
Female	...	25	41	...	...
Access to safe water (percent of population)					
Total 1/	...	...	24	58	76
Urban	...	...	81	83	90
Rural	...	...	12	46	70
Immunization rate (percent under 12 months)					
Measles	...	12	52	58	60
DPT	...	6	56	53	61
Life expectancy at birth (years)					
Total	42	44	42	46	59
Male	40	42	41	45	58
Female	43	45	43	47	60
Mortality					
Infant (per thousand live births)	151	143	116	105	80
Under 5 (per thousand live births)	239	213	172	171	121
Adult (15-59)					
Male (per thousand of population) 1/	482	491	594	520	312
Female (per thousand of population) 1/	411	401	535	461	256

Sources: World Bank, *World Development Indicators,* 2003; and National Bank of Ethiopia.

1/ The numbers for the period 1993-2001 are as of 2000.
2/ Latest available data are as of 1999.

Table 10. Ethiopia: Selected Economic and Financial Indicators, 2002/03-2015/16 - Comparison of Baseline and Double Aid Scenarios 1/

	2003/04 Est.	2004/05 Proj.	2005/06 Proj.	2006/07 Proj.	2007/08 Proj.	2008/09 Proj.	2009/10 Proj.	2015/16 Proj.
Baseline								
National income, prices, and money				(Annual percentage change)				
GDP at constant prices (at factor cost)	11.6	5.7	5.6	5.3	5.1	5.1	5.2	5.7
Consumer prices (period average)	9.6	5.4	3.0	3.0	3.0	3.0	3.0	3.0
Broad money	22.1	11.3	8.9	9.2	8.7	9.9	9.4	9.3
Velocity (GDP/broad money)	1.9	1.9	1.9	1.9	1.9	1.8	1.8	1.8
Savings deposits rate (minimum rate)	3.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Financial balances				(In percent of GDP, unless otherwise indicated)				
Gross domestic saving	1.3	2.3	3.4	6.7	7.5	8.1	8.4	8.6
Gross domestic investment	20.6	20.3	20.7	22.2	22.4	22.4	22.5	22.0
Resource gap	-19.4	-17.9	-17.4	-15.4	-14.9	-14.3	-14.1	-13.4
External current account balance, including official transfers	-4.0	-8.7	-7.4	-3.5	-3.4	-2.2	-1.8	-3.2
External current account balance, excluding official transfers	-13.0	-12.6	-12.1	-10.1	-9.9	-9.4	-9.4	-9.4
Government finances								
Revenue	18.6	18.4	18.3	18.7	18.7	19.0	19.0	19.5
External grants	7.8	5.8	7.0	6.9	6.8	7.3	7.6	6.3
Expenditure and net lending	30.3	30.0	28.3	30.5	30.4	30.7	30.6	28.8
Fiscal balance, excluding grants	-12.6	-10.5	-10.5	-11.8	-11.7	-11.7	-11.6	-9.3
Fiscal balance, including grants	-4.8	-4.7	-3.5	-4.9	-4.9	-4.4	-4.0	-3.0
Total financing	4.8	4.7	3.5	4.9	4.9	4.4	4.0	3.0
External financing	3.1	3.2	2.3	3.9	3.9	3.4	3.0	2.0
Domestic financing	1.7	1.5	1.2	1.0	1.0	1.0	1.0	1.1
Domestic debt	33.6	31.7	30.3	28.7	27.5	26.3	25.3	20.6
External sector								
Export volume 2/	12.0	4.7	6.0	6.2	6.2	6.2	6.4	7.7
Import volume 2/	13.2	-4.9	3.8	0.7	5.7	5.7	5.6	6.0
Terms of trade (deterioration -) 2/	-7.9	1.5	0.3	3.0	2.0	2.0	0.6	0.0
NPV of external debt-to-exports ratio 3/	168.3	182.8	199.9	206.3	208.3	207.7	205.6	186.3
External debt-service ratio 3/	6.6	5.3	6.9	7.2	7.3	7.1	7.1	4.6
Gross official reserves (in millions of U.S. dollars)	1,289	1,205	1,166	1,315	1,486	1,741	1,997	2,852
(in months of imports of goods and nonfactor services of following year)	5.3	4.7	4.5	4.8	5.2	5.7	6.1	5.7
Double aid scenario								
National income, prices, and money				(Annual percentage change)				
GDP at constant prices (at factor cost)	11.6	6.5	6.8	7.0	7.1	7.0	7.0	7.0
Consumer prices (period average)	9.6	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Broad money	22.1	12.9	14.5	13.2	13.3	14.3	14.4	14.2
Velocity (GDP/broad money)	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.8
Savings deposits rate (minimum rate)	3.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0
Financial balances				(In percent of GDP, unless otherwise indicated)				
Gross domestic saving	1.3	4.7	8.1	6.7	8.3	9.8	11.0	9.1
Gross domestic investment	20.6	24.8	27.5	27.5	29.4	31.3	33.2	34.3
Resource gap	-19.4	-20.0	-19.4	-20.8	-21.1	-21.6	-22.2	-25.2
External current account balance, including official transfers	-4.0	-7.5	-3.0	-2.7	-2.6	-1.1	-0.1	0.1
External current account balance, excluding official transfers	-13.0	-14.9	-14.3	-15.4	-16.0	-16.5	-17.4	-21.0
Government finances								
Revenue	18.6	18.5	18.6	18.7	19.0	19.0	19.0	19.6
External grants	7.8	9.3	13.4	12.6	13.2	14.7	16.4	20.6
Expenditure and net lending	30.3	31.5	34.9	36.0	36.7	37.6	38.9	42.4
Fiscal balance, excluding grants	-12.6	-14.0	-16.8	-17.3	-17.7	-18.6	-19.9	-22.8
Fiscal balance, including grants	-4.8	-4.7	-3.4	-4.6	-4.5	-4.0	-3.5	-2.3
Total financing	4.8	4.7	3.4	4.6	4.5	4.0	3.5	2.3
External financing	3.1	3.2	2.2	3.7	3.7	3.1	2.7	1.6
Domestic financing	1.7	1.5	1.1	0.9	0.9	0.8	0.8	0.6
Domestic debt	33.6	31.2	28.7	26.1	23.8	21.8	20.0	12.4
External sector								
Export volume 2/	12.0	4.7	6.0	6.2	6.2	6.2	6.4	9.5
Import volume 2/	13.2	4.5	4.7	13.3	9.2	10.0	10.0	10.1
Terms of trade (deterioration -) 2/	-7.9	1.5	0.3	3.0	2.0	2.0	0.6	0.0
NPV of external debt-to-exports ratio 3/	168.3	182.8	199.9	206.3	208.3	207.7	204.8	166.6
External debt-service ratio 3/	6.6	5.3	6.9	7.2	7.3	7.1	7.0	4.0
Gross official reserves (in millions of U.S. dollars)	1,289	1,289	1,650	1,871	2,120	2,492	2,966	6,624
(in months of imports of goods and nonfactor services of following year)	4.9	4.7	5.3	5.6	5.8	6.2	6.6	7.8

Sources: Ethiopian authorities; and staff estimates and projections.

1/ Data pertain to the period July 8-July 7.

2/ Annual percentage change.

3/ After enhanced HIPC Initiative relief, additional bilateral relief, and topping up of HIPC Initiative relief.

Table 11. Ethiopia: Indicators of Financial Soundness, June 1998-March 2004 1/

(In percent, unless otherwise indicated)

	1998	1999	2000			2001				2002				2003				2004
	Jun.	Jun.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun. 2/	Sep. 2/	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.
Regulatory capital to risk-weighted assets 3/	9.3	8.8	9.9	10.6	12.2	12.9	12.4	13.6	14.3	14.8	13.0	14.5	14.6	15.7	11.9	12.1	13.8	14.6
Of which: public banks	9.0	8.3	8.5	9.4	11.1	11.8	11.0	12.6	13.4	14.0	11.3	13.2	14.0	15.4	10.4	10.8	13.0	14.5
Nonperforming loans to total gross loans	28.3	26.2	23.0	27.9	25.5	25.8	28.2	37.0	35.9	39.1	43.8	42.0	36.5	37.1	40.5	38.9	35.8	34.1
Of which: public banks	28.5	26.5	24.3	30.2	28.2	29.1	32.6	43.3	42.0	44.8	50.5	48.0	42.7	45.1	51.9	49.5	47.5	44.2
Nonperforming laons net of provisions to capital	132.7	117.4	80.8	100.0	83.9	76.9	110.3	146.4	131.9	132.6	167.8	140.6	111.0	105.5	121.7	106.8	88.8	70.8
Of which: public banks	142.3	122.1	87.6	112.6	94.6	87.2	137.7	179.5	157.1	152.3	211.4	165.3	121.1	116.5	155.0	128.9	107.2	83.4
Sectoral distribution of loans to total loans																		
Agriculture	7.9	8.8	8.5	10.7	10.5	8.9	8.1	10.0	10.4	9.3	8.7	9.7	9.8	8.8	8.5	9.4	8.8	7.5
Industry	13.0	13.9	13.3	13.8	13.6	14.3	15.1	15.5	15.9	15.6	15.8	16.8	17.0	16.7	17.2	17.4	17.5	17.0
Domestic trade	16.2	12.7	13.5	11.6	11.0	12.1	11.5	11.1	10.8	10.3	10.4	10.2	11.3	11.4	10.9	10.3	11.4	11.9
International trade	21.2	21.5	18.8	15.6	16.9	16.7	18.2	15.7	14.5	17.0	16.9	14.2	14.2	14.2	14.4	14.3	15.3	17.8
Export	7.3	7.8	6.2	5.7	5.5	6.5	6.2	6.0	5.3	5.6	4.9	4.0	4.8	5.1	4.8	3.9	4.5	5.7
Import	13.8	13.6	12.7	9.9	11.4	10.3	12.1	9.8	9.3	11.4	12.0	10.2	9.4	9.0	9.6	10.3	10.8	12.2
Hotels and tourism	3.1	2.8	1.9	2.6	2.5	2.5	2.3	2.3	2.4	2.5	2.6	2.4	2.3	2.2	2.1	2.0	2.0	1.7
Transport and construction	6.7	4.4	5.7	6.6	6.0	5.6	5.5	5.4	4.9	4.7	4.5	4.5	4.1	3.5	3.4	3.0	2.9	3.8
Housing and construction	14.4	10.4	9.8	10.2	10.1	10.2	9.8	10.0	9.8	9.6	9.6	10.8	10.7	10.5	11.0	10.7	10.5	10.6
Mines, power, and water resources	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.1	0.1
Others	13.5	21.7	24.1	24.7	25.4	26.2	25.9	26.7	27.9	27.7	28.4	28.1	27.6	29.7	29.5	30.0	28.9	27.2
Personal	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3
Interbank lending	3.6	3.6	4.0	4.0	3.7	3.2	3.1	3.1	3.1	2.9	2.9	2.9	2.7	2.6	2.6	2.4	2.3	2.1
Return on assets	1.1	0.3	1.9	...	...	...	0.4	...	...	...	-1.4	...	...	...	1.9	...	...	...
Of which: public banks	1.1	0.2	2.0	...	...	...	0.1	...	...	...	-1.9	...	...	...	2.1	...	...	...
Return on equity	23.9	6.6	25.4	...	...	...	4.5	...	...	...	-18.6	...	...	...	29.4	...	...	...
Of which: public banks	25.8	5.4	30.3	...	...	...	1.4	...	...	...	-31.5	...	...	...	40.4	...	...	...
Interest margin to gross income	43.1	40.2	44.8	...	...	...	41.0	...	...	...	24.7	...	...	...	34.3	...	...	...
Of which: public banks	43.4	42.1	45.8	...	...	...	41.2	...	...	...	19.5	...	...	...	32.5	...	...	...
Noninterest expenses to gross income	18.9	43.5	26.0	...	...	...	46.9	...	...	...	86.6	...	...	...	30.9	...	...	...
Of which: public banks	16.5	43.9	23.6	...	...	...	50.2	...	...	...	105.4	...	...	...	25.5	...	...	...
Liquid assets to total assets	29.3	29.0	36.8	41.8	30.1	30.1	32.8	35.5	33.3	36.5	39.3	42.4	51.9	52.2	53.5	55.6	51.7	36.6
Of which: public banks	29.0	28.4	37.2	41.6	29.3	29.8	33.3	35.8	34.5	37.8	40.4	42.9	56.1	57.7	59.0	60.2	57.2	40.1
Liquid assets to short-term liabilities	40.5	40.4	48.7	55.9	38.8	38.0	40.9	44.3	42.4	45.8	48.8	52.0	64.3	64.8	67.4	71.3	65.2	65.2
Of which: public banks	40.3	39.7	49.3	55.7	37.6	37.5	41.4	44.8	43.9	47.6	50.1	52.6	69.2	70.8	74.5	77.8	72.2	75.0
Net open position in foreign exchange to capital	...	...	...	...	...	...	...	...	...	...	...	...	...	...	1.8	26.5	2.9	63.6
Of which: public banks	...	...	...	...	...	...	...	...	...	...	...	...	...	...	1.0	33.0	2.3	90.1

Source: National Bank of Ethiopia.

