INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/300

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

SEPTEMBER 2015

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE FEDERAL DEMOCRATIC REPUBLIC OF 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 2015 Article IV consultation with The Federal Democratic Republic of Ethiopia the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 21, 2015 consideration of the staff report that concluded the Article IV consultation with The Federal Democratic Republic of Ethiopia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 21, 2015, following discussions that ended on June 17, 2015, 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 September 2, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff of the IMF.
- A **Statement by the Executive Director** for The Federal Democratic Republic of Ethiopia.

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

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COMMUNICATIONS DEPARTMENT

Press Release No. 15/445
FOR IMMEDIATE RELEASE
September 30, 2015

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

IMF Executive Board Concludes 2015 Article IV Consultation with Ethiopia

On September 21, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Ethiopia.

Ethiopia's recent macroeconomic performance has continued to be strong overall, though with some rising domestic and external vulnerabilities. Economic growth in 2014/15 was buoyant (at an estimated 8.7 percent), supported by booming manufacturing and construction sectors. However, inflation has been on the rise, with domestic food prices pushing it above 10 percent. External vulnerabilities have also increased as exports of goods and services slowed significantly, while imports continued growing fast. A sharp widening of the current account deficit (to an estimates 12.8 percent of GDP) was largely offset by robust capital inflows, with a 50 percent increase in foreign direct investment and a much higher public borrowing from abroad. The general government deficit expanded only marginally (by 0.2 percentage point) to an estimated 2.8 percent of GDP. At the same time, public enterprises continued to borrow heavily to finance their accelerated investment plans. As a result, their financing needs increased to 7.4 percent of GDP, while public and publicly-guaranteed debt reached an estimated 50 percent of GDP in June 2015.

The economic outlook remains favorable, reflecting the country's significant potential, generally sound macroeconomic policies, and the government's efforts to improve infrastructure and attract foreign direct investment. In the medium term, staff forecast strong growth at 7½ - 8 percent. Public investment is expected to moderate, while private investment is projected to increase only gradually, reflecting constraints on access to credit and foreign exchange, the

[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.

overvalued exchange rate, as well as other competitiveness challenges. The authorities' medium-term budget targets a general government deficit of less than 3 percent of GDP and maintains a strong pro-poor focus. Monetary policy, anchored on base money growth, is geared toward maintaining inflation in single digits. The public debt-to-GDP ratio is expected to increase, reflecting large financing needs associated with implementation of the second Growth and Transformation Plan.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities' macroeconomic management that has delivered robust GDP growth and poverty reduction. Directors noted that the outlook for Ethiopia remains broadly favorable but domestic and external vulnerabilities have increased. Accordingly, they encouraged the authorities to persevere with policies that safeguard macroeconomic stability, strengthen buffers, and foster private-sector participation in the economy.

Directors agreed that fiscal policy has been prudent and appropriately pro-poor. However, with tax revenue below potential, they recommended broadening the tax base and improving revenue administration to mobilize more resources for needed development spending. Directors expressed concern over the acceleration of public sector borrowing with attendant risks of external debt distress and private sector crowding-out. In this regard, they advised careful selection and implementation of public projects with judicious use of non-concessional external financing and greater use of public-private partnerships. Directors welcomed the authorities' plans to establish an agency for the oversight of state-owned enterprises, which will strengthen the transparency of the public sector.

Directors supported the National Bank of Ethiopia's tight monetary stance, in light of recent inflationary pressures. Phasing out the central bank's direct advances to the government and full pass-through of lower oil prices would also help reduce inflation. More broadly, Directors recommended modernizing the monetary policy framework and strengthening liquidity management. Directors took note of the staff assessment that the exchange rate appears to be

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

overvalued in real effective terms and encouraged the authorities to allow greater exchange rate flexibility to facilitate external adjustment.

Directors agreed that further steps to secure positive real interest rates and greater financial deepening remain key to bolstering domestic savings and investment. To increase credit to the private sector, Directors also supported phasing out the requirement for banks to channel resources to the national development bank, which may distort financial intermediation. They also stressed the importance of maintaining an adequate regulatory and supervisory framework to support financial development.

Noting a softening of export activity, Directors recommended more decisive action to strengthen the business climate and enhance external competitiveness. Greater exchange rate flexibility, less burdensome regulation, and easier private sector access to credit and foreign exchange would be steps in the right direction. Opening some strategic sectors to foreign investment could also improve the provision of critical services.

Directors emphasized the importance of timely and comprehensive data for effective policy design and evaluation. They called for continued improvements in Ethiopia’s statistical capacity, particularly as regards national accounts and financial sector statistics.

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

September 4, 2015

KEY ISSUES

Context. Ethiopia's state-led development model has delivered rapid economic growth, reduced poverty, and improved social welfare. However, structural transformation has proceeded less quickly than planned, and slow export growth has increased external vulnerabilities. In addition, over the past year the economy has faced a sharp appreciation of the real exchange rate, a significant widening of the current account deficit, and (more recently) an increase in inflation. Large public borrowing from abroad, combined with weak exports, resulted in the risk of external debt distress increasing from "low" to "moderate".

Outlook and Risks. The outlook for Ethiopia remains largely favorable, reflecting its significant economic potential, policies that generally support macroeconomic stability, and reforms aimed at improving competitiveness. There are some external downside risks, including a possible weakening of foreign demand and a tightening in foreign financing conditions. Domestically, risks stem from the gradual pace of economic and financial reforms, as well as weather-related shocks that could hike inflation and have large social costs. A persistent overvaluation of Ethiopia's exchange rate is another notable downside risk to a pick-up in exports. On the upside, more ambitious reforms could deliver faster growth and greater poverty reduction.

Key Challenges. The discussions focused on how to address short-term macroeconomic and external challenges (including inflation and real exchange rate appreciation), and how to overcome longer-term challenges related to structural transformation and equitable growth. An important theme of the discussions was how to increase domestic resource mobilization, which remains critical to secure sustainable financing to meet Ethiopia's significant social and economic investment needs.

Policy Recommendations. Key policies recommended by staff include: (i) tight monetary policy to contain inflation; (ii) strengthening tax administration to bolster revenue; (iii) slowing public investment, to safeguard debt sustainability; (iv) increasing real interest rates, to promote savings; (v) enhancing competitiveness, through a more flexible exchange rate, reducing the cost of doing business, and easier access to credit for the private sector; and (vi) attracting more private capital flows, by opening key sectors to foreign investors.

Approved By
Michael Atingi-Ego (AFR) and Masato Miyazaki (SPR)

Discussions were held in Addis Ababa from June 3–17, 2015. The mission met with Prime Minister Hailemariam Desalegn, Minister of Finance Sufian Ahmed, National Bank Governor Teklewold Atnafu, Advisor to the Prime Minister Newai Gebre-ab, State Minister for Finance and Economic Development Abraham Tekeste, other senior officials, and members of the donor community, business, and civil society. The staff team comprised Ms. Richter Hume (head), Ms. Radzewicz-Bak, Mr. Ramirez, Mr. Hellwig, Ms. Morgan (all AFR) and Ms. Mendes Tavares (SPR). Mr. Tucker (OED) joined the mission.

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GROWTH AND TRANSFORMATION: ON THE ROAD TO MIDDLE-INCOME STATUS

1. **Ethiopia has achieved remarkable economic and social development gains during the past decade.** Income per capita has more than doubled in real terms since 2004/05.[3] At the same time, poverty has fallen (to 29.6 percent in 2010, and likely even more since then), while inequality has remained low (Gini coefficient of 0.30 in 2010). Ethiopia is also making progress towards achieving the Millennium Development Goals (Table 7).

2. **Economic growth remained buoyant in 2014/15, though primarily driven by domestic demand (Figure 1 and Table 1).[4]** Real GDP growth is estimated at 8.7 percent, with manufacturing and construction performing particularly well**.** Exports were depressed by weak oilseed and gold prices, while the Ebola crisis lowered travel receipts. With imports growing rapidly, the current account deficit widened to an estimated 12.8 percent of GDP. Capital inflows were buoyed by a 50 percent increase in foreign direct investment (FDI) and higher public borrowing from abroad. Foreign reserves rose to $3.3 billion by end-June 2015, increasing import coverage to two months.

3. **While macroeconomic policies have remained generally sound, pressures have increased in some areas.** Through June 2015, reserve money was growing more slowly than nominal GDP, which helped contain inflation to single digits. However, rising food prices (reflecting below-average rainfall) have pushed headline inflation to 11.8 percent in July, with non-food inflation nearing 10 percent. While the exchange rate continued its steady depreciation against the U.S. dollar (6 percent year-on-year through June 2015), it appreciated by about 21 percent in real effective terms. The general government deficit increased marginally, to an estimated 2.8 percent of GDP. Public salaries were raised by 33-46 percent—the first increase since January 2011. The cost (1.1 percent of GDP) was mostly offset by improved tax collection (particularly in domestic value-added and direct taxes), higher non-tax revenue, and windfall gains in the Oil Stabilization Fund (Tables 2 and 3). The financing needs of state-owned enterprises (SOEs) increased to 7.4 percent of GDP (up from 5.7 percent in 2013/14), reflecting accelerated investment. Total public debt reached an estimated 47 percent of GDP in June 2015.

4. **Large-scale public investment in infrastructure is supporting structural transformation and growth.** Major hydropower projects (including the Grand Ethiopia Renaissance Dam, which at 6,000 MWs will be the largest in Africa) will help Ethiopia triple its generation capacity to roughly 9,000 MWs—enough to meet domestic demand and generate significant export earnings. Mobile telephone subscriptions have increased four-fold since 2010. A new rail link to the port of Djibouti will lower Ethiopia's high transportation costs.

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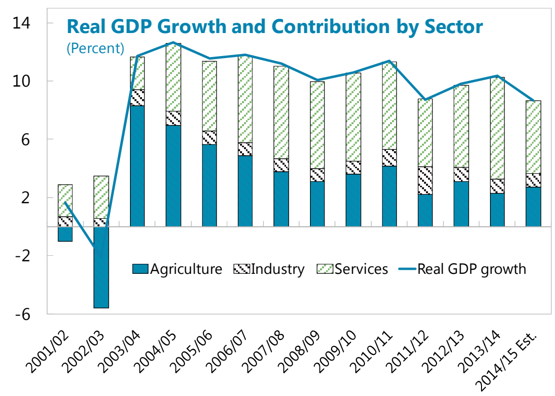
[3] The fiscal year runs from July 8 to July 7.

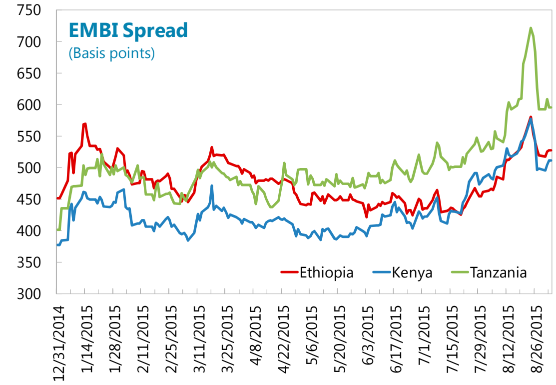
[4] Historical GDP data published by the IMF are those issued by Ethiopia's Central Statistical Agency. Staff projections for GDP are based on an underlying growth rate that is lower than that of the authorities, and that reflect identified weaknesses in national accounts data (see paragraph 45).

Figure 1. Ethiopia: Recent Economic Developments

Economic growth has been strong, driven in particular by services…

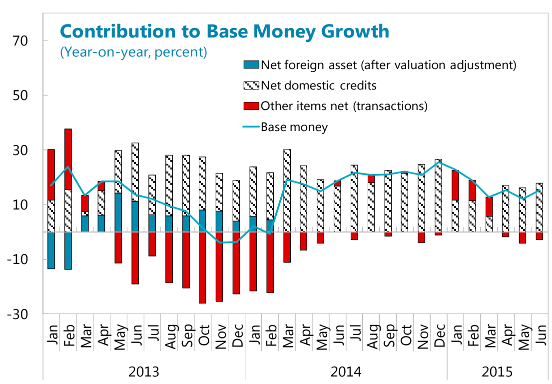


…though Ethiopia's Eurobond has sold off recently along with increased global financial market volatility.

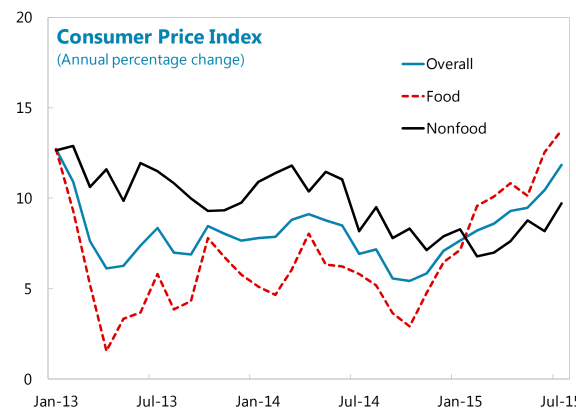


Source: Bloomberg.

