

The Federal Democratic Republic of Ethiopia: 2012 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; Staff Statement; and Statement by the Executive Director for Ethiopia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2012 Article IV consultation with the Federal Democratic Republic of Ethiopia, the following documents have been released and are included in this package:

- The staff report for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 13, 2012, 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 27, 2012. 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 Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its September 12, 2012, discussion of the staff report that concluded the Article IV consultation.
- A statement by the IMF Staff Representative, dated September 12, 2012.
- A statement by the Executive Director for the Federal Democratic Republic of Ethiopia.

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

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THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

August 27, 2012

KEY ISSUES

Context: Ethiopia pursues a public sector-led growth strategy that focuses on promoting growth through high public investment supported partly by low nominal interest rates. While the strategy has contributed to robust economic growth in the past, recent developments indicate a buildup of vulnerabilities which need to be addressed in order to sustain this growth performance.

Growth prospects: While inflation remains high (21 percent at end-2011/12), real GDP growth, which is estimated at around 7 percent in 2011/12 and is projected to decline to 6.5 percent in subsequent years under the continuation of current policies, is still robust.

Policy mix: The discussions focused on policy options to sustain strong growth and the current disinflation process and to address emerging risks and vulnerabilities. Staff recommendations centered on achieving low inflation, maintaining financial sector stability, increasing the role of the private sector in economic activities, and managing risks associated with the current public investment plan. Staff supported the monetary and fiscal policy stance to bring inflation down and emphasized the need for continuing the fight against inflation, in particular by maintaining the policy of no central bank financing of the budget. Immediate activation of the treasury bill market for liquidity management and raising of interest rates is recommended for proactive monetary policy implementation, and to support domestic savings mobilization efforts for financing investment under the Growth and Transformation Plan (GTP). Easing of restrictions on private banks would also help promote financial deepening and facilitate the realization of the GTP objectives.

Risks: The planned significant domestic financing of the GTP could result in a deceleration of medium-term growth and a buildup of vulnerabilities absent the necessary policy adjustments. Other risks arise from the uncertain prospects for the global economy, which could affect the GTP objectives. Additionally, challenges related to realizing domestic financing of the GTP remain.

Approved By
**Anne-Marie Gulde-
 Wolf and Elliott Harris**

Discussions were held in Addis Ababa on May 30–June 13, 2012. The mission met with the late Prime Minister Meles Zenawi, Minister of Finance and Economic Development Sufian Ahmed, National Bank Governor Teklewold Atnafu, Economic Advisor to the Prime Minister Newai Gebre-ab, other senior officials, and representatives of the donor, business, and civil society communities. The mission team comprised Mr. Atingi-Ego (head), Mr. Kinoshita, Mr. Yehoué, and Ms. Baba (all AFR); Mr. Mikkelsen, resident representative, assisted. Ms. Teferra, senior advisor to Mr. Majoro (OED) participated in some key meetings. Staff collaborated closely with the World Bank and African Development Bank staffs.

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BACKGROUND

1. Ethiopia is pursuing a public sector-led development strategy that focuses on promoting growth through high public investment facilitated partly by low nominal interest rates. The strategy calls for government directed economic policy, with a dominant role for public enterprises in infrastructure development. Within this development strategy, the authorities adopted a 5-year Growth and Transformation Plan (GTP) in November 2010, which aims to attain high GDP growth (an average annual rate of over 11 percent) and achieve the Millennium Development Goals (MDGs).¹ Among its strategic pillars is an emphasis on agriculture, promotion of industrialization, and investment in infrastructure.

2. The strategy has contributed to lifting economic growth, and Ethiopia has been making significant progress in all areas of the MDGs (Table 1). Robust growth in the recent past and pro-poor focus of the government budget have resulted in significant poverty reduction: the authorities' preliminary estimates indicate that the poverty head count declined from 38.7 percent in 2004/05 to 29.6 percent in 2010/11.

3. However, after the second and final Exogenous Shocks Facility review was completed in November 2010,

¹ The macroeconomic objectives and planned investments in the GTP are discussed in the Joint Staff Advisory Note (IMF Country Report, No. 11/303). The authorities published the Annual Progress Report for 2010/11 in March 2012. The financing plan in the original GTP was only indicative, and the authorities are mindful of the implications on debt sustainability in implementing the plan.

macroeconomic imbalances have resurfaced. Inflation rose above 40 percent in August 2011 from 10 percent in November 2010 and resulted in highly negative real interest rates and an overvalued real exchange rate. Federal government budget execution and monetary policy were tightened later in 2011 and as some special factors contributing to the surge in inflation—including the after effects of birr devaluation in September 2010, international commodity price increases, and drought—began to subside, inflation, though still elevated, is now on a declining path (Figure 1). However, other risks and vulnerabilities related to the financing model of the large public investment projects are now emerging.

4. The recommendations from the 2011 Article IV consultations have only been partially implemented. The authorities implemented the base money nominal anchor; however, positive real interest rates are yet to be realized and little was done to reinforce liquidity management at the National Bank of Ethiopia (NBE). Similarly, little progress has been made on structural reforms to liberalize the foreign exchange and trade regimes, or improve the business climate. The authorities continue to put much emphasis on improving physical infrastructures such as road and electricity supply, which they believe would help improve business climate.

5. The 2012 Article IV discussions focused on policy options to sustain the robust growth rate and the current disinflation process and to address emerging risks and vulnerabilities in the system. The mission's recommendations

focused on achieving low inflation, appropriate pacing of scaling up public investment,

financial sector stability, and increasing the role of the private sector in economic activities.

RECENT DEVELOPMENTS AND OUTLOOK

A. Recent Economic Developments

6. The authorities' determination to reduce inflation has been paying off, though some challenges remain. Inflation has decelerated to 21 percent in June 2012 from the recent peak of about 40 percent in August 2011, reflecting a tight monetary policy stance and a slowdown in food inflation (Figure 1). Despite this achievement, inflation remains high and nonfood inflation continues to hover around 20 percent. Absent the significant public sector spending to achieve the GTP objectives the pace of inflation decline would have been sharper. According to the authorities, the slow pace of inflation decline reflects instead supply side constraints. Although economic activity has been affected by high inflation, real GDP growth in 2011/12 is estimated at around 7 percent; this is a robust performance given the weakness of the global economy, and is above the average growth for sub-Saharan African countries.² Domestic credit grew by 41 percent year-on-year at end-April 2012, driven by a sharp rise in public sector borrowing to finance large infrastructure investment projects, contributing to an increase in broad money by 30 percent.

7. The authorities have been implementing their national accounts improvement action plan.³ A recent AFRITAC EAST mission found commendable

² The authorities' estimate differs and is projected at 11.2 percent.

³ This plan is based on recommendations of the IMF 2010 Article IV mission.

progress in improving the compilation methodology. Additional efforts by the authorities and the IMF staff are expected to help reconcile the historical differences between official GDP statistics and the staff estimates.

8. Although federal government budget execution has been tight given the objective of supporting inflation reduction, the public sector as a whole has been providing strong fiscal impulse (Figure 1). In the first 10 months of 2011/12, federal government revenue grew by 51 percent while total expenditure including transfers to regional governments grew only by 30 percent; the overall deficit was 0.8 percent of annual GDP compared to 2.3 percent in the budget. However, the public sector (including state-owned enterprises) as a whole has been providing strong fiscal impulse based on its borrowing from the state-owned Commercial Bank of Ethiopia (CBE). A sharp rise in regional government deposits at CBE, a drawdown of excess reserves, and a lowering of reserve requirement in January 2012 contributed to the funding.⁴

9. Implementation of the base money nominal anchor has been instrumental in reducing inflation. Annual base money growth at end-April 2012 slowed to 1.3 percent as the central bank has ceased

⁴ The authorities are trying to understand the large build up of regional government deposits with CBE.

providing new direct credit to the government since July 2011 and has been selling foreign exchange (FX) reserves in recent months to achieve a base money contraction target of 4 percent for the fiscal year (Figure 1).

However, as some banks significantly drew down their excess reserves and started having difficulty maintaining the required reserves, NBE lowered the reserve requirement ratio in January 2012. The lowering of the ratio from 15 percent to 10 percent has weakened the tightening effect of the base money contraction. Broad money at end-April 2012 grew by 30 percent year-on-year on account of strong credit growth to public enterprises.

10. The real effective exchange rate has been appreciating, an indication of loss of competitiveness and a cause of concern for external stability. After the large devaluation of September 2010, and as a result of high inflation, the real effective exchange rate (REER) in May 2012 reached the highest level since March 2009 and is overvalued in the range of 11–23 percent according to the assessment based on the IMF’s Consultative Group on Exchange Rate (CGER) methodology. Survey-based indicators also suggest that high costs of doing business are undermining competitiveness. (Figure 1 and Annex I).

B. Outlook

13. Growth is projected to decelerate in the medium term. This is largely attributed to the limited opportunities for the private sector to leverage the large public investment to further raise growth. In view of these developments, and based on continuation of current policies, staff project real GDP growth to moderately decline to 6.5 percent in the

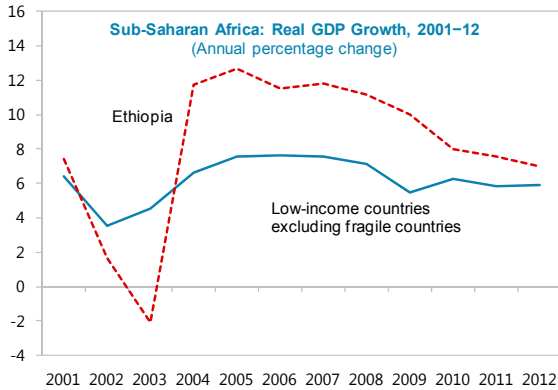
11. Foreign exchange reserves were significantly run down as a result of foreign exchange sales to sterilize liquidity. Gross official reserves in April 2012 decreased by almost \$1.2 billion to 1.8 months of projected imports for 2012/13 from its peak in September 2011. In the absence of an active treasury bill market, FX reserves have been the primary monetary policy tool to affect the level of liquidity. Reserve adequacy analysis indicates that higher months of imports coverage are recommended given the exchange rate regime in Ethiopia (Annex II).

12. The improvement of current account balance in 2010/11 is reversed due to a strong growth of imports in 2011/12. The current account recorded a small surplus in 2010/11 owing to a decline in imports of capital and consumer goods, which appear to reflect some front loading of imports in the previous year. Foreign investors in the targeted sectors that receive government support contributed to a diversification of exports. Despite a continued robust performance in export of goods and remittances in 2011/12, strong consumer goods imports and the deteriorating service balance in the first half of the period, moved the current account into a deficit. Notwithstanding these improvements, large errors and omissions recorded in 2011/12 need to be addressed.

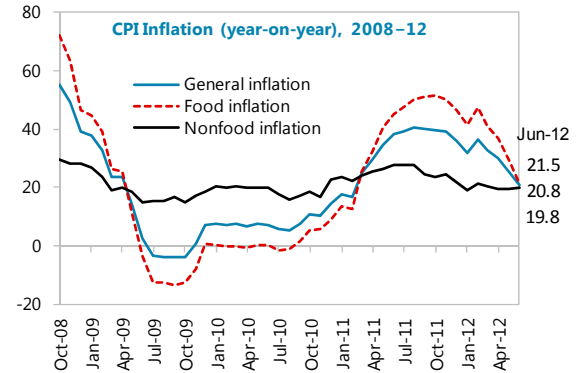
medium term (Box 1 and Table 3). On the external side, solid increases in goods exports are expected, supported by growth of emerging sectors. Vulnerabilities remain, however, as the prospects for the world economy are uncertain and the REER is overvalued.

Figure 1. Ethiopia: Recent Economic Developments

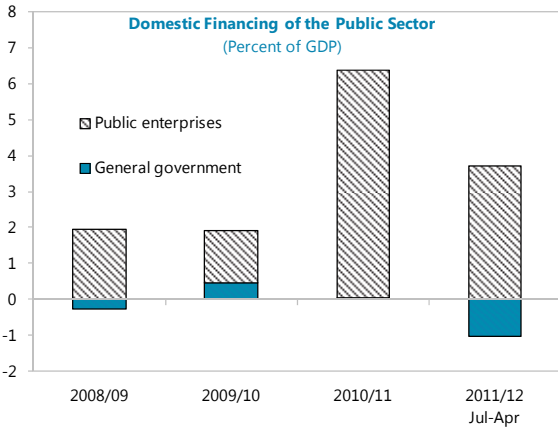
Growth remains above the SSA average...



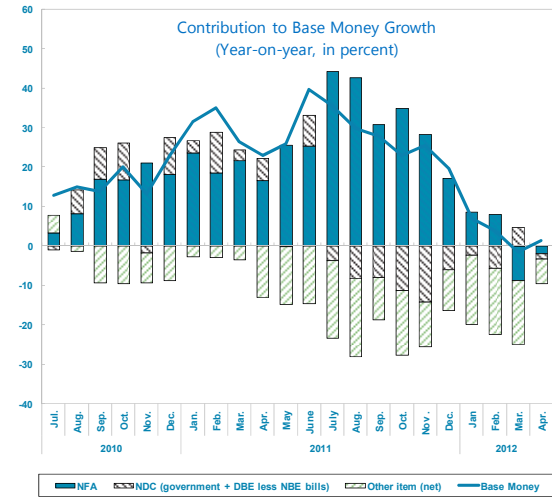
and inflation is coming down.



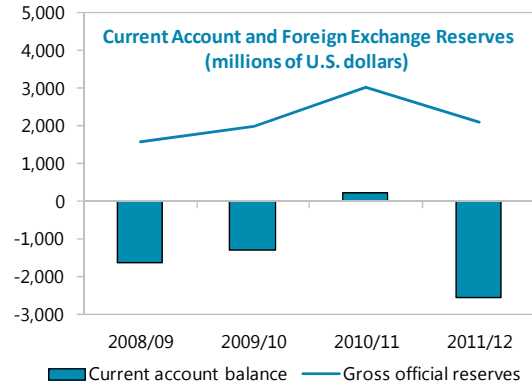
Government budget execution has been tight but the public sector as a whole has been stimulative.



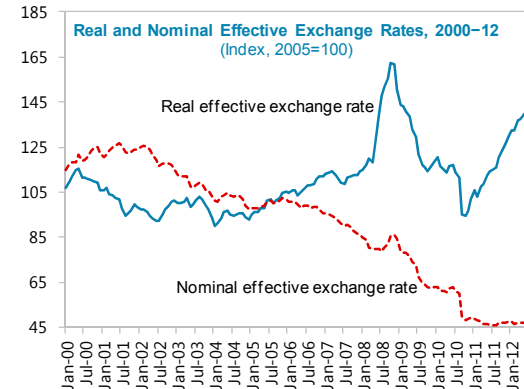
Base money growth has drastically declined reflecting the implementation of base money nominal anchor.



However, foreign exchange reserves were run down to control liquidity...



and due largely to the recent high inflation, the REER displays a rising trend, thereby eliminating competitiveness gains from the last devaluation.



Sources: Ethiopian authorities and IMF staff estimates.

Box 1. Ethiopia: Growth Accounting

The official statistics registers remarkable economic growth in Ethiopia in the last 8 years. The real GDP growth has remained above 10 percent since 2003/04 when the Ethiopian economy recovered from a severe drought in 2002/03.

A growth accounting applied to Ethiopian data reveals two underlying features (Table below). First, large part of the growth was driven by large capital investment in the public sector. Capital stock grew, on average, by 10.8 percent, which by far exceeds capital growth rates for sub-Saharan Africa in the 1980s (2.0 percent) and even East Asian countries in the 1980s (8.9 percent) where the growth was highly capital intensive.

Second, the official statistics implies long-lasting rapid productivity growth between 2006/07 and 2010/11, the average contributions to the growth are estimated at 2.6 percent from the labor and 3.2 percent from the capital, implying total factor productivity (TFP) growth of 5.2 percent. The estimated TFP growth is high both by the Ethiopian historical standard and the cross-country comparison.

For Ethiopia, existing literature finds TFP growth between 0 to 1.4 percent until the early 2000s. For other countries, studies find TFP growth of 1.6 percent for OECD countries, 0.5–1.6 percent in East Asia and 1.4–4.6 percent in China in 1984–94.

Several factors that normally support high TFP were absent in Ethiopia. These factors include: initial human and physical capital conditions, terms of trade and openness, good macroeconomic environment, such as low inflation, competitive real exchange rate, low government consumption, high international reserve coverage, and low external debt.

High implied TFP productivity growth in Ethiopia seems therefore implausible, suggesting an existence of problems in the official growth estimates. Possible issues include remaining weaknesses in national accounts compilation methodologies and the accuracy of the source data.

With moderate TFP growth, reflecting the factors that are less supportive for Ethiopia, moderate real GDP growth would be expected over the medium term.

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	Average 2007-11
Real GDP growth (official)	-2.1	11.7	12.6	11.5	11.8	11.2	10.0	10.6	11.4	11.0
Real GDP growth (IMF estimates)								8.0	7.5	
Labor contribution	2.7	2.6	2.67	2.20	2.15	2.25	3.38	2.53	2.50	2.56
Labor force growth (%) 1/	3.8	3.7	3.8	3.1	3.1	3.2	4.8	3.6	3.6	3.7
Labor share (%GDP)	70	70	70	70	70	70	70	70	70	70
Capital contribution	4.4	2.8	4.2	3.3	3.7	2.8	3.0	3.0	3.7	3.2
Capital stock growth (%) 2/	14.7	9.4	14.1	11.1	12.4	9.5	9.9	10.0	12.2	10.8
Capital share (%GDP)	30	30	30	30	30	30	30	30	30	30
Implied TFP growth in official statistics	-9.2	6.3	5.8	6.0	5.9	6.1	3.7	5.0	5.2	5.2

Sources: Ethiopian authorities; IMF IFS database; World Bank's WDI database; IMF staff estimates.

1/ Average growth for the preceding five years is used for 2009/10 and 2010/11.

2/ The capital stock series is constructed by the perpetual inventory method using the time-series data of gross capital formation from 1981/82. The depreciation rate of 0.10 is used. The capital share of 30 percent is assumed.

C. Risks

14. There are near-term downside risks (Table 2). Key risks arise from the uncertain prospects for the global economy that could lower export prices and from domestic policies. Although the crisis in Europe has had little spillover to the Ethiopian economy to date, a worsening of the crisis could reduce demand for Ethiopian exports and lower export prices and result in shortfalls of aid flows, lower remittances, and limited financing for infrastructure investment in the GTP. On domestic policies, the planned significant

domestic financing for large public investment projects of the GTP could result in a further buildup of vulnerabilities. Other key risks include: (i) entrenched inflation expectations and a return to monetary expansion in the context of limited active use of monetary instruments; (ii) weather related shocks, particularly the late onset of the rainy season and possible drought returning to the Horn of Africa; and (iii) a further deterioration of the restrictive business environment.

POLICY DISCUSSIONS: PROMOTING GROWTH AND REDUCING VULNERABILITIES

15. Ethiopia aims to sustainably raise growth in line with its goal to reach middle income levels by 2025, while maintaining macroeconomic stability. The government's objectives for 2012/13 are to sustain the robust economic performance and to lower inflation further to single digits by the end of 2012. For the medium term, the authorities target growth at around 11 percent a year and inflation at single digits in line with the GTP. To achieve these objectives, authorities' current policies promote high public investment supported partly by low nominal interest rates and a tight monetary policy, which has relied so far on two instruments—FX sales and no NBE financing of fiscal deficit, with the latter planned to be reversed in 2012/13.

16. On the basis of a continuation of these policies, staff baseline scenario expects a deceleration of medium-term growth and a building up of vulnerabilities on both domestic and external fronts. The vulnerabilities relate to: limited use of available

monetary policy instruments (securities) to control inflation; low foreign reserve levels; a possible reinforcement of systemic risks associated with the dominant state-owned CBE and its increasing exposure to public enterprises; large accumulation of debt by public enterprises; and crowding out of the private sector—all of these being associated with the authorities' policy choices. Some adjustments in macroeconomic and financial policies would therefore be needed to mitigate these vulnerabilities as discussed below.

17. The discussions focused on prioritized recommendations which aim at improving macroeconomic performance and mitigating vulnerabilities without fundamentally altering the country's development model. These include (i) maintaining financial sector stability; (ii) keeping inflation under control to eliminate highly negative real interest rates and exchange rate overvaluation; (iii) creating space for an increased private sector's role in

the economy; and (iv) achieving higher foreign reserve coverage.

18. Given the development model and based on these recommendations, staff developed an alternative scenario that aims at safeguarding macroeconomic stability and reducing vulnerabilities, while preserving strong growth (Table 7). Under staff's alternative scenario, the growth rate is projected to rise to 8.5 percent in 2016–17 through appropriate pacing of scaling up public investment; a larger private sector

A. Monetary Policy

19. The authorities' efforts resulted in inflation reduction. Following the implementation of the base money nominal anchor policy, base money contracted by about 9 percent over the first 10 months of 2011/12. Supported by a slowdown in global food and fuel price inflation, the contractionary base money policy has been instrumental in the recent decline in inflation to 21 percent in June 2012. The policy of no NBE financing of the government and significant sales of foreign exchange were deployed to achieve this outcome.

20. The NBE's direct financing of the government is expected to resume in 2012/13. This policy reversal could raise inflationary expectations, which are still high, and hamper authorities' efforts to bring inflation down.

21. Going forward and absent additional active use of other monetary policy instruments such as flexibly priced securities, sustaining inflation reduction will be challenging. Absent additional active use of other monetary policy instruments, the planned NBE budget financing for 2012/13 will

participation; inflation would decline further to 6 percent by 2014; real interest rates would turn positive, expanding the deposit base; the exchange rate would become more competitive; and FX reserves would recover to the 3.2 months of imports at the end of the projection period. This scenario assumes that the 27 percent NBE-bill requirement would be modified through a dialogue with private banks (Box 2) and private sector access to credit from the banking system would increase.

leave FX sales as the only active instrument for liquidity management. In this context, the low level of FX reserves which are under two months of import cover projected in 2012/13 makes the monetary policy stance less credible, especially in the context of changing money demand conditions.

22. A proactive liquidity management (e.g., use of treasury bills) will be important to contain the risks of inflation resurging. This would facilitate matching money supply to money demand, encourage the development of the money market, and through a response by the broader interest rate structure support domestic mobilization of resources by the financial sector. Staff expects that the pace of inflation reduction will be slower than anticipated by the authorities (Table 3).