1/ Only commercial banks, namely excluding the Development Bank of Ethiopia (DBE). The DBE is not a deposit-taking bank.
2/ Loan classification and providioning requirements were strengthened in April and September 2002.
3/ Only tier 1 capital exists.

Table 12. Ethiopia: Millennium Development Goals

	1990	1995	2001	2002
1. Eradicate extreme poverty and hunger (2015 target = halve 1990 $1 a day poverty and malnutrition rates)				
Population below $1 a day (%)	...	...	26.3	...
Poverty gap at $1 a day (%)	...	...	5.7	...
Percentage share of income or consumption held by poorest 20%	...	...	9.1	...
Prevalence of child malnutrition (% of children under 5)	47.7		47.2	...
Population below minimum level of dietary energy consumption (%)	...	57.0	42.0	...
2. Achieve universal primary education (2015 target = net enrollment to 100)				
Net primary enrollment ratio (% of relevant age group)	...	27.9	46.2	...
Percentage of cohort reaching grade 5 (%)	58.1	50.6	61.3	...
Youth literacy rate (% ages 15-24)	43.0	49.0	56.2	57.4
3. Promote gender equality (2005 target = education ratio to 100)				
Ratio of girls to boys in primary and secondary education (%)	70.6	60.1	69.0	
Ratio of young literate females to males (% ages 15-24)	66.1	73.0	80.9	82.1
Share of women employed in the nonagricultural sector (%)	44.1	...	...	...
Proportion of seats held by women in national parliament (%)	...	5.0	...	...
4. Reduce child mortality (2015 target = reduce 1990 under 5 mortality by two-thirds)				
Under 5 mortality rate (per 1,000)	204.0	192.0	176.0	171.0
Infant mortality rate (per 1,000 live births)	131.0	123.0	116.0	114.0
Immunization, measles (% of children under 12 months)	38.0	38.0	52.0	52.0
5. Improve maternal health (2015 target = reduce 1990 maternal mortality by three-fourths)				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	850	...
Births attended by skilled health staff (% of total)	...	...	5.6	...
6. Combat HIV/AIDS, malaria and other diseases (2015 target = halt, and begin to reverse, AIDS, etc.)				
Prevalence of HIV, female (% ages 15-24)	...	...	7.8	...
Contraceptive prevalence rate (% of women ages 15-49)	4.3	...	8.1	...
Number of children orphaned by HIV/AIDS	...	...	990,000	...
Incidence of tuberculosis (per 100,000 people)	...	...	292.0	370.3
Tuberculosis cases detected under DOTS (%)	...	14.0	42.0	33.3
7. Ensure environmental sustainability (2015 target = various)				
Forest area (% of total land area)	5.0	...	4.6	...
Nationally protected areas (% of total land area)	...	5.5	5.5	22.8
GDP per unit of energy use (PPP $ per kg oil equivalent)	1.8	2.0	2.6	...
CO2 emissions (metric tons per capita)	0.1	0.0	0.1	...
Access to an improved water source (% of population)	25.0	...	24.0	...
Access to improved sanitation (% of population)	8.0	...	12.0	...
Access to secure tenure (% of population)	...	...	...	...
8. Develop a Global Partnership for Development (2015 target = various)				
Youth unemployment rate (% of total labor force ages 15-24)	...	...	...	...
Fixed line and mobile telephones (per 1,000 people)	2.6	2.5	4.8	6.0
Personal computers (per 1,000 people)	...	...	1.1	1.5

Source: World Bank, World Development Indicators database, April 2004

August 12, 2004

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

In accordance with the provisions of the three-year arrangement (approved on March 22, 2001), under the Poverty Reduction and Growth Facility (PRGF), the Government of Ethiopia, in cooperation with staff of the IMF, has evaluated the implementation of the third annual program (July 8, 2003–July 7, 2004); performance is to be measured through end-March 2004. Following the completion of the sixth review under the PRGF arrangement by the Executive Board, the government requests the seventh disbursement in an amount equivalent to SDR 10.429 million under the arrangement.

In 2003/04, real GDP is provisionally estimated to have increased by 11.6 percent, mainly reflecting a sharp recovery in agricultural output, which grew by 18.9 percent. Inflation is estimated to have fallen to 12.1 percent in the 12 months to April 2004. All the quantitative performance criteria for end-March 2004 and the structural performance criteria for end-June 2004 have been met (Tables 1 and 2), and we believe that the current stance of macroeconomic policies remains fully consistent with achieving all the quantitative and structural benchmarks for end-June 2004. We will be reporting to you on the performance relating to the benchmarks for April–June of fiscal year 2003/04 by end-August, 2004.

The government wishes in particular to stress that it is continuing in its efforts to maintain budget discipline, to develop a public debt strategy which will set public debt on to a sustainable path, and to continue to reorient public spending in favor of poverty-related expenditures as envisaged in the PRSP.

The government believes that its policies are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Ethiopia will consult with the Fund on the adoption of these measures, and in advance of revisions to its policies, in accordance with the Fund's policies on such consultation.

Sincerely yours,

/s/	/s/
Sufian Ahmed Minister of Finance and Economic Development	Teklewold Atnafu Governor National Bank of Ethiopia

Table 1. Ethiopia: Quantitative Benchmarks and Performance Criteria for the Third Annual Program Supported by the PRGF Arrangement, July 2003-July 2004 1/

(In millions of birr, unless otherwise indicated)

	2003							2004			
	July 7	September			December			March			July 7
	Actual (Stock)	Perf. Crit.	Adjusted Perf. Crit. 2/	Actual	Revised Benchmark	Adjusted Benchmark	Actual	Perf. Crit.	Adjusted Perf. Crit.	Actual	Benchmark
I. Quantitative benchmarks and performance criteria											
Floor on net foreign assets of the National Bank of Ethiopia 3/ 4/	6,267	-136	-68	266	128	230	874	820	1,194	2,238	831
Ceiling on net domestic assets of the National Bank of Ethiopia 5/ 6/	6,972	319	251	-799	370	268	-723	-336	-710	-2,206	991
Ceiling on net domestic financing of the general government (incl. privatization receipts) 6/ 7/ 8/	19,211	269	201	-327	460	358	-124	-236	-610	-1,590	1,262
Ceiling on outstanding external payments arrears of the public sector (in million of US$) 9/	0	0	0	0	0	0	0	0	0	0	0
Ceiling on new nonconcessional external debt contracted or guaranteed by the public sector 10/	0	0	0	0	0	0	0	0	0	0	0
II. Indicative target											
Floor on net foreign liquid reserves of the National Bank of Ethiopia 3/ 4/	5,748	-136	-68	374	128	230	945	820	1,194	2,281	831
III. Triggers for adjustment of quantitative benchmark and performance criteria											
Disbursed nonproject external funding (in million of U.S. dollars) 11/	271	37	45	45	95	107	107	282	326	326	355

Source: Ethiopian authorities.

1/ For 2003/04, cumulative flows from July 8, 2003. Program exchange rate of 8.5937 Birr/USD used.
2/ Nonproject disbursements have been revised by the authorities. Nonetheless, the observance of performance criteria for end-September 2004 remains.
3/ Adjusted upward for external assistance (nonproject, excluding enhanced HIPC interim assistance) that exceeds programmed amounts (paragraph 12 of the Technical Memorandum (TM) dated July 2003).
4/ Adjusted downward for 50 percent of any shortfall in programmed external assistance (nonproject, excluding enhanced HIPC interim assistance) up to a maximum of US$50 million (paragraph 15 of the TM dated July 2003).
5/ Adjusted downward for external assistance (nonproject, excluding enhanced HIPC interim assistance) that exceeds programmed amounts (paragraph 13 of the TM dated July 2003).
6/ Adjusted upward for 50 percent of any shortfall in programmed external assistance (nonproject, excluding enhanced HIPC interim assistance) up to a maximum of US$50 million (paragraph 15 of the TM dated July 2003).
7/ Adjusted downward for external assistance (nonproject, excluding enhanced HIPC interim assistance) that exceeds programmed amounts (paragraph 14 of the TM dated July 2003).
8/ Stocks at July 7, 2003 reflect domestic government borrowing but exclude privatization receipts.
9/ There shall be a continuous performance criterion on the nonaccumulation of new external arrears.
10/ This limit applies not only to debt as defined in Point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted by the IMF on August 24, 2000, but also to commitments contracted or guaranteed for which the value has not been received. Excluded from this limit are short-term import credits and long-term financing operations of Ethiopian Airlines.
11/ Excluding fertilizer projects.