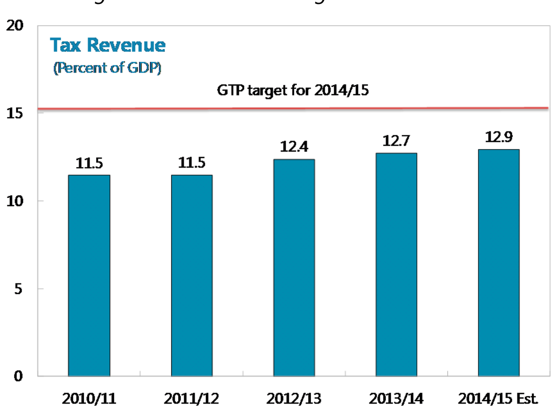
While base money growth has been contained, reflecting below-ceiling borrowing by the government and no increase in NFA …



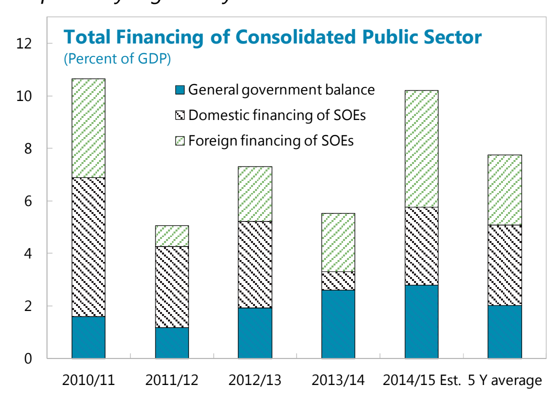
… inflation has picked up, with low rainfall contributing to sharply higher food prices.



Tax revenue has continued to increase, though it remains below the government's 2015 target…

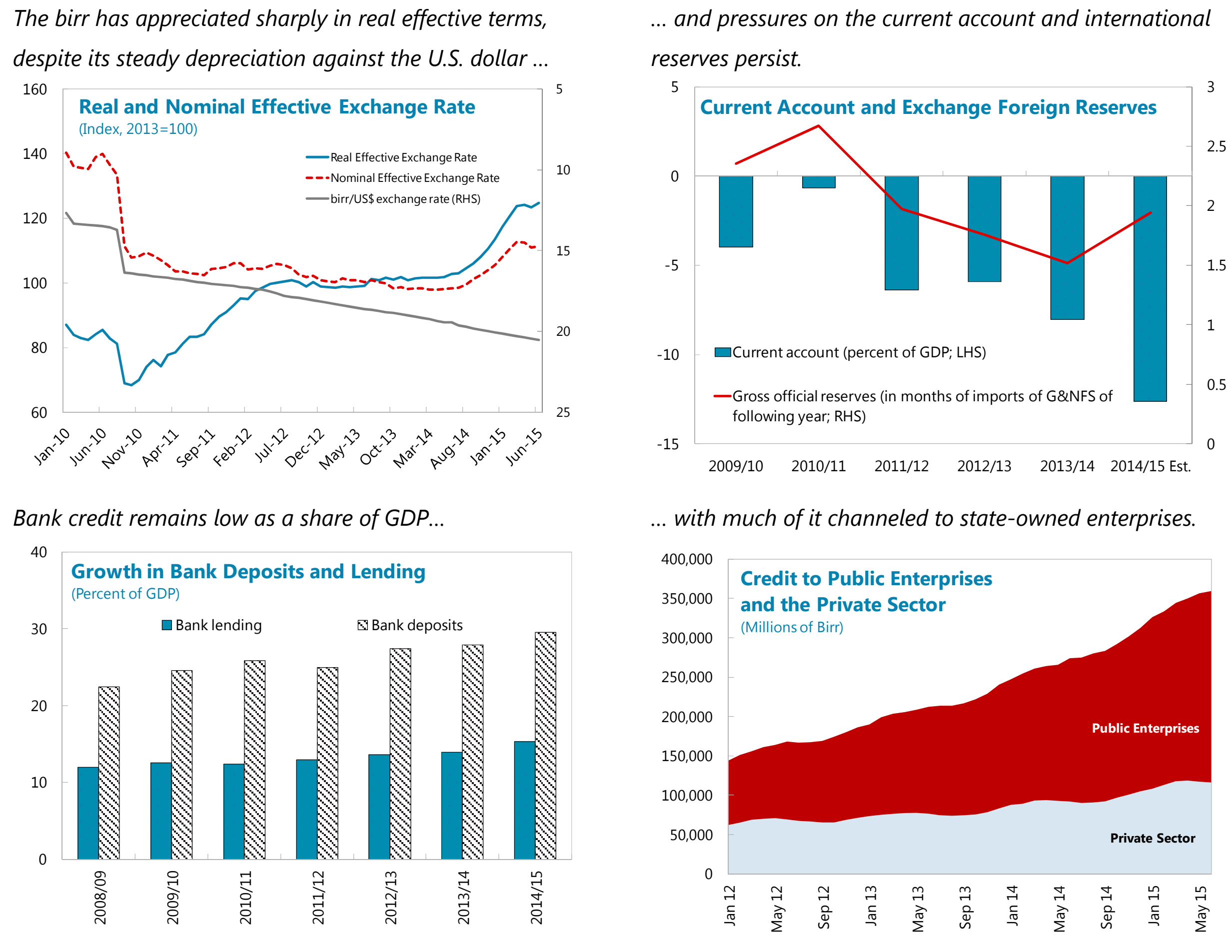


… while financing requirements of SOEs have been exceptionally high this year.



Sources: Ethiopian authorities, IMF staff estimates, and World Development Indicators

Figure 1. Ethiopia: Recent Economic Developments (concluded)



Sources: Ethiopian authorities, IMF staff estimates, and World Development Indicators.

5. In December 2014, the government issued its first Eurobond. The $1 billion issue (at a 10-year maturity) was priced favorably compared to regional peers, at 6.625 percent, and spreads narrowed considerably after issuance. However, along with other frontier markets, Ethiopia's spread rose sharply in August in the wake of heightened global financial market volatility. Its sovereign rating was reaffirmed at "B" by Fitch and "B1" by Moody's in early 2015. The proceeds are being used to finance industrial parks, the sugar industry, and power transmission infrastructure.

6. Policy implementation has only aligned partially with the Fund's 2014 Article IV recommendations (Annex I). A prudent monetary and fiscal stance has supported macroeconomic stability. Competitiveness has been improved, though challenges in some areas (for example customs and logistics) remain significant. However, Fund recommendations on interest rate, exchange rate, and financial sector policies have gained relatively little traction. Disbursements of non-concessional loans to SOEs were accelerated significantly rather than curtailed, as had been advised by the Fund.

A FAVORABLE OUTLOOK, THOUGH RISKS ARE RISING

7. The government's outlook for the economy is highly positive. The authorities' Growth and Transformation Plan II (GTP II, 2015-20), to be launched later this year, has as its ultimate goal for Ethiopia to reach middle-income status by 2025. GTP II targets 11 percent growth per year (underpinned by strong manufacturing and exports), an improved external balance, and higher foreign reserves. The private sector will play an increased role in the economy, though public investment will remain strong. With the ruling coalition winning all 547 seats in the May 2015 parliamentary elections, the government has wide scope for policy implementation.

8. Staff also forecast rapid growth, though below the GTP II target (Table 1). Public investment is expected to moderate in light of debt sustainability concerns, while private investment would grow gradually given credit and foreign exchange constraints, an overvalued exchange rate, and other competitiveness challenges. The weakening in global commodity prices should have a broadly neutral impact on Ethiopia, with a lower oil import bill mostly offset by lower agricultural exports. Robust private capital inflows (especially FDI) would largely finance imports, thus preventing an increase in foreign reserves.

Table 1: Ethiopia: GTP II Targets and IMF Projections
(2015/16 – 2019/20)

	GTP II	IMF
Average annual growth rate (2015/16 – 2019/20)		
Real GDP (percent)	11.0	7.7
Goods exports (U.S. dollars, incl. electricity, percent)	29.0	15.2
Target (GTP II) or projection (IMF) for 2019/20		
Taxes / GDP (percent)	17.0	14.4
Savings / GDP (percent)	29.0	18.9
Investment / GDP (percent)	41.3	32.9

9. Staff's generally positive outlook is subject to some downside risks (Annex II). Domestically, constraints on financing for development, slow implementation of structural reforms, and deterioration of SOE loan quality are the principal risks. Ethiopia also remains vulnerable to weather shocks, which would drive up inflation and have significant social costs. Weaker foreign demand would depress exports and foreign reserve accumulation. However, if demand in China rebalances towards consumption, this may benefit Ethiopia (which exports mainly vegetable products to China). A potential tightening in global financing conditions (as well as a faster slowdown in China) could affect FDI and other foreign financing. On the upside, if resource and competitiveness constraints are addressed more decisively, medium-term growth could be faster.

POLICY DISCUSSIONS

10. The discussions focused on the policies needed to support rapid and inclusive growth, while safeguarding macroeconomic and debt sustainability. Ensuring that the policy framework supports the development of the private sector is also essential to achieve economic diversification, promote exports, and create jobs for Ethiopia's young population.

11. The following policy challenges anchored the discussions:

- ***Preserving macroeconomic sustainability.*** A stable macroeconomic environment remains essential for catalyzing private investment. While economic growth has remained buoyant, inflation is on the rise, the exchange rate has appreciated sharply, the current account deficit has widened significantly, and the risk of external debt distress has increased. Reducing these vulnerabilities will require adjusting monetary, exchange rate, and public investment policies.
- ***Securing sustainable financing for development.*** While domestic savings has increased, it remains well below the authorities' investment target of roughly 40 percent of GDP. Staff recommended reforms to increase mobilization of domestic resources through the tax system, and financial sector policies to promote longer-term savings and greater private sector access to credit and foreign exchange.
- ***Increasing competitiveness and reducing external risks.*** Export development has been hampered by the high costs of doing business in Ethiopia. Reforms that improve competitiveness therefore remain critical to promote private investment (including FDI), bolster exports, and rebuild foreign reserves.
- ***Sustaining equitable growth.***[5] While structural transformation generally raises incomes, it can have adverse distributional impacts. To sustain equitable growth, economic and financial sector reforms should be accompanied by policies that help all groups benefit from reforms.

A. Preserving Macroeconomic Stability

12. Monetary policy should remain geared to keeping core (non-food) inflation below 10 percent. Reserve money continues to serve as an effective nominal anchor, given that indirect monetary policy instruments are not yet in active use (and Ethiopia's weak monetary transmission more generally). With core inflation on the rise, staff recommend reserve money growth below that of nominal GDP, and phasing out NBE advances to the government (estimated at about 1 percent of GDP in 2014/15). Lower oil prices should also be passed through fully, rather than saved as windfall gains by the Oil Stabilization Fund. Given the large share of food prices in inflation, measures to support domestic agricultural supply (especially for major staples) remain important.[6] Increased food aid may also be needed to protect the most vulnerable. If secondary effects of food inflation

[5] Ethiopia is a pilot country for the IMF's initiative to operationalize work on inequality.

[6] See Durevall, Loening and Ayalew, "Inflation dynamics and food prices in Ethiopia", *Journal of Development Economics (2013).*

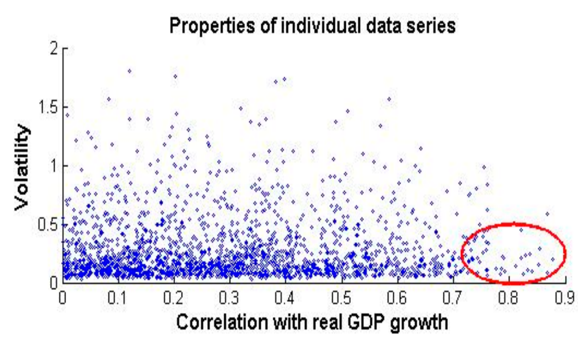
become significant, staff recommend halting NBE financing of the deficit and slowing credit growth by state-owned banks.