Authorities' views

23. The authorities share staff concerns regarding high inflation but view last year's pick-up in inflation as only weakly linked to monetary policy. Instead, they attribute the pick-up to imported inflation given the rise in

international commodity prices last year. They believe that the planned NBE budget financing would be consistent with the demand for base money. They also argue that low nominal interest rates are necessary to finance public investment and only aim to have real rates

B. Financial Sector Policy

24. The country's banking sector comprises 16 banks, including a dominant state-owned bank, CBE, whose assets represent about 70 percent of the sector total, as of April 2012. The remaining 15 banks, mainly private, together account for the remainder. The authorities' development strategy is based on directed lending mainly to public enterprises via CBE and, to some extent, government targeted private sector activities via the government-owned Development Bank of Ethiopia (DBE). This policy, combined with the current high inflation, and negative real interest rates, results in a significant transfer of resources from creditors (savers) to borrowers, especially the public sector.

25. The NBE directive introduced in April 2011 is having tangible impacts on the banking sector, including maturity mismatch and less profitability.⁵ The requirement on private banks to purchase NBE bills equivalent to 27 percent of any new loans appears to have a sizable negative impact on private banks' intermediation activities (Box 2). The requirement also has the potential of creating maturity mismatches as private banks collect savings at two to three-year maturity

⁵ The directive requires private commercial banks to hold 27 percent of the gross loan extension (irrespective of the tenor) in a 5 year NBE bill at an interest rate of 3 percent per annum while deposit rates are around 5 percent.

near zero over time: flexible pricing of securities for the conduct of monetary policy will be considered when single-digit inflation is firmly achieved. If money demand conditions were to change direct instruments would be used.

and even shorter in some cases, but have to freeze these resources for five years at rates lower than cost of funds. There is also a risk that as the profitability of private banks reduces on account of less intermediation because of this directive, they could raise noninterest income charges such as fees and commissions to recoup these losses, further impacting negatively on the private sector.⁶ Staff proposed that appropriate pricing of NBE bills and changing the basis for the allotment from gross to net disbursements should be considered.

26. Financial soundness indicators provided by the authorities do not point to immediate concerns, but vulnerabilities appear to be building in the sector. The banking sector overall is well capitalized and the capital adequacy ratio (CAR) for the sector has consistently been around 18 percent over June-2008—June-2011 well above the regulatory 8 percent minimum (Table 8). However, in less than a year the ratio sharply declined from 18.1 percent (June 2011) to 13.6 percent (March 2012), possibly reflecting

⁶ The directive does not have any direct effects on liquidity for the banking sector. The liquidity absorbed through the issuance of the NBE bills is re-injected into the system via DBE, where the proceeds are transferred for on-lending to finance government targeted private sector activities. The NBE bills are illiquid as they are not tradable since banks are required to hold them to maturity.

Box 2. Ethiopia: Assessing the Impact of the 27 percent NBE Bill Requirement on Private Banks

In April 2011, the Ethiopian authorities issued a directive requiring private banks to purchase NBE bills equivalent to 27 percent of any new loan disbursements. These bills have low-interest earning of 3 percent and a maturity of 5 years.

The 27 percent NBE bill requirement has the potential of crowding out private sector financing. To highlight this possibility, an illustrative numerical scenario is considered where the initial fund available to a bank for its intermediation activities is birr 1.27 million (Box Table 1). Out of this fund, the bank is assumed to disburse a one-year loan in the amount of 1 million birr at the current lending rate of 9 percent and purchase NBE bills of 0.27 million birr as required. After one year when this loan is paid back, the total loanable fund available to the bank (birr 1,098,100) would be the loan repaid plus the interest it generated, plus the interest accrued on the NBE bills. Out of this fund, the bank can extend the maximum of birr 864,676 and is required to purchase additional NBE bills of birr 233,463, with the stock of NBE bills rising to birr 503,454.

Renewing such an operation every other year over five years would reduce the fund available for lending by the bank to birr 590,677 in the fifth year, while the stock of NBE bills rises sharply to birr 1,045,748 (Box Table 1), suggesting a significant crowding out of private bank lending to the private sector. It is also an indication that the allocative role of private banks is being taken over by the government, raising the issue of the efficiency of such an allocation. If private banks were to try to circumvent this heavy penalty, by issuing one long term (5 years) loan and to comply with the 27 percent only once, it would put the financing of the DBE—which relies on the proceeds of the 27 percent NBE bills—at risk.

The requirement also has the potential of creating maturity mismatches. Private banks collect savings mostly at two to three-year maturity and even shorter in some cases. Fulfilling the 27 percent requirement means that they have to freeze these resources for 5 years, creating a clear maturity mismatch.

Box Table 1. Impact of the 27 percent NBE Bill Requirement on Lending to the Private Sector

Years	1	2	3	4	5
Lending to the private sector	1,000,000	864,646	753,990	663,827	590,677
Stock of NBE bills	270,000	503,454	707,032	886,265	1,045,748

Source: IMF staff calculations.

an increase in risk-weighted assets driven by the high domestic credit growth to finance public enterprises. The authorities are yet to provide an explanation behind the decline in the solvency ratio. Non-performing loan ratio standing at 1.8 percent as of March 2012 appears unusually low, especially given the strong domestic credit expansion. The aggregate loan-to-deposit (LTD) ratio, which has remained within prudent bounds at above 80 percent over June-2008—June-2011, has now jumped to more than 92 percent in March 2012, raising the need to strengthen oversight. Similarly, the ratio of liquid assets to

total assets, which has consistently been above 30 percent over June-2008—June-2011, declined to 19 percent in March 2012. The sharp decline in CAR and the liquidity ratio, and the sharp jump in LTD could reflect warning signs that vulnerabilities might be building in the sector. Staff did not have access to sufficient data to fully assess the reported financial sector indicators.

27. Recent developments in the banking sector require continued close scrutiny by the NBE. Ethiopia's financial sector policies mirror the country's development strategy.

These policies have so far delivered robust economic growth and the NBE is strengthening its oversight of the financial sector to ensure its stability. However, recent developments such as the increasingly dominant market share of CBE and its growing exposure to large public enterprises, and the impact of the 27 percent requirement on private banks, suggest a need for a closer scrutiny of the banking system. It would be important to undertake a diagnostic of the sector to better assess potential vulnerabilities that might be building up even in the context of the authorities' ongoing implementation of measures in the sector. An assessment such as under the Bank-Fund Financial Sector Assessment Program would be helpful to this end. The authorities have a long-standing opposition to a Financial Sector Assessment Program (FSAP), and the mission's attempt to obtain banks' balance sheet data in order to undertake a banking sector diagnostic—which could be useful in coming up with specific recommendations—did not succeed. Thus,

substantial information gaps on the health of the financial sector remain.

Authorities' views

The authorities do not share staff concerns about the financial sector. They disagree with staff assessment of the impact of the 27 percent NBE bill requirement arguing that private banks remain overall highly profitable. In addition, the authorities indicated that NBE is vigilant in taking actions to mitigate any risks that would emerge. These actions include training of staff on risk based supervision, implementation of World Bank financial sector capacity building recommendations, quarterly stress testing of banks, close supervision of CBE given its systemic importance and exposure to large public enterprises, and benchmarking of the CBE operations to those of international banks. They saw no need for an assessment such as under the FSAP for at least two years and until capacity building exercise being undertaken is completed.

C. Fiscal Policy

28. Spending by the public sector is contributing to increased vulnerabilities.

Some of the large infrastructure investments are financed domestically, causing inflationary and balance of payments pressures, possible systemic risks in the banking sector, large accumulation of public debt, and crowding out of the private sector. This suggests the need to start monitoring the operations of the consolidated public sector to assess the overall fiscal stance. Currently the only available timely indicator is credit from the banking system in the monetary survey.

29. The 2012/13 government budget focuses on sustaining growth, lowering

inflation further, mobilizing revenue, and spending on pro-poor projects. The revenue target is within reach with the continuation of administrative efforts. Total expenditure is projected to grow slower than nominal GDP, but poverty-related spending as a share of GDP will be maintained. The projected overall fiscal deficit is 2.9 percent of GDP, an increase from 2.3 percent in 2011/12, because of a change in the donor-funded Protection of Basic Services from a grants-based project to a loan-based one. About half of the deficit is financed domestically, including central bank financing of 1.0 percent of GDP.

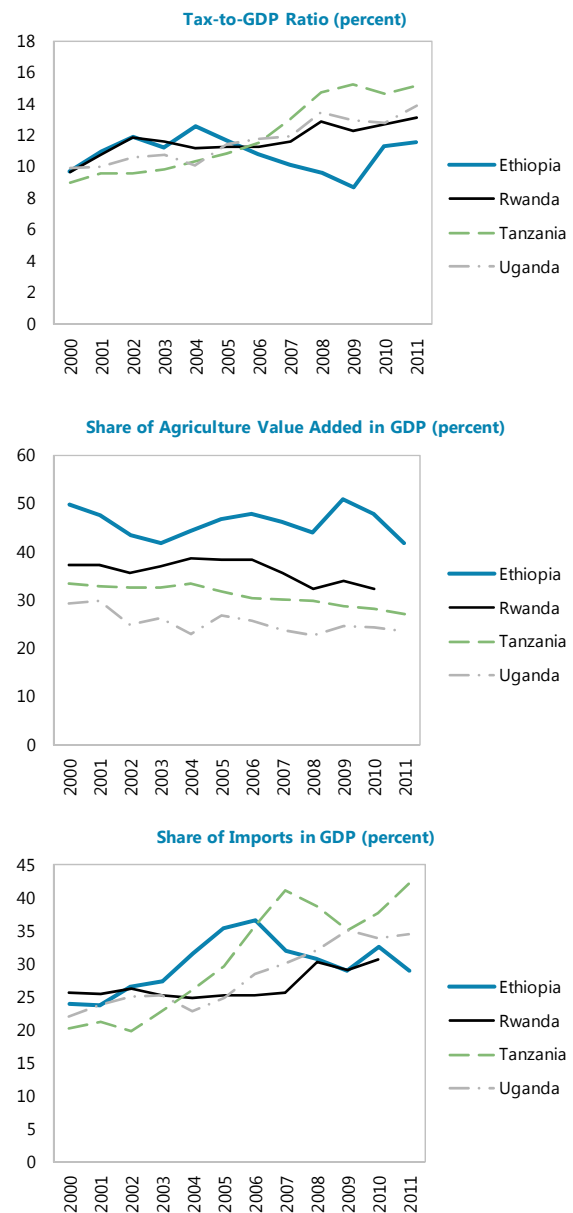
30. Fiscal structural reforms need to be accelerated to achieve the GTP fiscal objectives. The revenue administration reform supported by IMF technical assistance, with the focus on key priority areas, should help maintain the moderate increase in the tax revenue-to-GDP ratio. However, going by the current trend, achieving the GTP target for the tax revenue-to-GDP ratio of 15 percent would require additional efforts, such as a major improvement in taxpayer compliance. A comparator analysis suggests that Ethiopia's relatively low tax-to-GDP ratio reflects a larger share of agriculture (particularly small scale, noncommercial farms) and less openness. Stronger tax administrative efforts by Ethiopia would therefore be needed to overcome these constraining factors and catch up with the comparators in raising tax revenue.⁷

31. An improvement in public financial management should support further strengthening of the social impact of government spending. This is important because, given the Ethiopian economy's vulnerabilities to large exogenous shocks such as food price increases and droughts, strengthening the existing social protection mechanism is essential to preserve the gains towards the MDGs. The implementation of program-based budgeting (PBB), which started in 2011/12 with the federal government, has proven effective in improving allocation efficiency and performance monitoring. The challenge, however, is to introduce the PBB to regions where the capacity constraints remain.

⁷ A panel regression analysis with data for 15 emerging African countries indicates that an increase in the share of agricultural GDP by 1 percentage point would lower the tax-to-GDP ratio by 0.27 percentage point and an increase in the share of imports in GDP by 1 percentage point would raise the ratio by 0.19 percentage point.

The Integrated Financial and Management Information System is being piloted in several federal and regional bodies. The pilot will end by August 2012, and a rolling-out strategy will be developed subsequently. The government has been putting in place a strong control on its cash flows.

Figure. Selected Emerging African Countries: Factors Affecting the Tax-to-GDP Ratio



Sources: IMF, African Department database; World Bank, World Development Indicators database.

Authorities' views

32. The authorities see vulnerabilities related to the high public sector spending as manageable. In their view, monetary and financial sector policies are adequate and priority investment projects should continue. They acknowledge difficulties in monitoring the operations of the consolidated public sector, given the capacity and data constraints in terms of timeliness and coverage. They

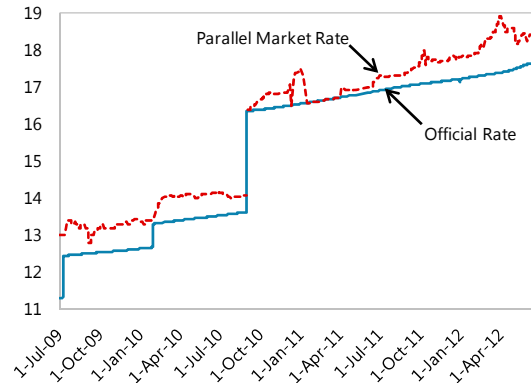
D. External Policy

33. Foreign exchange reserve sales were used for liquidity sterilization, and are likely not to recover given the substantial imports needs to finance GTP investment.

Substantial FX sales have led to significant decline in FX reserves, which currently stand at about 1.8 months of imports. Higher inflation in 2011/12 has contributed to an appreciation of REER. Going forward the real appreciation needs to be reversed in order to reduce vulnerabilities and restore competitiveness of the economy. The premium between the official and parallel market exchange rates recently widened possibly reflecting unsatisfied demand at the official exchange rate which according to NBE is not the case as all formal demand was met at this rate. However, staff did not receive sufficient data to analyze or underpin these developments.

consider their focus on revenue mobilization through administrative improvements as appropriate and expect that these would deliver the necessary revenue increases. They also noted that public financial management reforms would need to be appropriately paced and sequenced given the capacity constraint. Continued technical assistance from the IMF and other development partners is necessary to support their efforts.

Figure. Ethiopia: Official and Parallel Exchange Rates (birr per U.S. dollar)



Source: Ethiopian authorities.

34. Buildup of foreign exchange reserves from currently projected 1.8 months of import cover at end-2011/12 to above 3 months will be required in the coming years to provide a buffer against potential exogenous shocks. An analytical assessment suggests that an optimal precautionary level of FX reserves for Ethiopia is even higher, estimated at 7.1 months of prospective imports (Annex II). Maintaining an adequate stock of safe and liquid assets will be critical, especially in the current volatile global environment notwithstanding the low financial returns on FX reserves. This would also call for some flexibility in the nominal exchange rate.

Authorities' views

35. The authorities shared the view that building up foreign exchange reserves would be desirable, but did not plan to do so immediately. The priority now is to fight

against inflation through FX sales, and will accumulate the reserves once inflation is stabilized. In addition, they see a high opportunity cost of holding foreign exchange reserves given the returns in highly profitable infrastructure projects.

E. Unlocking the Growth Potential Through Structural Reforms

36. Ethiopia's track record of growth and poverty reduction in recent years is solid. Growth in Ethiopia has been robust compared to other Sub-Saharan African countries. According to the authorities the decline in poverty likely reflects the development in the economic and social sectors and better implementation of welfare program such as the productive safety net program.⁸

37. Despite this remarkable performance, achieving the authorities' own goal of reaching middle-income status would require sustaining such a performance and even some acceleration of growth. However, the disruptions to the supply-side from stiffer licensing regulations, high inflation, and most significantly from recent NBE directive which constrains private sector credit weigh on the short and medium-term growth outlook. More broadly, business climate indicators highlight structural weakness that could undermine competitiveness. In the World Bank's Doing Business Survey, Ethiopia stands at 111 out of 183 countries in 2012, moved down from 97 out of 179 countries in 2007.

38. Structural reforms aimed at promoting inclusive growth are critical for sustaining high growth and making further progress in achieving the MDGs. Inclusive growth over an extended period is vital for progress towards poverty reduction and the MDGs. Inasmuch as inclusiveness encompasses equity and equality of opportunity—in terms of access to markets, resources, and unbiased regulatory environment for businesses and individuals—policies should be geared towards a longer-term perspective. They should focus on providing incentives for the emergence of a wide range of activities capable of creating jobs for high-skilled and low-skilled workers alike. The authorities would need to: (i) develop and implement with the assistance of key donors, including the International Labor Organization a growth strategy that is anchored on improving productivity and creating new employment opportunities; (ii) undertake deep reforms aimed at creating a business-friendly environment, in particular by strengthening the judiciary and the regulatory framework, land registry and promoting access to financing; (iii) consider structural improvements to alleviate credit constraints and trade related restrictions; (iv) continue the privatization of commercially-run enterprises; and (v) provide opportunities for the private sector to leverage the large public investment.

⁸ The authorities are undertaking detailed poverty analysis in order to underpin the factors explaining poverty reduction.

Authorities' views

39. The authorities recognized the importance and need for continuing inclusive growth. They noted the emphasis on agriculture—a labor intensive sector—as a

strategic pillar in the GTP. They underscored that they are promoting the development of non-traditional export sectors such as flowers, leather products, and textile. They noted that they are already pursuing privatization of commercially-run enterprises.

F. Managing Debt and Risks Associated With the Current Public Investment Plan

40. Public sector debt is increasing as the government implements its public sector-led growth policy. The implementation requires large public sector borrowing and domestic resource mobilization. Staff noted that at the current negative real interest rates, mobilizing additional resources through the financial sector to facilitate GTP financing will be difficult to achieve and there is a risk of a reversion to monetary financing or excessive non-concessional borrowing (Box 3).

promote dialogue among the authorities on appropriate types of financing and levels of public infrastructure investments.

41. Based on staff's macroeconomic projections and authorities' external borrowing plans, Ethiopia maintains a low risk of external debt distress. It is important to note that this scenario assumes that the government maintains the amount of new external loans, particularly nonconcessional ones, as currently in the pipeline for the next few years. The ongoing large public investment projects rely heavily on domestic financing which would lead to a large accumulation of public debt and crowd out the private sector. In this context, the macroeconomic model (presented during the mission) designed to analyze the impact of scaling-up public investments with a mixture of financing options could be a useful tool to better understand the risks involved and

42. Expanding the scope of the monitoring of public debt will be needed to manage risks associated with rapidly rising domestic debt of major public enterprises.

The debt sustainability analysis that was conducted during the Article IV mission showed that Ethiopia would remain at a low risk of external debt distress. Maintaining the low risk of external debt distress is the current focus of the Ministry of Finance and Economic Development. However, the authorities are encouraged to develop a comprehensive debt management strategy and to monitor domestic and external public sector debt more comprehensively. Monitoring the whole operations of the consolidated public sector, including contingent liabilities arising from financial transactions among public entities and their potential implications for the budget, would be desirable. Given the capacity and data constraints including timeliness and coverage, an immediate focus on monitoring at least consolidated public debt should be a priority. Staff supports the authorities' intention to request technical assistance from World Bank and the IMF in developing a medium-term debt strategy.

Box 3. Ethiopia: Financing of Public Investment

Background

Under the Growth and Transformation Plan, Ethiopia is aiming for an ambitious growth objective supported by a scaled-up public investment plan. Large part of investment will be carried out by public enterprises, most notably Ethiopian Electricity Power Company (EEPCO), Ethiopian Telecom Company (ETC) and Ethiopian Railway Company (ERC).

Public investment depends largely on non-market mode of financing. External financing relies on loans from multilateral and bilateral official creditors as well as commercial loans from non-traditional creditors. Domestic financing relies on borrowings from state-owned Commercial Bank of Ethiopia and Development Bank of Ethiopia. Even though new government securities are being issued, their terms do not reflect market conditions.

The mode of financing reflects both Ethiopia's development strategy and the constraints. The development strategy is characterized by state control of financial flows and pricing. Government securities market is not active. External concessional borrowing is not enough or not available for key projects.

Recent developments

The authorities have been cautious in contracting of external commercial loans, but external financing need is strong. EEPCO and ETC have contracted commercial loans and suppliers credits mostly from China, for which government guarantees have been provided. ERC recently signed contracts with Chinese and Turkish companies for projects whose total size is about 6 percent of 2012/13 GDP. The Ministry of Finance and Economic Development (MOFED), whose stated objective is to maintain a low risk of external debt distress, has full control and monitoring of these loans.

Domestic borrowings by public enterprises are increasing rapidly. Building of the Renaissance Dam, which is estimated to cost 10 percent of 2012/13 GDP according to the authorities, is being given a high priority. EEPCO's investment plan shows an increasing reliance on domestic borrowing.

Absent supporting reforms, the government's measures to mobilize additional domestic resources are unlikely to generate sufficient additional financing relative to the large financing need. The measures include issuance of new government securities and branch expansion by the state-owned bank CBE. Reforms that support sustainable mobilization of long term savings are crucial.

Expanding domestic borrowing will give rise to vulnerabilities. Increasing domestic financing of public investment projects would create a rapid rise in domestic debt of major public enterprises, crowd out private sector activities, and exert a balance of payments pressure from substantial import needs. Even though these borrowings may not be government guaranteed, they could become a source of contingent liabilities which could have significant macroeconomic implications.

Way forward

Within the authorities' development strategy, adjustments are required for the mode and pace of financing and improvements in debt management are needed. Achievement of real positive interest rates is important for mobilizing more domestic financing. Sustainable forms of financing for DBE lending to priority sectors—such as issuance of bonds/long-term securities—should be considered. In addition, the expanding the coverage of debt monitoring and reporting by the MOFED is important to ensure sustainability of debt. To this end, developing a medium-term debt strategy would be helpful.

Authorities' views

43. While recognizing the challenges of financing the GTP, the authorities indicated that several measures are being introduced to address these challenges. These measures include issuance of new government securities, a new private pension scheme, and branch expansion of by the state-owned bank CBE to

mobilize additional domestic resources. They acknowledged that raising domestic financing for the Renaissance Dam—a flagship project for the country estimated to cost 10 percent of 2012/13 GDP—is a challenge but underscored that this project is a high priority and other projects could be postponed if needed to complete the dam project.

OTHER ISSUES

44. Data provided to the Fund are broadly adequate for surveillance, albeit with notable shortcomings and delays. In addition to the financial sector data gaps discussed above, fiscal and BOP statistics require improvements.⁹ Official GDP growth rates imply productivity increases that appear implausible, suggesting an urgent need to reconcile the historical differences between official GDP statistics and the staff estimates and to ensure accuracy of source data. Addressing these issues would be important for proper assessment of the level of economic activities. Staff welcomes ongoing efforts to strengthen capacity for improvements in macroeconomic statistics and encourages the authorities to complete the implementation of their national accounts action plan, for which Fund TA has been provided.