Table 2. Ethiopia: Structural Benchmarks, and Performance Criteria
Under the Third Annual Program Supported by the Three-Year PRGF Arrangement

Prior Actions, Structural Benchmarks, and Performance Criteria	Timing
Finalization and adoption of a financial restructuring plan by the government for the CBE that includes (i) ensuring that the CBE complies fully with the NBE provisioning directives by January 2004; (ii) a time bound plan for reducing NPLs to 20 percent of total loans; (iii) ensuring that the capital adequacy ratio will not fall below the minimum required ratio of 8 percent, and promptly recapitalizing the bank should the ratio fall below 8 percent; and (iv) not paying annual dividends until the capital adequacy ratio reaches at least 10 percent.	end-November, 2003 (done) (performance criterion)
Consolidate federal and regional budgets for both the past year and the budget year—including all extrabudgetary funds and accounts.	end-November 2003 (done) (performance criterion)
Reconcile monetary and fiscal accounts.	end-December 2003 (done) (structural benchmark)
Finalization of a restructuring plan for the NBE, based on the recent KPMG study, and beginning of its implementation.	end-December, 2003 (done) (structural benchmark)
Full provisioning by all commercial banks for nonperforming loans and other doubtful assets in line with the existing NBE directive.	end-January 2004 (done) (structural benchmark)
As part of the CBE restructuring plan, instituting a policy to limit the renewal or restructuring of any delinquent loan to two iterations.	January 1, 2004 (done) (prior action)
As part of the CBE restructuring plan, (i) transferring cofinanced loans (Birr 1.03 billion) from the CBE to the DBE in exchange for a government guaranteed bond with discount factor equivalent to the amount of the provisions already constituted on these loans; and (ii) eliminating the maximum annual write-off limit.	end-June 2004 (done) (performance criterion)

Ethiopia: Relations with the Fund

(As of June 30, 2004)

I. Membership Status: Joined 12/27/1945; Article XIV

II. General Resources Account	**SDR Million**	**Percent of quota**
Quota	133.70	100.00
Fund Holdings of Currency	126.52	94.63
Reserve position in Fund	7.19	5.38

III. SDR Department	**SDR Million**	**Percent of allocation**
Net cumulative allocation	11.16	100.00
Holdings	0.35	3.10

IV. Outstanding Purchases and Loans	**SDR Million**	**Percent of quota**
Structural Adjustment Facility (SAF)	1.41	1.06
Enhanced Structural Adjustment Facility (ESAF) and Poverty Reduction and Growth Facility (PRGF)	110.49	82.64

V. Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
PRGF	03/22/2001	07/31/2004	100.28	89.85
ESAF	10/11/1996	10/22/1999	88.47	29.49
SAF	10/28/1992	11/08/1995	49.42	49.42

VI. Projected Obligations to Fund (without HIPC Assistance)

	Forthcoming; in SDR million				
	2004	2005	2006	2007	2008
Principal	4.4	5.9	7.6	12.3	16.8
Charges/interest	0.4	0.7	0.7	0.6	0.6
Total	4.8	6.6	8.3	12.9	17.3

Projected Payments to Fund (with Board-approved HIPC Assistance)

	Forthcoming; in SDR million				
	2004	2005	2006	2007	2008
Principal	3.7	5.4	5.5	7.5	12.2
Charges/Interest	0.4	0.7	0.7	0.6	0.6
Total	4.1	6.1	6.2	8.1	12.8

VII. Implementation of HIPC Initiative

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	Nov. 2001
Assistance committed (NPV terms)[16]	
Total assistance by all creditors (US$ Million)	1,275
Of which: IMF Assistance (SDR Million)	26.93
Completion point date	Apr 2004
Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	26.93
Interim assistance	10.28
Completion point	16.65
Additional disbursement of interest income[17]	--

VIII. Safeguards Assessment

Under the Fund's safeguards assessment policy, the National Bank of Ethiopia (NBE) is subject to a full safeguards assessment with respect to the Poverty Reduction and Growth Facility arrangement approved on March 22, 2001, which is scheduled to expire on July 31, 2004. An off-site safeguards assessment of the NBE was completed on May 4, 2001. The assessment concluded that high risks may exist in financial reporting and in the system of internal controls and recommended an on-site assessment. The on-site assessment was completed on September 12, 2001. The staff's findings and recommendations are reported in

[16]NPV terms at the decision point under the enhanced framework.

[17] 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.

Appendix V of Country Report No. 02/68. The NBE is implementing the outstanding issues of recommendations under the safeguards assessment.

IX. Exchange Rate Arrangement

Effective October 24, 2001, NBE terminated the weekly wholesale foreign exchange auctions for the birr (Br) and moved all foreign exchange operations to the interbank market. The current exchange rate regime is classified as managed floating. The transaction-weighted average interbank market exchange rate on May 31, 2004 was Br 8.633 = US$1.

In March 2001, the authorities eliminated previously existing restrictions on the purchase of foreign exchange for holiday travel and education purposes. Since then, exporters have been allowed to retain 10 percent of their export proceeds in foreign exchange for an indefinite period. The rest may be retained for a period of 28 days, after which it has to be converted into local currency by the customer's bank using the prevailing transaction rate, unless an exporter spends it on eligible imports within 28 days. The multiple currency practice that might have arisen from the NBE's weekly foreign exchange auction was lifted with the replacement of the auction by the interbank foreign exchange market. Remaining current account exchange restrictions relate to (a) the tax certification requirement for repatriation of investment income; (b) restrictions on repayment of legally entered into external loans and supplies and foreign partner's credits; (c) rules for issuance of import permits; and (d) the requirement to provide a clearance certificate from NBE to obtain import permits. These restrictions are inconsistent with Article VIII, Section 2(a) of the IMF's Articles of Agreement.

X. Article IV Consultation

Ethiopia is on the 24-month cycle for members with Fund arrangements in accordance with the provisions of the decision on consultation cycles approved on July 15, 2002. The Executive Board concluded the last Article IV consultation on September 23, 2002, concurrently with the completion of the third review under the second annual PRGF-supported program (Country Report No. 02/220).

XI. Technical Assistance (2001 - present)

Department	**Purpose**	**Time of Delivery**
FAD/LEG	Tax administration and VAT legislation	January-February 2001
MAE	Monetary and banking reforms	February-March 2001
FAD	Tax administration	April 2001
MAE	Bank supervision	April-May 2001
MAE	Monetary and banking reforms	May 2001
MAE	Interbank foreign exchange market	June-July 2001
LEG	Income tax legislation	September 2001

FAD	Tax administration	September-November 2001
MAE	Bank supervision	September-October 2001
LEG	Review of compliance with Article VIII	November 2001
STA	Consumer price index	November-December 2001
STA	Multisector	January 2002
MAE	Bank supervision	February 2002
FAD	Tax administration	February 2002
STA	Fiscal and monetary accounts	May 2002
LEG	VAT law	May 2002
MAE	Payment system	May-June 2002
FAD	Public expenditure management	July 2002
FAD	Tax administration	July 2002
MAE	Accounting and internal audit of central bank	August 2002
FAD	Tax administration	November 2002
MAE	Accounting and internal audit of central bank	November-December 2002
FAD	Tax and Customs Administration Reforms	June-July 2003
STA	Reconciliation of fiscal and monetary accounts	August 2003
MFD	Restructuring plan of the CBE	November 2003
STA	Monetary and Financial Statistics Mission	January-February 2004

XII. Resident Representative

Mr. Alexander Kyei assumed the post in August 2001.

Ethiopia: Relations with the World Bank[18]

(As of July 2004)

A. Partnership in Ethiopia's Development Strategy

1. In July 2002, the government of Ethiopia finalized its full Poverty Reduction Strategy Paper (PRSP), known as the Sustainable Development and Poverty Reduction Program (SDPRP). This was discussed in September 2002 by the Boards of the World Bank and the Fund, along with a Joint Staff Assessment of the SDPRP strategy. The first Annual Progress Report (APR) on SDPRP implementation was finalized by the Government in December 2003. The second Annual Progress Report is expected to be presented in December 2004, with an interim APR to be shared by Government in August 2004.

2. The IMF has taken the lead in helping Ethiopia maintain macroeconomic stability, under a three year Poverty Reduction and Growth Facility (PRGF) arrangement approved in March 2001. The PRGF addresses issues related to fiscal consolidation and structural reforms that are key to maintaining macroeconomic stability and fostering growth. The PRGF's structural conditionality has focused on the following areas: the financial sector, budget consolidation and reconciliation, and public expenditure management.

3. The Bank leads the policy dialogue on structural reforms relevant to economic growth and poverty reduction, including rural development, infrastructure, private sector development (PSD), human development, governance, and vulnerability. The Bank and Fund share joint responsibility in supporting financial sector, taxation, decentralization, and public expenditure reforms.

B. Key Areas of Common Interest to Bank and Fund

4. **Preparation and Implementation of the PRSP.** The World Bank and the IMF collaborated in providing support to the government in the preparation of the PRSP, including preparing joint comments on an early draft of the PRSP and the Joint Staff Assessment. The Bank and the IMF also collaborated on the preparation of the Joint Staff Assessment of the first APR on SDPRP implementation.

5. Through lending and analytical work, the Bank and the Fund jointly support implementation of the SDPRP's policy reforms, including the following main areas:

6. **Macroeconomic policy, PSD, and the financial sector.** There is close cooperation between the World Bank and the IMF in discussing macroeconomic policy with the government. Complementing the PRGF's focus on macroeconomic issues, one of the key focus areas of the Bank's Poverty Reduction Support Credit (PRSC) series is structural

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[18] Prepared by staff of the World Bank.

policy reforms to support pro-poor growth, and the Fund has joined in PRSC dialogue on the financial sector. Staff of the Fund and Bank are working jointly on a Pilot Case Study on Public Investment and Fiscal Policy that will examine the fiscal implications of state ownership of public enterprises as an input into the privatization program.

7. **Public sector reforms.** The Bank and Fund have been supporting the Government's movement towards decentralization with a view to improving the working of the civil service and improving service delivery at the local level, particularly in terms of improving the incentives for regional and local level performance in the formula for sub-national transfers of public resources. In addition to support to decentralization, the Bank is also providing assistance for civil service reform, tax and customs administration reform, legal and judicial reforms and urban management, through the Public Sector Capacity Building Project (PSCAP, $100 m.), approved by the Board of the World Bank on May 11, 2004.

8. **Public expenditure management.** The Fund has been an active participant in Bank-coordinated annual public expenditure reviews (PERs), which have provided an objective analysis of the government's public expenditure strategy, as well as an opportunity to study issues in public finance management of common interest and concern. The 2001 PER was the first review of public expenditure at the regional level. The 2002 PER focused on (a) spending in the social sectors; and (b) an update on overall spending patterns, budget systems issues, and fiscal decentralization developments. In the context of HIPC, the government, IDA and the IMF have been tracking the use of savings arising from HIPC interim assistance.

9. Going forward, the government has confirmed its commitment to introduce a *Joint Budget and Aid Review (JBAR)* as a key element of the ongoing planning and budget cycle. This instrument is intended to replace the series of PERs that had traditionally been undertaken by the World Bank which, together with the proposed FAs (see below), assume larger importance in the context of decentralization and the Bank and other donors' shift in development assistance to programmatic/budget support. The JBAR's primary objective is to review budget allocations – at the sectoral, sub-sectoral, regional and local levels – in terms of the links to national growth, poverty and human development outcomes as laid out in the SDPRP. More specifically, the objectives of the JBAR would be to: improve information and predictability on expected resource flows to sector agencies and lower levels of government; give decision-makers a better sense of where money is going, and that money is being spent on intended uses; and provide better information on overall fiscal aggregates and how this is financed, to better inform macro-level discussions.

10. **Fiduciary assessments.** MOFED has also agreed with DBS donors and the Bank that a joint fiduciary assessment—the first in a series of annual *Fiduciary Assessments (FAs)*—will be carried out as a key input into the direct budget support decision cycle. FAs are intended to consolidate and replace the varied reviews of expenditure management systems in Ethiopia, including the aspects of the PER related to institutional and inter-governmental fiscal design issues, as well as the CFAA and CPAR. The Bank is expected to work closely with AFRITAC on the FAs.

11. **Millennium Development Goals.** The Bank and Fund, together with the U.N. Millennium Project, are supporting the Government in undertaking a needs assessment to estimate the cost of the investments needed to put Ethiopia on a path to meet the MDGs, and develop a strategy to finance these costs.

12. **Debt sustainability analysis and the Enhanced HIPC Initiative.** The Boards of the Bank and the Fund agreed on April 20, 2004 that Ethiopia had taken the necessary steps to reach its HIPC completion point. In addition to making irrevocable the $1.3 billion of NPV debt relief envisaged at Decision Point in November 2001, the Boards approved the topping-up of debt relief by an additional $0.7 billion in NPV terms. The exceptional additional topping up assistance was granted on account of exogenous factors—particularly changes in the discount rate and exchange rate since the decision point—that had fundamentally changed Ethiopia's economic circumstances and thereby adversely affected its debt sustainability. In preparation for the Board discussions, Bank and Fund staff jointly monitored progress by the Government toward meeting the HIPC triggers necessary to reach Completion Point. The World Bank and the Fund also jointly updated the debt sustainability analysis (DSA) for Ethiopia prior to Completion Point. Post-HIPC, the Bank and Fund are working together to support Government in developing a debt management strategy.