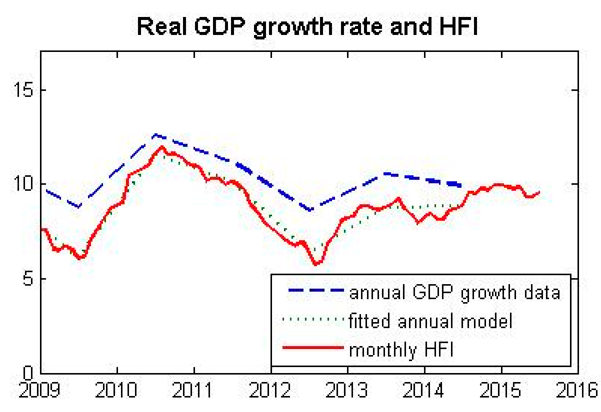
13. Staff encouraged the NBE to modernize the monetary policy framework, which will support financial market development and improve intermediation. Enhancing the NBE's capacity to monitor and forecast economic activity will help monetary policy become more forward-looking (Box 1). To increase the use indirect instruments and interest rates to signal the monetary policy stance, the NBE needs to strengthen its ability to forecast and actively manage liquidity. More flexible interest rates and exchange rates are prerequisites for developing interbank money and foreign exchange markets, improving the transmission mechanism, and developing secondary markets.

Box 1. Tracking Economic Activity in Real Time

Tools that allow policymakers to monitor economic activity with short lags facilitate timely policy responses. The authorities (with support from AFRITAC East) and AFR staff are both working on high-frequency indicators (HFI) of economic activity. The Article IV mission provided an opportunity to discuss methodologies and experiences with Ethiopia-specific challenges, with a view to enhancing HFI tools.

Ethiopia produces many timely monthly data series (fiscal, monetary, trade) which contain useful information about economic momentum. Building an HFI involves (i) selecting the most relevant variables and (ii) aggregating the selected series into a single index. Staff's methodology assigns a score to each series, reflecting criteria including the correlation with GDP growth and volatility (see figure), and selects the five series with the highest score. These series are then aggregated using the Conference Board methodology.

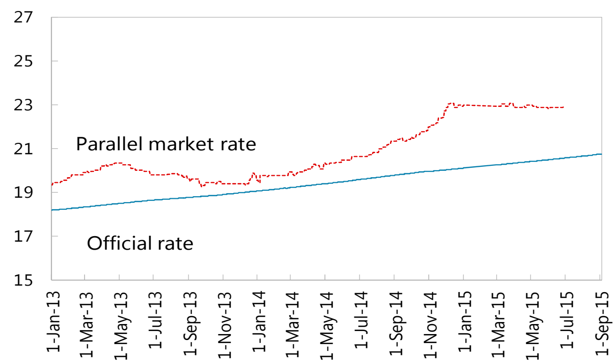




Results from staff's initial approach provide fairly successful out-of-sample predictions. The five selected series (out of nearly 2000 series of trade data) are: exports of coffee, and imports of used tires, fabric, office machine accessories, and bandages. Through mid-2015, the HFI suggests continued strong growth momentum.

14. On the exchange rate, staff stressed that greater flexibility would support Ethiopia's competitiveness and help bolster foreign exchange reserves.[7] Staff estimate that as of June 2015, the birr was overvalued by over 30 percent in real terms (Annex II). The fact that the parallel market premium has increased significantly (Figure 2) and that businesses report at times significant delays in access to foreign exchange further attest to overvaluation. A more flexible exchange rate would enhance the competitiveness of Ethiopia's exports.[8] The gap between the official and the parallel market exchange rates should also be reduced. The impact of depreciation on inflation should be fairly muted, since imported goods account for a small share of the CPI. Better functioning of foreign exchange auctions, including a more transparent price setting mechanism, could help the NBE accumulate foreign reserves (Annex III).

Figure 2. Ethiopia: Exchange Rates
(Birr per US$)



Source: National Bank of Ethiopia.

15. Turning to fiscal policy, the overall public sector position should support macroeconomic and debt sustainability. The general government fiscal position should remain cautious (with a deficit below 3 percent of GDP, as targeted by the authorities), with spending maintaining its pro-poor focus. External non-concessional public borrowing should however slow down, in light of the increase in the risk of external debt distress from "low" to "moderate" (Debt Sustainability Analysis), caused by higher-than-expected non-concessional borrowing and export underperformance in 2014/15.[9]

Against this backdrop, public investment should be paced carefully, and be subjected to careful cost-benefit analysis.[10] SOE products (for example, electricity) should be priced to ensure a good return on the government's investment. Staff recommended enhanced oversight of SOEs—ideally through a dedicated agency—and more careful monitoring of the financing requirements of the consolidated public sector. This would enhance transparency of fiscal policy and reduce fiscal risks and external vulnerabilities from contingent liabilities. To diversify sources of external financing, the government should consider innovative financing structures. For example, public-private partnerships could mobilize private equity financing while allowing the government to maintain ownership control.

[7] Ethiopia's exchange rate regime is classified *de jure* as "managed floating", and *de facto* as "crawl like".

[8] A more robust monetary policy framework would support a more flexible exchange rate regime.

[9] The debt distress risk rating faces downside risks from export underperformance, terms-of-trade shocks, and accelerated external borrowing.

[10] The 2014 Article IV used model-based analysis to assess the trade-offs of investment and debt sustainability.

Authorities' views

16. The authorities reiterated their commitment to maintaining price and exchange rate stability. Prudent monetary and fiscal policies would continue delivering low inflation (though administrative measures would be taken if needed to increase the supply of critical food items). They indicated that NBE's direct financing of the government will decline over the medium term. The NBE is strengthening its liquidity forecasting capabilities and re-designing its liquidity management framework (and plans to introduce standing credit facilities and management of liquidity through open market operations). On the exchange rate, the NBE reaffirmed their policy of gradual depreciation vis-à-vis the U.S. dollar, which seeks to retain competitiveness while minimizing the inflationary impact of a weaker exchange rate. While acknowledging that the appreciated *birr* presented headwinds to exporters, the NBE highlighted the cost of a weaker birr to the government (higher external debt service) and to importers (especially of capital goods needed for infrastructure and manufacturing).[11]

17. The authorities agreed with the Fund's recommendations to improve SOE oversight. They announced plans to establish an independent ministry to monitor the largest public enterprises. They also plan to privatize some smaller companies still under state control.

18. The authorities disagreed with the results of the DSA, arguing that the telecoms SOE should be excluded from the analysis. They noted that just like Ethiopian Airlines (which is excluded from the DSA), Ethio Telecom is run on a commercial basis, and its debt is not guaranteed by the government. Staff noted that including SOEs was the norm for DSAs, and that Ethio Telecom did not yet meet the conditions required for exclusion (which include regular publication of audited financial accounts).

B. Securing Sustainable Financing for Development

19. Ethiopia requires higher domestic savings to finance its significant infrastructure and social development needs. Total savings has increased to about 18-19 percent of GDP, reflecting solid growth in private savings. However, given the authorities' investment target of 40 percent of GDP, more resources are needed. Staff advocated a strategy based on two pillars—fiscal policy and financial sector policy—to help finance Ethiopia's development strategy.

Fiscal Policy

20. A more effective tax system could help raise more resources to finance development. With an estimated tax-to-GDP ratio of 12.9 percent in 2014/15, Ethiopia falls short of its revenue potential. Measures that increase the tax base—such as promoting private sector growth and increasing coverage of commercial agriculture—would support revenue. The Ethiopian Revenue and Customs Authority should accelerate its reform program, focusing in particular on improving

[11] With regards to fiscal costs of depreciation, staff estimate that higher tax revenue from exporters would largely offset higher debt service.

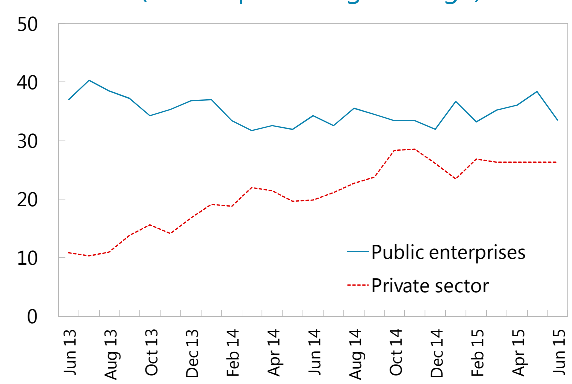
taxpayer registration, strengthening customs administration, upgrading IT systems, and implementing a compliance management and enforcement strategy.

21. Tax incentives and tax expenditures should be used judiciously, to minimize foregone revenue and potential economic distortions.[12] Measures that do not deliver significant economic and/or social returns should be phased out. Staff also recommended caution with regards to tax benefits being considered for investors in industrial zones. Rather than providing incentives through tax policy, the government could use these resources to finance infrastructure in these zones. This would benefit the Ethiopian economy over the longer term.

22. The public sector should avoid crowding out the private sector in credit and foreign exchange markets. SOEs continue to absorb a large share of new credit to the economy (Figure 3). They may also benefit from preferential access to foreign exchange. These factors constrain the private sector's ability to start new businesses and expand existing ones.

Figure 3. Ethiopia: Credit to Public Enterprises and the Private Sector

(annual percentage change)



Sources: Ethiopian authorities; and IMF staff calculations.

Authorities' views

23. The authorities agreed with the overall thrust of staff's recommendations on revenue mobilization. They noted that GTP II would target an increase in tax revenue to 17 percent of GDP, with reduction in leakages playing an important role. Staff consider this goal achievable, though additional tax policy measures would be needed. With regards to tax incentives, the authorities consider them important for attracting FDI, since many other countries offer them. However, they acknowledged that the associated revenue losses were sizable.

Financial sector policies

24. Policies that encourage savings are also critical elements to mobilize financing. The importance of savings in the development experience of Asian countries may be relevant in this regard (Annex IV). In Ethiopia, while deposits have been growing rapidly, further mobilization is needed to satisfy the significant demand for financing. Policies that promote the expansion of bank branches, increase financial awareness, and diversify savings instruments will help boost savings. Maintaining Ethiopia's well-developed social safety net program will reduce the need for the poor to maintain cash buffers.

[12] The IMF's Fiscal Affairs Department has estimated that tax exemptions on capital goods and income tax holidays alone may have cost Ethiopia about 3 percent of GDP in 2010. They may also distort consumption and investment decisions.

25. For banks to increase their lending in support of structural transformation, they need to extend the average maturity of their deposit base. Longer-term deposits currently only account for 11 percent of the deposit base. Banks pay about 10 percent on longer-term deposits, roughly twice the interest rate on savings accounts. However, even these higher rates do not ensure a positive real rate of return. If real interest rates on banks' "safe" assets (e.g., government securities) were higher, banks would have more financial space to increase the rates they pay on term deposits. Raising rates on government and NBE securities could therefore lead to more term deposits.

26. The private sector needs greater access to credit if is to contribute more to growth. The state-owned Commercial Bank of Ethiopia, which accounts for two-thirds of system-wide assets, can play a critical role in making more credit available to the private sector. Exploring new modalities for funding the Development Bank of Ethiopia (DBE) could also help. Since 2011, private banks have been required to invest the equivalent of 27 percent of their new lending in NBE bonds (at a negative real rate of return), with the proceeds used to help DBE fund its loans to priority sectors. While this policy has a good objective—namely to promote longer-term lending—DBE has faced challenges in disbursing all the resources it receives from private banks. Staff therefore recommended phasing out the NBE bond financing policy, in order to leave more resources for private banks to lend to the private sector. Staff also recommended allowing Ethiopia's banks to tap foreign credit lines, with safeguards in place to limit currency and maturity mismatches.[13] Policies that help small- and medium-sized firms gain better access to credit markets would also help.[14]

27. Maintaining a healthy financial sector is essential for successful intermediation. Ethiopia's banking sector has favorable aggregate indicators: in March 2015, the average risk-weighted, system-wide capital adequacy ratio was 16.6 percent (double the minimum requirement); profitability was robust; and the non-performing loan ratio was only 2.4 percent (Table 8). However, the absence of detailed bank data precludes the assessment of potential vulnerabilities in individual banks. One source of risk is credit concentration, given the potentially large exposure of some banks to single borrowers. Staff encouraged the NBE to remain vigilant in this regard. Liquidity management may also be an issue, with short-term liquidity pressures having surfaced at a few banks during the year.

Authorities' views

28. The authorities presented their strategy for promoting deposit growth, and emphasized that the financial system remains resilient. To promote savings, banks were being encouraged to expand their branch network and to develop better-targeted savings instruments (for example for homebuyers and Ethiopia's Diaspora). The NBE agreed with staff that higher interest rates (especially for term deposits) could also promote savings, though they saw greater impact from structural policies. With regards to the DBE funding mechanism, the NBE explained that they were considering other funding options (including DBE bonds), and that the bank was being

[13] External borrowing is subject to approval by the NBE.

[14] A recent World Bank study found that financing constraints of micro, small and medium enterprises are one of the key obstacles to job creation and growth in Ethiopia.

restructured to enhance its lending capacity. The NBE expressed some doubt whether private banks would make use of additional liquidity if the DBE funding model was changed, noting past episodes of banks accumulating excess reserves.