45. Ethiopia is still under the Article XIV regime and maintains several exchange restrictions on payments and transfers for

⁹ For fiscal statistics, timeliness of the reporting of the consolidated general government operations, reconciliation of government operations with the corresponding monetary account data, and coverage of the public sector need improvement. The existence of large errors and omissions in the BOP point out to data collection challenges which need to be addressed through better surveys of international transactions.

current international transactions that are not consistent with Article VIII.¹⁰ A unification of the official and parallel exchange markets would free up significant efficiency gains. Staff also reiterated the need to clarify the terms of the 2006 China EXIM Bank Framework agreement to ensure its consistency with Ethiopia's commitments under the Articles of Agreement. The authorities did not provide a clear explanation on these outstanding exchange restriction issues. They maintain, however, that the agreement with China is consistent with the obligations to the Fund.

46. Ethiopia has yet to bring its anti-money laundering/combating the financing of terrorism (AML/CFT) regime into line with international standards. Since June 2011, Ethiopia has been listed by the Financial Action Task Force (FATF) among the jurisdictions with strategic AML/CFT deficiencies that have not made sufficient progress in addressing them. If not improved, heightened due diligence may impede access to global financial markets. The World Bank has been discussing a technical assistance program with the authorities to address

¹⁰ See Informational Annex.

remaining issues, with a plan to conduct an assessment of the AML/CFT framework in the first quarter of 2013.

47. WTO accession negotiations are ongoing. Since the submission of the Memorandum of Foreign Trade Regime in 2006, three rounds of Working Party meetings

took place and the fourth is scheduled for September 2012. The authorities are aiming to conclude negotiations by the end of the GTP period (2014/15), but they recognize difficulties in committing to the level of liberalization demanded by the Working Party member countries, particularly in service sectors.

STAFF APPRAISAL

48. Ethiopia's economic growth performance has been robust. This has been achieved through the authorities' public sector-led development strategy that promotes high public investment supported partly by low nominal interest rates.

49. However, macroeconomic imbalances have resurfaced, with high inflation, resulting in highly negative real interest rates and an overvalued real exchange rate. The authorities' implementation of the base money nominal anchor—combined with the phasing out of the effects of international commodity price increases and drought—has put inflation on a declining path, though it remains elevated. Other risks and vulnerabilities related to the financing model of the GTP are also emerging in the system.

50. The authorities are encouraged to consider policy adjustment aimed at addressing the macroeconomic imbalances and mitigating the vulnerabilities. Staff recommendations centered on achieving low inflation thereby eliminating highly negative real interest rates and exchange rate overvaluation; higher foreign reserve coverage; maintaining financial sector stability; increasing the role of the private sector in economic

activities; and managing risks associated with the current public investment plan.

51. Appropriately pacing the scaling up of public investment will be required. This would help mitigate vulnerabilities arising from the large and front-loaded public investment plan and offer opportunities for the private sector to leverage the large public investment.

52. The authorities are commended for the implementation of the base money nominal anchor and encouraged to take a more comprehensive approach in addressing the rising macroeconomic imbalances. The implementation of the base money nominal anchor has so far been instrumental in bringing inflation down, but only relied on two instruments—no central bank financing of the budget and FX sales. Staff urges the authorities to immediately activate the use of securities (treasury bills) for liquidity management to facilitate monetary policy implementation by starting to raise nominal interest rates, which, combined with declining inflation, will bring real interest rates close to zero. Raising interest rates would also support domestic savings mobilization efforts that are essential for financing investment to achieve ambitious objectives in the GTP.

53. The monetary and fiscal policy stance to bring inflation down needs to be maintained. In this context, staff is concerned about the reversal of the no central bank financing of the budget policy, which could lead to entrenched inflation expectations. This may send a negative signal on government's commitment to lower inflation. Staff urges the authorities to reconsider their planned government borrowing from the NBE in 2012/13.

54. The authorities are urged to start building FX reserves. Staff raises concerns about the sustainability of the FX sales as a key monetary policy instrument as FX reserves in months of imports have declined, and advises the authorities to begin gradually building FX coverage to about 3 months of imports mainly through some flexibility in the exchange rate, which will improve the current account balance.

55. The authorities are encouraged to continue the momentum of revenue administration reforms and accelerate reforms in public financial management to achieve the GTP fiscal objectives. Effective implementation of the technical assistance recommendations is a key in this regard. Given the limited prospects for realizing the GTP revenue targets which are currently lagging behind, it would be desirable to define an expenditure contingency plan to be put in place.

56. An assessment such as under the FSAP is recommended given the fast evolving economic environment and financial sector's closer linkages with the real sector created by the financing needs of the GTP. For the stability of the financial sector, it would be important to understand to what extent vulnerabilities are building up in

the system even in the context of the authorities' ongoing implementation of measures to strengthen the sector.

57. Easing of restrictions on the private banks would help promote financial deepening and facilitate the GTP financing. Without abandoning the NBE bill directive of April 2011, staff urges a dialogue with private commercial banks to identify ways to make the financing of long term projects—the key objective of the directive—effective and sustainable, while preserving the viability of private banks. Specifically, appropriate pricing of NBE bills and changing the basis for the allotment from gross to net disbursements should be considered.

58. The authorities are commended for their achievements in reducing poverty and are urged to continue and strengthen the policies for inclusive growth. The poverty reduction strategies have achieved important results and the government's focus on pro-poor expenditure has been paying off in terms of improved social indicators. Staff, however, underscores the necessity for the authorities to undertake structural reforms aimed at promoting inclusive growth by providing incentive for the emergence of a wide range of activities capable of creating jobs for high-skilled and low-skilled workers. This is instrumental for further progress in achieving the MDGs.

59. The authorities are urged to seek the support of their international partners to develop a medium term debt management strategy which comprehensively covers both domestic and external debt.

Monitoring all operations of the consolidated public sector, including contingent liabilities, will be important for effectively managing the risks associated with rapidly rising domestic debt of major public enterprises.

60. Further improvement in data quality is needed. There are significant financial sector data gaps and fiscal and BOP statistics require improvements, consolidated public sector (including public enterprises) data would be desirable for a proper assessment of the fiscal stance. Staff urges the authorities to continue working with the IMF to reconcile staff's estimates with the official GDP growth rates,

which currently imply productivity increases that appear implausible.

61. Staff recommends that the next Article IV consultation with Ethiopia be held on the 12-month consultation cycle. This is in accordance with the decision on consultation cycles, Decision No. 14747-(10/96) (9/28/2010).

Table 1. Ethiopia: Millennium Development Goals

	1990	1995	2000	2005	2010
Goal 1: Eradicate extreme poverty and hunger					
Employment to population ratio, 15+, total (%)	76	75	75	80	80
Employment to population ratio, ages 15-24, total (%)	70	70	70	73	71
GDP per person employed (constant 1990 PPP \$)	1,303	1,272	1,385	1,543	2,184
Income share held by lowest 20%	...	7	9	9	...
Malnutrition prevalence, weight for age (% of children under 5)	...	...	42	35	...
Poverty gap at \$1.25 a day (PPP) (%)	...	21	16	10	...
Poverty headcount ratio at \$1.25 a day (PPP) (% of population)	...	61	56	39	...
Vulnerable employment, total (% of total employment)	...	91	91	91	...
Goal 2: Achieve universal primary education					
Literacy rate, youth female (% of females ages 15-24)	...	28	...	39	33
Literacy rate, youth male (% of males ages 15-24)	...	39	...	62	56
Persistence to last grade of primary, total (% of cohort)	...	...	61	61	47
Primary completion rate, total (% of relevant age group)	23	15	23	43	72
Total enrollment, primary (% net)	30	24	40	63	82
Goal 3: Promote gender equality and empower women					
Proportion of seats held by women in national parliaments (%)	...	2	2	21	28
Ratio of female to male tertiary enrollment (%)	22	25	28	32	36
Ratio of female to male primary enrollment (%)	65	59	65	83	91
Ratio of female to male secondary enrollment (%)	75	79	66	60	82
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	...	...	41	44	...
Goal 4: Reduce child mortality					
Immunization, measles (% of children ages 12-23 months)	38	38	52	59	81
Mortality rate, infant (per 1,000 live births)	111	98	87	77	68
Mortality rate, under-5 (per 1,000)	184	161	141	122	106
Goal 5: Improve maternal health					
Adolescent fertility rate (births per 1,000 women ages 15-19)	...	112	103	82	58
Births attended by skilled health staff (% of total)	...	...	6	6	...
Contraceptive prevalence (% of women ages 15-49)	5	3	8	15	...
Maternal mortality ratio (modeled estimate, per 100,000 live births)	950	880	700	510	350
Pregnant women receiving prenatal care (%)	...	...	27	28	...
Unmet need for contraception (% of married women ages 15-49)	...	...	35	34	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases					
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	...	...	3	3	...
Condom use, population ages 15-24, female (% of females ages 15-24)	...	...	2	2	...
Condom use, population ages 15-24, male (% of males ages 15-24)	...	...	20	18	...
Incidence of tuberculosis (per 100,000 people)	173	182	235	276	261
Prevalence of HIV, female (% ages 15-24)	...	...	...	...	...
Prevalence of HIV, male (% ages 15-24)	...	...	...	...	...
Prevalence of HIV, total (% of population ages 15-49)	...	...	...	...	...
Tuberculosis case detection rate (all forms)	110	25	59	61	72
Goal 7: Ensure environmental sustainability					
CO2 emissions (kg per PPP \$ of GDP)	0	0	0	0	0
CO2 emissions (metric tons per capita)	0	0	0	0	0
Forest area (% of land area)	14	...	14	13	12
Improved sanitation facilities (% of population with access)	3	4	9	14	21
Improved water source (% of population with access)	14	20	29	37	44
Marine protected areas (% of total surface area)	...	...	...	...	...
Goal 8: Develop a global partnership for development					
Net ODA received per capita (current US\$)	21	15	10	26	42
Debt service (PPG and IMF only, % of exports, excluding workers' remittances)	38	18	15	2	2
Internet users (per 100 people)	0	0	0	0	1
Mobile cellular subscriptions (per 100 people)	0	0	0	1	8
Telephone lines (per 100 people)	0	0	0	1	1
Other					
Fertility rate, total (births per woman)	7	7	6	6	4
GNI per capita, Atlas method (current US\$)	250	150	130	160	390
GNI, Atlas method (current US\$) (billions)	12	8	8	12	32
Gross capital formation (% of GDP)	13	18	20	23	22
Life expectancy at birth, total (years)	47	49	52	55	59
Literacy rate, adult total (% of people ages 15 and above)	...	27	...	36	30
Population, total (millions)	48	57	66	75	83
Trade (% of GDP)	14	25	36	51	44

Source: 2011 World Development Indicators database

Table 2. Ethiopia: Risk Assessment Matrix

Source of Risks	Relative Likelihood	Impact if Realized
Strong intensification of the euro area crisis	Medium	The impact of such an intensification would include, falling commodity prices and higher risk aversion. Specifically, it would reduce demand for Ethiopian exports and lower coffee prices, and also result in shortfalls of aid flows, lower remittances, and limited financing for infrastructure investment in the GTP.
A global economic slowdown	Medium	A global economic downturn would lead to a sharper commodity price decline with a sharper negative impact on Ethiopian exports. It would result in severe shortfalls of aid flows, and a drastic decline in remittances. The financing of the GTP would be jeopardized with significantly lower growth.
Sharp slowdown in China	Low	FDIs from China, which have been rising rapidly across sectors, could decrease, slowing development of newly emerging export sectors, like textile and leather manufacturing. Major infrastructure investments, particularly in power, telecom, and roads, may not be fully financed, delaying the implementation of the GTP.
Strain on the state-owned Commercial Banks of Ethiopia resulting from increased domestic financing of GTP	Medium	Given the systemic importance of CBE (70 percent of total banking sector assets), it would slow down the entire Ethiopian economy, resulting in significant deceleration of medium-term growth and a buildup of further vulnerabilities on both domestic and external fronts.
Lack of sufficient financing for GTP	Medium	Lower growth.
International commodity price increases	Medium	Commodity price fluctuations affect both export price (coffee) and import price (fuel and wheat) in Ethiopia. It is likely that the negative impact from import price increase outweighs the benefit from export price increases.

Table 3. Ethiopia: Selected Economic and Financial Indicators, 2009/10–2016/17 ¹

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
	Prel.	Est.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
(Annual percentage change)								
National income and prices								
GDP at constant prices (at factor cost)	8.0	7.5	7.0	6.5	6.5	6.5	6.5	6.5
GDP deflator	3.9	24.4	31.9	13.3	9.1	9.8	9.1	8.7
Consumer prices (period average)	2.8	18.1	33.4	14.4	9.0	9.0	9.0	9.0
Consumer prices (end period)	7.3	38.1	20.8	9.0	9.0	9.0	9.0	9.0
External sector								
Exports (in U.S. dollars, f.o.b.)	38.3	37.1	16.9	11.3	11.6	15.5	16.0	13.1
Imports (in U.S. dollars, c.i.f.)	7.7	-0.9	35.5	15.4	5.5	7.3	12.0	7.0
Export volume	10.3	8.6	1.1	18.1	8.8	8.5	13.1	13.8
Import volume	14.1	-8.5	29.5	15.9	3.4	5.2	9.8	5.9
Terms of trade (deterioration –)	29.6	18.7	10.6	-6.3	0.8	4.9	0.9	-1.7
Nominal effective exchange rate (end of period)	-13.4	-26.5	...	...	...	...	...	...
Real effective exchange rate (end of period)	-9.7	-2.3	...	...	...	...	...	...
(Percent of beginning-period stock of broad money, unless otherwise indicated)								
Money and credit								
Net foreign assets	9.6	29.1	-14.5	0.0	3.7	2.7	2.5	1.3
Net domestic assets (including other items net)	14.7	10.1	48.0	22.1	19.3	20.8	21.2	22.5
Claims on the government	1.7	-2.9	1.3	5.7	3.5	3.3	3.1	2.9
Claims on public enterprises	6.8	25.1	32.8	14.9	12.7	10.5	10.4	10.2
Claims on private sector	10.5	9.8	13.9	5.9	4.4	6.1	6.3	6.4
Broad money	24.3	39.2	33.5	22.1	23.0	23.5	23.7	23.8
Base money (annual percentage change)	6.5	40.7	-7.0	12.9	15.0	17.0	17.9	18.3
Velocity (GDP/broad money)	3.68	3.53	3.76	3.71	3.51	3.33	3.13	2.93
Lending rates (maximum rate)	16.5	...	...	...	...	...	...	...
(Percent of GDP, unless otherwise indicated)								
Financial balances								
Gross domestic saving	5.2	8.8	7.6	7.5	6.9	7.7	8.3	8.6
Public saving	4.5	4.3	4.8	4.7	5.0	5.3	5.4	5.5
Private saving	0.7	4.5	2.7	2.8	1.9	2.4	2.9	3.2
Gross domestic investment	24.7	25.5	26.1	26.1	24.3	24.1	24.8	24.5
Public investment	16.0	18.6	19.7	19.2	17.0	15.8	16.3	15.5
Private investment	8.7	6.9	6.5	6.9	7.3	8.2	8.5	9.0
Resource gap	-19.5	-16.7	-18.6	-18.6	-17.4	-16.4	-16.5	-15.9
External current account balance, including official transfers	-4.4	0.7	-6.1	-7.5	-6.2	-6.2	-6.3	-6.0
Government finances								
Revenue	14.1	13.5	13.6	13.3	13.5	13.6	13.7	13.7
Tax revenue	11.3	11.5	11.9	11.9	12.0	12.2	12.3	12.3
Nontax revenue	2.8	2.0	1.8	1.4	1.4	1.4	1.4	1.4
External grants	3.2	3.2	1.8	1.3	1.3	1.2	1.1	1.1
Expenditure and net lending	18.6	18.4	17.8	17.5	17.0	16.9	16.9	16.7
Fiscal balance, excluding grants (cash basis)	-4.6	-4.8	-4.1	-4.2	-3.6	-3.2	-3.2	-3.0
Fiscal balance, including grants (cash basis)	-1.3	-1.6	-2.3	-2.9	-2.3	-2.1	-2.1	-1.9
Total financing (including residuals)	1.3	1.6	2.3	2.9	2.3	2.1	2.1	1.9
External financing	1.1	1.5	0.8	1.4	1.3	1.1	1.1	0.9
Domestic financing (not including privatization)	0.5	0.0	1.2	1.5	1.0	1.0	1.0	1.0
Public debt ²	39.0	37.4	34.2	39.6	40.6	40.1	39.7	38.7
Domestic debt	20.9	15.4	15.7	20.6	20.4	19.4	18.0	16.5
External debt (including to the IMF)	18.1	22.0	18.5	19.0	20.1	20.7	21.7	22.2
Overall balance of payments (in millions of U.S. dollars)	685	1446	-1215	0	435	361	397	232
Gross official reserves (in millions of U.S. dollars)	1,979	3,044	2,114	2,114	2,549	2,910	3,306	3,538
(in months of imports of goods and nonfactor services of following year)	2.4	2.8	1.7	1.6	1.8	1.8	1.9	1.9
GDP at current market prices (in billions of birr)	382.9	511.2	726.5	876.7	1,020.0	1,193.7	1,387.6	1,606.7

Sources: Ethiopian authorities and IMF staff estimates and projections.

¹ Data pertain to Ethiopian fiscal year from July 8 to July 7.² Including debt of major public enterprises.

Table 4a. Ethiopia: General Government Operations, 2009/10–2016/17
(Millions of birr)

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	66,237	85,611	112,173	128,131	150,722	176,456	206,070	238,182
Revenue	53,861	69,120	99,129	116,383	137,322	162,698	190,593	220,725
Tax revenue	43,315	58,981	86,171	103,985	122,898	145,818	170,971	198,006
Direct taxes	14,903	19,550	29,231	35,276	42,063	50,418	59,996	69,466
Indirect taxes	28,412	39,431	56,941	68,710	80,835	95,401	110,975	128,540
Domestic indirect taxes	10,727	15,705	22,679	27,366	32,113	37,804	44,203	51,200
Import duties and taxes	17,685	23,726	34,261	41,342	48,720	57,596	66,770	77,339
Nontax revenue	10,546	10,139	12,957	12,397	14,424	16,880	19,622	22,719
Grants	12,376	16,491	13,045	11,748	13,400	13,757	15,478	17,457
Emergency assistance (food and nonfood aid)	631	338	675	506	405	324	259	300
Program grants ¹	6,816	9,633	6,054	3,102	3,325	2,748	3,186	3,691
Project grants	4,930	6,521	6,315	8,139	9,670	10,685	12,032	13,466
Total expenditure and net lending (cash basis) ²	71,335	93,831	129,028	153,540	173,839	201,447	234,586	268,704
Recurrent expenditure ²	32,012	40,535	54,754	65,090	76,439	90,554	105,467	122,071
Defense spending	4,000	4,750	6,500	7,000	7,500	8,500	9,000	10,421
Poverty-reducing expenditure ³	14,750	18,995	26,997	32,580	37,906	44,359	51,566	59,706
Interest payments	1,587	1,913	2,584	3,939	6,003	8,526	10,848	12,517
Domestic interest and charges	1,220	1,300	1,603	2,570	4,551	6,954	8,984	10,332
External interest payments ⁴	368	613	981	1,369	1,452	1,572	1,863	2,185
Emergency assistance (food and other emergency aid)	631	338	675	506	405	324	259	300
Other recurrent expenditure	11,044	14,539	17,998	21,065	24,624	28,845	33,794	39,128
Capital expenditure	39,322	53,297	74,274	88,450	97,400	110,893	129,119	146,632
Central treasury	29,947	38,340	61,427	68,592	75,865	87,781	103,636	120,600
External project grants	4,930	6,521	6,315	8,509	9,670	10,685	12,032	13,466
External project loans	4,446	8,436	6,531	11,349	11,865	12,427	13,451	12,566
Of which: poverty-reducing expenditure ³	32,704	43,383	61,545	74,264	86,403	100,849	116,913	135,418
Overall balance								
Including grants	-5,097	-8,220	-16,855	-25,409	-23,117	-24,991	-28,516	-30,522
Excluding grants	-17,473	-24,712	-29,899	-37,157	-36,517	-38,748	-43,994	-47,979
Financing	6,586	9,506	16,855	25,409	23,117	24,991	28,516	30,522
Net external financing	4,131	7,798	5,516	12,387	12,916	13,054	14,640	14,455
Gross borrowing	4,446	8,436	6,531	13,886	14,654	15,275	17,151	17,247
Project loans	4,446	8,436	6,531	8,849	9,365	9,927	10,951	10,066
Protection of Basic Services (PBS)	0	0	0	5,037	5,289	5,348	6,200	7,181
Amortization ⁴	-315	-638	-1,016	-1,498	-1,738	-2,221	-2,512	-2,792
Total net domestic financing	1,758	251	8,575	13,022	10,200	11,937	13,876	16,067
Privatization	697	1,458	2,764	0	0	0	0	0
Float/unidentified financing	-1,489	-1,286	0	0	0	0	0	0
Memorandum items:								
Poverty-reducing expenditure	47,453	62,379	88,542	106,844	124,310	145,208	168,479	195,123
Primary fiscal balance, including grants	-3,510	-6,308	-14,271	-21,471	-17,113	-16,465	-17,668	-18,005
Domestic fiscal balance, including grants	-7,099	-8,804	-15,397	-15,424	-13,124	-13,741	-16,387	-19,461
Gross domestic government debt	53,009	53,260	61,835	74,857	85,057	96,994	110,870	126,937

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

¹ Including the disbursements under the PBS operations starting from 2005/06.

² Excluding special programs (demobilization and reconstruction).