13. **Statistical issues.** Both institutions have been providing technical assistance to the government of Ethiopia on the compilation of data and statistics, with the Fund focusing on the compilation of macroeconomic statistics and the Bank supporting the improvement of data on poverty and social indicators, and on the monitoring of output and outcomes of poverty reduction programs.

C. Bank Group Strategy

14. The FY03-FY05 Country Assistance Strategy (CAS) for Ethiopia supports implementation of the SDPRP, thereby assisting the country's efforts to reduce poverty and achieve the MDGs. The CAS was developed with the benefit of an extensive consultation process, and focused on three key pillars of the SDPRP: pro-poor growth (urban and rural); institutional development and capacity building; and reducing vulnerability. The CAS also proposed a shift away from traditional project-based lending toward increased programmatic approaches such as Poverty Reduction Support Credits (PRSCs), supported by larger investments in analytical work. Since the writing of the CAS, the Government has developed a Food Security Program in collaboration with the Bank and donors that aims to eliminate hunger and break the cycle of vulnerability to shocks such as drought. The Bank is supporting the program through a broad range of interventions—IDA grants and credits, technical assistance, and analytical work.

15. The CAS envisaged new Bank commitments of around US$1.5 billion in the base case, with up to 40 percent provided in grants under IDA13. However, due to debt sustainability concerns arising from exogenous shocks, the Bank halted all new lending until the Boards of the Bank and Fund approved the 'topping-up' of debt relief by $0.7 billion in April 2004. As a consequence of the halt of lending, IDA commitments in FY03 and FY04 were limited to nine projects totaling $724 million, of which $361 million was grants. Lending under the

CAS has now resumed, though debt sustainability concerns are being taken into consideration in all future lending to prevent Ethiopia from falling back into a situation where its debt is again unsustainable. A CAS progress report will be prepared by the Bank in early FY05.

16. At the end of FY04, Ethiopia's portfolio of IDA operations comprised 20 active projects, with total net commitments of $1,956 million and an undisbursed balance of $947 million. Total disbursements to Ethiopia increased substantially to $422 million (of which $179 million of grants) in FY04 as compared to $362 million (with no grants) in FY03.

Ethiopia: Statistical Issues

General

51. Recognizing the importance of accurate and timely data, not only for macroeconomic policy formulation, but also for monitoring implementation of Ethiopia's PRSP, and for assessing progress with the implementation of the PRSP, the authorities have developed a comprehensive Medium-Term National Statistical Program. The program will be implemented over a period of five years, and aims at addressing data deficiencies in each of the major socio-economic sectors. The Medium-Term National Statistical Plan has been identified as an essential element of the authorities' efforts to strengthen the Monitoring and Evaluation System for implementation of Ethiopia's PRSP. Ethiopia is a participant in the General Data Dissemination System (GDDS) and its metadata are posted on the Fund's Dissemination Standards Bulletin Board (DSBB). Ethiopia also participates in the GDDS project for Anglophone Africa and had been receiving technical assistance in the fiscal and external sectors under the project.

Real sector

52. The authorities have improved the timeliness and coverage of national accounts, economic surveys, and prices since 1993. Preliminary national accounts are available through 2002/03 (July 8-July 7). A new series of GDP estimates, updating the base year from 1980/81 to 1999/2000, is under construction and is expected to be released shortly. Additionally, with technical assistance from AFRITAC East, the authorities have been developing an Establishment Census, the objective of which is to collect data on a range of economic indicators (e.g. employment, capital stock, inputs and outputs) for all business establishments in the country. The first census was conducted during March 2004. Following the successful completion of the program to amend the methodological framework of the consumer price index, the Ethiopian authorities are currently working on the establishment of a production price index with technical assistance from AFRITAC East. Survey focused on the development of a set of indicators of economic activity are expected to commence in 2004/05.

Public finances

53. Monthly federal government accounts are reported with a six- to eight-week lag. Under the three-year PRGF arrangement, progress was made in 2002/03 in improving the quality and coverage of reporting on the consolidated general government. The consolidation of federal and regional budgets, inclusive of all extrabudgetary funds and accounts, for the past year and the budget year was a performance criterion under the Third Annual Program of the PRGF, as well as a trigger for reaching the completion point under the HIPC Initiative. However, with the ongoing decentralization of fiscal powers to woredas (districts), ensuring

the integrity of the consolidated budget reporting will be an ongoing task. Progress was also made in 2002/03 in eliminating discrepancies between data on the domestic and foreign financing of the budget deficit and the monetary accounts. With the assistance of an STA mission which visited Addis Ababa in August 2003, the joint reconciliation committee, composed of the Ministry of Finance and Economic Development (MOFED) and the National Bank of Ethiopia (NBE), established a short-term work program to achieve the reconciliation of provisional quarterly fiscal and monetary data for 2001/02 and 2002/03. This action was also a performance criterion under the Third Annual Program of the PRGF and trigger for the completion point under the HIPC Initiative. The second assessment of the public expenditure management systems in Ethiopia which was conducted by FAD in the first quarter of 2004 identified a lack of timely fiscal reporting as a key concern, particularly as it hampers the management of fiscal policy within the year. A detailed action plan for improving the public expenditure management system has been developed.

Monetary accounts

3. The monetary survey is reported with a six-week lag. An STA technical assistance mission in January-February 2004 found that the quality of Ethiopia's monetary and financial statistics is compromised by various methodological problems. The mission recommended correcting a number of instances of misclassification of accounting data, and commenced the development of an Integrated Monetary Database for Ethiopia. A follow-up mission is expected to complete the latter project.

Balance of payments

4. Balance of payments data still require improvements in the coverage, valuation, timing, and classification of transactions. The authorities have begun working toward the adoption of the fifth edition of the *Balance of Payments Manual*, but problems persist. In particular, key surveys recommended by the 1995 STA mission for the collection of basic data were not carried out until early 1999/2000. Import data still rely primarily on exchange control data, even though the quality of that data has worsened in the wake of the exchange system liberalization in 1998. The use of customs records to generate trade data has begun with the operationalization of the Automated System for Customs Data (ASYCUDA) at major customs stations in February 1999, which should improve the timeliness and coverage of trade statistics. An export unit value index is available (with a two-year delay), but no import unit value index is produced. Data on official and private transfers and private capital flows are also weak. The NBE, in collaboration with the Ethiopia Investment Authority and other government agencies, is preparing a database on foreign direct investment, including a reporting system for tracking new investment. The January 2002 multisector mission recommended methods for improving the quality of the data on tourism, insurance, foreign direct investment, private transfers, and private debt. A follow-up mission was conducted in April-May 2004 in the context of the General Data Dissemination project for Anglophone Africa.

Social indicators

5. Data on poverty exist in the form of several household surveys regularly conducted by the Central Statistical Authority (CSA).[19] In addition, the World Bank has produced reports on Education and Health Sector Development Programs, as well as the Poverty and Policies for the New Millennium Report (1999), that contain data on the poverty situation in Ethiopia. On the basis of this information, the government, with assistance from the World Bank, has constructed welfare indicators for measuring poverty reduction, including income and expenditure per capita, income inequality, literacy, malnutrition, and infant/child mortality measures. For 2003/04, a Participatory Poverty Assessment will be conducted with support from the World Bank. For 2004/04, the authorities plan to conduct a Household Income, Consumption and Expenditure Survey, as well as a Welfare Monitoring Survey. Adequate data do not exist on prevalence rates of HIV/AIDS, especially among the rural population, and it is not clear whether there is sufficient monitoring of food consumption among people living in drought-prone areas. The Welfare Monitoring Survey, planned for 2004/05, is expected to include a number of indicators relating to HIV/AIDS.

[19] Examples of existing surveys include the Household Income, Consumption, and Expenditure Survey (1995/96 and 1999/2000) and the Welfare Monitoring Survey (1996, 1997, 1998, and 1999). Additional household and consumption surveys were carried out by the University of Addis Ababa in collaboration with Oxford University.

Ethiopia: Survey of Reporting of Main Statistical Indicators
(As of June 30, 2004)

	Exchange Rates	Net Foreign Assets of the Banking System	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates[1]	Consumer Price Index (CPI)	Exports and Imports[2]	Current Account Balance	Overall Federal Government Balance	GDP	External Debt/Debt Service
Date of latest observation	May 31, 2004	May 2004	May 2004	May 2004	May 2004	March 2004	May 2004	March 2004	March 2004	March 2004	2002/03	July 2003
Date received	June 2004	July 2004	July 2004	July 2004	July 2004	May 2004	July 2004	June 2004	June 2004	May 2004	November 2003	November 2003
Frequency of data	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Annual	Quarterly
Frequency of reporting	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Quarterly	On mission	On mission
Source of data	National Bank of Ethiopia	National Bank of Ethiopia	National Bank of Ethiopia	National Bank of Ethiopia	National Bank of Ethiopia	National Bank of Ethiopia	Central Statistical Authority	National Bank of Ethiopia	National Bank of Ethiopia	Ministry of Finance	Ministry of Finance and Economic Development	Ministry of Finance and Economic Development
Mode of reporting	Electronic	Fax	Fax	Fax	Fax	Electronic	Electronic	On mission	On mission	On mission	On mission	On mission
Frequency of publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Annually	Annually	Irregularly
Confidential	No	No	No	No	No	No	No	No	No	No	No	No

1 Savings and time deposits and lending rates. Yields on treasury bills at the auction are reported every two weeks.
2 Export and import data are based on customs records.

Authorities' Views on the Ex-Post Assessment

54. **The authorities welcomed the Ex Post Assessment as providing an opportunity to revisit their performance over the last decade and to enhance their future policies.** They considered that Ethiopia had benefited from Fund-supported programs and the dialogue with the Fund, which had made a significant difference to their policies and kept them "on their toes." Relations under the current PRGF have been particularly close.

The authorities expressed four general concerns with the report.[20]

- **The report showed a lack of new thinking by the Fund.** It still applied the "old paradigm" of the "Washington consensus." The Fund should be more mindful of different routes to development and that the authorities have their own path. In particular, there needs to be more awareness of sequencing issues and less axiomatic assumption that liberalization is always the answer. For example, the authorities mentioned that: although the fertilizer market was controlled, prices were lower than in other countries; financial sector liberalization, while desirable in principle, needs a functioning money market first (which is not present); and the Fund should recognize that the authorities have a different, and theoretically and practically valid, view on capital account liberalization.

- **The report should better represent the basis for the authorities' policy differences with the Fund.** These differences should be presented as being based on the results of their own concrete analysis and developmental strategy rather than due to an inherent gradualist approach or suspicion of markets.

- **The report should be more nuanced and specific**. In particular, more credit should be given to recent reforms undertaken by the authorities in many areas, for example, of the civil service, land security, and revenue administration.

- **The discussion of the ESAF breakdown should better represent the authorities' position.** They considered that as they had met the backward-looking conditionality, the reviews should have been completed and that it was unreasonable for the Fund to require agreement on the following year's budget.

The authorities had the following views on the implications for any future arrangement:

[20]The authorities also provided detailed specific comments, which have been largely incorporated.

- **While they would prefer a high-access arrangement, Fund financial support was not key.** They considered that their performance warranted high-access, but pointed out that Fund financing was relatively minor and the key benefits of Fund-supported programs were the policy framework and the seal of approval. They also did not envisage having major balance of payments needs.

- **While they agreed with the need for future arrangements to focus on private sector development, they questioned whether financial sector reform should be a priority.** They also noted that agricultural and land reforms were already afoot.