C. Increasing Competitiveness and Reducing External Risks[15]

29. Ethiopia's investment-led development model entails some external risks. The country has considerable potential to move its exports up the value chain, especially in leather, textiles, and agro-processing—sectors in which Ethiopia already exports raw materials. There is also potential to export processed coffee, if better logistics reduced export times. Developing the infrastructure to support these export industries has required substantial imports of intermediate and capital goods, as well as business services. But because the export response takes time (Figure 4), foreign reserves have remained under pressure. Given the volatility of Ethiopia's terms of trade and its less flexible exchange rate regime, staff consider the overall level of reserves as inadequate (Annex V).

30. Easing the trade-off between growth and stability will depend critically on structural reforms that improve competitiveness (Figure 5). The World Economic Forum ranked Ethiopia 118th out of 144 countries in its 2014–15 report. Ethiopia does relatively well with regards to the level of wages, business security, and quality of air transport. Weaker areas include customs, administrative procedures, the quality of logistics, and access to credit and foreign exchange (especially for small and medium enterprises).

31. Ethiopia's slower approach to multilateral trade negotiations may dampen foreign investment in industries that are critical for growth. Accession to the World Trade Organization (underway since 2003) is currently at the stage of discussing service sectors (banking, telecoms, and logistics). Full accession to the free trade area of the Common Market for Eastern and Southern Africa (COMESA) is now expected by 2021.

32. Industrial parks (IPs) are expected to feature prominently in GTP II as a way to overcome structural bottlenecks and boost investment.[16] Incentives include income tax holidays for 5–7 years (and up to 9 years for exporters), and exemption from customs duties on raw materials and capital goods and from value-added taxes; a reduced waiting period for foreign exchange; access to developed land at subsidized rates; streamlined customs procedures; and better power and telecoms services.

33. Other countries' experience with IPs suggests several lessons.[17] First, strengthening administrative procedures is essential for the success of "one-stop shop" reforms. Second, to generate spillovers to the broader economy, IPs should be integrated in the local value chain. Third, fiscal incentives may make IPs more attractive, but they are seldom the decisive element in investors' decisions. As with any tax incentive, staff encouraged the authorities to undertake a careful

[15] The 2014 Article IV contained a special section on promoting competitiveness.

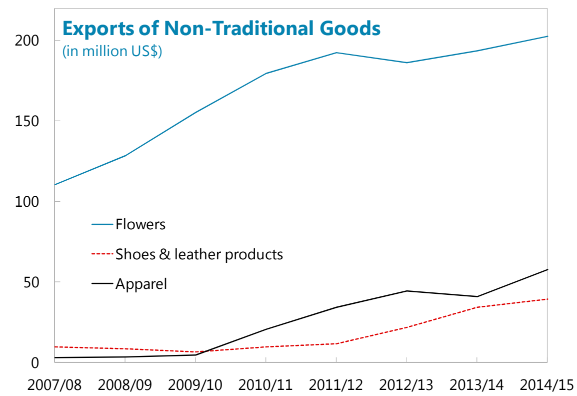
[16] A public IP outside Addis focuses on textiles, garments, leather, and footwear. There are also five private IPs.

[17] "Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development", World Bank (April 2008).

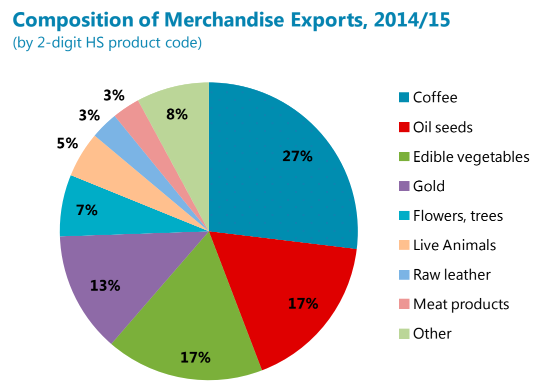
assessment of the pros and cons, given the revenue loss and the potential for distorting economic decisions.

Figure 4. Ethiopia: Merchandise Export Growth and Diversification

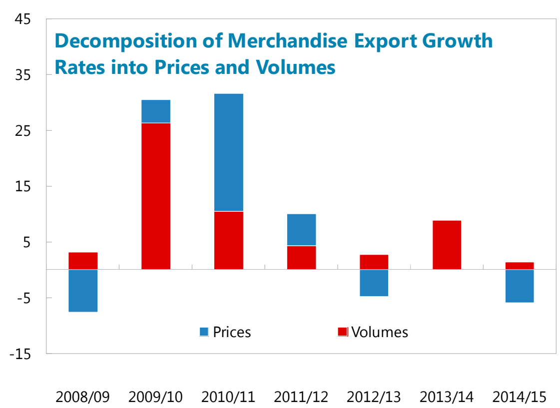
Despite strong export growth of non-traditional products…



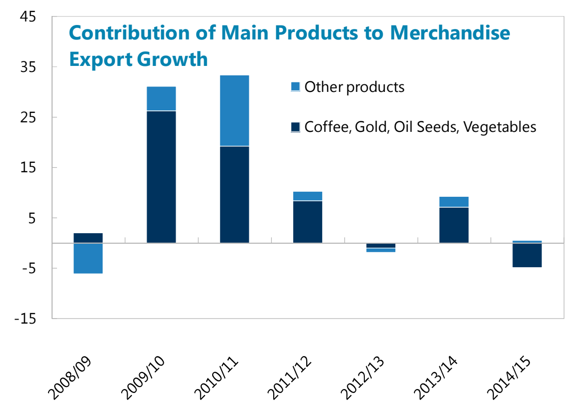
… Ethiopia's exports remain heavily dependent on commodities…



… which leaves the country vulnerable to global commodity price movements.



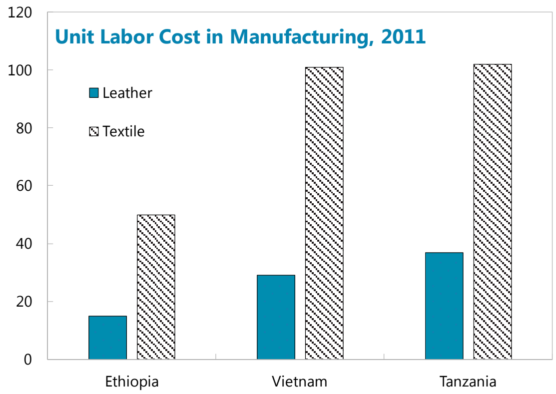
A few commodities therefore continue to dominate overall export performance.



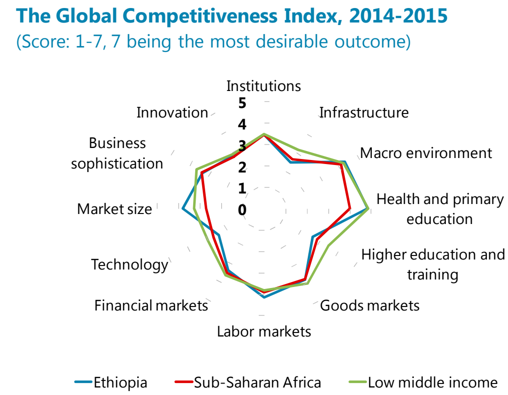
Sources: ERCA and IMF staff estimates.

Figure 5. Ethiopia: Competitive Position in the Global Marketplace

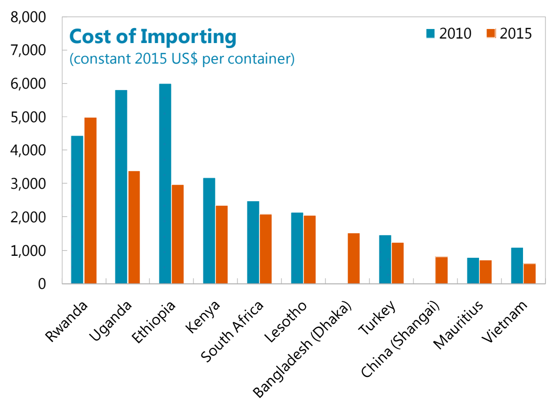
Competitive wages make Ethiopia an attractive destination for investors in light manufacturing...



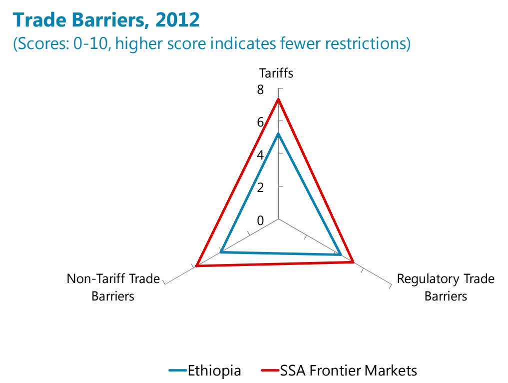
... though competitiveness challenges remain.



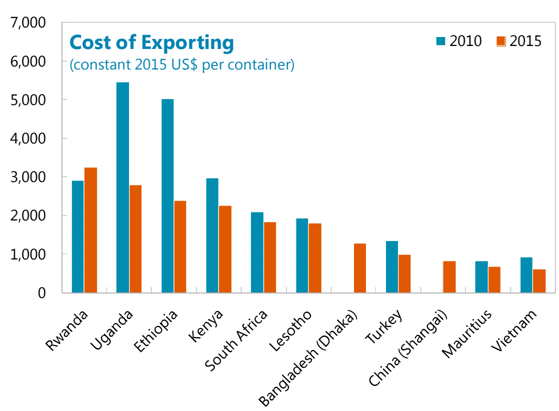
Despite significant improvement, the cost of importing remains high...



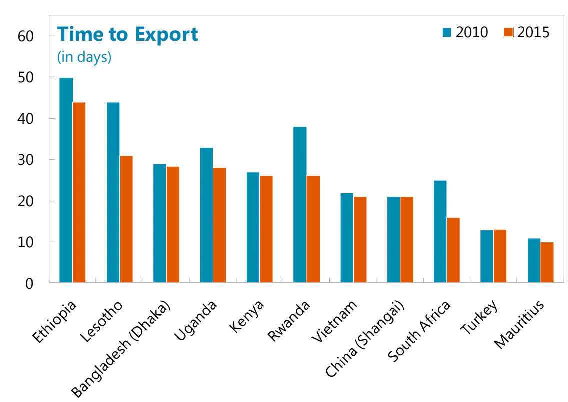
... as do trade barriers.



The cost of exporting is regionally competitive though far above that of other textile exporters...



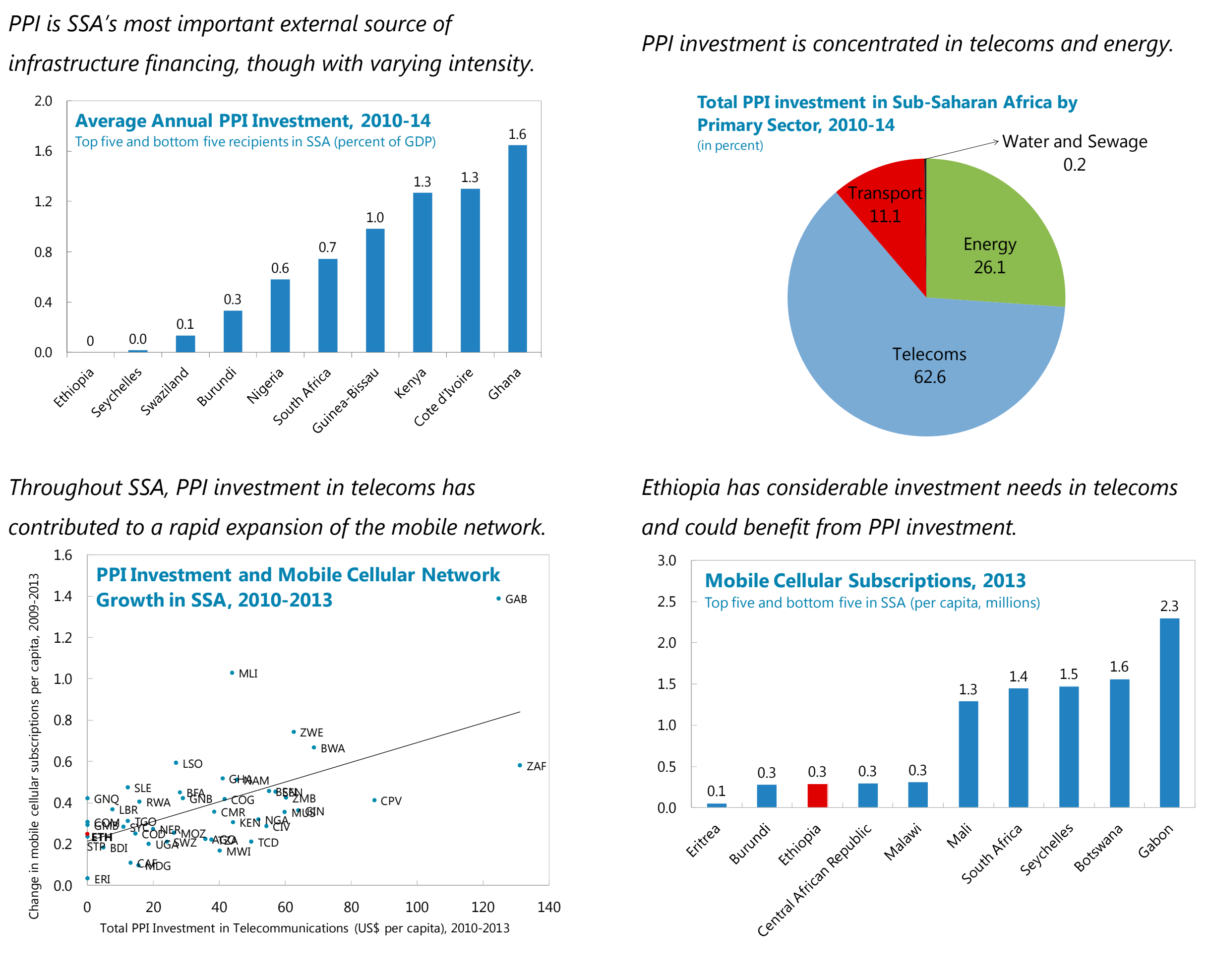
... and long export times remain a major challenge.