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

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

Table 4b. Ethiopia: General Government Operations, 2009/10–2016/17
(Percent of GDP)

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	17.3	16.7	15.4	14.6	14.8	14.8	14.9	14.8
Revenue	14.1	13.5	13.6	13.3	13.5	13.6	13.7	13.7
Tax revenue	11.3	11.5	11.9	11.9	12.0	12.2	12.3	12.3
Direct taxes	3.9	3.8	4.0	4.0	4.1	4.2	4.3	4.3
Indirect taxes	7.4	7.7	7.8	7.8	7.9	8.0	8.0	8.0
Domestic indirect taxes	2.8	3.1	3.1	3.1	3.1	3.2	3.2	3.2
Import duties and taxes	4.6	4.6	4.7	4.7	4.8	4.8	4.8	4.8
Nontax revenue	2.8	2.0	1.8	1.4	1.4	1.4	1.4	1.4
Grants	3.2	3.2	1.8	1.3	1.3	1.2	1.1	1.1
Emergency assistance (food and nonfood aid)	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Program grants ¹	1.8	1.9	0.8	0.4	0.3	0.2	0.2	0.2
Project grants	1.3	1.3	0.9	0.9	0.9	0.9	0.9	0.8
Total expenditure and net lending (cash basis) ²	18.6	18.4	17.8	17.5	17.0	16.9	16.9	16.7
Recurrent expenditure ²	8.4	7.9	7.5	7.4	7.5	7.6	7.6	7.6
Defense spending	1.0	0.9	0.9	0.8	0.7	0.7	0.6	0.6
Poverty-reducing expenditure ³	3.9	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Interest payments	0.4	0.4	0.4	0.4	0.6	0.7	0.8	0.8
Domestic interest and charges	0.3	0.3	0.2	0.3	0.4	0.6	0.6	0.6
External interest payments ⁴	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1
Emergency assistance (food and other emergency ai	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Other recurrent expenditure	2.9	2.8	2.5	2.4	2.4	2.4	2.4	2.4
Capital expenditure	10.3	10.4	10.2	10.1	9.5	9.3	9.3	9.1
Central treasury	7.8	7.5	8.5	7.8	7.4	7.4	7.5	7.5
External project grants	1.3	1.3	0.9	1.0	0.9	0.9	0.9	0.8
External project loans	1.2	1.7	0.9	1.3	1.2	1.0	1.0	0.8
Of which : poverty-reducing expenditure ³	8.5	8.5	8.5	8.5	8.5	8.4	8.4	8.4
Overall balance								
Including grants	-1.3	-1.6	-2.3	-2.9	-2.3	-2.1	-2.1	-1.9
Excluding grants	-4.6	-4.8	-4.1	-4.2	-3.6	-3.2	-3.2	-3.0
Financing	1.7	1.9	2.3	2.9	2.3	2.1	2.1	1.9
Net external financing	1.1	1.5	0.8	1.4	1.3	1.1	1.1	0.9
Gross borrowing	1.2	1.7	0.9	1.6	1.4	1.3	1.2	1.1
Project loans	1.2	1.7	0.9	1.0	0.9	0.8	0.8	0.6
Protection of Basic Services (PBS)	0.0	0.0	0.0	0.6	0.5	0.4	0.4	0.4
Amortization ⁴	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2
Total net domestic financing	0.5	0.0	1.2	1.5	1.0	1.0	1.0	1.0
Privatization	0.2	0.3	0.4	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Poverty-reducing expenditure	12.4	12.2	12.2	12.2	12.2	12.2	12.1	12.1
Primary fiscal balance, including grants	-0.9	-1.2	-2.0	-2.4	-1.7	-1.4	-1.3	-1.1
Domestic fiscal balance, including grants	-1.9	-1.7	-2.1	-1.8	-1.3	-1.2	-1.2	-1.2
Gross domestic government debt	13.8	10.4	8.5	8.5	8.3	8.1	8.0	7.9

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

¹ Including the disbursements under the PBS operations starting from 2005/06.

² Excluding special programs (demobilization and reconstruction).

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

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

Table 4c. Ethiopia: Statement of Government Operations (GFSM2001), 2009/10–2016/17

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
(Millions of birr)								
Transactions affecting net worth:								
Revenue	66,237	85,611	112,173	128,131	150,722	176,456	206,070	238,182
Taxes	43,315	58,981	86,171	103,985	122,898	145,818	170,971	198,006
Taxes on income, profits, and capital gains	14,903	19,550	29,231	35,276	42,063	50,418	59,996	69,466
Taxes on goods and services	10,727	15,705	22,679	27,366	32,113	37,804	44,203	51,200
Taxes on international trade and transactions	17,685	23,726	34,261	41,343	48,721	57,597	66,772	77,340
Grants	12,376	16,491	13,045	11,748	13,400	13,757	15,478	17,457
Other revenue	10,546	10,139	12,957	12,397	14,424	16,880	19,622	22,719
Expense	32,012	40,535	54,754	65,090	76,439	90,554	105,467	122,071
Non-interest expenditure	30,425	38,622	52,170	61,151	70,435	82,028	94,619	109,555
Interest payment	1,587	1,913	2,584	3,939	6,003	8,526	10,848	12,517
Domestic	1,220	1,300	1,603	2,570	4,551	6,954	8,984	10,332
External	368	613	981	1,369	1,452	1,572	1,863	2,185
Gross operating balance	34,117	44,883	57,171	62,802	74,007	85,578	100,227	115,675
Transactions in nonfinancial assets:								
Net acquisitions of nonfinancial assets	39,322	53,297	74,274	88,450	97,400	110,893	129,119	146,632
Net lending(+)/borrowing(-)	-5,097	-8,220	-16,855	-25,409	-23,117	-24,991	-28,516	-30,522
Transactions in financial assets and liabilities:								
Net acquisition of financial assets	-697	-1,458	-2,764	0	0	0	0	0
Domestic	-697	-1,458	-2,764	0	0	0	0	0
Net incurrence of liabilities	5,889	8,049	14,091	25,409	23,117	24,991	28,516	30,522
Domestic	1,758	251	8,575	13,022	10,200	11,937	13,876	16,067
Foreign	4,131	7,798	5,516	12,387	12,916	13,054	14,640	14,455
Statistical discrepancies	1,489	1,286	0	0	0	0	0	0
(Percent of GDP)								
Transactions affecting net worth:								
Revenue	17.3	16.7	15.4	14.6	14.8	14.8	14.9	14.8
Taxes	11.3	11.5	11.9	11.9	12.0	12.2	12.3	12.3
Taxes on income, profits, and capital gains	3.9	3.8	4.0	4.0	4.1	4.2	4.3	4.3
Taxes on goods and services	2.8	3.1	3.1	3.1	3.1	3.2	3.2	3.2
Taxes on international trade and transactions	4.6	4.6	4.7	4.7	4.8	4.8	4.8	4.8
Grants	3.2	3.2	1.8	1.3	1.3	1.2	1.1	1.1
Other revenue	2.8	2.0	1.8	1.4	1.4	1.4	1.4	1.4
Expense	8.4	7.9	7.5	7.4	7.5	7.6	7.6	7.6
Non-interest expenditure	7.9	7.6	7.2	7.0	6.9	6.9	6.8	6.8
Interest payment	0.4	0.4	0.4	0.4	0.6	0.7	0.8	0.8
Domestic	0.3	0.3	0.2	0.3	0.4	0.6	0.6	0.6
External	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1
Gross operating balance	8.9	8.8	7.9	7.2	7.3	7.2	7.2	7.2
Transactions in nonfinancial assets								
Net acquisitions of nonfinancial assets	10.3	10.4	10.2	10.1	9.5	9.3	9.3	9.1
Net lending(+)/borrowing(-)	-1.3	-1.6	-2.3	-2.9	-2.3	-2.1	-2.1	-1.9
Transactions in financial assets and liabilities								
Net acquisition of financial assets	-0.2	-0.3	-0.4	0.0	0.0	0.0	0.0	0.0
Domestic	-0.2	-0.3	-0.4	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	1.5	1.6	1.9	2.9	2.3	2.1	2.1	1.9
Domestic	0.5	0.0	1.2	1.5	1.0	1.0	1.0	1.0
Foreign	1.1	1.5	0.8	1.4	1.3	1.1	1.1	0.9
Statistical discrepancies	0.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0

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

Table 5. Ethiopia: Monetary Survey and Central Bank Accounts, 2009/10–2012/13¹

	2009/10	2010/11	2011/12		2012/13	
	Act.	Act.	Auth	Est.	Auth	Proj.
(Millions of birr)						
Monetary survey						
Net foreign assets	27,905	58,157	34,751	37,107	38,986	37,107
Central bank	15,895	35,637	21,393	19,525	22,332	19,525
Commercial banks	12,010	22,520	13,358	17,582	16,654	17,582
Net domestic assets	76,212	86,735	150,787	156,324	191,285	199,053
Domestic credit	105,407	138,696	201,070	208,116	243,425	259,350
Claims on government (net) ²	34,695	31,655	23,261	33,522	27,589	44,522
Claims on nongovernment	70,712	107,041	177,809	174,594	215,836	214,828
Public enterprises	31,436	57,613	...	105,095	...	133,915
Private sector	39,276	49,428	...	69,499	...	80,913
Other items (net)	-29,195	-51,961	-50,283	-51,792	-52,140	-60,297
Broad money	104,117	144,892	185,539	193,431	230,271	236,159
Money	51,985	75,763	...	96,929	...	114,137
Currency outside banks	23,950	32,768	40,079	38,666	45,995	41,713
Demand deposits	28,034	42,996	...	58,263	...	72,424
Quasi money	52,133	69,129	...	96,502	...	122,023
Savings deposits	48,196	64,405	...	89,982	...	113,831
Time deposits	3,937	4,724	...	6,520	...	8,192
Central bank						
Net foreign assets	15,895	35,637	21,393	19,525	22,332	19,525
Foreign assets	26,805	51,517	37,555	35,405	39,435	35,405
Foreign liabilities	10,910	15,880	16,162	15,880	17,103	15,880
Net domestic assets	32,774	32,832	44,957	44,152	52,084	52,353
Domestic credit	36,421	48,647	58,126	56,397	73,126	72,199
Government (net)	36,421	42,397	45,324	42,397	54,324	53,397
Other items (net)	-3,647	-15,815	-13,168	-12,245	-21,042	-19,846
Base money	48,670	68,469	66,350	63,676	74,416	71,877
Currency outside banks	23,950	32,768	40,079	38,666	45,995	41,713
Commercial bank reserves	24,719	35,701	26,271	25,010	28,421	30,165
Cash in vault	4,977	6,693	7,619	4,439	8,761	5,052
Reserve deposit	19,742	29,008	18,652	20,571	19,660	25,113
(Annual percentage change, unless otherwise indicated)						
Monetary survey						
Net foreign assets	40.4	108.4	...	-36.2	12.2	0.0
Net domestic assets	19.3	13.8	...	80.2	26.9	27.3
Domestic credit	17.7	31.6	...	50.1	21.1	24.6
Claims on government (net)	4.1	-8.8	...	5.9	18.6	32.8
Claims on nongovernment	25.7	51.4	...	63.1	21.4	23.0
Public enterprises	22.0	83.3	...	82.4	...	27.4
Private sector	28.9	25.8	...	40.6	...	16.4
Broad money	24.3	39.2	...	33.5	24.1	22.1
Money	20.6	45.7	...	27.9	...	17.8
Quasi money	28.2	32.6	...	39.6	...	26.4
Memorandum items:						
Base money growth	6.5	40.7	-3.9	-7.0	12.2	12.9
Excess reserve deposit (billions of birr)	3,838	7,033	...	3,664	...	4,237
in percent of deposits	4.2	5.5	...	2.2	...	2.0
Money multiplier (broad money/reserve money)	2.14	2.12	2.80	3.04	3.36	3.29
Velocity (GDP/broad money)	3.68	3.53	...	3.76	...	3.71
Currency-deposit ratio	0.299	0.292	0.276	0.250	0.250	0.215
Gross official foreign reserves (millions of U.S. dollars)	1,979	3,044	2,118	2,114	2,188	2,114
Birr per US dollar (end of period)	13.54	16.91	17.73	17.77	18.62	...
Nominal GDP (millions of birr)	382,939	511,157	...	726,475	...	876,713

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

¹ Year ending July 7. Including commercial bank claims and liabilities to Eritrea. The columns for the authorities reflect NBE's estimates and targets for end-June.² Claims on the general government by the banking system less deposits of the general government with the banking system.

Table 6. Ethiopia: Balance of Payments, 2009/10–2016/17¹

	2009/10	2010/11	2011/12		2012/13		2013/14	2014/15	2015/16	2016/17
	Act.	Act.	Auth.	Est.	Auth.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-1,293	234	-2,680	-2,556	-1,743	-3,554	-3,173	-3,448	-3,823	-3,919
(Percent of GDP)	-4.4	0.7	-6.4	-6.1	-3.7	-7.5	-6.2	-6.2	-6.3	-6.0
Current account balance, excl. official transfers	-3,207	-1,657	-4,323	-4,255	-3,327	-5,417	-5,171	-5,550	-6,029	-6,225
(Percent of GDP)	-10.8	-5.2	-10.3	-10.1	-7.0	-11.5	-10.1	-10.0	-10.0	-9.5
Trade balance	-6,321	-5,506	-7,818	-7,970	-6,784	-9,324	-9,616	-9,988	-10,997	-11,438
Exports of goods	2,003	2,747	3,200	3,211	4,068	3,574	3,988	4,605	5,341	6,039
Imports of goods	-8,324	-8,253	-11,018	-11,181	-10,852	-12,897	-13,604	-14,592	-16,338	-17,476
Services (net)	513	757	233	685	87	999	1,165	1,266	1,376	1,391
Exports	2,044	2,595	2,828	2,783	2,890	3,302	3,692	4,039	4,420	4,732
Imports	-1,531	-1,837	-2,596	-2,098	-2,803	-2,303	-2,527	-2,773	-3,044	-3,340
Income (net)	-108	-70	-91	-158	-118	-195	-257	-317	-350	-418
Private transfers (net)	2,708	3,162	3,354	3,188	3,488	3,103	3,537	3,490	3,941	4,240
Official transfers (net)	1,915	1,890	1,643	1,699	1,584	1,863	1,998	2,102	2,206	2,305
Capital account balance	2,574	2,473	2,636	2,599	3,016	3,554	3,608	3,809	4,219	4,151
Foreign direct investment (net)	956	1,243	1,305	1,309	1,409	1,529	1,801	2,081	2,241	2,556
Other investment (net) ²	1,437	1,231	1,332	1,290	1,607	2,024	1,807	1,728	1,979	1,596
Of which: Official long-term loans	1,210	1,387	1,582	1,290	1,882	2,024	1,795	1,716	1,927	1,596
Disbursements	1,387	1,539	...	1,605	...	2,365	2,260	2,318	2,614	2,382
Amortization	-177	-152	...	-316	...	-341	-465	-603	-687	-786
Monetary Authority	180	0	0	0	0	0	0	0	0	0
Errors and omissions	-596	-1,261	-1,464	-1,258	0	0	0	0	0	0
Overall balance	685	1,446	-1,507	-1,215	1,273	0	435	361	397	232
Financing	-685	-1,446	1,507	1,215	-1,273	0	-435	-361	-397	-232
Central bank (net; increase -)	-323	-1,002	754	930	0	0	-435	-361	-397	-232
Reserves (increase -)	-398	-1,065	948	930	0	0	-435	-361	-397	-232
Liabilities (increase +)	75	62	-194	0	0	0	0	0	0	0
Commercial banks (net; increase -)	-361	-444	753	285	-1,273	0	0	0	0	0
Memorandum items:										
Exports of goods	38.3	37.1	...	16.9	...	11.3	11.6	15.5	16.0	13.1
Export volume index	10.3	8.6	...	1.1	...	18.1	8.8	8.5	13.1	13.8
Imports of goods	7.7	-0.9	...	35.5	...	15.4	5.5	7.3	12.0	7.0
Import volume index	14.1	-8.5	...	29.5	...	15.9	3.4	5.2	9.8	5.9
Services exports	5.7	26.9	...	7.3	...	18.6	11.8	9.4	9.4	7.1
Services imports	1.1	20.0	...	14.2	...	9.8	9.7	9.7	9.7	9.7
Exports of goods and services (percent of GDP)	13.6	16.8	...	14.3	...	14.5	15.1	15.5	16.1	16.4
Imports of goods and services (percent of GDP)	-33.2	-31.8	...	-31.7	...	-32.1	-31.6	-31.2	-32.0	-31.8
Gross official reserves (millions U.S. dollars)	1,979	3,044	...	2,114	...	2,114	2,549	2,910	3,306	3,538
(Months of following year imports of goods and services)	2.4	2.8	...	1.7	...	1.6	1.8	1.8	1.9	1.9
Terms of trade index	29.6	18.7	...	10.6	...	-6.3	0.8	4.9	0.9	-1.7

Sources: Ethiopian authorities and IMF staff estimates and projections.

¹ Data pertain to Ethiopian fiscal year from July 8 to July 7.² For 2008/09 and 2009/10, other investment (net) includes a correction for the timing difference between entry of ETC imports and corresponding loan disbursements.

Table 7. Ethiopia: Alternative Scenario - Selected Economic and Financial Indicators, 2009/10–2016/17 ¹

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
	Prel.	Est.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
(Annual percentage change)								
National income and prices								
GDP at constant prices (at factor cost)	8.0	7.5	7.0	7.0	7.5	7.5	8.0	8.5
GDP deflator	3.9	24.4	31.6	12.8	7.5	6.5	5.8	5.9
Consumer prices (period average)	2.8	18.1	33.4	14.4	7.3	6.0	6.0	6.0
Consumer prices (end period)	7.3	38.1	20.8	9.0	6.0	6.0	6.0	6.0
External sector								
Exports (in U.S. dollars, f.o.b.)	38.3	37.1	16.9	12.4	18.5	19.3	19.7	24.8
Imports (in U.S. dollars, c.i.f.)	7.7	-0.9	35.5	15.2	6.9	8.3	13.0	9.7
Export volume	10.3	8.6	1.1	20.5	15.9	14.5	18.9	24.8
Import volume	14.1	-8.5	27.1	13.5	4.8	6.2	10.8	8.6
Terms of trade (deterioration –)	29.6	18.7	8.6	-9.5	0.6	2.8	-1.2	-1.1
Nominal effective exchange rate (end of period)	-13.4	-26.5	...	...	...	...	...	...
Real effective exchange rate (end of period)	-9.7	-2.3	...	...	...	...	...	...
(Percent of beginning-period stock of broad money, unless otherwise indicated)								
Money and credit								
Net foreign assets	9.6	29.1	-14.5	4.8	8.8	8.3	4.7	4.3
Net domestic assets (including other items net)	14.7	10.1	48.0	18.0	15.3	17.8	22.4	23.2
Claims on the government	1.7	-2.9	1.3	5.7	3.4	3.2	2.9	2.6
Claims on public enterprises	6.8	25.1	32.8	12.8	10.3	9.4	12.2	11.5
Claims on private sector	10.5	9.8	13.9	4.4	2.9	5.4	7.4	7.3
Broad money	24.3	39.2	33.5	22.8	24.1	26.1	27.1	27.5
Base money (annual percentage change)	6.5	40.7	-7.0	13.5	16.0	19.1	21.1	25.0
Velocity (GDP/broad money)	3.68	3.53	3.75	3.69	3.44	3.12	2.81	2.54
Lending rates (maximum rate)	16.5	...	...	...	...	...	...	...
(Percent of GDP, unless otherwise indicated)								
Financial balances								
Gross domestic saving	5.2	8.8	7.8	7.5	8.2	10.3	12.8	14.4
Public saving	4.5	4.3	4.8	4.7	5.1	5.4	5.8	6.0
Private saving	0.7	4.5	3.0	2.8	3.1	4.8	7.0	8.4
Gross domestic investment	24.7	25.5	26.5	26.1	25.6	27.0	29.9	30.6
Public investment	16.0	18.6	20.0	18.2	16.4	16.4	17.0	16.4
Private investment	8.7	6.9	6.5	7.8	9.2	10.5	12.9	14.2
Resource gap	-19.5	-16.7	-18.6	-18.6	-17.4	-16.7	-17.1	-16.2
External current account balance, including official transfers	-4.4	0.7	-6.1	-7.5	-6.1	-6.2	-6.5	-5.9
Government finances								
Revenue	14.1	13.5	13.7	13.3	13.6	13.9	14.3	14.5
Tax revenue	11.3	11.5	11.9	11.9	12.2	12.5	12.9	13.1
Nontax revenue	2.8	2.0	1.8	1.4	1.4	1.4	1.4	1.4
External grants	3.2	3.2	1.8	1.3	1.3	1.2	1.2	1.1
Expenditure and net lending	18.6	18.4	17.8	17.5	17.2	17.2	17.6	17.6
Fiscal balance, excluding grants (cash basis)	-4.6	-4.8	-4.1	-4.2	-3.6	-3.3	-3.3	-3.1
Fiscal balance, including grants (cash basis)	-1.3	-1.6	-2.3	-2.9	-2.3	-2.1	-2.1	-1.9
Total financing (including residuals)	1.3	1.6	2.3	2.9	2.3	2.1	2.1	1.9
External financing	1.1	1.5	0.8	1.4	1.3	1.1	1.1	0.9
Domestic financing (not including privatization)	0.5	0.0	1.2	1.5	1.0	1.0	1.0	1.0
Privatization receipts								
Public debt ²	39.0	37.4	34.3	37.3	37.8	37.6	37.7	37.1
Domestic debt	20.9	15.4	15.8	18.2	17.6	16.3	15.1	13.8
External debt (including to the IMF)	18.1	22.0	18.5	19.0	20.3	21.3	22.6	23.3
Overall balance of payments (in millions of U.S. dollars)	685	1446	-1215	497	1046	1146	757	838
Gross official reserves (in millions of U.S. dollars)	1,979	3,044	2,114	2,611	3,657	4,803	5,560	6,398
(in months of imports of goods and nonfactor services of following year)	2.4	2.8	1.7	1.9	2.5	2.9	3.0	3.2
GDP at current market prices (in billions of birr)	382.9	511.2	724.9	875.4	1,013.1	1,161.9	1,330.3	1,530.8

Sources: Ethiopian authorities and IMF staff estimates and projections.

¹ Data pertain to Ethiopian fiscal year from July 8 to July 7.² Including debt of major public enterprises.

Table 8. Ethiopia: Financial Soundness Indicators of the Commercial Banking Sector, 2008–12
(In percent, unless otherwise indicated)

	Jun-08	Jun-09	Jun-10	Jun-11	Mar-12
Capital adequacy					
Regulatory capital to risk-weighted assets	18.9	18.7	18.7	18.1	13.6
Regulatory Tier I capital to risk-weighted assets	18.9	18.7	18.7	18.1	13.6
Capital (net worth) to assets	10.1	9.6	9.1	7.8	7.0
Asset quality and composition					
NPLs to gross loans	6.8	6.0	3.5	2.1	1.8
NPLs net of provision to capital	5.6	7.3	0.7	-3.8	-1.2
Spread between highest and lowest interbank rate	...	...	...	...	...
Earning and profitability ¹					
ROA	2.9	3.2	4.0	3.0	4.1
ROE (total capital) ²	27.7	31.5	42.2	31.5	34.2
ROE (core capital) ³	29.8	34.0	46.4	34.9	55.8
Gross interest income to total income ⁴	54.9	57.1	60.1	54.4	54.7
Interest margin to gross income ⁵	46.1	50.6	38.7	40.0	45.0
Noninterest expenses to gross income	36.6	27.8	28.0	28.7	26.6
Personnel expenses to noninterest expenses	40.6	50.5	46.0	51.1	42.3
Trading and fee income to gross income	53.9	49.4	61.3	52.0	55.0
Spread between reference loan and deposit rates	7.0	7.4	6.4	6.4	6.4
Liquidity					
Liquid assets to total assets	31.5	30.8	32.7	32.7	19.1
Liquid assets to short term liabilities	41.9	40.4	42.7	43.4	24.1
Total (non-interbank) loans to customer deposit ⁶	87.2	82.0	80.1	81.9	92.5
FX liabilities to total liabilities					

Source: Ethiopian authorities.