- **The focus on external debt sustainability should be on expanding exports rather than constraining borrowing. Similarly, on domestic debt, the burden on the budget was low (due to low real interest rates) and more revenue will be generated in the future.**

Table 1. Ethiopia: Selected Economic and Financial Indicators, 2002/03-2008/09 - Double Aid Scenario 1/

	2002/03	2003/04		2004/05		2005/06		2006/07	2007/08	2008/09
		5th Review	Rev. Prog.	5th Review	Rev. Proj.	5th Review	Rev. Proj.	Proj.	Proj.	Proj.
	(Annual percentage change)									
National income and prices										
GDP at constant prices (at factor cost)	-3.9	6.7	11.6	6.4	6.5	6.1	6.8	7.0	7.1	7.0
GDP deflator	14.5	5.2	8.3	3.7	6.2	3.2	6.0	6.4	6.3	6.3
Consumer prices (period average)	15.1	5.5	9.6	3.0	6.0	3.0	6.0	6.0	6.0	6.0
External sector										
Exports, f.o.b.	6.7	7.3	14.4	11.5	10.2	9.5	6.0	9.1	8.6	8.2
Imports, c.i.f.	14.4	9.3	24.5	1.8	8.5	1.3	4.3	13.3	9.6	10.0
Export volume	9.8	3.8	12.0	7.1	4.7	7.8	6.0	6.2	6.2	6.2
Import volume	6.8	2.9	13.2	1.7	4.5	1.4	4.7	13.3	9.2	10.0
Terms of trade (deterioration -)	-10.0	-2.6	-7.9	4.2	1.5	1.6	0.3	3.0	2.0	2.0
Nominal effective exchange rate (end of period)	-12.5	...	...	...	...	...	...	...	...	...
Real effective exchange rate (end of period)	5.9	...	...	...	...	...	...	...	...	...
	(In percent of beginning-period stock of broad money, unless otherwise indicated)									
Money and credit										
Net foreign assets	10.8	6.2	13.4	2.7	1.2	0.0	1.2	6.1	6.4	8.1
Net domestic assets	-0.4	7.2	8.7	8.0	11.7	9.1	13.3	7.1	6.9	6.2
Net claims on the government	5.7	3.3	3.3	0.0	2.4	0.0	1.6	1.2	1.1	1.1
Credit to the nongovernment sector	-3.2	5.8	7.5	8.6	9.6	9.5	5.2	7.3	7.2	6.6
Broad money	10.4	13.4	22.1	10.7	12.9	9.2	14.5	13.2	13.3	14.3
Velocity (GDP/broad money)	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Interest rates (in percent at end of period)										
Savings deposits (minimum rate)	3.0	…	…	…	…	…	…	…	…	…
Lending rates (maximum rate)	13.0	…	…	…	…	…	…	…	…	…
Treasury bill (91-day maturity)	1.3	…	…	…	…	…	…	…	…	…
	(In percent of GDP, unless otherwise indicated)									
Financial balances										
Gross domestic saving	1.0	3.8	1.3	5.4	4.7	7.1	8.1	6.7	8.3	9.8
Government saving	0.4	0.5	1.0	2.7	0.2	4.1	-1.4	-1.7	-1.6	-1.9
Private saving	0.6	3.3	0.3	2.6	4.5	3.0	9.5	8.4	9.9	11.7
Gross domestic investment	20.5	23.3	20.6	23.1	24.8	22.9	27.5	27.5	29.4	31.3
Government investment	10.5	11.9	11.2	11.6	12.5	11.0	14.0	14.7	15.7	16.6
Private investment	10.0	11.4	9.4	11.5	12.3	11.9	13.5	12.8	13.7	14.7
Resource gap	-19.4	-19.5	-19.4	-17.7	-20.0	-15.8	-19.4	-20.8	-21.1	-21.6
External current account balance, including official transfers	-4.7	-7.9	-4.0	-7.4	-7.5	-6.2	-3.0	-2.7	-2.6	-1.1
Saving-investment (government)	-3.0	-6.4	-2.3	-4.8	-5.4	-3.5	-4.6	-4.2	-4.3	-3.5
Saving-investment (private)	-1.7	-1.5	-1.8	-2.5	-2.1	-2.8	1.6	1.5	1.7	2.4
External current account balance, excluding official transfers	-12.8	-14.0	-13.0	-12.4	-14.9	-10.6	-14.3	-15.4	-16.0	-16.5
Government finances										
Revenue	19.5	19.5	18.6	20.1	18.5	20.4	18.6	18.7	19.0	19.0
Tax revenue	14.4	15.5	14.8	16.2	14.9	16.6	15.2	15.3	15.6	15.6
Nontax revenue	5.1	4.1	3.7	3.9	3.6	3.8	3.4	3.4	3.4	3.4
External grants	8.0	7.1	7.8	6.0	9.3	5.2	13.4	12.6	13.2	14.7
Expenditure and net lending 2/	34.8	32.8	30.3	30.7	31.5	29.2	34.9	36.0	36.7	37.6
Fiscal balance, excluding grants (cash basis)	-17.1	-14.2	-11.7	-11.6	-13.0	-9.1	-16.3	-17.3	-17.7	-18.6
Fiscal balance, including grants (cash basis)	-9.7	-7.1	-3.9	-5.6	-3.7	-3.9	-2.9	-4.6	-4.5	-4.0
Total financing	9.7	7.1	4.8	5.6	4.7	3.9	3.4	4.6	4.5	4.0
External financing	6.8	5.1	3.1	5.1	3.2	3.3	2.2	3.7	3.7	3.1
Domestic financing (including residual)	2.9	1.8	1.7	0.4	1.5	0.4	1.1	0.9	0.9	0.8
Privatization receipts	0.0	0.2	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Domestic debt 3/	39.0	36.4	33.6	33.3	31.2	30.7	28.7	26.1	23.8	21.8
External debt (including to Fund)	98.5	94.3	87.2	92.5	84.2	89.5	82.5	77.5	73.1	68.6
Net present value (NPV) of external debt-to-exports ratio (including to Fund) 4/	150.0	246.1	168.3	244.4	182.8	246.9	199.9	206.3	208.3	207.7
NPV of external debt-to-revenue ratio (including to Fund) 5/	119.3	188.1	130.4	184.7	141.4	181.5	153.3	152.4	150.1	148.3
External debt-service ratio 6/	14.9	18.5	16.1	16.8	18.1	16.0	19.1	19.0	18.1	17.1
External debt-service ratio 7/	7.3	9.3	6.6	7.1	5.3	7.1	6.9	7.2	7.3	7.1
Overall balance of payments (in millions of U.S. dollars)	161	-121	105	-194	-167	-189	147	-17	-1	139
Gross official reserves (in millions of U.S. dollars)	931	1,043	1,289	1,084	1,289	1,076	1,650	1871	2120	2492
(in months of imports of goods and nonfactor services of following year)	3.8	4.6	4.9	4.8	4.7	4.8	5.3	5.6	5.8	6.2
GDP at current market prices (in millions of birr)	57,077	64,277	69,708	71,197	79,581	78,177	89,263	99,658	111,335	125,239
Exchange rate (birr per U.S. dollar; period average rate)	8.58	...	...	...	...	...	...	...	...	...

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

1/ Data pertain to the period July 8-July 7.
2/ Excluding special programs.
3/ Whole series was revised.
4/ After enhanced HIPC relief. Exports of goods and services used.
5/ After enhanced HIPC relief. Revenues exclude grants.
6/ Before debt relief; on an accrual basis; in percent of exports of goods and nonfactor services.
7/ After enhanced HIPC relief.

Table 2. Ethiopia: General Government Operations, 2003/04-2015/16 - Double Aid Scenario 1/
(in millions of Birr)

	2003/04		2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2015/16
	5th Review	Rev. Proj.	Proj. 2/	Proj. 2/	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	17,084	18,413	21,860	28,543	31,884	37,256	44,337	52,918	128,309
Revenue	12,542	12,950	14,540	16,591	19,021	21,992	25,017	28,405	62,593
Tax revenue (incl. measures)	9,932	10,340	11,738	13,558	15,563	18,057	20,541	23,322	51,735
Direct taxes	3,673	3,294	3,946	4,638	5,289	6,366	7,242	8,223	19,161
Indirect taxes	6,259	7,045	7,792	8,920	10,274	11,690	13,299	15,100	32,574
Domestic indirect taxes	2,150	2,150	2,597	3,033	3,560	4,051	4,608	5,233	11,497
Import duties and taxes	4,109	4,895	5,194	5,887	6,713	7,639	8,690	9,867	21,077
Nontax revenue	2,610	2,610	2,802	3,033	3,458	3,935	4,477	5,083	10,858
Grants 5/	4,542	5,463	7,320	11,952	12,863	15,264	19,320	24,512	65,716
Total expenditure and net lending (cash basis) 3/	21,093	21,118	24,793	31,144	36,589	42,514	49,547	58,190	135,514
Expenditure (incl. special programs)	21,628	21,761	25,529	31,536	36,589	42,514	49,547	58,190	135,514
Recurrent expenditure	12,752	12,750	14,152	17,485	20,311	23,134	26,460	30,710	77,796
Defense spending	2,400	2,400	2,400	2,600	3,000	3,000	3,000	3,364	7,185
Poverty-targeted expenditure	4,446	4,446	5,749	7,594	9,215	11,152	13,485	16,269	49,372
Education	2,513	2,513	3,127	3,904	4,722	5,698	6,873	8,274	22,601
Health	711	711	1,115	1,690	2,066	2,516	3,059	3,708	13,658
Agriculture	1,038	1,038	1,366	1,801	2,186	2,645	3,198	3,858	11,675
Roads	183	183	141	198	241	293	355	429	1,438
Interest payments	1,447	1,474	1,185	1,912	2,054	2,203	2,361	2,533	3,933
Domestic interest and charges	773	773	984	1,687	1,794	1,903	2,022	2,149	3,213
External interest payments	675	702	201	225	260	300	339	384	720
Emergency assistance 5/	874	874	882	919	955	992	1,030	1,069	1,339
Other recurrent spending	3,583	3,556	3,935	4,460	5,086	5,787	6,584	7,475	15,967
Net lending	0	0	0	0	0	0	0	0	0
Capital expenditure	8,341	8,368	10,641	13,660	16,279	19,379	23,088	27,480	57,717
Central Treasury (domestic capital outlays)	4,442	4,922	5,557	6,298	7,182	8,172	9,296	10,555	22,547
External assistance (baseline project grants) 5/	1,326	2,295	1,677	2,193	3,014	3,359	3,990	4,589	6,558
External loans (baseline project loans) 5/	2,574	1,152	1,433	1,766	2,285	2,575	2,480	2,472	3,376
Of which: poverty-targeted expenditure	6,841	6,917	7,827	10,560	12,845	15,588	18,907	22,883	49,813
Special programs 4/	535	642	736	392	0	0	0	0	0
Overall balance									
Including grants	-4,544	-3,348	-3,669	-2,993	-4,705	-5,258	-5,210	-5,273	-7,205
Excluding grants	-9,086	-8,811	-10,988	-14,945	-17,568	-20,522	-24,530	-29,785	-72,921
Financing	4,545	3,347	3,669	2,993	4,705	5,258	5,210	5,273	7,205
External (net)	3,283	2,171	2,481	1,990	3,774	4,246	4,112	4,083	5,175
Gross borrowing 5/	3,336	2,048	2,627	2,158	3,951	4,443	4,293	4,290	5,866
Capital budget	2,574	1,152	1,433	1,766	2,285	2,575	2,480	2,472	3,376
CPF generations/loans	227	253	459	0	1,666	1,868	1,814	1,818	2,490
Special programs	535	642	736	392	0	0	0	0	0
HIPC Initiative relief 6/	695	934	0	0	0	0	0	0	0
Amortization repayment	-748	811	146	168	177	197	182	207	691
Total domestic financing	1262	1,176	1,188	1,003	932	1,012	1,098	1,190	2,030
Domestic(net)	1162	1,162	1,188	1,003	932	1,012	1,098	1,190	2,030
Banking system	1000	1,000	888	676	575	625	678	734	1,285
Nonbank sources	162	162	300	327	357	387	420	456	746
Privatization	100	14	0	0	0	0	0	0	0
Memorandum items:									
Nominal GDP (millions of birr)	64,277	69,708	78,704	89,199	101,718	115,747	131,671	149,501	319,350
Nominal GDP growth		12.2	12.9	13.3	14.0	13.8	13.8	13.5	13.5
Population (millions)	67.5	67.5	70.2	73.0	75.0	77.1	79.1	81.3	94.5
Poverty spending (as a percent of GDP)	17.6	16.3	17.3	20.4	21.7	23.1	24.6	26.2	31.1
Poverty spending per capita in USD	19.4	19.5	21.9	27.1	30.8	35.0	39.7	45.0	78.4
Wages and salaries	5,437	5,437	6,490	7,807	9,188	10,799	12,698	14,915	39,170
External grants, fin. and the gap (millions of ETB)	7,825	7,634	9,800	13,942	16,636	19,510	23,432	28,595	70,891
including off-budget safety nets and food security	7,825	9,593	12,053	16,506	19,556	22,820	27,176	32,816	79,968
(in millions of USD)	908	1,113	1,367	1,797	2,047	2,300	2,639	3,069	5,973