Sources: 2014 African Transformation Report (African Center for Economic Transformation), Competitiveness Report (2014-15), Doing Business (World Bank, 2015), and Frazer Report (2012).

34. Greater foreign financing can also play an important role in supporting development, but should be consistent with macroeconomic and debt sustainability. External borrowing on commercial terms should be for high-return projects that will generate sufficient returns to service the debt. Public-private partnerships could be a good way to catalyze foreign financing, while allowing the government to retain control of high-priority sectors (Figure 6). FDI can also play a key role in improving efficiency and bolstering growth. In particular, opening up telecoms and banking could have a major impact on the cost and quality of these critical, growth-enhancing services.

Figure 6. Ethiopia: Private Participation in Infrastructure (PPI) in Sub-Saharan Africa



Sources: World Bank (WDI, PPIAF), World Economic Outlook, and IMF staff estimates.

Authorities' views

35. The authorities expressed their commitment to overcoming competitiveness challenges, and their expectation of a rapid export response to their promotion policies. Continued public investment in infrastructure, the creation of IPs, and structural reforms would increase FDI and domestic investment, and bolster growth. Strategic sectors were expected to remain closed to FDI for now. Regarding trade negotiations, the authorities explained that domestic industries needed more time to develop before facing foreign competition. Regarding the foreign reserves policy, they reiterated their medium-term target of achieving an import cover of three months.[18]

D. Sustaining Equitable Growth[19]

36. As Ethiopia's structural transformation accelerates, it may become more challenging to sustain equitable growth. Ethiopia has an impressive track record of low inequality despite very rapid growth (although more recent studies suggest that inequality may be on the rise in urban areas). This outcome reflects the fact that Ethiopia allocates a high share (about 70 percent) of its expenditure to poverty-related programs, and that its Productive Safety Net Program (which integrates income support with public employment) delivers transfers in a well-targeted and cost-effective way. Government policies supporting agriculture have also played a major role in sustaining equitable growth, given that poverty is primarily in rural areas.

37. Looking ahead, as Ethiopia seeks to accelerate its structural transformation, growth may become less equitable. As the economy shifts into manufacturing and services, measures may be needed to support those who are less likely to gain from this transformation.

38. Fiscal policy can play a central role in sustaining equitable growth. Enhanced tax collection and lower tax exemptions would increase the fiscal space for poverty reduction. Staff also recommended updating nominal income tax thresholds, which have lost their progressivity since the last revision a decade ago. With regards to spending, staff support the government's plans to continue its pro-poor focus.

39. Financial sector policies should also have a pro-poor dimension. Financial instruments targeted to rural savers are important in this regard. Mobile banking (such as M-Pesa in Kenya) holds great promise for promoting financial inclusion. The authorities should also continue encouraging banks and particularly MFIs to increase their outreach.

40. Complementing economic reforms with social policies can help sustain rapid and equitable growth. Using a dynamic general equilibrium model tailored to Ethiopia, staff analyzed the macroeconomic and distributional impacts of selected policy recommendations, such as streamlining tax incentives and leaving more funds with private banks (by changing the DBE funding modality). As more resources are channeled to private investment, manufacturing and services expand, and economic growth accelerates. Private consumption also increases. Some of the policies would have distributionally regressive outcomes if implemented on their own. However, if combined with increased social protection, greater financial inclusion, and support for rural-urban migration, the overall impact of the package could be positive even for the poorest members of society (Figure 7).

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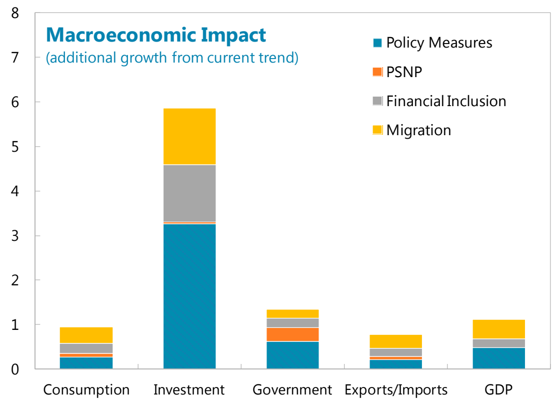
[18] The authorities exclude imports related to foreign aid and *franco valuta* imports when measuring the reserves-to-imports ratio.

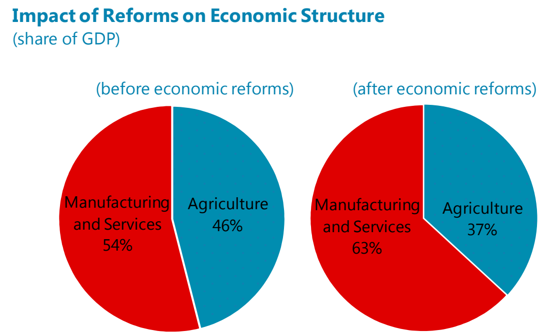
[19] The Selected Issues Paper analyzes policies that can promote structural transformation and sustain equitable growth.

Figure 7. Ethiopia: Distributional Impact of Economic and Financial Reforms

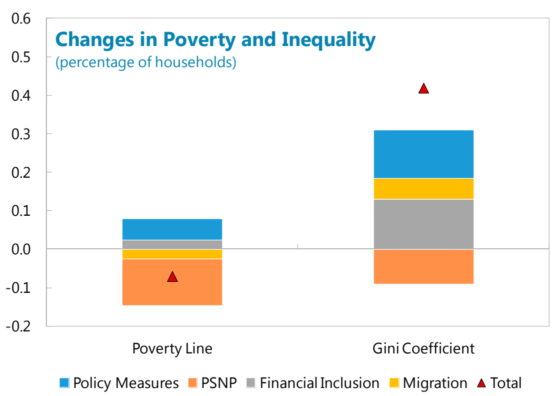
The reforms would have a strong positive macroeconomic impact…



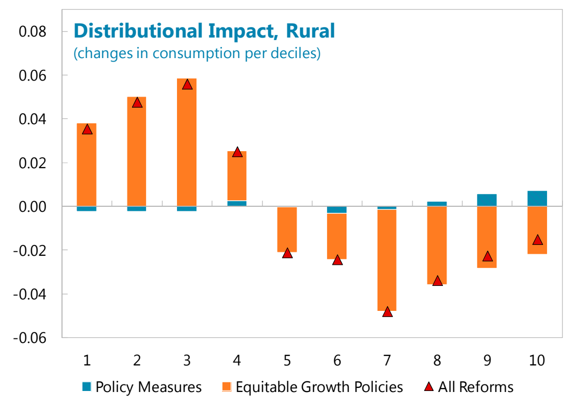
…and promote structural transformation.



After the reforms, poverty falls but inequality increases…



… although the poorest deciles in rural areas enjoy higher consumption.



Source: IMF staff estimates.

Authorities' views

41. The authorities welcomed staff's focus on equitable growth and their analysis of the distributional impacts of economic and financial policies. On income taxes, they acknowledged the need for a regular revision of thresholds to ensure progressivity over time. With regards to staff's model-based analysis, they noted that the presence of excess labor in urban areas could reduce the positive impact of the proposed reforms. They also questioned whether private banks would actually lend the additional resources they would receive if the DBE funding modality was changed, noting banks' accumulation of excess reserves in the past.

E. Alternative Scenario

42. Implementation of staff's recommended policies could ease Ethiopia's financing constraints and promote rapid and inclusive growth, while reducing external vulnerabilities (Table 6). The implications of these policies would be (i) higher tax revenue (with stronger growth adding 0.5 percentage point, and reduced tax exemptions adding 3 percentage points to the tax-to-GDP ratio), allowing more social spending and a lower deficit; (ii) higher savings, in response to positive real interest rates; (iii) enhanced competitiveness, reflecting a more flexible exchange rate and more ambitious structural reforms; and (iv) higher capital inflows, reflecting greater competitiveness and opening key sectors to FDI. Inflation would be higher initially (reflecting faster depreciation), but lower in the long run as greater competition reduces mark-ups. Such measures could increase growth between 1-2 percentage points on average over the next five years, and accelerate poverty reduction. Improved export performance would bolster foreign reserves and enhance macroeconomic stability.

OTHER ISSUES

43. While data provision is broadly adequate for surveillance, **the quality and timeliness of some key data still need to improve.** Publication of an extensive and timely set of macroeconomic statistics by the NBE has been an important positive development. However, national accounts statistics (especially from the expenditure side) remain a work in progress, and data on economic growth, savings, and investment are subject to considerable uncertainty. The authorities noted that the TA they are receiving from AFRITAC East is helping them build capacity in monitoring economic activity and in compiling quarterly national accounts statistics. In the financial sector, staff encouraged the authorities to provide more detailed information, including commercial banks' income, non-performing loans, and loan-loss provisions. The government is working with the largest SOEs so that they publish audited financial reports. This would improve public sector transparency and enhance monitoring of potential financial risks.

44. Ethiopia is encouraged to address the exchange restrictions maintained on current international transactions. These relate to: (i) the tax certification requirement for repatriation of dividends and other investment income; (ii) restrictions on the repayment of external loans and supplies and foreign partner credits; (iii) rules for issuance of import permits by commercial banks; and (iv) the requirement to provide an NBE clearance certificate to obtain import permits.

STAFF APPRAISAL

45. **As Ethiopia embarks on GTP II, the time is right to adjust policies in support of greater structural transformation.** While Ethiopia's state-led development model has delivered in many respects, success going forward will depend critically on a greater role for the private sector. This will require adjustments in many policy areas. At the same time, Ethiopia is facing more immediate challenges, with rising inflation, an overvalued exchange rate, a large external imbalance, and increased risk of debt distress. These too will need to be addressed in order to maintain investor confidence and bolster private capital inflows.

46. **Enhancing revenue mobilization and improving oversight of state-owned enterprises should be given high priority.** Improved tax administration and a more judicious use of tax incentives and expenditures can bolster government revenue. With regards to SOEs, it is critical that their borrowing and investment plans are consistent with macroeconomic and debt sustainability, in particular given the increased risk of external debt distress. Staff encourage the government to consider innovative forms of financing, such as private-public partnerships and other options that could help mobilize private non-debt financing.

47. **Monetary and financial policies should remain consistent with single-digit inflation, and further steps need to be taken to promote financial intermediation.** To contain core inflation to single digits, the monetary policy stance should remain tight. Additional measures (such as slowing credit creation by state banks) may also be needed if inflationary expectations become more entrenched. Improved capacity to monitor economic indicators would allow monetary policy to be more forward-looking. Staff also encouraged the authorities to enhance liquidity forecasting and increase the use of indirect tools for monetary management. Bringing real interest rates on key securities to a positive level would enhance the transmission mechanism and promote financial intermediation. Policies that support the growth of credit to the private sector—including a new funding modality for DBE—are also needed.

48. **Decisive reforms are needed to foster export growth and diversification.** Greater flexibility of the exchange rate would reduce overvaluation, enhance competitiveness, and support reserve accumulation. Improving customs, logistics, and access to credit and foreign exchange (especially for small and medium enterprises) would be particularly important. Industrial parks could help boost investment, but fiscal costs should be contained.

49. **Data deficiencies present challenges to effective surveillance.** In the absence of timely and comprehensive data, it is more difficult to analyze economic and financial developments and to provide effective policy advice. Intensified efforts to address data weaknesses, combined with greater transparency regarding financial sector and state-owned enterprise data, would provide a stronger basis for surveillance.