1/ Earning ratios indicated for March 2012 is provisional.

2/ The average capital used to calculate the ROE includes retained earnings, profits and loss.

3/ The average capital used to calculate the ROE excludes retained earnings, profits and loss.

4/ Total income comprises gross interest income and gross non-interest income.

5/ Gross income comprises net interest income and total non-interest income.

6/ Customer deposit includes time, current and saving deposits and total loans include bonds.

Annex I: Exchange Rate Assessment

The exchange rate assessment based on the IMF's CGER methodology suggests that Ethiopia's real effective exchange rate (REER) is overvalued in the range of 11–23 percent in mid-2012 (Figure I.1). The CGER involves three standard approaches: (i) the macroeconomic balance approach, (ii) the equilibrium REER approach, and (iii) the external sustainability approach. The estimates indicate increased overvaluation compared to the assessment of 8–11 percent in the 2011 Article IV consultation.

The macroeconomic balance approach indicates the REER depreciation of 11 percent is required to close the gap between the underlying current account projection and an estimated equilibrium current account balance. The current account balance is projected to be 6.1 percent of GDP in 2011/12, while its medium-term forecast is 6.0 percent of GDP. By removing temporary factors, an underlying current account deficit is estimated at 6.1 percent of GDP¹. It is compared to the estimated equilibrium current account balance norm, obtained from a panel regression. The current account deficit norm for Ethiopia is estimated at 5.1 percent of GDP, mainly reflecting continued aid inflows and net import of oil to support growth. With the estimated elasticity of the current account with respect to the REER of -0.1,² an exchange rate depreciation of 11 percent is necessary to close the gap.

¹ The underlying current account deficit is obtained as the average of the estimate of 2011/12 current account balance, the current account balance forecast for 2016/17, and the Hodrick-Prescott filtered series.

² The elasticity is calculated using Ethiopia's export and import share in GDP and the volume elasticities suggested in Isard and others (2001).

The equilibrium real exchange rate approach shows the overvaluation of 11 percent from an equilibrium REER estimated with medium-term fundamentals. The model suggests a stable path of the equilibrium REER reflecting minor deteriorations in terms of trade and slightly improved government consumption. However, the actual REER deviates from the equilibrium level and is overvalued by 11 percent in 2012. The external sustainability approach suggests a higher level of overvaluation estimated at 23 percent. The approach calculates the current account balance that would stabilize the net foreign asset (NFA) position at an appropriate level. With projected nominal growth of 14.7 percent in Ethiopia, the underlying current account deficit of 6.1 percent would result in a long-run NFA position equal to -48 percent of GDP. To sustain the NFA position at the average of the past five years (-31.3 percent of GDP), the current account deficit should be 4 percent of GDP. To close the gap from the underlying current account deficit, the REER needs to depreciate by 23 percent.

Business climate indicators also highlight structural weakness that could undermine competitiveness. In the World Bank's Doing Business Survey, Ethiopia stands at 111 out of 183 countries in 2012, moved down from 97 out of 179 countries in 2007. Compared to the SSA average, Ethiopia shows strength in the ease of paying taxes and enforcing contracts. On the other hand, weakness is found in a number of areas including registering property, getting credit, protecting investors, trading across borders. In some areas, especially on the access to credit and the trading costs, Ethiopia's rank dropped significantly in the last five years. Structural improvements in these areas can help reduce the cost of doing business and strengthen Ethiopia's external competitiveness.

Figure I.1. Ethiopia: 2012 Exchange Rate Assessment

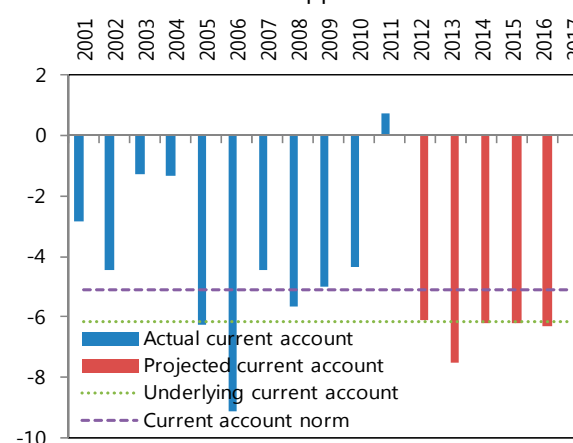
Summary of the Assessment

Overvaluation of the Real Effective Exchange Rate

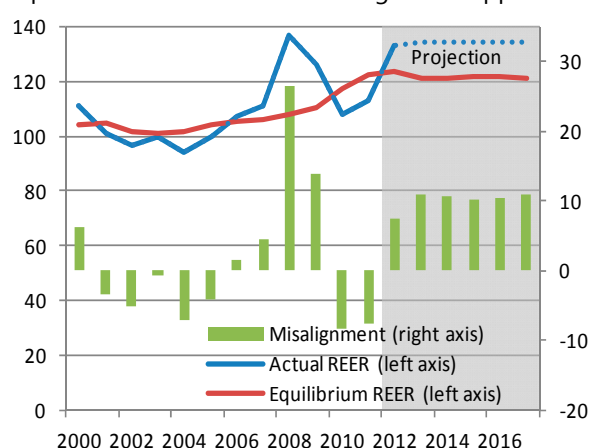
(Percent)

	Overvaluation
Overall	11-23
Macroeconomic balance approach	11.4
Equilibrium real effective exchange rate approach	10.8
External sustainability approach	23.4

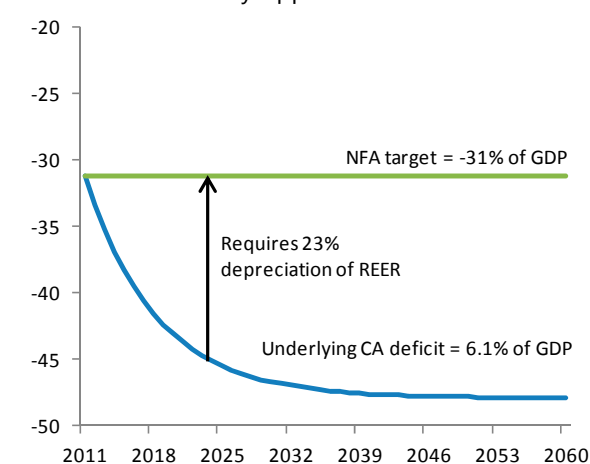
Macroeconomic Balance Approach



Equilibrium Real Effective Exchange Rate Approach



External Sustainability Approach



Survey Based Indicators

Ranking on the Ease of Doing Business

	2012	2007
	Ethiopia	SSA 1/ Ethiopia
Overall Ranking	111	97
Starting a business	99	123
Dealing with construction permits	56	112
Getting electricity	93	122
Registering property	113	119
Getting credit	150	110
Protecting investors	122	112
Paying taxes	40	115
Trading across borders	157	134
Enforcing contracts	57	117
Resolving insolvency	89	127
Number of countries	183	175

Source: World Bank Doing Business 2012

1/ Regional average for Sub-saharan Africa.

Annex II. Reserve Adequacy Assessment

Ethiopia had been accumulating foreign exchange reserves since 2008 when the country faced world commodity price surges and the global recession and with Fund support¹, but the trend reversed in 2011 as a result of foreign exchange reserve sales to control domestic liquidity. Foreign exchange reserves decreased from a peak at about US\$3.5 billion in September 2011 to about US\$2.3 billion (1.8 months of prospective imports) in April 2012. The current level is well below the commonly-used rule of thumb of 3 months of import cover, potentially putting external stability at risk. This annex analyzes the optimal level of foreign exchange reserves for Ethiopia by applying standard metrics and a new analytical method that takes into account possible adverse external shocks.

The Ethiopian economy is exposed to various exogenous shocks, such as volatilities in the terms of trade, export demand, and aid inflows, suggesting a need for an adequate level of foreign exchange reserve to smooth adjustment. Ethiopia's major exports are agricultural goods and commodities (notably, coffee and gold) whose international prices fluctuate greatly and whose outputs are affected by periodic significant droughts. Risks of fuel price increases or global downturns can also adversely affect the trade balance, given Ethiopia's dependence on petroleum imports (5 percent of GDP). In addition, although capital account transactions are limited in Ethiopia, aid inflows have been large (about 5–7 percent of GDP) and volatile.

¹ The disbursements under the 2009/10 ESF totaled 153.76 million SDR and the SDR allocation was 116.8 million SDR.

Traditional measures of reserve adequacy provide mixed evaluations for Ethiopia. The most commonly used rule of thumb is reserves equivalent to 3 months of prospective imports of goods and services. It represents the number of months a country can support if all external inflows were to cease. In Ethiopia, reserve coverage has stayed below the threshold since mid-2005. Another often used metric is a ratio of foreign exchange reserve to broad money, which captures the potential for capital flight and is an appropriate measure for countries with a pegged exchange rate. Wijnholds and Kapteyn (2001) argue that the minimum for countries with a managed float regime could be 10–20 percent of broad money.² In Ethiopia, the ratio was 23 percent in April 2012, which is above a suggested threshold. However, the relevance of the latter measure is limited because Ethiopia has a closed capital account and the possibility of capital flight is limited.

Dabla-Norris and Others (2011)³ proposed a new methodology to assess the optimal precautionary reserve holdings for low income countries considering country characteristics and fundamentals. The methodology calculates a crisis mitigating benefit of reserve holdings by calculating the likelihood and the cost of a crisis for given policy fundamentals, exchange rate regime, and assumed external

² Wijnholds and Kapteyn, 2001, "Reserve Adequacy in Emerging Market Economies," IMF Working Paper 01/143 (Washington: International Monetary Fund).

³ Dabla-Norris, Kim and Shirono, 2011, "Optimal Precautionary Reserves for Low-Income Countries: A Cost-Benefit Analysis," IMF Working Paper 11/249 (Washington: International Monetary Fund).

shocks. A crisis is defined as a sharp drop in absorption per capita. The benefit is compared to the cost of holding reserves, which is typically measured by a difference between domestic and foreign real interest rates.

This methodology suggests the optimal amount of foreign exchange reserves for Ethiopia is equivalent to 7.1 months of imports (US\$9.5 billion). The benefit maximizing amount of reserve is calculated with the following assumptions. Policy fundamentals, i.e., government fiscal balance and CPIA, are set at the average of 2005/16–2010/11. The shock variables include global growth, terms of trade growth, the FDI to GDP ratio, and the aid to GDP ratio. Their bottom 10 percentiles during 2005/06–2010/11 are used. In the absence of market determined interest rates, the results are evaluated with setting the cost of holding foreign exchange reserves at 5 percent that is a middle point of the range of the marginal product of capital in low income countries in the literature.⁴ ⁵ With these assumptions, the implied optimal reserves are equivalent to 7.1 months of imports for Ethiopia where de facto exchange rate regime is crawling peg. If Ethiopia refrained from interventions and would allow the exchange

rate to float, the optimal reserves would be lowered to 2.7 months of imports.

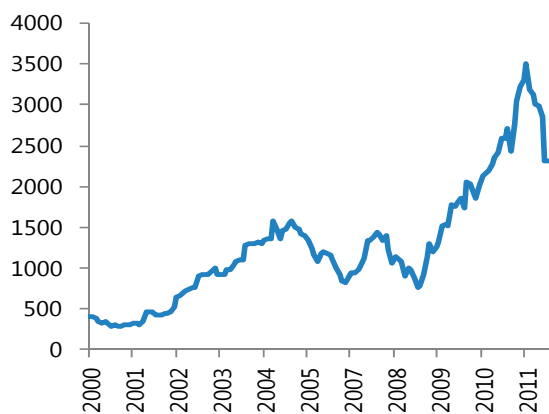
The overall results suggest Ethiopia should accumulate a larger amount of foreign exchange reserves to mitigate the potential adverse impact from external shocks. If Ethiopia maintains the crawling peg without devaluation, despite a significantly overvalued real effective exchange rate (see Annex I), the reserves would serve an important role in preventing an external payment crisis. Given the trade volume growth has been on rise in recent years, it could be difficult to keep up with the optimal amount to maintain the exchange rate regime.

⁴ Domestic real interest rates are highly negative in Ethiopia, implying a low cost of holding reserves. On the other hand, a return on public investment – another measure of opportunity costs of holding reserves – can be high. The results are evaluated at 4 percent drawing on Caselli and Freyer (2007) that suggest a 3–8 range for the marginal product of capital in low income countries after correcting for reproducible capital and relative price of capital goods. See Caselli and Freyer, 2007, “The Marginal Product of Capital,” *Quarterly Journal of Economics*, 122, pp. 535–568.

⁵ The authorities recognize that the returns on public investments in Ethiopia are high.

Figure II.1. Assessment of Reserve Adequacy

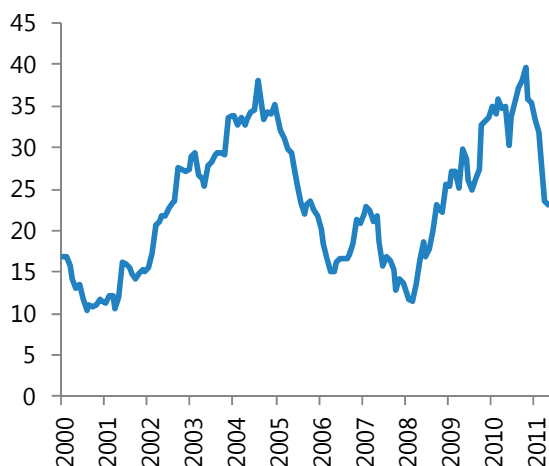
Foreign Exchange Reserves
(Millions US\$)



Foreign Exchange Reserves to imports
(Months of imports)



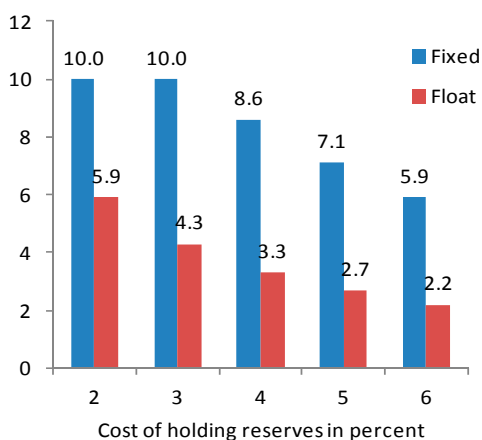
Foreign Exchange Reserves to Broad Money
(Percent)



Fundamentals and adverse external shocks

Government balance, % of GDP	-2.95
CPIA	3.40
External demand growth, percent	1.56
Terms of trade growth, percent	-1.70
Change in FDI to GDP	-0.30
Change in aid to GDP	-0.79

Optimal level of reserves for Ethiopia
(months of prospective imports)





THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

August 27, 2012

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Prepared by the International Monetary Fund and the
International Development Association

Based on the Low-Income Country Debt Sustainability Analysis (LIC DSA) framework, Ethiopia's risk of external debt distress remains low. The public DSA suggests Ethiopia's overall public sector debt dynamics are sustainable under the baseline scenario but vulnerable under several alternative scenarios. Public sector debt ratios are projected to rise in the medium term, suggesting that close monitoring of borrowing by public enterprises remains a necessity. Maintaining the growth of exports through diversification of the export sector, developing a medium-term debt strategy for the public sector, and limiting non-concessional borrowing remain keys to maintaining a low risk of external debt distress.

BACKGROUND AND KEY FINDINGS

1. The last Debt Sustainability Analysis (DSA), prepared in August 2011, concluded that Ethiopia was at a low risk of external debt distress. Ethiopia reached the completion point under the Heavily Indebted Poor Country (HIPC) Initiative in 2004 and benefited from debt relief under the Multilateral Debt Relief Initiative (MDRI) in 2006. In recent years, public and publicly guaranteed (PPG) external debt rose rapidly and reached 23 percent of GDP at end-2010/11.^{1,2} The share of commercial loans in total PPG external debt at end-2010/11 was 28 percent.³ Domestic public debt consists of short-term treasury bills and public enterprises bonds, both carrying low interest rates. There is no foreign exchange denominated domestic debt.

2. Ethiopia remains at low risk of external debt distress in 2012. The present value (PV) of PPG external debt declined from 15.3 percent of GDP as projected in the 2011 DSA to 13.6 percent of GDP, reflecting higher-than-projected inflation and smaller than-projected currency depreciation. The ratio of PV of PPG external debt to exports

¹ The Ethiopian fiscal year runs from July 8 to July 7.

² While Ethiopia has received debt relief from most of its creditors, it has not been able to reach agreement with bilateral official creditors from Bulgaria, Libya, and FR Yugoslavia and commercial creditors from Italy, former Czechoslovakia, and FR Yugoslavia whose outstanding loans (US\$378.8 million) accounted for 7.0 percent of the debt stock in 2009/10. HIPC terms are assumed for these loans. Negotiations with Russia on outstanding loans (US\$161.6 million) are at an advanced stage, and debt service on these loans is excluded from this DSA.

³ Ethiopian Airlines (EAL) debt is excluded from PPG debt, because, although owned by the government, it is run on commercial terms. EAL enjoys managerial independence, borrows without any government guarantees, publishes annual audited reports and has a sizeable profit margin.

remains broadly the same at around 97 percent. The inclusion of workers' remittances significantly lowers the baseline average of the debt-to-exports ratios in the projection period (2011/12–2031/32) by 20 percentage points.⁴ There is no breach of any indicative threshold in either case, excluding or including workers' remittances.⁵ Consequently, the current DSA follows the practice prescribed in the LIC DSA framework and focuses on the baseline without remittances in the following analysis.

3. The current DSA assumes lower concessional loan disbursements, particularly from International Development Association (IDA), and higher nonconcessional external loan disbursements between 2013/14 and 2019/20. A decrease in projected concessional loan disbursements by multilateral creditors has contributed to improvements in the external debt sustainability indicators although it implies a lower

⁴ Based on the 2011 Country Policy and Institutional Assessment (CPIA) score, Ethiopia is classified as a medium performer. The thresholds for the debt burden for medium performers are 150, 40 and 250 for the PV of debt to exports, GDP, and revenue, respectively; debt service thresholds are 20 and 30 percent of exports and revenue, respectively. In the scenarios that include workers' remittances, the thresholds were revised recently, and the corresponding threshold for PV of debt to exports and remittances is 120 percent (compared to 135 in the 2011 DSA) and is 16 percent for debt service to exports and remittances (compared to 18 percent in the 2011 DSA); the PV of debt to GDP and remittances is 36 percent.

⁵ Consistent with the approach described in the 2009 debt sustainability framework review, workers' remittances are accounted for because they have proven to be a reliable source of foreign exchange for Ethiopia, even through the crisis. They materially lower the debt and debt service ratios and their profiles, and threshold breaches associated with their exclusion are not protracted.

grant element on new borrowing throughout the projection periods (Text Table 1). Disbursements of some nonconcessional loans were delayed, resulting in a decline in 2011/12 and 2012/13. This DSA (2012) assumes disbursements of about US\$523 million in nonconcessional loans a year in the next three years and US\$643 million on average over the projection period (2012–32) with a peak of US\$968 million in 2015/16.⁶ Over the time horizon of the DSA, 53 percent of new external loans are assumed to be concessional on average. Average maturity on all new external loans is assumed to be 28 years while new nonconcessional loans are assumed to carry a maturity of 12–13 years. Average interest rates on new external loans are assumed at 3.2 percent over the horizon, and interest rates on new nonconcessional loans are assumed to be in the 6–7 percent range.

4. Some of the large public investment projects by state-owned enterprises could pose risks to Ethiopia’s debt risk rating and overall public debt sustainability. The state-owned power company, the Ethiopia Electricity Power Company, is undertaking several large investment projects. Most rely on external assistance and loans (including both concessional and nonconcessional) while the Renaissance Dam project, estimated by the authorities to cost 10 percent of 2012/13 GDP, is intended to be entirely financed domestically. The Ethiopian Railway Corporation recently signed contracts with Chinese and Turkish companies for projects whose total size is more than US\$3 billion, or 6 percent of 2012/13 GDP. It would be prudent for the authorities to formulate a medium-term debt management strategy and to start monitoring the overall debt (including external and domestic) of the consolidated public sector.

⁶ Ethiopia is subject to the IDA Non-Concessional Borrowing Policy (NCBP). In 2011 and 2012, the authorities have requested a ceiling on nonconcessional borrowing of US\$1 billion a year under IDA’s nonconcessional borrowing policy framework (see IDA’s Nonconcessional Borrowing Policy: A Progress Update, April 2010). In the absence of an IMF program, IDA could establish an NCB limit if consistent with the maintenance of low debt vulnerabilities and if the planned investments are critical and growth-enhancing. A request to establish such a limit has to be made by the authorities; the World Bank Board would then be informed of the decision per the NCBP. This DSA suggests a nonconcessional borrowing limit of US\$1 billion a year for 2012/13–2015/16 to maintain a low risk rating.