Sources: Authorities and staff estimates.

1/ Fiscal year ending July 7.

2/ Projections are based on a normative scenario consistent with the gradual doubling of foreign aid as a share of GDP.

3/ Excluding special programs (demobilization and reconstruction).

4/ Demobilization and reconstruction.

5/ Figures for external financing and grants are provided by donors, and differ in some cases from government estimates.

6/ External interest payments are presented after traditional debt relief up to 2003/04, but following the completion point in 2003/04 are presented after HIPC relief starting in 2004/05. HIPC Initiative relief below the line becomes zero beginning in 2004/05 following the completion point.

Table 3. Ethiopia: General Government Operations, 2003/04-2015/16 - Double Aid Scenario 1/
(In percent of GDP)

	2003/04		2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2015/16
	5th Review	Rev. Proj.	Proj. 2/	Proj. 2/	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	26.6	26.4	27.8	32.0	31.3	32.2	33.7	35.4	40.2
Revenue	19.5	18.6	18.5	18.6	18.7	19.0	19.0	19.0	19.6
Tax revenue (incl. measures)	15.5	14.8	14.9	15.2	15.3	15.6	15.6	15.6	16.2
Direct taxes	5.7	4.7	5.0	5.2	5.2	5.5	5.5	5.5	6.0
Indirect taxes	9.7	10.1	9.9	10.0	10.1	10.1	10.1	10.1	10.2
Domestic indirect taxes	3.3	3.1	3.3	3.4	3.5	3.5	3.5	3.5	3.6
Import duties and taxes	6.4	7.0	6.6	6.6	6.6	6.6	6.6	6.6	6.6
Nontax revenue	4.1	3.7	3.6	3.4	3.4	3.4	3.4	3.4	3.4
Grants 5/	7.1	7.8	9.3	13.4	12.6	13.2	14.7	16.4	20.6
Total expenditure and net lending (cash basis) 3/	32.8	30.3	31.5	34.9	36.0	36.7	37.6	38.9	42.4
Expenditure (incl. special programs)	33.6	31.2	32.4	35.4	36.0	36.7	37.6	38.9	42.4
Recurrent expenditure	19.8	18.3	18.0	19.6	20.0	20.0	20.1	20.5	24.4
Defense spending	3.7	3.4	3.0	2.9	2.9	2.6	2.3	2.3	2.3
Poverty-targeted expenditure	6.9	6.4	7.3	8.5	9.1	9.6	10.2	10.9	15.5
Education	3.9	3.6	4.0	4.4	4.6	4.9	5.2	5.5	7.1
Health	1.1	1.0	1.4	1.9	2.0	2.2	2.3	2.5	4.3
Agriculture	1.6	1.5	1.7	2.0	2.1	2.3	2.4	2.6	3.7
Roads	0.3	0.3	0.2	0.2	0.2	0.3	0.3	0.3	0.5
Interest payments	2.3	2.1	1.5	2.1	2.0	1.9	1.8	1.7	1.2
Domestic interest and charges	1.2	1.1	1.3	1.9	1.8	1.6	1.5	1.4	1.0
External interest payments	1.0	1.0	0.3	0.3	0.3	0.3	0.3	0.3	0.2
Emergency assistance 5/	1.4	1.3	1.1	1.0	0.9	0.9	0.8	0.7	0.4
Other recurrent spending	5.6	5.1	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Capital expenditure	13.0	12.0	13.5	15.3	16.0	16.7	17.5	18.4	18.1
Central Treasury (own-source capital outlays)	6.9	7.1	7.1	7.1	7.1	7.1	7.1	7.1	7.1
External assistance (project grants) 5/	2.1	3.3	2.1	2.5	3.0	2.9	3.0	3.1	2.1
External loans (project loans) 5/	4.0	1.7	1.8	2.0	2.2	2.2	1.9	1.7	1.1
Of which: poverty-targeted expenditure	10.6	9.9	9.9	11.8	12.6	13.5	14.4	15.3	15.6
Special programs 4/	0.8	0.9	0.9	0.4	0.0	0.0	0.0	0.0	0.0
Overall balance									
Including grants	-7.1	-4.8	-4.7	-3.4	-4.6	-4.5	-4.0	-3.5	-2.3
Excluding grants	-14.1	-12.6	-14.0	-16.8	-17.3	-17.7	-18.6	-19.9	-22.8
Financing	7.1	4.8	4.7	3.4	4.6	4.5	4.0	3.5	2.3
External (net)	5.1	3.1	3.2	2.2	3.7	3.7	3.1	2.7	1.6
Gross borrowing 5/	5.2	2.9	3.3	2.4	3.9	3.8	3.3	2.9	1.8
Capital budget	4.0	1.7	1.8	2.0	2.2	2.2	1.9	1.7	1.1
CPF generations/loans	0.4	0.4	0.6	0.0	1.6	1.6	1.4	1.2	0.8
Special programs	0.8	0.9	0.9	0.4	0.0	0.0	0.0	0.0	0.0
HIPC Initiative relief 6/	1.1	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization repayment	-1.2	1.2	0.2	0.2	0.2	0.2	0.1	0.1	0.2
Total domestic financing	2.0	1.7	1.5	1.1	0.9	0.9	0.8	0.8	0.6
Domestic(net)	1.8	1.7	1.5	1.1	0.9	0.9	0.8	0.8	0.6
Banking system	1.6	1.4	1.1	0.8	0.6	0.5	0.5	0.5	0.4
Nonbank sources	0.3	0.2	0.4	0.4	0.4	0.3	0.3	0.3	0.2
Privatization	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Nominal GDP	64,277	69,708	78,704	89,199	101,718	115,747	131,671	149,501	319,350
Population (millions)	67.5	67.5	70.2	73.0	75.0	77.1	79.1	81.3	94.5
Poverty spending (as a percent of GDP)	17.6	16.3	17.3	20.4	21.7	23.1	24.6	26.2	31.1
Poverty spending per capita in USD	19.4	19.5	21.9	27.1	30.8	35.0	39.7	45.0	78.4
Wages and salaries	7.8	7.8	8.2	8.8	9.0	9.3	9.6	10.0	12.3
External grants, financing and the gap	12.2	11.0	12.5	15.6	16.4	16.9	17.8	19.1	22.2
including off-budget safety net and food security	12.2	13.8	15.3	18.5	19.2	19.7	20.6	22.0	25.0

Sources: Authorities and staff estimates.

1/ Fiscal year ending July 7.
2/ Projections are based on a normative scenario consistent with the gradual doubling of foreign aid as a share of GDP.
3/ Excluding special programs (demobilization and reconstruction).
4/ Demobilization and reconstruction.
5/ Figures for external financing and grants are provided by donors, and differ in some cases from government estimates.
6/ External interest payments are presented after traditional debt relief up to 2003/04, but following the completion point in 2003/04 are presented after HIPC relief starting in 2004/05. HIPC Initiative relief below the line becomes zero beginning in 2004/05 following the completion point.

Table 4. Ethiopia: Monetary Survey, 2002/03-2015/16 - Double Aid Scenario 1/

	2003/04		2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2015/16
	5th Review	Rev. Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In millions of birr)								
Net foreign assets	13,168	15,373	15,828	16,328	19,248	22,723	27,716	34,214	93,683
National Bank of Ethiopia (NBE)	7,395	9,600	9,618	10,014	12,688	15,912	20,645	26,873	84,491
Assets	9,333	11,538	11,602	15,462	18,216	21,429	26,149	32,315	90,354
Liabilities	1,938	1,938	1,984	5,448	5,529	5,517	5,504	5,441	5,862
Commercial banks	5,773	5,773	6,210	6,314	6,561	6,811	7,071	7,341	9,192
Assets	7,556	7,556	8,003	8,480	8,811	9,147	9,497	9,859	12,344
Liabilities	1,783	1,783	1,793	2,166	2,250	2,336	2,426	2,518	3,153
Net domestic assets	21,424	21,863	26,216	31,813	35,225	38,983	42,806	46,449	85,523
Domestic credit	31,094	31,633	36,080	38,929	43,020	47,564	52,331	57,132	110,043
Claims on government (net) 2/	18,855	18,855	19,743	20,419	20,994	21,619	22,297	23,031	29,191
NBE	10,804	10,804	11,248	11,586	11,873	12,185	12,524	12,891	15,972
Commercial banks	8,052	8,052	8,496	8,834	9,121	9,433	9,772	10,139	13,220
Claims on nongovernment	12,239	12,778	16,337	18,510	22,027	25,945	30,034	34,101	80,852
NBE	114	114	0	0	0	0	0	0	0
Commercial banks	12,125	12,664	16,337	18,510	22,027	25,945	30,034	34,101	80,852
Other items (net)	-9,671	-9,771	-9,864	-7,116	-7,796	-8,581	-9,524	-10,682	-24,520
Broad money	34,592	37,236	42,044	48,141	54,473	61,706	70,523	80,664	179,206
Money	19,591	21,838	23,682	25,927	28,203	32,024	37,298	41,097	94,316
Currency outside banks	10,001	11,994	11,941	15,712	17,731	20,193	24,055	29,278	73,093
Demand deposits	9,591	9,844	11,740	10,215	10,471	11,831	13,243	11,819	21,223
Quasi money	15,001	15,398	18,363	22,214	26,270	29,682	33,225	39,567	84,890
Savings deposits	13,771	14,135	16,858	20,593	24,433	27,606	30,901	36,997	79,585
Time deposits	1,230	1,262	1,505	1,621	1,837	2,076	2,323	2,569	5,306
	(Annual change in percent of beginning-period broad money; unless otherwise indicated)								
Net foreign assets	6.2	13.4	1.2	1.2	6.1	6.4	8.1	9.2	7.9
Net domestic assets	7.2	8.7	11.7	13.3	7.1	6.9	6.2	5.2	6.4
Domestic credit	9.1	10.8	11.9	6.8	8.5	8.3	7.7	6.8	8.5
Claims on government (net)	3.3	3.3	2.4	1.6	1.2	1.1	1.1	1.0	0.8
Claims on nongovernment	5.8	7.5	9.6	5.2	7.3	7.2	6.6	5.8	7.7
Broad money	13.4	22.1	12.9	14.5	13.2	13.3	14.3	14.4	14.2
Money	9.1	16.5	5.0	5.3	4.7	7.0	8.5	5.4	5.4
Quasi money	4.3	5.6	8.0	9.2	8.4	6.3	5.7	9.0	8.8
Memorandum items:									
Reserve money growth	14.5	31.2	1.8	22.1	12.2	13.0	16.8	18.7	12.9
Money multiplier	2.39	2.24	2.49	2.33	2.35	2.36	2.31	2.22	2.11
Velocity (GDP/broad money)	1.86	1.87	1.87	1.85	1.87	1.88	1.87	1.85	1.78
Gross official foreign reserves (in millions of U.S. dollars)	1,043	1,289	1,289	1,650	1,871	2,120	2,492	2,966	6,624
Net foreign assets of the banking system (in millions of U.S. dollars	1,471	1,717	1,758	1,743	1,977	2,248	2,641	3,141	6,869
Excess reserves (in percent of deposits)	10.6	10.6	9.0	7.9	7.6	7.2	6.9	6.6	4.5

Sources: National Bank of Ethiopia; and Fund staff estimates and projections.