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

Table 2. Ethiopia: Selected Economic and Financial Indicators, 2012/13–2019/20

Social Indicators

GDP		**Poverty**	
Nominal GDP (2015, billions of U.S. dollars)	63.0	Headcount ratio at 1.25$ a day (2010, percent of population)	36.8
GNI per capita, Atlas method (2014, current US$)	550	Undernourished (2013, percent of population)	35.0
Population characteristics (2014)		**Income distribution, 2010**	
Total (million)	88.3	Income share of the highest 10 percent of population	27.5
Urban population (percent of total)	19.0	Income share of the lowest 20 percent of population	8.0
Life expectancy at birth (2013, total years)	63.6	GINI index	30.0

Economic Indicators

	2012/13 Act	2013/14 Act.	2014/15 Est.	2015/16 Proj.	2016/17 Proj.	2017/18 Proj.	2018/19 Proj.	2019/20 Proj.
	(Annual percentage change)							
National income and prices								
GDP at constant prices (at factor cost)	9.8	10.3	8.7	8.1	7.6	7.5	7.5	7.5
GDP deflator	4.7	10.2	8.3	9.5	8.7	8.5	8.5	8.6
Consumer prices (period average)	13.5	8.1	7.7	10.4	8.5	8.5	8.5	8.5
Consumer prices (end period)	7.4	8.5	10.4	8.0	8.5	8.5	8.5	8.5
External sector								
Exports of goods and services (U.S. dollars, f.o.b.)	-0.5	8.4	-5.9	15.4	16.0	15.9	15.1	12.9
Imports of goods and services (U.S. dollars, c.i.f.)	0.7	17.7	20.7	1.7	7.2	7.5	7.2	6.8
Export volume	11.2	2.9	-3.6	16.9	16.6	11.8	11.0	10.0
Import volume	8.1	27.5	28.3	7.5	6.1	5.6	6.1	6.3
Terms of trade (goods, deterioration –)	-9.0	1.1	1.6	2.8	-1.3	0.1	0.6	1.1
Nominal effective exchange rate (end of period)	-5.2	-2.0	13.2	…	…	…	…	…
Real effective exchange rate (end of period)	-0.9	3.7	21.4	…	…	…	…	…
	(Percent of beginning-period stock of broad money, unless otherwise indicated)							
Money and credit								
Net foreign assets	2.7	0.5	0.7	-2.4	1.0	1.3	1.8	3.4
Net domestic assets (including other items net)	21.5	26.4	23.5	24.3	18.5	16.7	16.1	14.7
Broad money	24.2	26.9	24.2	22.0	19.6	18.0	17.9	18.1
Base money (annual percentage change)	13.6	18.7	15.2	18.3	17.2	16.9	16.8	17.0
Velocity (GDP/broad money)	3.69	3.52	3.36	3.25	3.19	3.16	3.13	3.10
	(Percent of GDP, unless otherwise indicated)							
Financial balances								
Gross domestic savings	19.2	19.0	18.2	18.6	18.7	18.7	18.8	18.9
Public savings	5.7	5.0	4.9	4.8	4.8	4.9	5.0	5.0
Private savings	13.5	14.0	13.3	13.8	13.9	13.8	13.8	13.9
Gross domestic investment	35.8	36.8	40.0	37.1	35.9	34.8	33.8	32.9
Public investment	19.1	20.0	22.4	19.0	17.5	16.2	15.0	14.1
Private investment	16.7	16.8	17.6	18.1	18.4	18.6	18.8	18.8
Resource gap	-16.6	-17.8	-21.8	-18.5	-17.2	-16.1	-15.0	-14.0
External current account balance, including official transfers	-5.9	-8.0	-12.8	-9.4	-8.5	-7.6	-6.9	-6.3
Government finances								
Revenue	14.3	14.0	15.0	14.6	15.0	15.3	15.7	15.9
Tax revenue	12.4	12.7	12.9	13.1	13.5	13.8	14.2	14.4
Nontax revenue	2.0	1.2	2.1	1.5	1.5	1.5	1.5	1.5
External grants	1.5	1.1	1.4	1.0	1.1	0.9	0.8	0.7
Expenditure and net lending	17.8	17.7	19.2	18.5	18.7	19.0	19.1	19.1
Fiscal balance, excluding grants (cash basis)	-3.5	-3.8	-4.2	-3.9	-3.7	-3.6	-3.4	-3.2
Fiscal balance, including grants (cash basis)	-1.9	-2.6	-2.8	-2.8	-2.6	-2.7	-2.6	-2.5
Total financing (including residuals)	1.9	2.6	2.8	2.8	2.6	2.7	2.6	2.5
External financing	1.9	1.9	1.3	1.2	1.0	0.9	0.8	0.7
Domestic financing (not including privatization)	0.2	1.3	1.5	1.6	1.6	1.8	1.8	1.8
Public debt[1]	37.0	41.2	50.2	57.1	61.3	63.6	62.9	61.6
Domestic debt	16.6	19.1	24.1	28.4	30.2	31.8	32.6	32.9
External debt (including to the IMF)	20.3	22.1	26.2	28.8	31.0	31.8	30.3	28.7
Overall balance of payments (in millions of U.S. dollars)	144	-36	148	-449	143	219	378	832
Gross official reserves (in millions of U.S. dollars)	2,368	2,496	3,256	2,787	2,930	3,150	3,528	4,360
(months of imports of goods and nonfactor services of following year)[2]	1.8	1.5	2.0	1.6	1.5	1.5	1.6	2.0
GDP at current market prices (billions of birr)	865	1,047	1,241	1,468	1,720	2,010	2,349	2,746

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] Public debt includes general government and state own entriprises (excluding Ethiopian Airlines).

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

Table 3a. Ethiopia: General Government Operations, 2012/13–2019/20[1]

(millions of birr)

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	137,192	158,078	203,178	230,143	276,970	327,254	387,607	456,338
Revenue	124,077	146,174	186,350	214,853	258,184	308,162	368,202	436,567
Tax revenue	107,010	133,119	160,146	192,357	232,075	278,100	333,084	395,504
Direct taxes	36,393	47,021	56,128	69,443	85,138	103,665	125,950	150,167
Indirect taxes	70,618	86,098	104,019	122,915	146,938	174,436	207,135	245,338
Domestic indirect taxes	32,440	40,499	47,969	60,372	74,113	88,295	105,577	126,198
Import duties and taxes	38,177	45,599	56,048	62,541	72,824	86,140	101,557	119,139
Nontax revenue	17,067	13,055	26,204	22,497	26,109	30,062	35,118	41,062
Grants	13,115	11,904	16,828	15,290	18,786	19,092	19,404	19,771
Program grants	3,416	2,510	4,135	1,074	2,864	1,259	1,471	1,720
Project grants	9,699	9,394	12,693	14,216	15,922	17,833	17,934	18,052
Total expenditure and net lending (cash basis)[3]	153,929	185,472	238,113	271,362	322,256	381,387	448,544	524,853
Recurrent expenditure[2]	62,746	78,087	111,343	116,187	133,503	151,254	176,710	204,280
Defense spending	6,493	7,489	8,000	9,500	10,000	10,500	12,266	14,342
Poverty-reducing expenditure[3]	31,444	38,141	45,176	56,240	62,965	67,950	79,379	90,691
Interest payments	2,931	3,794	7,536	10,534	12,858	15,790	18,462	21,370
Domestic interest and charges	1,792	2,290	3,104	3,953	4,987	6,256	7,497	8,849
External interest payments[4]	1,139	1,504	4,432	6,580	7,872	9,535	10,965	12,522
Other recurrent expenditure	21,877	28,663	50,630	39,914	47,680	57,013	66,602	77,876
Capital expenditure	91,183	107,385	126,770	155,175	188,752	230,133	271,834	320,573
Central treasury	68,552	82,175	102,432	128,590	161,380	200,007	242,560	290,357
External project grants	9,699	9,394	12,693	14,216	15,922	17,833	17,934	18,052
External project loans	12,933	15,816	11,644	12,369	11,450	12,293	11,340	12,165
of which : poverty-reducing expenditure[3]	76,334	88,641	104,357	123,470	144,478	168,572	196,617	229,609
Overall balance								
Including grants	-16,736	-27,394	-34,935	-41,219	-45,286	-54,133	-60,937	-68,515
Excluding grants	-29,851	-39,298	-51,763	-56,509	-64,072	-73,225	-80,341	-88,287
Financing	19,810	33,384	34,935	41,219	45,286	54,133	60,937	68,515
Net external financing	16,846	19,874	16,158	17,548	17,277	18,713	18,665	20,346
Gross borrowing	17,965	21,258	17,352	19,122	19,366	21,542	22,146	24,799
Project loans	12,933	15,816	11,644	12,369	11,450	12,293	11,340	12,165
Protection of Basic Services (PBS)	5,032	5,442	5,708	6,752	7,916	9,250	10,805	12,634
Amortization[4]	-1,281	-1,424	-1,195	-1,574	-2,089	-2,830	-3,481	-4,453
Public debt	1,764	13,510	18,777	23,671	28,009	35,420	42,272	48,170
Privatization	1,200	0	0	0	0	0	0	0
Memorandum items :								
Total poverty-reducing expenditure	107,779	126,782	149,533	179,709	207,443	236,522	275,996	320,300
Primary fiscal balance, including grants	-13,805	-23,600	-27,398	-30,685	-32,427	-38,343	-42,475	-47,145
Domestic fiscal balance, including grants	-6,081	-12,584	-22,993	-23,343	-28,828	-33,564	-40,102	-45,549

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

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

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

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

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

Table 3b. Ethiopia: General Government Operations, 2012/13–2019/20

(percent of GDP)

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	15.9	15.1	16.4	15.7	16.1	16.3	16.5	16.6
Revenue	14.3	14.0	15.0	14.6	15.0	15.3	15.7	15.9
Tax revenue	12.4	12.7	12.9	13.1	13.5	13.8	14.2	14.4
Direct taxes	4.2	4.5	4.5	4.7	4.9	5.2	5.4	5.5
Indirect taxes	8.2	8.2	8.4	8.4	8.5	8.7	8.8	8.9
Domestic indirect taxes	3.8	3.9	3.9	4.1	4.3	4.4	4.5	4.6
Import duties and taxes	4.4	4.4	4.5	4.3	4.2	4.3	4.3	4.3
Nontax revenue	2.0	1.2	2.1	1.5	1.5	1.5	1.5	1.5
Grants	1.5	1.1	1.4	1.0	1.1	0.9	0.8	0.7
Emergency assistance (food and nonfood aid)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Program grants	0.4	0.2	0.3	0.1	0.2	0.1	0.1	0.1
Project grants	1.1	0.9	1.0	1.0	0.9	0.9	0.8	0.7
Total expenditure and net lending (cash basis)	17.8	17.7	19.2	18.5	18.7	19.0	19.1	19.1
Recurrent expenditure [2]	7.3	7.5	9.0	7.9	7.8	7.5	7.5	7.4
Defense spending	0.8	0.7	0.6	0.6	0.6	0.5	0.5	0.5
Poverty-reducing expenditure [3]	3.6	3.6	3.6	3.8	3.7	3.4	3.4	3.3
Interest payments	0.3	0.4	0.6	0.7	0.7	0.8	0.8	0.8
Domestic interest and charges	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
External interest payments [4]	0.1	0.1	0.4	0.4	0.5	0.5	0.5	0.5
Emergency assistance (food and other emergency aid)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other recurrent expenditure	2.5	2.7	4.1	2.7	2.8	2.8	2.8	2.8
Capital expenditure	10.5	10.3	10.2	10.6	11.0	11.4	11.6	11.7
Central treasury	7.9	7.8	8.3	8.8	9.4	9.9	10.3	10.6
External project grants	1.1	0.9	1.0	1.0	0.9	0.9	0.8	0.7
External project loans	1.5	1.5	0.9	0.8	0.7	0.6	0.5	0.4
of which: poverty-reducing expenditure [3]	8.8	8.5	8.4	8.4	8.4	8.4	8.4	8.4
Overall balance								
Including grants	-1.9	-2.6	-2.8	-2.8	-2.6	-2.7	-2.6	-2.5
Excluding grants	-3.5	-3.8	-4.2	-3.9	-3.7	-3.6	-3.4	-3.2
Financing	2.3	3.2	2.8	2.8	2.6	2.7	2.6	2.5
Net external financing	1.9	1.9	1.3	1.2	1.0	0.9	0.8	0.7
Gross borrowing	2.1	2.0	1.4	1.3	1.1	1.1	0.9	0.9
Project loans	1.5	1.5	0.9	0.8	0.7	0.6	0.5	0.4
Protection of Basic Services (PBS)	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Amortization [4]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2
Total net domestic financing	0.2	1.3	1.5	1.6	1.6	1.8	1.8	1.8
Privatization	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Poverty-reducing expenditure	12.5	12.1	12.1	12.2	12.1	11.8	11.8	11.7
Primary fiscal balance, including grants	-1.6	-2.3	-2.2	-2.1	-1.9	-1.9	-1.8	-1.7
Domestic fiscal balance, including grants	-0.7	-1.2	-1.9	-1.6	-1.7	-1.7	-1.7	-1.7