Text Table 1. Comparison of PPG External Debt: Baseline Scenario							
	2011/12	2012/13	2013/14	2014/15	2015/16	2020/21	2030/31
(Percent, unless otherwise indicated)							
PV of Debt to Exports Ratio							
2012DSA	94.9	98.7	102.1	103.4	106.1	97.6	58.5
2011DSA	96.5	100.4	102.1	101.9	101.5	94.8	62.8
PV of Debt to GDP Ratio							
2012DSA	13.6	14.3	15.4	16.0	17.1	16.2	9.7
2011DSA	15.3	17.4	18.2	18.6	19.0	18.3	13.1
PV of Debt to Revenue Ratio							
2012DSA	99.2	111.2	119.2	123.1	129.5	118.5	74.4
2011DSA	102.2	116.2	121.7	122.5	122.3	111.7	78.1
Debt Service to Exports Ratio							
2012DSA	5.4	5.7	6.4	7.3	7.3	8.3	5.4
2011DSA	4.5	5.2	6.2	7.3	7.4	7.0	5.0
<i>Memorandum items:</i>							
Grant Element of New External Borrowing							
2012DSA	22.4	30.1	25.6	23.8	17.7	25.5	21.9
2011DSA	30.2	30.3	28.0	28.0	29.5	27.6	27.4
New Commercial Loan Disbursements (billions of U.S. dollars)							
2012DSA	0.395	0.424	0.538	0.606	0.968	0.571	0.718
2011DSA	0.514	0.493	0.519	0.500	0.500	0.571	0.718
Real GDP Growth (annual percent change)							
2012DSA	7.0	6.5	6.5	6.5	6.5	6.5	6.5
2011DSA	6.0	6.0	6.5	6.5	6.5	6.5	6.5
Current Account Balance to GDP Ratio							
2012DSA	-6.1	-7.5	-6.2	-6.2	-6.3	-5.6	-5.2
2011DSA	-8.5	-8.4	-7.4	-6.7	-5.9	-5.8	-5.2
Sources: Ethiopian authorities; IMF and World Bank staff estimates and projections.							

MACROECONOMIC ASSUMPTIONS

5. The medium-term macroeconomic outlook remains broadly in line with the assumptions of the 2011 DSA (Box 1). Real GDP growth in 2012/13 is revised upward from 6 percent in the 2011 DSA to 6.5 percent, reflecting stronger activities mainly led by public infrastructure investment, but the projected long-

run GDP growth rate is maintained at 6.5 percent. Inflation was higher than projected in 2011/12, but is projected to reach the same long-run rate as in the 2011 DSA on account of the governments' commitment to inflation reduction. Nominal GDP in US dollars is higher because of the inflationary effect of the initial periods.

6. Robust export growth is projected to continue, a key assumption for maintaining a low risk rating. Despite further real exchange appreciation since the 2011 DSA, export growth has been strong, partly reflecting developments in commodity prices. In the medium-to long-run, export growth would be supported by

diversification of the export sector as emerging export industries expand, funded by foreign direct investment, and service exports including electricity grow albeit at a slower pace than projected in the 2011 DSA. Overall, exports of goods and services are projected to remain broadly the same as in the 2011 DSA.

Box 1. Ethiopia: Macroeconomic Assumptions for the Baseline Scenario

Real GDP growth is projected to slow to 6.5 percent in 2012/13 and to remain at that rate during the projection period. This assessment contrasts with the government's growth ambitions in the Growth and Transformation Plan (GTP) and reflects the poor business environment giving limited space for private sector growth on account of crowding out by public sector borrowing. Inflation is projected to fall to 9 percent by the end of 2012/13 and to stay at that level in the long run. The primary balance of the public sector is projected to record a large deficit initially (averaging 3.8 percent of GDP in 2012–17) reflecting investment by public enterprises, but it is expected to converge to a modest level in the long run (averaging 0.8 percent in 2018–32).

The external current account deficit (before official transfers) is expected to deteriorate from 5.2 percent of GDP in 2010/11 to 10.1 percent of GDP in 2011/12 and 11.5 percent of GDP in 2012/13, but improve to 8.5 percent of GDP in the long run.

Exports of goods are projected to grow by 11.3 percent in 2012/13, slowing from 37.1 percent in 2010/11 and 16.9 percent in 2011/12. Higher commodity prices, especially in gold and coffee, largely accounted for recent rapid export growth. Large foreign investments in the targeted sectors that receive government support are expected to contribute to export growth, and export volume growth is projected at around 10 percent over the DSA horizon. Exports of services are projected to grow at a slower pace than in the 2011 DSA on account of delays in electricity generation projects. Imports of goods and services are projected to increase in the near term (15 percent for goods imports and 10 percent for service imports in 2012/13) on account of substantial import needs for public infrastructure projects.

Workers' remittances have increased strongly in recent years and reached almost 8 percent of GDP in 2010/11. Although remittances in 2011/12 and 2012/13 are projected to remain at the same level in absolute terms, they are expected to start growing as the global economy recovers.

Foreign direct investment (FDI) is projected to increase gradually to a long run yearly average of 4.5 percent of GDP from 3.1 percent in 2011/12 on account of policies to promote large scale FDIs.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

A. Baseline Without Remittances

7. Under the baseline scenario, the PPG external debt indicators will rise in the next several years, but will remain well under the relevant indicative thresholds. The PV of PPG external debt in percent of GDP declined in 2011/12 by 2 percentage points to 13.6 percent because of high inflation and overvalued currency; but it is projected to start rising in 2012/13 to a peak of 17.5 percent of GDP in 2016/17, reflecting the assumed steady increase in new loan

disbursements. The PV of debt in percent of exports increased in 2011/12, and despite continued strength in exports, it is projected to continue increasing, peaking at 106.8 percent in 2016/17. The debt service-to-exports ratio also remains well below the relevant threshold although it keeps rising to a peak of 8.6 percent in 2018/19, reflecting servicing of non-concessional loans by public enterprises.

B. Sensitivity Tests Without Remittances

8. Under the historical scenario, the debt stock indicators would be lower than under the baseline scenario in the short term but rise above those of the baseline scenario over time.

The scenario reflects significantly higher nominal GDP and export growth (than in the baseline) which works to drive the debt ratios down. It also reflects larger net debt creating flows (than in the baseline) which work to drive the debt ratios up. The dynamic path under the historical scenario is determined by these two offsetting forces. As a result, the PV of debt to GDP would fall by 2.4 percentage points in three years, but would begin to rise afterward, reaching a peak of 12.1 percent. Similarly, the PV of exports would fall by 24.7 percentage points in five years, but then rise to reach the peak of 72.9 percent.

9. Without remittances, no stress test breaches the indicative threshold for the PV of PPG external debt to exports over the forecast horizon.

The 2011 DSA results highlighted that Ethiopia's debt sustainability was most sensitive to the terms of new public sector borrowing and export value growth, and two stress tests breached the threshold. The 2012 DSA did not find such vulnerability: even in the most extreme case in which new public sector external loans are secured on less favorable terms (i.e., a 200 basis point increase in the interest rate), the PV of debt to export ratio would peak at 142.6 percent in 2020 relative to the threshold of 150 percent. The scenario in which export growth is slower than the historical average by one standard deviation produces the debt to exports ratio of 119 percent in 2017 (an increase from 94.9 percent in 2012).

C. A Scenario with Higher Commercial Loan Disbursements

10. An alternative scenario including additional commercial loan disbursements indicates that an annual nonconcessional borrowing limit of US\$1 billion in 2012/13–2015/16 would be consistent with maintaining a low external debt risk rating. In

light of several large public investment projects under considerations, the authorities asked for a simulation of the implications of increased commercial loan disbursements in addition to those assumed in the baseline. The result indicates that there would be a breach of the

threshold for PV of external debt-to-exports without remittances under the most extreme shocks but there is no breach when remittances are included. The low external debt risk rating would be maintained in this scenario. However, given the result of the sensitivity analysis which indicates that a breach could occur if new public sector loans were in less favorable terms, the

staffs are of the view that maintaining the concessionality of external loans is important and the authorities should remain vigilant regarding new debt accumulation, particularly with commercial loans. This view is also consistent with IDA's Non-Concessional Borrowing Policy.

PUBLIC DEBT SUSTAINABILITY ANALYSIS

11. Under the baseline scenario, the total public sector debt-to-GDP ratio would rise sharply in the near term. This reflects large domestic borrowing and continued accumulation of external PPG debt by public enterprises to implement infrastructure investment projects. It is expected that after an initial period of high spending, total public sector expenditure would revert to a lower level in the long run.

12. Debt stock related indicators peak in 2014 and debt service related indicators peak in 2017. All debt indicators decline gradually from the peak; this result depends on continuation of robust GDP growth, moderate public sector primary deficits, and most crucially the authorities' policy of keeping domestic interest rates low, at negative levels in real terms because inflation is assumed to stay at 9 percent in the long run. Compared to the 2011 DSA, the peak is to be reached earlier; at the peak, the debt-to-GDP ratio is lower, but the debt-to-revenue and grants ratio and the debt service-to-revenue and grants ratio are higher mainly because lower levels are projected from grants.

13. Under any alternative scenario, public sector debt would become unsustainable. The scenario with unchanged primary balance from 2012 shows particularly sharp deterioration because of a large primary deficit in 2012 reflecting investment activities by public

enterprises. This suggests that the current level of public investment is not sustainable in the long-run. The other two alternative scenarios (real GDP growth and primary balance at the historic average; permanently lower GDP growth) show milder but unsustainable debt trajectories.

14. The baseline scenario understates the public debt burden for the economy because it reflects actual costs of borrowing by the public sector, which are significantly lower than inflation. Although inflation is projected to decline to a single-digit level, given the current policy of financing public investment at low costs, interest rates on public enterprise domestic borrowing would not be fully adjusted to a positive level in real terms.⁷ If the actual cost of borrowing were to rise above inflation, the debt indicators would worsen or fiscal adjustment could be required to maintain fiscal sustainability.

⁷ The authorities claim that, once inflation stabilizes at single digits, interest rates would be adjusted to the same level as the inflation rate.

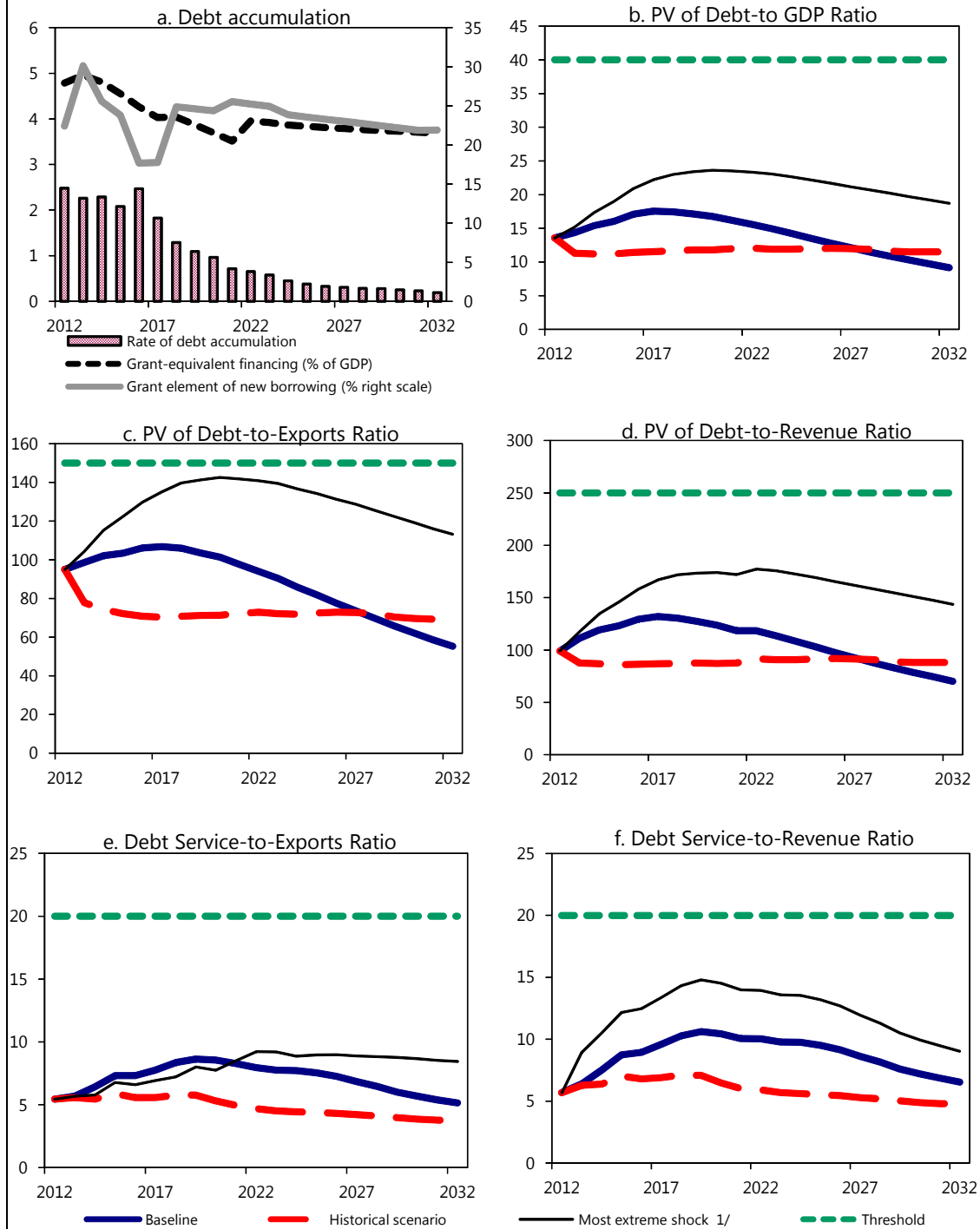
CONCLUSION

15. The level of Ethiopia’s external debt distress remains at a low risk rating. The external debt ratios have risen rapidly in recent years, and this trend is projected to continue in the medium-term with the exception of 2012. The results suggest the importance for Ethiopia of monitoring debt closely and remaining vigilant regarding new debt accumulation, particularly with commercial loans. The financing plan underlying the GTP needs to be reviewed taking into account these results. Vulnerabilities identified in various sensitivity analyses are relevant for considering policies that would help maintain the low risk rating of external debt distress. Particularly important is maintaining the concessionality of external loans.

16. Monitoring the overall debt of the consolidated public sector is needed to avoid a building up of vulnerabilities. Since domestic

borrowing by the public sector is rapidly increasing, it is becoming more important to monitor the overall debt (including external and domestic) of the consolidated public sector. To that end, diagnosis through Debt Management and Performance Assessment and capacity building through Medium-Term Debt Strategy technical assistance could be recommended. Also, the macroeconomic assumptions underlying the baseline scenario are subject to risks, including both exogenous shocks and policy-induced deterioration of the business environment, leading to vulnerabilities as highlighted in the alternative scenarios. Adjustments to policies to ensure price stability, remove exchange rate overvaluation, and address structural impediments to private sector investment and trading activities would go a long way in enhancing Ethiopia’s debt sustainability.

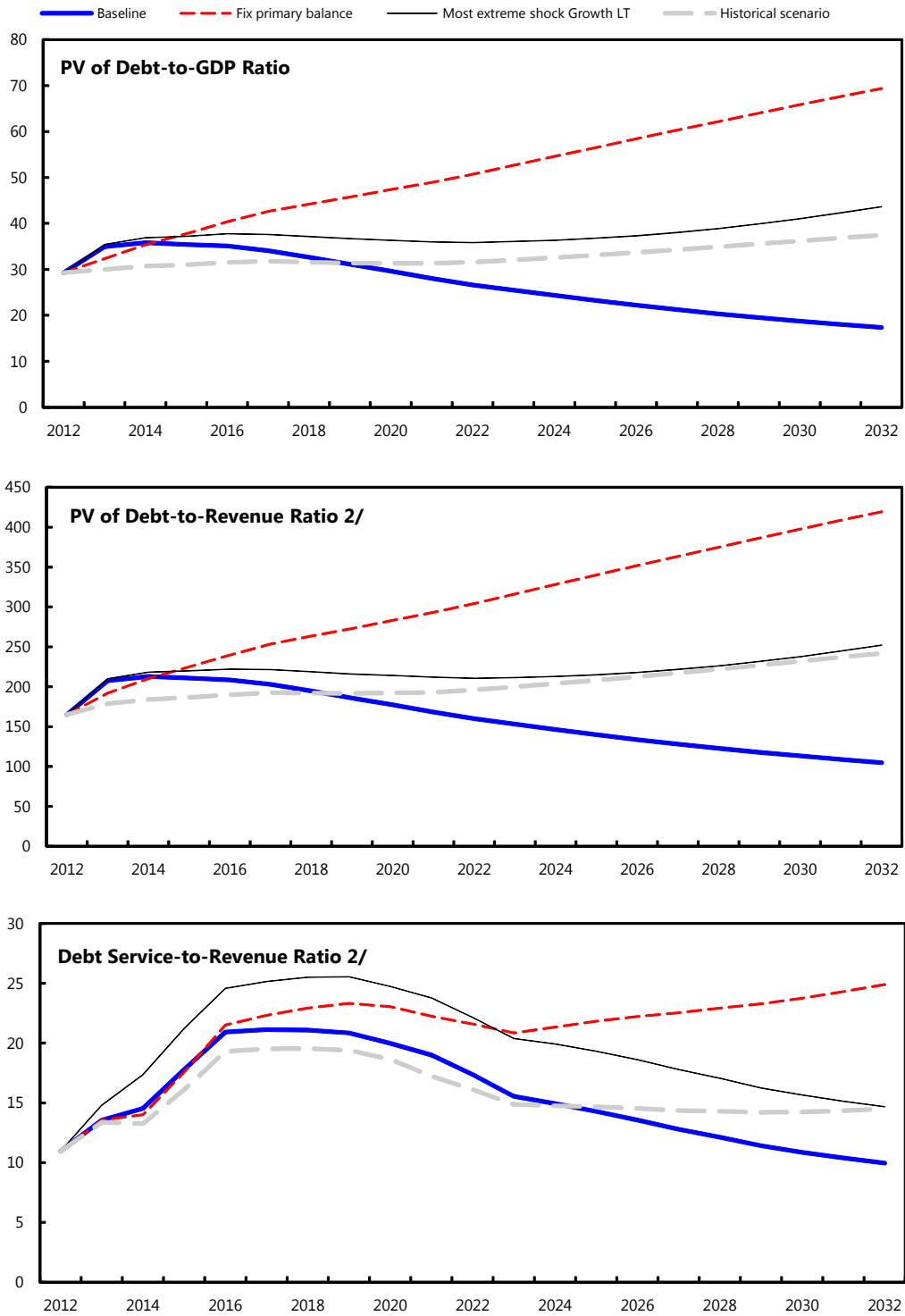
Figure 1. Ethiopia: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2012–2032 1/



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

1/ The most extreme stress test is the test that yields the highest ratio in 2022. In figure b, it corresponds to a Terms shock; in c, to a Terms shock; in d, to a Terms shock; in e, to a Terms shock and in figure f, to a One-time depreciation shock

Figure 2. Ethiopia: Indicators of Public Debt Under Alternative Scenarios, 2012–2032 1/



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

1/ The most extreme stress test is the test that yields the highest ratio in 2022.

2/ Revenue is defined inclusive of grants.

Table 1. Ethiopia: External Debt Sustainability Framework, Baseline Scenario, 2009–2032 1/
(Percent of GDP, unless otherwise indicated)