1/ Year ending July 7.
2/ Claims on general government (federal and regional governments and other public agencies) by the banking system less deposits of the general government with the banking system.

Table 5. Ethiopia: Balance of Payments - Double Aid Scenario, 2002/03-2015/16
(In millions of U.S. dollars, unless otherwise indicated)

	2003/04		2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2015/16
	5th Review	Rev. Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Trade balance	-1,602	-1,863	-2,012	-2,089	-2,393	-2,631	-2,908	-3,265	-6,426
Exports of goods	518	552	609	645	704	765	828	898	1,700
Coffee	167	208	221	225	236	246	265	284	428
Other	351	344	388	421	468	518	563	614	1,272
Imports of goods	2,120	2,415	2,621	2,734	3,097	3,396	3,735	4,163	8,126
Fuel	305	329	327	324	330	347	384	425	775
Cereals	120	180	110	80	60	60	60	60	60
Aircraft	117	117	117	117	0				
Imports excl. fuel,cereals,aircraft	1,578	1,789	2,067	2,214	2,707	2,989	3,292	3,679	7,291
Nonfactor services (net)	169	298	203	203	223	259	287	328	581
Exports of nonfactor services	650	817	752	784	828	883	938	1,018	1,651
Imports of nonfactor services	481	519	549	582	605	624	651	691	1,070
Income (net)	-49	-77	-22	-26	28	43	60	83	276
Of which : gross official interest payments 2/	-80	-83	-41	-50	-50	-51	-51	-51	-54
Private transfers (net)	454	592	490	522	537	531	550	554	687
Current account balance, excl. official transfers	-1,028	-1,049	-1,341	-1,390	-1,605	-1,798	-2,010	-2,300	-4,882
(in percent of GDP)	-14.0	-13.0	-15.0	-14.3	-15.1	-15.4	-15.7	-16.5	-20.5
excluding EAL imports	-12.4	-11.5	-13.7	-13.1	-15.1				
Official transfers (net)	449	724	660	1,098	1,319	1,505	1,872	2,288	4,904
Current account balance, incl. official transfers	-579	-325	-681	-292	-286	-293	-139	-12	23
(in percent of GDP)	-7.9	-4.0	-7.6	-3.0	-2.7	-2.5	-1.1	-0.1	0.1
excluding EAL imports	-6.3	-2.6	-6.3	-1.8	-2.7				
Capital account balance (incl. errors and omissions)	459	429	514	439	269	292	278	267	386
Foreign direct investment (net)	20	0	50	70	70	74	79	83	197
Other investment (net)	439	248	464	369	199	218	200	184	189
Official long-term loans	456	281	465	372	203	222	204	188	195
Disbursements	562	387	482	403	239	260	241	231	252
EAL loan	117	117	117	117	0	0	0	0	0
Amortization 2/	106	106	17	31	36	37	37	43	57
Other public sector long-term loans (net) 3/	-17	-17	-2	-3	-4	-4	-4	-5	-6
Other (net)	0	-16	0	0	0	0	0	0	0
Errors and omissions	0	198	0	0	0	0	0	0	0
Overall balance	-121	105	-167	147	-17	-1	139	255	409
Financing	121	-105	167	-147	17	1	-139	-255	-409
Central bank (net; increase -)	-97	-343	4	-370	-235	-271	-393	-499	-675
Reserves (increase -)	-112	-358	0	-361	-221	-249	-372	-474	-675
Liabilities (increase +)	15	15	4	-8	-14	-22	-21	-25	0
Fund credit (net)	15	15	4	-8	-14	-22	-21	-25	0
Commercial banks (net; increase -)	-62	-62	-45	16	0	0	0	0	0
Changes in arrears	0	0	0	0	0	0	0	0	0
Debt relief (Paris Club II and III, Naples terms) 4/	25	0	0	0	0	0	0	0	0
Financing gap	254	284	208	206	251	272	254	244	266
Exceptional financing 5/	146	153	208	206	251	272	253	244	266
Traditional debt relief	27	21	0	0	0	0	0	0	0
HIPC relief	81	109	0	0	0	0	0	0	0
Residual gap	0	0	0	0	0	0	0	0	0
Memorandum items:									
Exports of goods (percent change)	7.3	14.4	10.2	6.0	9.1	8.6	8.2	8.5	11.3
Export price index (percent change)	3.4	2.4	5.6	0.0	3.0	2.4	2.0	2.0	1.8
Export volume index (percent change)	3.8	12.0	4.7	6.0	6.2	6.2	6.2	6.4	9.5
Total imports of goods (percent change)	9.3	24.5	8.5	4.3	13.3	9.6	10.0	11.5	11.9
Import price index (percent change)	6.2	11.2	4.0	-0.4	-0.1	0.4	0.0	1.5	1.8
Import volume index (percent change)	2.9	13.2	4.5	4.7	13.3	9.2	10.0	10.0	10.1
Import volume index (excluding cereals, aircraft) (percent change)	8.0	17.1	9.0	6.4	19.8	9.4	10.2	10.2	10.2
Gross official reserves	1,043	1,289	1,289	1,650	1,871	2,120	2,492	2,966	6,624
(in months of imports of goods and nonfactor services of following year)	4.6	4.9	4.7	5.3	5.6	5.8	6.2	6.6	7.8
Terms of trade index % change(1996/97 = 100)	-2.6	-7.9	1.5	0.3	3.0	2.0	2.0	0.6	0.0

Sources: Ethiopian authorities, and Fund staff estimates and projections.

1/ Data pertain to the period July 8-July 7.
2/ From 2004/05, incorporates debt relief under HIPC (including topping up) and additional bilateral voluntary cancellations.
3/ Ethiopian Airlines and other public enterprises.
4/ Includes 1997 and 2001 Paris Club rescheduling agreements (including Russia) under Naples terms, and 2002 Paris Club topping up to Cologne terms, and HIPC interim relief including estimates of relief beyond HIPC & relief on non-Paris Club debt under negotiation
5/ Balance of payments support from the World Bank (PRSC) and AfDB (SAL)

Statement by the IMF Staff Representative
September 13, 2004

This statement updates the staff report to reflect information that has become available since its issuance (August 19, 2004). The new information does not change the thrust of the staff appraisal.

Average annual inflation declined from 15.1 percent in 2002/03 (July-June) to 9.0 percent in 2003/04, mostly on account of a slow-down in the pace of food price increases following the recovery of food production from the droughts of 2001/02 and 2002/03. Average annual food inflation declined from 24.8 percent in 2002/03 to 11.8 percent in 2003/04; nonfood inflation, however, rose from 1.6 percent to 4.3 percent over the same period. Inflation slowed further in July 2004, with the year-on-year rate of increase declining to 2.3 percent, from 2.9 percent in June. Nonfood inflation, however, continued to rise; the year-on-year rate of increase accelerating to 6.0 percent in July 2004 from 5.8 percent in June.

Broad money growth continued to rise throughout 2003/04, and amounted to 15.2 percent in June 2004 when compared with June 2003. As a proportion of the stock of broad money at end-June 2003, net foreign assets increased by 6.5 percent, while net domestic assets rose by 8.7 percent. The increase in net claims on the government was 6.5 percent, and that of claims on the nongovernment sector 3.2 percent of the beginning period stock of broad money.

The projected number of people requiring food aid during 2004 was revised upward in August 2004 from 7.1 million people to 7.8 million people based on an assessment of the short rainy season. The total food aid requirements were revised upward from 871,000 metric tons to 1.2 million metric tons; of the total required aid, 907,000 metric tons (76 percent) has already been pledged by donor agencies. In the six months to end June 2004, a total of 386,000 metric tons of food aid were distributed.

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FOR IMMEDIATE RELEASE
September 13, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Sixth Review Under Ethiopia's Poverty Reduction and Growth Facility Arrangement

The Executive Board of the International Monetary Fund (IMF) has completed the sixth and final review of Ethiopia's performance under an SDR 100.28 million (about US$147 million) Poverty Reduction and Growth Facility (PRGF) arrangement (see Press Release No. 01/11 and News Brief No.02/23). This decision enables Ethiopia to receive the final disbursement of SDR 10.4 (about US$15 million).

After the Executive Board's discussion on Ethiopia, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, issued the following statement:

"Ethiopia's performance under the three-year PRGF-supported program has been good. Real GDP growth has rebounded strongly, price stability has been maintained, and progress has been made with key structural reforms. However, Ethiopia remains highly vulnerable to external shocks, notably drought and export prices, while poverty indicators continue to be among the highest in the world.

"The main challenges going forward are to achieve faster growth and the Millennium Development Goals (MDGs), to increase the economy's resilience to shocks, and to ensure debt sustainability. This will require both higher levels of external aid and improvements in Ethiopia's capacity to absorb and use such assistance more effectively. Continued prudent macroeconomic policies and more ambitious structural reforms in key areas, especially in the agricultural, fiscal, and financial sectors, will be essential for reaching these objectives.

"Fiscal policy is expected to continue to focus on strengthening expenditure management and enhancing revenues, while containing inflationary domestic financing and reducing the public debt burden. Improving public expenditure management also remains a critical priority for the government, especially for bolstering the capacity of local governments, given their new expenditure mandates following fiscal decentralization.

"A significant increase in external assistance to Ethiopia would need to be largely in the form of grants if public debt sustainability is to be maintained. The authorities are developing a comprehensive and prudent public debt management strategy to clarify the rules for containing future domestic and external borrowing to sustainable levels. The plans to develop their own fiscal scenarios aimed at achieving the MDGs are also welcome. In this context, it will be important to work with realistic assumptions, identify challenges early, and mitigate any potential adverse effects on the broader macroeconomic framework.

"Monetary and exchange rate policies will continue to focus on achieving the inflation and international reserve targets. Safeguarding external competitiveness requires implementing structural reforms that improve productivity and efficiency, while the exchange rate should be fully market-determined.

"In order to lay firm foundations for achieving a significant and sustained increase in long-term growth, it is essential to press ahead with structural reforms, focusing on agriculture, food security, capacity building, export promotion, privatization, and strengthening the legal and regulatory framework. Attention will also need to be paid to strengthening the financial sector and promoting competition within that sector. In this regard, full implementation of the restructuring plan for the Commercial Bank of Ethiopia and enhancement of the central bank's independence and its supervisory capacity remain high priorities," Mr. Kato said.