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

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

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

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

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

Table 4. Ethiopia: Monetary Survey and Central Bank Accounts, 2012/13–2019/20

	2012/13 Act.	2013/14 Act	2014/15 Act.	2015/16 Proj.	2016/17 Proj.	2017/18 Proj.	2018/19 Proj.	2019/20 Proj.
Monetary survey								
Net foreign assets	44,832	46,014	48,200	39,429	44,100	50,987	62,548	87,769
Central bank	24,646	26,821	29,973	19,860	23,161	28,582	38,575	62,117
Commercial banks	20,187	19,193	18,226	19,569	20,939	22,405	23,973	25,651
Net domestic assets	189,740	251,585	321,547	411,509	495,064	585,313	687,952	798,399
Domestic credit	234,177	300,473	389,785	467,149	552,292	628,932	714,696	804,168
Claims on government (net)[1]	21,965	26,631	30,736	43,708	62,734	82,951	113,303	140,535
Claims on nongovernment	212,212	273,842	359,050	423,441	489,558	545,981	601,393	663,632
Public enterprises	135,517	181,900	242,927	289,974	342,069	382,737	421,768	465,418
Private sector	76,695	91,942	116,123	133,467	147,489	163,245	179,625	198,215
Other items (net)	-44,437	-48,888	-68,238	-55,640	-57,228	-43,619	-26,745	-5,769
Broad money	234,572	297,599	369,747	450,938	539,164	636,300	750,500	886,167
Money	114,003	133,916	153,179	180,254	214,109	253,251	294,513	338,755
Currency outside banks	45,671	53,161	60,496	75,143	94,065	111,789	134,550	162,985
Demand deposits	68,332	80,755	92,683	105,111	120,044	141,461	159,963	175,771
Quasi money	120,569	163,683	216,568	270,685	325,055	383,050	455,987	547,412
Savings deposits	106,277	136,334	174,699	214,170	258,118	304,170	357,196	431,423
Time deposits	14,292	27,349	41,869	56,515	66,937	78,880	98,790	115,989
Central bank								
Net foreign assets	24,646	26,821	29,973	19,860	23,161	28,582	38,575	62,117
Foreign assets	44,140	48,216	66,818	56,704	60,005	65,426	75,419	98,962
Foreign liabilities	19,494	21,395	36,844	36,844	36,844	36,844	36,844	36,844
Net domestic assets	50,297	62,130	72,494	101,324	118,828	137,362	155,205	164,538
Domestic credit	71,884	84,469	100,434	116,395	119,855	144,855	157,855	164,855
Government (net)	55,377	64,212	77,077	94,527	105,277	130,277	143,277	150,277
Other items (net)	-21,588	-22,339	-27,939	-15,070	-1,027	-7,494	-2,650	-317
Base money	74,942	88,951	102,468	121,184	141,989	165,944	193,780	226,656
Currency outside banks	45,671	53,161	60,496	75,143	94,065	111,789	134,550	162,985
Commercial bank reserves	29,271	35,790	41,971	46,041	47,923	54,155	59,230	63,671
Cash in vault	9,247	11,179	14,744	17,095	17,794	20,107	19,623	16,637
Reserve deposit	20,025	24,611	27,227	28,946	30,130	34,047	39,607	47,034
			(Annual percentage change, unless otherwise indicated)					
Monetary survey								
Net foreign assets	12.7	2.6	4.8	-18.2	11.8	15.6	22.7	40.3
Net domestic assets	27.3	32.6	27.8	28.0	20.3	18.2	17.5	16.1
Domestic credit	23.5	28.3	29.7	19.8	18.2	13.9	13.6	12.5
Claims on government (net)	1.8	21.2	15.4	42.2	43.5	32.2	36.6	24.0
Claims on nongovernment	26.2	29.0	31.1	17.9	15.6	11.5	10.1	10.3
Public enterprises	37.0	34.2	33.5	19.4	18.0	11.9	10.2	10.3
Private sector	10.8	19.9	26.3	14.9	10.5	10.7	10.0	10.3
Broad money	24.2	26.9	24.2	22.0	19.6	18.0	17.9	18.1
Money	20.9	17.5	14.4	17.7	18.8	18.3	16.3	15.0
Quasi money	27.5	35.8	32.3	25.0	20.1	17.8	19.0	20.1
Memorandum items:								
Base money growth	13.6	18.7	15.2	18.3	17.2	16.9	16.8	17.0
Excess reserve deposit (billions of birr)	10,011	9,905	8,615	7,777	5,495	5,442	6,430	8,495
Percent of deposits	4.4	3.5	2.4	2.1	1.2	1.0	1.0	1.2
Money multiplier (broad money/reserve money)	3.13	3.35	3.61	3.72	3.80	3.83	3.87	3.91
Velocity (GDP/broad money)	3.69	3.52	3.36	3.25	3.19	3.16	3.13	3.10
Currency-deposit ratio	0.242	0.217	0.196	0.200	0.211	0.213	0.218	0.225
Gross official foreign reserves (millions of U.S. dollars)	2,368	2,496	3,249	2,780	2,923	3,143	3,521	4,353
Birr per U.S. dollar (end of period)	18.19	19.11	20.07	…	…	…	…	…
Nominal GDP (millions of birr)	864,673	1,047,393	1,240,593	1,467,649	1,720,479	2,010,391	2,348,529	2,746,060

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

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

Table 5. Ethiopia: Balance of Payments, 2012/13–2019/20

	2012/13 Act.	2013/14 Act.	2014/15 Est.	2015/16 Proj.	2016/17 Proj.	2017/18 Proj.	2018/19 Proj.	2019/20 Proj.
	(Millions of U.S. dollars, unless otherwise indicated)							
Current account balance	-2,821	-4,407	-7,893	-6,554	-6,534	-6,422	-6,311	-6,317
(Percent of GDP)	-5.9	-8.0	-12.8	-9.4	-8.5	-7.6	-6.9	-6.3
Current account balance, excl. official transfers	-4,351	-5,868	-9,110	-7846	-7994	-7887	-7846	-7888
(Percent of GDP)	-9.2	-10.7	-14.7	-11.3	-10.4	-9.4	-8.5	-7.9
Trade balance	-8,387	-10,467	-13,464	-13,171	-13,801	-14,577	-15,419	-16,275
Exports of goods	3,080	3,255	2,977	3,344	3,884	4,423	5,002	5,604
Coffee	747	714	780	757	821	956	1,061	1,201
Oil seeds	444	652	510	621	770	846	888	923
Gold	578	456	319	460	532	627	677	689
Other	1,312	1,432	1,367	1,505	1,761	1,994	2,375	2,791
Imports of goods	-11,467	-13,722	-16,440	-16,515	-17,685	-19,000	-20,421	-21,880
Services (net)	572	712	-20	279	583	1,044	1,651	2,238
Exports	2,853	3,174	3,070	3,633	4,205	4,956	5,797	6,591
Imports	-2,281	-2,462	-3,091	-3,353	-3,622	-3,911	-4,146	-4,353
Income (net)	-113	-153	-226	-404	-481	-513	-544	-576
Private transfers (net)	3,578	4,039	4,601	5,450	5,705	6,159	6,467	6,725
Official transfers (net)	1,530	1,461	1,217	1,293	1,460	1,464	1,535	1,572
Capital account balance	3,226	4,135	7,519	6,105	6,677	6,642	6,689	7,149
Foreign direct investment (net)	1,232	1,467	2,202	2,856	3,466	3,953	4,499	5,017
Other investment (net)	1,995	2,668	5,317	3,249	3,211	2,689	2,190	2,132
Federal government	1,688	2,309	1,901	916	906	852	799	842
Disbursements	1,743	2,443	2,130	1,171	1,186	1,158	1,116	1,163
Amortization	-56	-134	-229	-255	-280	306	317	320
Other public sector long term (net) [1]	399	332	2,992	1,821	1,684	1,106	529	420
Private sector borrowing (net)	0	0	350	438	547	656	788	795
Other (net)	-92	27	74	74	74	74	74	74
Errors and omissions	-261	237	522	0	0	0	0	0
Overall balance	144	-36	148	-449	143	219	378	832
Financing	-144	36	-148	449	-143	-219	-378	-832
Central bank (net; increase –)	-106	-66	-760	469	-143	-219	-378	-832
Reserves (increase –)	-106	-128	-760	469	-143	-219	-378	-832
Liabilities (increase +)	0	62	0	0	0	0	0	0
Commercial banks (net; increase –)	-38	102	612	-20	0	0	0	0
	(Annual percentage change, unless otherwise indicated)							
Memorandum items:								
Goods exports	-2.3	5.7	-8.6	12.3	16.2	13.9	13.1	12.0
Goods imports	4.1	19.7	19.8	0.5	7.1	7.4	7.5	7.1
Services exports	1.5	11.3	-3.3	18.3	15.8	17.9	17.0	13.7
Services imports	-13.6	7.9	25.5	8.5	8.0	8.0	6.0	5.0
Exports of goods and services (percent of GDP)	12.5	11.7	9.8	10.0	10.5	11.2	11.8	12.2
Imports of goods and services (percent of GDP)	-28.9	-29.5	-31.6	-28.5	-27.7	-27.2	-26.8	-26.1
Gross official reserves (millions U.S. dollars)	2,368	2,496	3,256	2,787	2,930	3,150	3,528	4,360
(Months of following year imports of goods and services) [2]	1.8	1.5	2.0	1.6	1.5	1.5	1.6	2.0
GDP (millions of U.S. dollars)	47,532	54,809	61,824	69,656	77,061	84,106	91,825	100,344

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] Includes net borrowing by state-owned enterprises

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

Table 6. Ethiopia: Alternative Scenario: Selected Economic and Financial Indicators, 2012/13–2019/20

Social Indicators

GDP		**Poverty**	
Nominal GDP (2015, billions of U.S. dollars)	61.8	Headcount ratio at 1.25$ a day (2010, percent of population)	36.8
GNI per capita, Atlas method (2014, current US$)	550	Undernourished (2013, percent of population)	35.0
Population characteristics (2014)		**Income distribution, 2010**	
Total (million)	88.3	Income shared by highest 10 percent of population	27.5
Urban population	19.0	Income shared by lowest 20 percent of population	8.0
Life expectancy at birth (2013, years)	63.6	GINI index	30.0