	Actual			Historical Average	Standard Deviation	Projections										
	2009	2010	2011			2012–2017					2018–2032					
						2012	2013	2014	2015	2016	2017	Average	2022	2032	Average	
External debt (nominal) 1/	14.8	20.0	24.6			20.9	23.3	25.0	26.1	27.3	27.7			25.3	17.1	
Of which: public and publicly guaranteed (PPG)	14.0	19.0	21.9			18.6	19.8	21.1	22.0	23.1	23.5			21.6	13.2	
Change in external debt	2.6	5.3	4.5			-3.6	2.3	1.8	1.0	1.2	0.4			-0.8	-0.7	
Identified net debt-creating flows	0.2	2.4	-5.9			1.7	3.1	1.3	1.0	1.1	0.5			-0.6	-0.6	
Non-interest current account deficit	4.9	4.2	-0.9	3.8	2.9	5.8	7.1	5.8	5.6	5.7	5.3			4.6	4.8	4.8
Deficit in balance of goods and services	18.2	19.6	15.0			17.4	17.6	16.6	15.6	15.9	15.3			14.6	14.8	
Exports	10.5	13.6	16.8			14.3	14.5	15.1	15.5	16.1	16.4			16.6	16.5	
Imports	28.7	33.2	31.8			31.7	32.1	31.6	31.2	32.0	31.8			31.2	31.3	
Net current transfers (negative = inflow)	-13.3	-15.6	-15.9	-13.9	1.6	-11.7	-10.5	-10.9	-10.0	-10.2	-10.0			-10.0	-10.0	-9.9
Of which: official	-4.9	-6.5	-6.0			-4.1	-3.9	-3.9	-3.8	-3.6	-3.5			-3.5	-3.5	
Other current account flows (negative = net inflow)	0.0	0.2	0.0			0.0	0.0	0.0	0.0	0.0	0.0			-0.1	0.0	
Net FDI (negative = inflow)	-2.7	-3.2	-3.9	-2.3	0.9	-3.1	-3.2	-3.5	-3.7	-3.7	-3.9			-4.2	-4.5	-4.3
Endogenous debt dynamics 2/	-2.0	1.4	-1.1			-1.0	-0.8	-0.9	-0.9	-0.9	-0.9			-1.0	-0.8	
Contribution from nominal interest rate	0.1	0.2	0.2			0.3	0.4	0.5	0.6	0.6	0.7			0.6	0.3	
Contribution from real GDP growth	-1.0	-1.3	-1.4			-1.3	-1.2	-1.4	-1.5	-1.6	-1.6			-1.6	-1.1	
Contribution from price and exchange rate changes	-1.1	2.6	0.1			...	...	...	...	...	...			...	...
Residual (3-4) 3/	2.4	2.8	10.5			-5.3	-0.7	0.5	0.0	0.1	0.0			-0.2	-0.2	
Of which: exceptional financing	-0.4	-0.3	-0.1			0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	
PV of external debt 4/	...	...	18.4			15.9	17.8	19.3	20.1	21.3	21.7			19.3	13.0	
Percent of exports	...	...	109.3			111.2	122.8	128.1	129.9	132.1	132.3			116.3	78.8	
PV of PPG external debt	...	...	15.8			13.6	14.3	15.4	16.0	17.1	17.5			15.6	9.1	
Percent of exports	...	...	93.7			94.9	98.7	102.1	103.4	106.1	106.8			94.0	55.3	
Percent of government revenues	...	...	120.6			99.2	111.2	119.2	123.1	129.5	132.0			118.4	70.2	
Debt service-to-exports ratio (percent)	2.4	3.2	4.3			7.6	7.5	9.1	10.5	10.8	11.4			10.7	5.1	
PPG debt service-to-exports ratio (percent)	1.3	2.2	2.9			5.4	5.7	6.4	7.3	7.3	7.8			8.0	5.1	
PPG debt service-to-revenue ratio (percent)	1.0	2.3	3.7			5.7	6.4	7.5	8.7	8.9	9.6			10.0	6.5	
Total gross financing need (Billions of U.S. dollars)	0.8	0.4	-1.3			1.6	2.4	1.8	2.0	2.3	2.1			2.1	2.4	
Non-interest current account deficit that stabilizes debt ratio	2.4	-1.1	-5.5			9.4	4.8	4.0	4.6	4.5	4.9			5.4	5.5	
Key macroeconomic assumptions																
Real GDP growth (percent)	10.0	8.0	7.5	8.4	4.9	7.0	6.5	6.5	6.5	6.5	6.5	6.6	6.5	6.5	6.5	6.5
GDP deflator in U.S. dollar terms (change in percent)	10.0	-14.8	-0.6	6.3	10.9	23.6	5.9	1.2	2.7	2.0	1.6	6.2	1.6	1.6	1.6	1.6
Effective interest rate (percent) 5/	1.0	1.1	1.1	0.9	0.2	1.9	2.0	2.2	2.5	2.6	2.8	2.3	2.4	1.6	2.1	2.1
Growth of exports of G&S (U.S. dollar terms, percent)	10.5	19.7	32.0	18.8	9.6	12.2	14.7	11.7	12.6	12.9	10.3	12.4	8.1	8.0	8.3	8.3
Growth of imports of G&S (U.S. dollar terms, percent)	11.6	6.7	2.4	18.7	14.7	31.6	14.5	6.1	7.7	11.6	7.4	13.1	8.6	7.9	8.1	8.1
Grant element of new public sector borrowing (percent)	...	...	...	...	...	22.4	30.1	25.6	23.8	17.7	17.7	22.9	25.2	21.9	23.6	23.6
Government revenue (excluding grants, percent of GDP)	13.9	13.2	13.1	...	...	13.7	12.9	12.9	13.0	13.2	13.3	...	...	13.2	13.0	13.2
Aid flows (Billions of U.S. dollars) 7/	2.4	2.7	2.4	...	...	2.3	2.9	3.0	3.1	3.2	3.2	...	...	4.4	8.5	8.5
Of which: grants	1.6	1.9	1.9	...	...	1.7	1.9	2.0	2.1	2.2	2.3	...	...	3.4	7.5	7.5
Of which: concessional loans	0.8	0.8	0.5	...	...	0.6	1.0	1.0	1.0	1.0	0.9	...	...	1.0	1.0	1.0
Grant-equivalent financing (percent of GDP) 8/	...	...	...	...	...	4.8	5.0	4.8	4.6	4.3	4.0	...	...	4.0	3.7	3.8
Grant-equivalent financing (percent of external financing) 8/	...	...	...	...	...	65.3	67.8	65.0	64.5	59.6	63.0	...	...	74.5	84.3	76.7
Memorandum items:																
Nominal GDP (Billions of U.S. dollars)	32.3	29.7	31.7	...	...	41.9	47.3	51.0	55.7	60.6	65.5	...	...	97.2	214.2	214.2
Nominal dollar GDP growth	21.0	-8.0	6.8	...	...	32.2	12.8	7.8	9.4	8.6	8.2	13.2	8.2	8.2	8.2	8.2
PV of PPG external debt (Billions of U.S. dollars)	...	...	4.8	...	...	5.6	6.5	7.6	8.6	10.0	11.1	...	...	14.7	19.0	19.0
(Pvt-Pvt-1)/GDPt-1 (percent)	...	...	...	...	...	2.5	2.3	2.3	2.1	2.5	1.8	2.2	0.6	0.2	0.5	0.5
Gross workers' remittances (Billions of U.S. dollars)	1.8	2.1	2.5	...	...	2.4	2.3	2.7	2.6	3.0	3.2	...	...	4.7	10.4	10.4
PV of PPG external debt (percent of GDP + remittances)	...	...	14.6	...	...	12.8	13.7	14.6	15.3	16.3	16.7	...	...	14.9	8.7	8.7
PV of PPG external debt (percent of exports + remittances)	...	...	63.8	...	...	67.9	73.7	75.9	79.4	81.4	82.4	...	...	72.7	42.8	42.8
Debt service of PPG external debt (percent of exports + remittances)	...	...	2.0	...	...	3.9	4.2	4.8	5.6	5.6	6.0	...	...	6.2	4.0	4.0
Sources: Ethiopian authorities; IMF and World Bank staff estimates and projections.																
1/ Includes both public and private sector external debt.																
2/ Derived as $[r - g - \rho(1+g)] / (1+g+\rho+gp)$ times previous period debt ratio, with r = nominal interest rate, g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.																
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections, also includes contribution from price and exchange rate changes.																
4/ Assumes that PV of private sector debt is equal to its face value.																
5/ Current-year interest payments divided by previous period debt stock.																
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.																
7/ Defined as grants, concessional loans, and debt relief.																
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).																

Table 2b. Ethiopia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012–2032 (Percent)								
	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
PV of Debt-to-GDP Ratio								
Baseline	13.6	14.3	15.4	16.0	17.1	17.5	15.6	9.1
A. Alternative scenarios								
A1. Key variables at their historical averages in 2012–2032 1/	14	11	11	11	11	12	12	11
A2. New public sector loans on less favorable terms in 2012–2032 2	14	15	17	19	21	22	23	19
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013–2014	14	14	16	16	17	18	16	9
B2. Export value growth at historical average minus one standard deviation in 2013–2014 3/	14	14	16	17	18	18	16	9
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2013–2014	14	15	17	18	19	20	18	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013–2014 4/	14	14	16	16	17	18	15	9
B5. Combination of B1–B4 using one-half standard deviation shocks	14	14	16	16	17	18	16	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	14	19	21	22	23	24	21	12
PV of Debt-to-Exports Ratio								
Baseline	95	99	102	103	106	107	94	55
A. Alternative scenarios								
A1. Key variables at their historical averages in 2012–2032 1/	95	78	74	72	71	70	73	69
A2. New public sector loans on less favorable terms in 2012–2032 2	95	104	115	122	130	135	141	113
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013–2014	95	95	99	100	102	103	90	53
B2. Export value growth at historical average minus one standard deviation in 2013–2014 3/	95	104	117	117	119	119	103	59
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2013–2014	95	95	99	100	102	103	90	53
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013–2014 4/	95	95	104	105	107	107	93	54
B5. Combination of B1–B4 using one-half standard deviation shocks	95	93	96	97	100	101	88	52
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	95	95	99	100	102	103	90	53
PV of Debt-to-Revenue Ratio								
Baseline	99	111	119	123	130	132	118	70
A. Alternative scenarios								
A1. Key variables at their historical averages in 2012–2032 1/	99	88	87	86	86	87	92	88
A2. New public sector loans on less favorable terms in 2012–2032 2	99	118	135	146	158	167	177	144
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013–2014	99	110	122	126	132	135	120	71
B2. Export value growth at historical average minus one standard deviation in 2013–2014 3/	99	111	127	130	135	137	121	70
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2013–2014	99	118	136	140	147	150	134	79
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013–2014 4/	99	107	121	124	130	132	117	68
B5. Combination of B1–B4 using one-half standard deviation shocks	99	110	122	126	132	135	120	71
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	99	149	161	166	174	178	158	93

Table 2b. Ethiopia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012–2032 (continued)								
(Percent)								
Debt Service-to-Exports Ratio								
Baseline	5	6	6	7	7	8	8	5
A. Alternative scenarios								
A1. Key variables at their historical averages in 2012–2032 1/	5	6	5	6	6	6	5	4
A2. New public sector loans on less favorable terms in 2012–2032 2	5	6	6	7	7	7	9	8
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013–2014	5	6	6	7	7	8	8	5
B2. Export value growth at historical average minus one standard deviation in 2013–2014 3/	5	6	7	8	8	9	9	6
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2013–2014	5	6	6	7	7	8	8	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013–2014 4/	5	6	6	7	7	8	8	5
B5. Combination of B1–B4 using one-half standard deviation shocks	5	6	6	7	7	8	8	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	5	6	6	7	7	8	8	5
Debt Service-to-Revenue Ratio								
Baseline	6	6	8	9	9	10	10	7
A. Alternative scenarios								
A1. Key variables at their historical averages in 2012–2032 1/	6	6	6	7	7	7	6	5
A2. New public sector loans on less favorable terms in 2012–2032 2	6	6	7	8	8	9	12	11
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013–2014	6	7	8	9	9	10	11	7
B2. Export value growth at historical average minus one standard deviation in 2013–2014 3/	6	6	8	9	9	10	11	7
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2013–2014	6	7	9	10	11	11	12	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013–2014 4/	6	6	8	9	9	10	10	7
B5. Combination of B1–B4 using one-half standard deviation shocks	6	7	8	9	9	10	11	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	6	9	10	12	12	13	14	9
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	9	9	9	9	9	9	9	9
Sources: Ethiopian authorities; IMF and World Bank staff estimates and projections.								
1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.								
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.								
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).								
4/ Includes official and private transfers and FDI.								
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.								
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.								

Table 3. Ethiopia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2009–2032

(Percent of GDP, unless otherwise indicated)

	Actual			Estimate		Projections									
	2009	2010	2011	Average 5/	Standard Deviation 5/	2012	2013	2014	2015	2016	2017	2012–17		2018–32	
												Average	2022	2032	Average
Public sector debt 1/	36.0	39.9	37.3			34.3	40.4	41.5	41.3	41.1	40.0			32.7	21.4
Of which: foreign-currency denominated	14.0	19.0	21.9			18.6	19.8	21.1	22.0	23.1	23.5			21.6	13.2
Change in public sector debt	-3.0	4.0	-2.6			-3.0	6.0	1.2	-0.2	-0.2	-1.1			-1.5	-0.9
Identified debt-creating flows	-6.3	-0.5	-3.6			-4.4	5.0	0.1	-0.9	-0.7	-1.1			-1.0	-0.9
Primary deficit	1.9	1.0	2.5	3.3	1.7	5.4	8.3	3.1	2.3	2.1	1.5	3.8		1.0	0.4
Revenue and grants	18.8	19.7	19.1			17.7	16.8	16.8	16.8	16.8	16.8			16.7	16.5
Of which: grants	4.9	6.5	6.0			4.1	3.9	3.9	3.8	3.6	3.5			3.5	3.5
Primary (noninterest) expenditure	20.7	20.7	21.5			23.2	25.2	20.0	19.1	19.0	18.3			17.7	17.0
Automatic debt dynamics	-8.1	-1.3	-5.8			-9.5	-3.3	-3.1	-3.2	-2.8	-2.6			-2.0	-1.3
Contribution from interest rate/growth differential	-7.8	-3.2	-6.2			-5.3	-2.9	-2.9	-3.0	-2.7	-2.7			-2.0	-1.3
Of which: contribution from average real interest rate	-4.2	-0.5	-3.5			-2.9	-0.8	-0.5	-0.4	-0.2	-0.2			0.0	0.1
Of which: contribution from real GDP growth	-3.6	-2.7	-2.8			-2.4	-2.1	-2.5	-2.5	-2.5	-2.5			-2.1	-1.4
Contribution from real exchange rate depreciation	-0.3	1.9	0.5			-4.1	-0.4	-0.1	-0.2	-0.1	0.1			...	...
Other identified debt-creating flows	-0.1	-0.2	-0.3			-0.4	0.0	0.0	0.0	0.0	0.0			0.0	0.0
Privatization receipts (negative)	-0.1	-0.2	-0.3			-0.4	0.0	0.0	0.0	0.0	0.0			0.0	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0
Residual, including asset changes	3.3	4.4	1.0			1.4	1.0	1.1	0.7	0.5	0.0			-0.5	0.0
Other sustainability indicators															
PV of public sector debt			31.2			29.3	35.0	35.8	35.4	35.1	34.1			26.6	17.3
Of which: foreign-currency denominated	...	...	15.8			13.6	14.3	15.4	16.0	17.1	17.5			15.6	9.1
Of which: external	...	...	15.8			13.6	14.3	15.4	16.0	17.1	17.5			15.6	9.1
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...			...	...
Gross financing need 2/	3.5	2.4	4.2			7.4	10.6	5.6	5.3	5.6	5.1			3.9	2.1
PV of public sector debt-to-revenue and grants ratio (percent)	...	...	163.7			165.2	207.6	212.8	210.8	208.5	202.8			159.9	104.9
PV of public sector debt-to-revenue ratio (percent)	...	...	238.3			214.1	271.0	277.5	271.8	266.1	256.5			202.5	133.0
Of which: external 3/	...	...	120.6			99.2	111.2	119.2	123.1	129.5	132.0			118.4	70.2
Debt service-to-revenue and grants ratio (percent) 4/	8.5	7.2	8.9			11.0	13.6	14.5	17.8	20.9	21.1			17.4	10.0
Debt service-to-revenue ratio (percent) 4/	11.5	10.7	13.0			14.2	17.7	18.9	23.0	26.7	26.7			22.0	12.6
Primary deficit that stabilizes the debt-to-GDP ratio	4.9	-3.0	5.0			8.4	2.3	2.0	2.5	2.3	2.6			2.5	1.3
Key macroeconomic and fiscal assumptions															
Real GDP growth (percent)	10.0	8.0	7.5	8.4	4.9	7.0	6.5	6.5	6.5	6.5	6.5	6.6	6.5	6.5	6.5
Average nominal interest rate on forex debt (percent)	0.7	0.9	0.8	0.8	0.3	1.5	1.8	2.0	2.2	2.3	2.5	2.0	2.4	2.0	2.3
Average nominal interest rate on domestic debt (percent)	2.7	3.3	3.6	2.6	0.6	5.6	7.1	6.1	6.7	7.0	7.0	6.6	7.9	9.2	8.3
Average real interest rate (percent)	-11.9	-1.5	-9.3	-5.8	5.2	-8.3	-2.4	-1.3	-1.1	-0.6	-0.4	-2.3	0.1	0.3	0.1
Average real interest rate on foreign-currency debt (percent)	-1.0	-1.1	-2.1	-2.2	0.8	-1.2	-1.4	-1.4	-1.5	-1.6	-1.9	-1.5	-1.7	-1.7	-1.7
Average real interest rate on domestic debt (percent)	-16.4	-2.3	-16.6	-8.8	8.2	-20.5	-5.5	-2.9	-2.9	-2.0	-1.6	-5.9	-0.8	0.4	-0.4
Exchange rate (US dollar per LC)	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nominal appreciation (increase in US dollar value of local currency, in pccr)	-15.1	-16.4	-19.9	-6.4	7.7	-4.7	-8.3	-6.5	-6.5	-6.5	-6.5	-6.5	-6.5	-6.5	-6.5
Real exchange rate depreciation (percent, + indicates depreciation)	-3.0	14.5	2.7	-2.7	8.8	-20.0	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, percent)	22.7	5.7	24.2	13.4	10.1	32.8	13.3	9.2	9.9	9.2	8.7	13.9	8.7	8.7	8.7
U.S. Inflation rate (GDP deflator, percent)	1.1	1.2	2.1	2.3	0.8	1.3	1.5	1.5	1.6	1.6	1.9	1.6	1.8	1.8	1.8
Growth of real primary spending (deflated by GDP deflator, percent)	-0.1	0.1	0.1	0.1	0.1	0.2	0.2	-0.2	0.0	0.1	0.0	0.0	0.1	0.1	0.1
Grant element of new external borrowing (percent)	...	...	...	...	...	22.4	30.1	25.6	23.8	17.7	17.7	22.9	25.2	21.9	...

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

1/ Public sector debt covers general government and selected nonfinancial public enterprises. Gross debt is used.

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

3/ Revenue excluding grants.

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

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

	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
PV of Debt-to-GDP Ratio								
Baseline	29	35	36	35	35	34	27	17
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	29	30	31	31	32	32	32	37
A2. Primary balance is unchanged from 2012	29	32	35	38	40	43	51	69
A3. Permanently lower GDP growth 1/	29	35	37	37	38	38	36	44
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviation in 2013–2014	29	36	39	39	40	39	34	28
B2. Primary balance is at historical average minus one standard deviation in 2013–2014	29	32	35	34	34	33	26	17
B3. Combination of B1-B2 using one-half standard deviation shocks	29	31	33	33	33	32	26	18
B4. One-time 30 percent real depreciation in 2013	29	41	41	40	40	39	32	24
B5. 10 percent of GDP increase in other debt-creating flows in 2013	29	44	44	44	43	42	33	21
PV of Debt-to-Revenue Ratio 2/								
Baseline	165	208	213	211	209	203	160	105
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	165	179	184	187	190	193	196	242
A2. Primary balance is unchanged from 2012	165	192	210	225	240	254	304	419
A3. Permanently lower GDP growth 1/	165	210	218	220	222	221	210	252
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviation in 2013–2014	165	214	228	230	232	229	201	167
B2. Primary balance is at historical average minus one standard deviation in 2013–2014	165	190	206	204	202	196	155	102
B3. Combination of B1-B2 using one-half standard deviation shocks	165	186	198	198	197	192	155	108
B4. One-time 30 percent real depreciation in 2013	165	242	243	239	236	230	191	144
B5. 10 percent of GDP increase in other debt-creating flows in 2013	165	261	264	259	255	248	197	128
Debt Service-to-Revenue Ratio 2/								
Baseline	11	14	15	18	21	21	17	10
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	11	13	13	16	19	20	16	14
A2. Primary balance is unchanged from 2012	11	14	14	18	22	22	22	25
A3. Permanently lower GDP growth 1/	11	14	15	18	22	22	20	17
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviation in 2013–2014	11	14	15	19	22	23	19	13
B2. Primary balance is at historical average minus one standard deviation in 2013–2014	11	14	14	17	21	21	17	10
B3. Combination of B1-B2 using one-half standard deviation shocks	11	14	14	17	21	21	17	10
B4. One-time 30 percent real depreciation in 2013	11	15	17	21	25	25	22	15
B5. 10 percent of GDP increase in other debt-creating flows in 2013	11	14	16	20	23	23	20	12
Sources: Ethiopian authorities; IMF and World Bank staff estimates and projections.								
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.								
2/ Revenue is defined inclusive of grants.								



THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

August 28, 2012

Prepared By

African Department (In consultation with other departments)

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FUND RELATIONS

As of July 31, 2012

Membership Status: Joined: December 27, 1945

[Article XIV](#)

General Resources Account:	SDR Million	%Quota
Quota	133.70	100.00
Fund holdings of currency	126.20	94.39
Reserve Tranche Position	7.51	5.62
Lending to the Fund		
Holdings Exchange Rate		

SDR Department:	SDR Million	%Allocation
Net cumulative allocation	127.93	100.00
Holdings	97.25	76.02

Outstanding Purchases and Loans:	SDR Million	%Quota
ESF Arrangement	153.76	115.00
ESF RAC Loan	33.43	25.00

Latest Financial Arrangements:

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

^{1/} Formerly PRGF.

Projected Payments to Fund ^{2/}

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
Principal			3.34	25.40	37.44
Charges/Interest	0.02	0.50	0.49	0.46	0.38
Total	0.02	0.50	3.84	25.86	37.82

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

Implementation of HIPC Initiative:

I. Commitment of HIPC assistance	Enhanced Framework
Decision point date	November 2001
Assistance committed by all creditors (US\$ Million) ^{1/}	1,982.20

	<i>of which:</i> IMF assistance (US\$ million)	60.85
	(SDR equivalent in millions)	45.12
	Completion point date	April 2004
II.	Disbursement of IMF assistance (SDR Million)	
	Assistance disbursed to the member	45.12
	Interim assistance	10.28
	Completion point balance	34.84
	Additional disbursement of interest income ^{2/}	1.54
	Total disbursements	46.66

^{1/} Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts can not be added.

^{2/} 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.

Implementation of Multilateral Debt Relief Initiative (MDRI):

I.	MDRI-eligible debt (SDR Million) ^{1/}	112.07
	Financed by: MDRI Trust	79.66
	Remaining HIPC resources	32.41
II.	Debt Relief by Facility (SDR Million)	

Eligible Debt

<u>Delivery Date</u>	<u>GRA</u>	<u>PRGT</u>	<u>Total</u>
January 2006	N/A	112.07	112.07

^{1/} The MDRI provides 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

Safeguards Assessment

An update safeguards assessment of the National Bank of Ethiopia (NBE) was completed in December 2009 in connection with Ethiopia's ESF-RAC approved on January 23, 2009. The assessment found that, since the previous assessment in 2001, the NBE has implemented some improvements to the safeguards framework but that several initiatives were a work-in-progress and substantial gaps remained. Financial transparency has improved through the publication of independently audited financial statements, and internal audit capacity has been strengthened. In response to the

assessment's recommendations, action has been taken to commence Audit Committee (AC) oversight, and introduce controls and independent reviews over program data reporting to the Fund. The authorities are also in the process of addressing remaining safeguards issues relating to enhancing AC oversight of the external audit mechanism, further strengthening of reserve management capacity, and introducing bank-wide risk management practices. Going forward, the NBE Law will need to be strengthened with regard to independence of the central bank and the potential scope for unlimited financing of the government.

Exchange Rate Arrangement

The de facto exchange rate regime is classified as a crawl-like arrangement, in light of the recent market developments. The authorities describe their exchange rate regime as a managed float with no predetermined path for the exchange rate. The pace of the depreciation, however, has been stable. The NBE supplies foreign exchange to the market based on plans established at the beginning of each fiscal year that takes into account estimates of likely supply and demand. The transaction-weighted average interbank market exchange rate on July 10, 2012, was Br 17.7801 = US\$1.

Ethiopia currently maintains four restrictions on the payments and transfers for current international transactions, which relate to: (i) the tax certification requirement for repatriation of dividend and other investment income; (ii) restrictions on repayment of legal external loans and supplies and foreign partner credits;

(iii) rules for issuance of import permits by commercial banks; and (iv) 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 and remain unapproved.

The staff is continuing to assess whether a general finance and economic cooperation agreement signed between the government of Ethiopia and China in 2006 gives rise to exchange restrictions under Article VIII.

Article IV Consultation

Ethiopia is on the standard 12-month consultation cycle, in accordance with the Decision on Article IV Consultation Cycles (Decision No. 14747-(10/96), 9/28/2010). The last consultation was concluded on August 26, 2011.