The PRGF is the IMF's concessional facility for qualifying low-income countries. The purpose of the PRGF is to support programs to strengthen substantially and in a sustainable manner a country's balance of payments position and to foster durable growth, leading to higher living standards and a reduction in poverty. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period.

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IMF Executive Board Concludes 2004 Article IV Consultation with Ethiopia

On September 13, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Ethiopia and completed the final review under the Poverty Reduction Groth Facility (PRGF) Arrangement.[1]

Background

The Ethiopian authorities have been implementing wide-ranging structural reforms and pursuing prudent macroeconomic polices. However, Ethiopia continues to face political uncertainties, which are mainly related to the unresolved dispute with Eritrea on boundary demarcation. The country ranks toward the bottom (170 out of 177 countries) in the 2004 Human Development Index ranking, an assessment combining life expectancy, adult literacy, primary school enrollment, and per capita income. The Poverty Reduction Strategy Paper (PRSP) indicates that the poverty headcount index was 44.2 percent in 1999/00 for the country as a whole, down from 45.5 percent in 1995/96.

Ethiopia's real GDP growth rebounded strongly by 11.6 percent during 2003/04, as agricultural production recovered fully from the drought-affected levels of 2001/02–2002/03. The average annual consumer price inflation rate has fallen from 15.1 percent in 2002/03 to about 9.6 percent in 2003/04. Although the exchange rate vis-à-vis the U.S. dollar has remained highly stable through 2003/04, the exchange rate has depreciated in nominal and real effective terms (by about 8 percent and 5 percent, respectively through end-March 2004). This policy has allowed the National Bank of

[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. 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.

Ethiopia (NBE) to build up its net foreign assets and establish a stronger reserve cushion for coping with future exogenous shocks.

Based on updated estimates, in 2003/04 the fiscal deficit (including grants) is likely to be about 4.8 percent of GDP. In nominal terms, revenue surpassed the program target because of strong indirect tax receipts stemming from buoyant import growth and improved customs administration, which more than offset lower-than-projected direct taxes that reflected weak corporate profits following the drought of 2001/02. Moreover, donors provided more external grants and less project loans, given the vulnerable debt situation. The external current account deficit (including grants) is estimated to narrow to 4 percent in 2003/04.

Progress has been made in implementing structural reforms that focused on public sector management, public expenditure policy, and the commencement of the implementation of restructuring plans for the Commercial Bank of Ethiopia (CBE) and the NBE. The first annual progress report of the poverty reduction strategy paper was discussed by the IMF and World Bank Boards in February 2004, and Ethiopia reached the completion point under the Heavily Indebted Poor Countries (HIPC) Initiative in April 2004.

Executive Board Assessment

Executive Directors welcomed the strong rebound of economic activity in 2003/04 despite the recent drought and the continued border conflict. Price stability has been maintained, the international reserve position has strengthened, and progress has been made with key structural reforms, notably in the fiscal and agricultural sectors. These achievements will help lay the foundation for sustaining higher growth over the medium term.

Directors observed, however, that Ethiopia remains highly vulnerable to external shocks, and poverty indicators continue to be among the highest in the world. Sustaining faster growth and making progress toward the Millennium Development Goals (MDGs), while maintaining debt sustainability, will require both stronger and broader structural reforms and stepped-up donor support. Directors underscored, in this regard, the importance of improving Ethiopia’s capacity to absorb and use donor assistance more effectively, a peaceful resolution of the border dispute with Eritrea, and the continued reorientation of public resources to poverty-related expenditures.

Directors agreed that fiscal policy should continue to focus on strengthening expenditure management and enhancing revenues, while containing domestic financing and reducing the public debt burden. While welcoming the projected rise in social spending in the 2004/05 budget, they expressed concern about the increase in military expenditure and the higher level of domestic borrowing needed to finance the budget, which complicates efforts to reduce inflation and crowds out credit to the private sector. Directors therefore urged the authorities to consider additional fiscal measures, including cuts in non-priority outlays. They stressed that implementation of the Food Security Program should be supported by steps to strengthen the capacity of local governments to absorb the substantially higher federal transfers. The authorities should also seek additional donor grants to finance the program; this could be facilitated by timely external audits of the achieved outcomes.

Directors welcomed the progress that has been achieved in fiscal reforms. They emphasized that improving public expenditure management remains a critical priority, particularly in view of the need to strengthen the capacity of local governments following fiscal decentralization. At the same time, efforts should continue to consolidate and report the general government accounts in a timely manner to enhance fiscal transparency and accountability. Directors also urged the authorities to consolidate the gains made in improving tax and customs administration, and to review the VAT refund mechanism along with other audit and enforcement guidelines, aimed at creating a tax environment that is more conducive to private sector investment.

Directors encouraged the authorities to develop a comprehensive, prudent public debt management strategy, with clear rules for containing future domestic and external borrowing, and limiting borrowing to highly concessional loans and, preferably, grants to keep the public debt at sustainable levels. Consistent with any scenario involving a significant increase in external assistance, the authorities' medium-term fiscal framework needs to involve a rebalancing of expenditure to recurrent items, given large gaps in the required number of teachers and medical personnel. Directors welcomed the authorities' plan to develop their own fiscal scenarios for MDG purposes. They noted, however, that the "double aid" scenario, which appears ambitious, requires a much stronger policy effort on the part of the authorities to materialize. In any event, continued close consultation with the Fund and donors will be crucial, to identify the challenges early and mitigate any potential adverse effects on the broader macroeconomic framework arising from a substantial scaling-up of aid inflows.

Directors stressed that monetary and exchange rate policies need to focus on achieving the inflation and international reserve targets. To this end, and in the present environment of increased inflationary pressures, they urged the authorities to remain prudent and adopt more cautious targets for the expansion of money and credit to the government. They also suggested that market-based instruments be developed to enhance the central bank's liquidity management capacity. Directors welcomed the authorities' commitment to allow the exchange rate to be fully market-determined, with interventions being limited to smoothing fluctuations. In this context, the authorities were encouraged to safeguard external competitiveness through structural reforms that improve productivity and efficiency. Measures to further liberalize foreign trade, eliminate remaining exchange restrictions, and streamline customs procedures would support these objectives.

Directors urged the authorities to expedite the implementation of the structural reform agenda in support of rural and private sector development. Particular emphasis should continue to be placed on agricultural productivity, capacity building, and privatization. In the financial sector, Directors stressed that it will be important to fully implement the restructuring plans for the state-owned banks, particularly for the Commercial Bank of Ethiopia. They commended the authorities for the progress in implementing safeguards recommendations, strengthening bank supervision, and restructuring the National Bank of Ethiopia, and urged further consideration of measures to increase its operational autonomy. Directors also encouraged the authorities to accelerate financial reform aimed at increasing competition and financial intermediation, as well as strengthening the soundness of domestic banks. Consideration should be given to opening up more of the financial sector to the private sector, including by allowing foreign bank entry.

Directors welcomed the opportunity to review Ethiopia's performance under Fund supported programs since 1992. They broadly concurred with the conclusions of the ex post assessment of long-term Fund engagement with Ethiopia, and with the strategy for future Fund involvement. Directors welcomed in particular the authorities' strong ownership of programs, which had translated directly into action. They noted with concern, however, that Ethiopia's debt sustainability remain precarious even after three successive Fund-supported programs and the HIPC completion point, and that fiscal and external deficits remain large. Going forward, Directors emphasized the importance of realistic projections for real growth, government revenues, and foreign grants in developing macroeconomic programs; prudent debt management; more ambitious structural reforms; and programs that explicitly incorporate policies to help cope with exogenous shocks. They also highlighted the need to translate past lessons into better program design and future action, as well as to learn from the successful experiences of similar countries. In addition, improved cooperation and coordination with the World Bank and donors is critical to ensuring steady aid flows. Directors noted that the Fund continues to have an important role to play in providing technical assistance to strengthen capacity in the priority areas identified in the assessment.

Table 1: Ethiopia: Selected and Financial Indicators, 1998/99–2003/04 1/

	1998/99	1999/00	2000/01	2001/02	2002/03 Est.	2003/04 Proj.
	(Annual percentage change)					
National Income and Prices						
GDP at constant prices (at factor cost)	6.0	5.4	7.7	1.6	-3.9	11.6
GDP deflator	3.3	2.9	-6.3	-6.3	14.5	8.3
Consumer prices (period average)	4.8	6.2	-5.2	-7.2	15.1	9.6
External sector						
Exports, f.o.b.	-19.6	0.4	-4.8	-2.2	6.7	14.4
Imports, c.i.f.	14.8	3.4	-3.4	8.9	14.4	24.5
Terms of trade (deterioration -)	-15.9	-33.9	-3.4	-10.9	-10.0	-7.9
Nominal effective exchange rate (end of period)	-9.1	1.5	6.5	-7.8	-12.5	-7.6
Real effective exchange rate (end of period)	1.1	-0.8	-12.0	-3.2	5.9	-4.7
	(In percent of beginning-of period stock of broad money, unless otherwise indicated)					
Money and credit						
Broad money	5.09	14.0	9.5	12.3	10.4	22.1
Velocity (GDP/broad money)	2.5	2.4	2.2	1.9	1.9	1.9
Interest rates (savings deposits; in percent)	6.0	6.0	6.0	3.0	3.0	...
	(In percent of GDP, unless otherwise indicated)					
External Sector						
External current account balance, including official transfers	-7.9	-5.1	-3.6	-5.7	-4.7	-4.0
External current account balance, excluding official transfers	-11.2	-9.6	-9.7	-12.9	-12.8	-13.0
Government finances						
Revenue	18.0	17.9	18.8	20.0	19.5	18.6
Tax revenue	11.3	12.2	13.7	15.3	14.4	14.8
Nontax revenue	6.6	5.7	5.0	4.8	5.1	3.7
External grants	3.6	3.2	4.8	4.7	8.0	7.8
Expenditure and net lending 2/	31.7	32.3	28.4	32.1	34.8	30.3
Fiscal balance, excluding grants (cash basis)	-13.7	-14.4	-9.6	-13.9	-17.7	-12.6
Fiscal balance, including grants (cash basis)	-10.1	-11.2	-4.8	-9.3	-9.7	-4.8
Total financing	10.1	11.2	5.5	9.3	9.7	4.8
External financing	3.7	1.6	3.8	9.4	6.8	3.1
Domestic financing (including residual)	4.7	8.4	0.9	-0.3	2.9	1.7
Privatization receipts	1.6	1.2	0.7	0.1	0.0	0.0
Domestic debt 3/	31.2	38.0	37.4	39.6	39.0	33.6
External debt (including to Fund)	82.1	83.6	86.3	109.4	98.5	68.7
External debt-service ratio 6/	63.3	52.3	22.7	17.0	14.9	16.1
External debt-service ratio 7/	...	...	...	11.0	7.3	6.6
Overall balance of payments (in millions of U.S. dollars)	-473	-366	-64	305	161	105
Gross official reserves (in millions of U.S. dollars)	434	349	337	664	931	1,289
(in months of imports of goods and nonfactor services of following year)	2.7	2.2	2.0	3.3	3.8	5.3
Exchange rate (birr per U.S. dollar; period average rate)	7.54	8.15	8.34	8.54	8.58	8.62

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

1/ Data pertain to the period July 8–July 7.
2/ Excluding special programs.
3/ Whole series was revised.
4/ After enhanced HIPC Initiative relief. Exports of goods and services used.
5/ After enhanced HIPC Initiative relief. Revenues exclude grants.
6/ Before debt relief; on an accrual basis; in percent of exports of goods and nonfactor services.
7/ After enhanced HIPC Initiative relief.