Technical Assistance (2007–present)

Department	Purpose	Time of Delivery
MCM	Bank supervision	July 2007
MCM	Monetary operations	July 2007
MCM	Payment system	July 2007
AFE	Customs administration	October 2007
FAD	Public expenditure management	December 2007
AFE	Program budgeting	December 2007
AFE	Macro-fiscal	January 2008
AFE	Program budgeting	January 2008
AFE	Banking supervision	February 2008
AFE	Consumer price index	March 2008
MCM	Islamic banking regulation	April 2009
AFE	Banking supervision	June 2009
AFE	Program budgeting chart of accounts	July 2009
FAD	Revenue administration	September 2009
FAD	Program budgeting	November 2009
FAD	Tax policy	December 2009
AFE	Cash management and treasury single account	February 2010
AFE	Price statistics	February 2010
AFE	Risk-based supervision	May 2010
AFE	Medium-Term Expenditure Framework	August 2010
AFE	Stress testing	November 2010
FAD	Tax administration	December 2010
AFE	Cash management	February 2011
STA	Balance of payments statistics	March 2011
AFE	National accounts statistics	March 2011
FAD	Tax incentives, tax expenditures, and transfer pricing	December 2011
AFE	Payment system	December 2011
AFE	National Accounts Statistics	March 2012

Resident Representative

The IMF has had a resident representative office in Addis Ababa since 1993. The current

Resident Representative, Mr. Jan Mikkelsen, took up the post in January 2012.

JOINT MANAGEMENT ACTION PLAN, JULY 2012– AUGUST 2013

Title	Products	Provisional and actual timing of missions	Expected and actual delivery date
A. Mutual information on relevant work program			
The World Bank work program in the next 12 months	Economic policy analysis and advice <ul style="list-style-type: none"> • Ethiopia Economic Update (bi-annual) • Policy dialogue on economic reform issues • Poverty and vulnerability analysis • Poverty mapping 	July 2012–June 2013 July 2012–June 2013 July 2012–June 2013 July 2012–June 2013	Q4 2012, Q2 2013 ongoing Q2 2013 Q2 2013
	Technical Assistance <ul style="list-style-type: none"> • Capacity Building of the Central Statistical Agency • Social policy and safety net strategy • Strengthen the capacity of public sector • Public financial management 	July 2012–June 2013 July 2012–June 2013 July 2012–June 2013 July 2012–June 2013	ongoing (until 2016) Q2 2013 Q2 2013 Q2 2013
The Fund work program in the next 12 months	Macroeconomic policy analysis and advice <ul style="list-style-type: none"> • Article IV consultation 	May 2013	July 2013
	Technical assistance <ul style="list-style-type: none"> • Statistical capacity (national accounts, CPI) • Tax administration 	October 2012 December 2012	
B. Requests for work program inputs			
Fund request to Bank	<ul style="list-style-type: none"> • Periodic update on progress on the financial sector capacity building project and social sector projects including poverty related work. • Macroeconomic and financial data to be shared regularly. 	Ongoing	
Bank request to Fund	<ul style="list-style-type: none"> • Periodic update on all TA activities. • Macroeconomic and financial data to be shared regularly. 	Ongoing	
C. Agreement on joint products and missions			
Joint products in the next 12 months	Debt sustainability analysis		July 2013

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance

General: *Data provided to the Fund are broadly adequate for surveillance purposes, albeit with shortcomings.* Despite recent progress, there are some shortcomings in financial, real, fiscal, and balance of payments statistics.

National Accounts: Shortcomings in the source data and compilation practices affect the accuracy and reliability of the statistics. The GDP estimates are heavily dependent on benchmark data that are outdated and therefore, may not reflect current economic activity. Further, the techniques used to compile the estimates for construction, distribution, and some other services activities do not conform to international best practice. While some progress has been made in compiling estimates of GDP by final expenditure, there remain substantial shortcomings, particularly in the estimation of private consumption and fixed capital formation. The statistical discrepancies between the estimates by expenditure categories and output remain large.

Government finance statistics: Despite recent improvements, general government fiscal statistics continue to be affected by shortcomings. Timely data on the consolidated operations of local governments is unavailable. Significant discrepancies between data on the domestic financing of the budget deficit and the monetary accounts continue to complicate assessment of fiscal developments.

Monetary statistics: Monetary statistics are broadly adequate for analytical purposes, although there is a need for the NBE to resume data submissions based on the SRF and IMD framework. For policy purposes, however, ensuring data collection and reporting in a timely manner continues to be critical.

Financial statistics: The staff does not have access to sufficient data to assess the soundness of the banking sector.

Balance of payments: Balance of payments data require improvements in coverage, valuation, timing, and classification of transactions. Long delays in the collection of trade and tourist arrival data and poor data on capital flows, especially FDI data, need to be addressed. Large errors and omission recorded in recent years need to be reconciled.

II. Data Standards and Quality

Ethiopia participates in the General Data Dissemination System (GDSD) and metadata were partially updated in early 2008. Ethiopia participates in the GDSD project for capacity building in statistics in Anglophone Africa (2006–09) including macro-economic and financial statistics and socio-demographic statistics.

No Report on the Observance of Standards and Codes has been completed.

TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(as of July 12, 2012)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange rates	May , 2012	July, 2012	D	D	D
International reserve assets and reserve liabilities of the monetary authorities ^{1/}	April 2012	June 2012	M	M	M
Reserve/base money	April 2012	June 2012	M	M	M
Broad money	April 2012	June 2012	M	M	M
Central bank balance sheet	April 2012	June 2012	M	M	M
Consolidated balance sheet of the banking system ^{2/}	....	....	NA	NA	NA
Interest rates ^{3/}	April 2012	June 2012	M	M	M
Consumer Price Index	June 2012	July 2012	M	M	M
Revenue, expenditure, balance, and composition of financing ^{4/} – general government ^{5/}	December 2011	May 2012	Q	Q	Q
Revenue, expenditure, balance, and composition of financing ^{4/} – central government	July 2012	April 2012	M	M	NA
Stocks of central government and central government-guaranteed debt ^{6/}	2010/11	June 2012	A	On mission	A
External current account balance	March 2012	June 2012	Q	Q	Q
Exports and imports of goods and services	April 2012	June 2012	M	Q	Q
GDP/GNP	2010/11	January 2012	A	A	A
Gross external debt	2010/11	May 2012	A	On mission	A
International investment position	...	...	NA	NA	NA

1/ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

2/ The authorities provide some balance sheet items but not comprehensive enough for proper financial stability analysis.

3/ Both market-based and officially determined, including discount rates, money market rates, and rates on treasury bills, notes, and bonds.

4/ Foreign, domestic bank, and domestic nonbank financing.

5/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

6/ Including currency and maturity composition.



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
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FOR IMMEDIATE RELEASE
October 1, 2012

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

IMF Executive Board Concludes 2012 Article IV Consultation with Ethiopia

On September 12, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Ethiopia.¹

Background

Ethiopia's macroeconomic performance in 2011/12 has been mixed. Strong, broad-based growth continues at a pace of about 7 percent and poverty reduction measured by poverty head count declined from 38.7 to 29.6 percent during the six years to 2010/11. However, inflation surged to 40 percent in August 2011, largely reflecting a combination of factors including loose monetary policy, and high global food prices but has eased to about 21 percent in June 2012 supported by a slowdown in global food and fuel price inflation and the implementation of the base money nominal anchor. Despite the continued robust increases in goods exports and remittances, the current account deteriorated in the first half of 2011/12 contrasting the surplus recorded in 2010/11 attributed to a frontloading of import of capital goods the previous year. The developments in 2011/12 largely reflect a recovery of imports of capital goods, an increase in consumer goods imports, and a weakening of the services balance due to a surge in service imports.

The federal government budget execution in 2011/12 has been tight based on a strong tax revenue increase when compared to the previous fiscal year, and a slower-than-budgeted execution of recurrent expenditure. However, the public sector (including state-owned enterprises) as a whole has been providing strong fiscal impulse given the state-owned

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. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

enterprise substantial capital expenditures financed by borrowing from external sources and the Commercial Bank of Ethiopia (CBE). A rise in regional government deposits at CBE contributed to the funding. The 2012/13 budget focuses on sustaining growth, lowering inflation further, mobilizing revenue, and spending on pro-poor projects. The revenue target is within reach with the continuation of administrative efforts. Total expenditure is projected to grow slower than nominal GDP, but poverty-related spending as a share of GDP will be maintained.

Monetary policy in 2011/12 has largely been geared toward lowering inflation with the implementation of the base money nominal anchor. Base money at end-May 2012 declined by 0.9 percent year-on-year as the central bank has ceased providing new direct credit to the government since July 2011 and has been selling foreign reserves in recent months to achieve a base money contraction target of 4 percent for the fiscal year. However, the lowering of the reserve requirement ratio in early January from 15 percent to 10 percent weakens the tightening effect of the base money contraction. Broad money at end-May 2012 grew by 29 percent year-on-year on account of strong credit growth to public enterprises. Despite the planned National Bank of Ethiopia (NBE) financing of the 2012/13 budget, which could affect inflation expectations, the 2012/13 monetary targets focus on lowering inflation.

The NBE directive that requires commercial banks (excluding CBE) to hold bills issued by NBE is impeding financial intermediation. By creating a significant maturity mismatch in the private banks balance sheets, it has a considerable negative impact on their capacity to play their conventional intermediation role. Financial sector soundness indicators do not point to immediate concerns. However, recent developments such as the increasingly dominant market share of CBE and its growing exposure to large public enterprises, and the adverse impact of NBE directive on private banks suggest a need for a closer scrutiny of the banking system.

Absent increased role of the private sector to leverage the large public infrastructure investment and efforts to improve the doing business conditions, IMF staff project that real GDP growth will slow down to 6.5 percent in 2012/13 and over the medium term. However, the authorities project the economy to grow at double digit rates.

Executive Board Assessment

Executive Directors welcomed Ethiopia's strong economic growth and continued progress in poverty reduction. However, Directors noted that the authorities' public sector-led development strategy is contributing to macroeconomic imbalances. To sustain robust growth and address the emerging risks, policies for the period ahead should focus on promoting disinflation, achieving an appropriate pace of public investment, reconstituting official reserves, and promoting greater financial sector stability.

Directors welcomed the authorities' goal of reducing inflation. In this context, they urged the central bank to pursue a tighter monetary stance and avoid further deficit financing. Directors also underscored the importance of broadening the toolkit of monetary policy instruments, including by revamping the market for government securities, which could foster private saving and investment. Greater exchange rate flexibility would safeguard foreign exchange reserves, strengthen external competitiveness, and mitigate external vulnerabilities.

Directors encouraged the authorities to persevere with their fiscal reforms. In particular, they saw scope for further improvements in tax administration and revenue mobilization. Additional public financial management reforms and development of a medium-term debt management strategy encompassing both domestic and external debt would help achieve the fiscal objectives under the Growth and Transformation Plan and maintain fiscal sustainability. Any non-concessional borrowing should be consistent with maintaining a low risk of debt distress.

Directors stressed that effective financial sector supervision and regulation remain crucial for macroeconomic stability. In this regard they advised the authorities to consider participation in the Financial Sector Assessment Program which would help identify vulnerabilities in the financial system and suggest corrective actions as appropriate. Directors encouraged the authorities to address the remaining deficiencies in Ethiopia's AML/CFT regime.

Directors agreed that deeper structural reforms are essential for promoting growth. Accordingly, they underscored the importance of creating a more favorable business environment and enhancing the role of private sector in the economy. Directors also called for further efforts to improve data quality and supported Fund technical assistance in this area.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Ethiopia: Selected Economic and Financial Indicators, 2009/10–2011/12 ¹

	2009/10	2010/11	2011/12 Est.
	(Annual percentage change)		
National income and prices			
GDP at constant prices (at factor cost)	8.0	7.5	7.0
Consumer prices (period average)	2.8	18.1	33.4
Consumer prices (end period)	7.3	38.1	20.8
External sector			
Exports, (In U.S. dollars, f.o.b.)	38.3	37.1	16.9
Imports, (In U.S. dollars, c.i.f.)	7.7	-0.9	35.5
Export volume	10.3	8.6	1.1
Import volume	14.1	-8.5	29.5
Terms of trade (deterioration -)	29.6	18.7	10.6
	(Percent of beginning-period stock of broad money, unless otherwise indicated)		
Money and credit			
Net foreign assets	9.6	29.1	-14.5
Net domestic assets	14.7	10.1	48.0
Net claims on the government	1.7	-2.9	1.3
Net claims on public enterprises	6.8	25.1	32.8
Net claims on private sector	10.5	9.8	13.9
Broad money	24.3	39.2	33.5
Velocity (GDP/broad money)	3.68	3.53	3.76
	(In percent of GDP, unless otherwise indicated)		
Financial balances			
Gross domestic saving	5.2	8.8	7.8
Government saving	4.5	4.3	4.8
Private saving	0.7	4.5	2.7
Gross domestic investment	24.7	25.5	26.1
Public investment	16.0	18.6	19.7
Private investment	8.7	6.9	6.5
Resource gap	-19.5	-16.7	-18.6
External current account balance, including official transfers	-4.4	0.7	-6.1
Government finances			
Revenue	14.1	13.5	13.6
External grants	3.2	3.2	1.8
Expenditure and net lending	18.6	18.4	17.8
Fiscal balance, excluding grants (cash basis)	-4.6	-4.8	-4.1
Fiscal balance, including grants (cash basis)	-1.3	-1.6	-2.3
Total financing	1.3	1.6	2.3
External financing	1.1	1.5	0.8
Domestic financing (not including privatization)	0.5	0.0	1.2
Public debt ²	39.0	37.4	34.2
Domestic debt	20.9	15.4	15.7
External debt (including to IMF)	18.1	22.0	18.5
Present value of external public and publicly guaranteed (PPG) debt-to-exports ratio (including to Fund) ²	97.0	100.2	96.6
External PPG debt-service-to-exports ratio ³	2.2	2.9	5.5
Overall balance of payments (in millions of U.S. dollars)	685	1446	-1215
Gross official reserves (in millions of U.S. dollars)	1979	3044	2114
(in months of imports of goods and nonfactor services of following year)	2.4	2.8	1.7
GDP at current market prices (in billions of birr)	382.9	511.2	726.5

Sources: Ethiopian authorities; and IMF staff estimates and projections

¹Data pertain to the Ethiopian fiscal year from July 8 to July 7.

²Including debt of major public enterprises

³After enhanced HIPC and MDRI relief.

**Statement by the IMF Staff Representative on
The Federal Democratic Republic of Ethiopia
September 12, 2012**

This statement provides an update on developments since the staff report was finalized. It does not alter the thrust of the staff appraisal.

1. Prime Minister Meles passed away on August 20 following a two-month illness. He was the dominant political figure since overthrowing the military dictatorship in 1991. His successors are most likely to continue the public sector-led development strategy, but absent strong leadership from the top, the progress toward addressing emerging vulnerabilities, associated with the ambitious public investment program, could stall.
2. Official foreign exchange reserves declined further to 1.6 months of imports by end-May 2012, and there are reports of foreign exchange shortages that have recently intensified. Further external pressures from heightened political uncertainty may push donors to provide financial support because of Ethiopia's geo-political importance. Given that Ethiopia imports some food, rising international food prices would further exert pressure on the foreign exchange reserves.
3. The latest data are in line with the staff's projections. CPI inflation (year-on-year) in August 2012 at 20.2 percent was almost unchanged from the previous month, indicating that reducing inflation to single-digit levels would take some time. Federal government budget execution in May and June 2012 showed continued strong growth in revenue and restraint in expenditure, resulting in a provisional overall federal government deficit (excluding grants) at 2.7 percent of GDP, compared to 3.6 percent in the budget. Base money at end-May 2012 showed a small contraction of -0.9 percent with no new central bank credit to government.

**Statement by Mr. Majoro, Executive Director
for The Federal Democratic Republic of Ethiopia
September 12, 2012**

The Ethiopian authorities appreciate staff's candid discussions during the recent 2012 Article IV consultation. They value the timely exchange of views with the mission team on key policy issues and options to achieve the objectives outlined in the Growth and Transformation Plan, while addressing the current imbalances. While they find the staff assessment of the country's economic policies, challenges and prospects informative, they do not share some of the analysis and conclusions reached by staff as articulated under the "authorities' views" and detailed below.

Recent Economic Developments and Outlook

The authorities' pro-growth policies have been highly successful in recent years in enabling the Federal Democratic Republic of Ethiopia to make significant strides in reducing poverty, and thus have kept the achievement of many of the Millennium Development Goals (MDGs) within reach. Despite the slowdown in the global economy, real GDP growth has been robust and broad-based, estimated at 11.1 percent for FY 2011/12¹. This growth was supported by a 7.4 percent growth in agriculture output as a result of both more land coming under cultivation and from better yields compared to the previous fiscal year. Non-agricultural sectors have also exhibited a stronger growth estimated at 17.9 percent for industry and 11.5 percent for services. Furthermore, the currently above-normal rainfall in most food-growing regions is also expected to sustain the harvest for the current fiscal year. Continued heavy infrastructure investments, a strong pipeline of FDI inflows, and generally buoyant service sector activities are also expected to propel activity levels in their respective domains and contribute to stronger growth going forward.

Notwithstanding these achievements, inflation which has fallen sharply from 41 percent in August 2011 to 20.2 percent in August 2012 remains an immediate challenge. The tight monetary policy and food price moderation explains the bulk of the decline in inflation, as prices stabilized across a range of non-staple foods. The authorities' decision to import and distribute flour products and edible oils has also contributed to the decline in inflation. Nevertheless, the Ethiopian authorities remain committed to pursuing prudent macroeconomic policies to bring inflation to single digits.

¹ The authorities do not share the staff's GDP estimates and outlook and are working with the East AFRITAC national accounts expert to reconcile the differences in growth figures.

The Federal Budget for FY 2012/13 has recently been passed with planned expenditure of Birr 138 billion (15.2 percent of GDP) and projected revenues and grants of Birr 111 billion (10.5 percent of GDP). The resulting Birr 27 billion deficit (2.9 percent of GDP) is expected to be financed in roughly equal parts by foreign and domestic bank borrowing. The authorities expect that most of the public investment projects can be covered by the public enterprises' own funds, bond issues, and borrowing from domestic as well as foreign banks. However, in the event that these sources turn out to be inadequate, my authorities will scale down or delay the projects so that their financing would not become inflationary.

Current Challenges

Notwithstanding these positive developments, the Ethiopian economy is confronted with the challenges of containing inflationary pressures; and low international reserves, which considerably limit the authorities' policy options. My authorities recognize that the current double-digit inflation poses a threat to the hard-won macroeconomic performance. Though inflation is expected to continue subsiding in response to their earlier tightening of monetary policy, the authorities are determined to take additional measures to counter excess demand pressures that are contributing to high inflation including further adjustments to fiscal and monetary policies, if needed. My authorities are also aware that measures to scale down import growth in order to stay within the confines of the available foreign reserves remain a priority. It is against this background that the authorities intend to revisit their planned public spending and limit overall public borrowing, in order to limit import demand.

Fiscal Policy

The thrust of government spending remains in conformity with the overall macroeconomic framework, namely maintaining the level of spending on the key MDG clusters and infrastructure. To protect spending in priority areas, my authorities will continue to strengthen domestic and concessional resource mobilization in the medium term. They are committed to improving domestic revenue mobilization, including through administrative improvements and, to this end, will continue to seek the International Monetary Fund Technical Assistance. Mindful of the overall resource limitations, they intend to facilitate greater participation of the private sector and mobilize a modest level of non-concessional financing while remaining vigilant of the contingent liabilities and debt sustainability implications and the need to strengthen their debt management strategy. My authorities also recognize the important role played by the public enterprises, particularly in the improvement of infrastructure critical to socio-economic development. While my authorities recognize staff's concern regarding the buildup of external debt, they would stress the undeniable need for such financing of major infrastructure investment should also be appreciated. Nevertheless, with a view to maintaining sustainable debt and to avoid debt stress, my authorities are committed to

continue seeking more grants and contract loans mostly on concessional terms. Moreover, the joint debt sustainability analysis undertaken by the International Monetary Fund and World Bank staffs reaffirms that the level of debt distress will not worsen.

Monetary Policy, International Reserves and NBE Bill

My authorities will continue with the implementation of the base money nominal anchor which has served well the monetary policy objective of reducing inflation. While they share staff's concerns regarding the high inflation, they are of the view that their monetary policy stance was only partially responsible and that imported inflation has also played a significant role. Nevertheless, recognizing that rising inflation poses a significant challenge to their plan to sustain the current real growth momentum, going forward they will continue to slowdown the growth in reserve money to ensure macroeconomic stability. They will also explore all options of monetary policy to achieve their single digit inflation objective.

While my authorities acknowledge the desirability of building up foreign exchange reserves, they would do so over a longer time horizon than recommended by staff as the immediate priority is to use foreign exchange sales to ward off inflation. Given the high returns from their planned infrastructure investments and the nonexistence of currency speculation in the economy, they also do not consider the rapid buildup of foreign reserves as an immediate concern at this time.

On the NBE Bills, while my authorities note staff's concern, they do not share the view that it is aggravating the financial repression but rather the introduction of NBE Bills is helping in shifting credit portfolio from short-term loans to medium and long-term loans. They would also point out that interest income for commercial banks participating in the NBE bills has increased by some 60 percent in the quarter ending March 2012 compared to the same quarter last year, suggesting substantial increase in profitability and absence of downside impact on banks profitability. Having said that, my authorities underscore that financial soundness indicators do not point to immediate concerns but they will remain vigilant in assessing the impact of the NBE bills and would take action accordingly to ensure that the intended objectives are met without disrupting the functioning of the financial sector. To this end, they are building capacity of NBE's staff on risk based supervision, implementing the World Bank's financial sector capacity building recommendations and conducting quarterly stress testing of banks. The authorities at this juncture do not see a need for an FSAP.

Structural Reforms

The Ethiopian authorities are making progress on key reforms aimed at improving productivity and efficiency in key sectors of the economy to strengthen the medium-term growth prospects. These include, creating a more dynamic and productive agricultural sector, strengthening the power sector to increase access and reliability of electricity

supply, promoting the development of non-traditional export sectors and improving the business environment.

The authorities recognize the important role of private sector development to complement public investment as a way to expand the capacity of the economy. In this regard, efforts to accelerate private sector development, particularly, private investment, both domestic and foreign are fundamental. To this end, the government will play an instrumental role to create conducive environment and remove bottlenecks to private investment.

Conclusion

My authorities recognize the challenges of macroeconomic management, and remain committed to taking appropriate measures to address the current imbalances. In this regard, they will remain engaged with the International Monetary Fund, and would appreciate the International Monetary Fund's catalytic role in providing the needed signals for development partners' support of their efforts to achieve macroeconomic stability, promote broad-based and pro-poor growth, and reduce poverty. My authorities intend to be vigilant and continue adjusting their economic policies and programs for the near term to meet the emerging challenges and restore macroeconomic stability while at the same time maintaining their focus on their long-term development objectives of closing their infrastructure gap and sustaining the growth momentum.