Economic Indicators

	2012/13 Act	2013/14 Act.	2014/15 Est.	2015/16 Proj.	2016/17 Proj.	2017/18 Proj.	2018/19 Proj.	2019/20 Proj.
	(Annual percentage change)							
National income and prices								
GDP at constant prices (at factor cost)	9.8	10.3	8.7	8.5	9.0	9.3	9.5	9.5
GDP deflator	4.7	10.2	8.3	11.2	9.6	6.9	6.0	6.2
Consumer prices (period average)	13.5	8.1	7.7	12.1	9.3	6.9	6.0	6.0
Consumer prices (end period)	7.4	8.5	10.4	11.0	8.0	6.0	6.0	6.0
External sector								
Exports of goods and services (U.S. dollars, f.o.b.)	-0.5	8.4	-5.9	16.4	17.3	19.3	18.5	17.0
Imports of goods and services (U.S. dollars, c.i.f.)	0.7	17.7	20.7	2.6	7.8	8.3	8.3	8.0
Export volume	11.2	2.9	-3.6	19.0	18.3	17.7	17.0	17.2
Import volume	8.1	27.5	28.3	8.7	7.0	6.6	7.6	7.8
Terms of trade (goods, deterioration –)	-9.0	1.1	1.6	2.8	-1.3	0.1	0.6	1.1
Nominal effective exchange rate (end of period)	-5.2	-2.0	13.2	…	…	…	…	…
Real effective exchange rate (end of period)	-0.9	3.7	21.4	…	…	…	…	…
	(Percent of beginning-period stock of broad money, unless otherwise indicated)							
Money and credit								
Net foreign assets	2.7	0.5	0.7	-0.4	3.0	3.7	4.9	6.8
Net domestic assets (including other items net)	21.5	26.4	23.5	26.7	21.3	17.6	14.5	11.3
Broad money	24.2	26.9	24.2	26.2	24.2	21.3	19.4	18.0
Base money (annual percentage change)	13.6	18.7	15.2	21.0	20.4	17.7	17.0	17.2
Velocity (GDP/broad money)	3.69	3.52	3.36	3.21	3.12	3.02	2.96	2.94
	(Percent of GDP, unless otherwise indicated)							
Financial balances								
Gross domestic savings	19.2	19.0	18.2	19.4	20.7	23.2	24.8	26.5
Public savings	5.7	5.0	4.9	5.2	5.8	6.2	6.7	7.1
Private savings	13.5	14.0	13.3	14.1	14.9	16.9	18.1	19.4
Gross domestic investment	35.8	36.8	40.0	38.3	38.4	39.6	39.9	40.3
Public investment	19.1	20.0	22.4	19.3	18.3	18.6	18.0	17.3
Private investment	16.7	16.8	17.6	19.0	20.1	21.0	21.9	23.1
Resource gap	-16.6	-17.8	-21.8	-19.0	-17.8	-16.4	-15.1	-13.9
External current account balance, including official transfers	-5.9	-8.0	-12.8	-9.7	-8.9	-7.8	-6.9	-6.1
Government finances								
Revenue	14.3	14.0	15.0	15.1	16.1	17.1	18.3	19.3
Tax revenue	12.4	12.7	12.9	13.5	14.6	15.7	16.8	17.9
Nontax revenue	2.0	1.2	2.1	1.5	1.5	1.4	1.4	1.4
External grants	1.5	1.1	1.4	1.0	1.0	0.9	0.8	0.7
Expenditure and net lending	17.8	17.7	19.2	18.7	19.4	20.2	21.0	21.8
Fiscal balance, excluding grants (cash basis)	-3.5	-3.8	-4.2	-3.6	-3.3	-3.0	-2.7	-2.5
Fiscal balance, including grants (cash basis)	-1.9	-2.6	-2.8	-2.6	-2.2	-2.1	-1.9	-1.8
Total financing (including residuals)	1.9	2.6	2.8	2.6	2.2	2.1	1.9	1.8
External financing	1.9	1.9	1.3	1.2	1.0	0.9	0.8	0.7
Domestic financing (not including privatization)	0.2	1.3	1.5	1.4	1.2	1.2	1.1	1.0
Public debt[1]	37.0	41.2	50.2	55.9	58.4	60.2	59.4	58.1
Domestic debt	16.6	19.1	24.1	25.6	26.6	27.8	28.6	28.9
External debt (including to the IMF)	20.3	22.1	26.2	30.3	31.8	32.4	30.8	29.2
Overall balance of payments (in millions of U.S. dollars)	144	-36	148	-171	496	755	1,155	1,805
Gross official reserves (in millions of U.S. dollars)	2,368	2,496	3,256	3,065	3,562	4,317	5,472	7,277
(months of imports of goods and nonfactor services of following year)[2]	1.8	1.5	1.9	1.7	1.8	2.0	2.4	3.0
GDP at current market prices (billions of birr)	865	1,047	1,241	1,501	1,806	2,125	2,487	2,914

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] Public debt includes general government and state own entreprises (excluding Ethiopian Airlines).

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

Table 7. Ethiopia: Millennium Development Goals

	1990	1995	2000	2005	2010	2013 or latest available
Goal 1: Eradicate extreme poverty and hunger						
Employment to population ratio, 15+, total (%) (modeled ILO estimate)	75	74	75	80	79	79
Employment to population ratio, ages 15-24, total (%) (modeled ILO estimate)	70	70	70	73	71	71
GDP per person employed (constant 1990 PPP $)	1289	1177	1284	1427	2009	2173
Income share held by lowest 20%	..	7	9	9	8	..
Malnutrition prevalence, weight for age (% of children under 5)	..	..	42	35	29	25[1]
Poverty gap at $1.25 a day (PPP) (%)	..	23	16	10	10	..
Poverty headcount ratio at $1.25 a day (PPP) (% of population)	..	63	55	39	37	..
Vulnerable employment, total (% of total employment)	..	91	91	91	..	..
Goal 2: Achieve universal primary education						
Literacy rate, youth female (% of females ages 15-24)	..	29	..	33	..	..
Literacy rate, youth male (% of males ages 15-24)	..	39	..	56	..	..
Persistence to last grade of primary, total (% of cohort)	30	20	61	61	41	..
Primary completion rate, total (% of relevant age group)	23	14	23	43	..	..
Adjusted net enrollment rate, primary (% of primary school age children)	29	22	40	61	..	..
Goal 3: Promote gender equality and empower women						
Proportion of seats held by women in national parliaments (%)	..	..	8	21	28	28[1]
Ratio of female to male primary enrollment (%)	66	60	65	84	..	..
Ratio of female to male secondary enrollment (%)	77	80	67	60	..	..
Ratio of female to male tertiary enrollment (%)	22	26	28	32	..	..
Share of women in wage employment in the nonagricultural sector (% of total nonagricultural employment)	..	..	41	44	42	42
Goal 4: Reduce child mortality						
Immunization, measles (% of children ages 12-23 months)	38	38	36	40	64	62
Mortality rate, infant (per 1,000 live births)	122	106	90	70	51	44
Mortality rate, under-5 (per 1,000 live births)	205	175	146	110	76	64
Goal 5: Improve maternal health						
Adolescent fertility rate (births per 1,000 women ages 15-19)	118	118	110	96	83	76
Births attended by skilled health staff (% of total)	..	..	6	6	10	23
Contraceptive prevalence (% of women ages 15-49)	5	..	8	15	29	..
Maternal mortality ratio (modeled estimate, per 100,000 live births)	1,400	1,200	990	740	500	420
Pregnant women receiving prenatal care (%)	..	..	27	28	43	..
Unmet need for contraception (% of married women ages 15-49)	..	..	37	36	26	..
Goal 6: Combat HIV/AIDS, malaria, and other diseases						
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	..	..	3	3	26	..
Condom use, population ages 15-24, female (% of females ages 15-24)	..	..	2	2	3	..
Condom use, population ages 15-24, male (% of males ages 15-24)	..	..	20	18	25	..
Incidence of tuberculosis (per 100,000 people)	369	418	421	341	268	224
Prevalence of HIV, female (% ages 15-24)	1	3	3	1	0	1
Prevalence of HIV, male (% ages 15-24)	0	1	1	0	0	0
Prevalence of HIV, total (% of population ages 15-49)	1	3	4	3	2	1
Tuberculosis case detection rate (%, all forms)	50	11	33	48	66	62
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)	15	14	14	13	12	12
Improved sanitation facilities (% of population with access)	2	3	8	15	21	24
Improved water source (% of population with access)	13	20	29	38	48	52
Marine protected areas (% of territorial waters)	..	..	..	..	..	..
Goal 8: Develop a global partnership for development						
Net ODA received per capita (current US$)	21	15	10	25	41	41
Debt service (PPG and IMF only, % of exports of goods, services and primary income)	38	18	15	2	3	8
Internet users (per 100 people)	0	0	0	0	1	3[1]
Mobile cellular subscriptions (per 100 people)	0	0	0	1	8	32[1]
Fixed telephone subscriptions (per 100 people)	0	0	0	1	1	1[1]
Other[2]						
Fertility rate, total (births per woman)	7	7	7	6	5	4
GNI per capita, Atlas method (current US$)	260	150	130	160	380	550
GNI, Atlas method (current US$) (billions)	12	8	8	12	33	53
Gross capital formation (% of GDP)	17	24	27	31	32	40
Life expectancy at birth, total (years)	47	49	52	57	62	64
Literacy rate, adult total (% of people ages 15 and above)	..	27	..	30	..	..
Population, total (millions)	..	..	64	75	83	88
Trade (% of GDP)	14	25	36	50	46	41

Source: World Development Indicators and Ethiopian authorities.

[1] Data available for 2014.

[2] All data in final column are for 2014, except for life expectancy at birth and adult literacy rate.

Table 8. Ethiopia: Financial Soundness Indicators of the Commercial Banking Sector, 2010–15

(in percent, unless otherwise indicated)

	Jun-10	Jun-11	Jun-12	Jun-13	Jun-14	Mar-15
Capital adequacy						
Capital to risk-weighted assets	18.7	18.1	13.4	17.9	17.4	16.6
Regulatory capital tier I to risk-weighted assets	18.7	18.1	13.4	17.9	17.4	16.6
Capital to assets	9.1	7.8	6.7	7.2	7.0	6.6
Asset quality						
NPLs to total loans	3.5	2.1	1.4	2.5	2.0	2.4
NPLs net of provisions to capital	0.7	-3.8	-5.6	-0.5	-2.3	2.4
Earning and profitability						
Return on assets (ROA)	3.1	3.0	4.1	3.2	3.1	3.0
Return on equity (ROE)[1]	34.4	34.9	55.8	48.0	44.9	45.0
Gross interest income to total income[2]	60.1	54.4	54.7	64.9	62.8	66.1
Interest margin to gross income	38.7	40.0	45.0	56.2	53.2	56.3
Non-interest expenses to gross income[3]	28.0	28.7	26.6	33.6	41.0	39.7
Personnel expenses to non-interest expenses	46.0	51.1	42.3	43.3	43.7	39.9
Liquidity						
Liquid assets to total assets	32.7	32.7	20.6	23.2	16.2	10.9
Liquid assets to short-term liabilities	42.7	43.4	26.7	30.1	21.5	14.7
Total loans and bonds to total deposits[4]	…	…	94.0	93.9	100.6	107.3

Source: Ethiopian authorities.

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

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

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

[4]Customer deposits include time, current and saving deposits.

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

Nature/Source of Risk	Likelihood	Expected Impact on Economy	Policy Responses
		Domestic Risks	
Weak domestic resource mobilization	***H***	***H***. Slower investment, growth, and poverty reduction; higher unemployment	Raise interest rates to encourage saving; bolster tax revenues; recalibrate expenditure; preserve access to external financing via prudent macroeconomic policies
Slow progress in enhancing competitiveness	***M***	***H***. Weak exports; less FX for imports; lower investment and growth	More flexible exchange rate; accelerate competitiveness-enhancing reforms
Drought	***M***	***H***. Food price shock, and higher overall inflation; adverse social impact; lower agricultural exports	Increase food aid; tighten monetary policy if second round inflationary effects significant; slow SOE imports
Deterioration in quality of SOE loans	***M***	***H***. Greater contingent liabilities for the government; banks may have to write off loans, slow down lending; lower investment and growth	Tighter government management of SOEs; strengthen bank supervision and enforce prudential lending limits; bank recapitalization
		External Risks	
Persistent U.S. dollar strength	***H***	***H.*** Further real exchange rate appreciation; weaker exports and widening trade deficit	More flexible exchange rate; accelerate competitiveness-enhancing reforms
Weak medium-term growth in Euro area and Japan	***H***	***M***. Lower demand for Ethiopia's main exports; widening trade deficit; weaker debt sustainability	More flexible exchange rate; accelerate competitiveness-enhancing reforms
Sharp asset price adjustment, decompression of credit spreads	***H***	***M.*** Increase in relative risk of Ethiopia for investors; slower growth in FDI; weaker balance of payments	More flexible exchange rate; accelerate competitiveness-enhancing reforms; reduce SOE borrowing
Structurally weak growth in China	***M***	***M.*** China's demand for Ethiopia's agricultural exports expected to remain strong; Chinese financing for investment could slow, though longer-term projects likely to remain financed	More flexible exchange rate; promote export diversification; seek other investment partners

[1] The RAM shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex II. Traction of Past IMF Recommendations

1. **Past policy recommendations have only gained partial traction.** Fiscal and monetary policy remained committed to preserving macroeconomic stability, while measures to attract foreign direct investment in export-oriented industries were stepped up. However, IMF recommendations to promote financial sector liberalization (including to bring real interest rates to positive levels) and to rationalize access to foreign exchange for the private sector have not been addressed. Moreover, reforms to improve the business climate and to enhance the role of the domestic private sector in the structural transformation have yet to gain momentum.

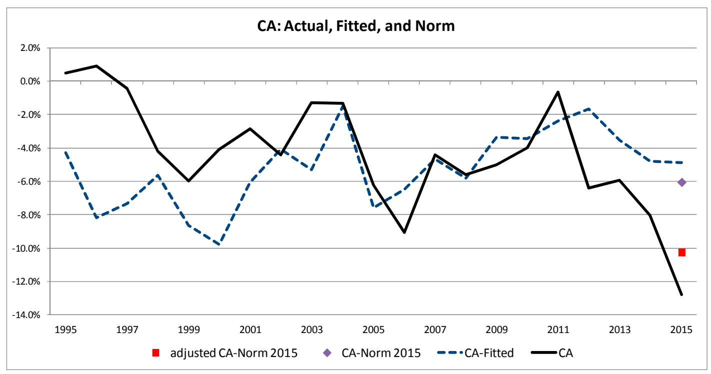
Summary of Key Policy Recommendations

Area	Specific Recommendation	Status
Fiscal Sector	• Establish consolidated fiscal position (including public enterprises) as an overall fiscal anchor	Not implemented
	• Strengthen data collection on public enterprises, including disclosure of audited financial statements, to improve monitoring of contingent liabilities	In progress
	• Rationalize tax incentives and tax expenditures	Not implemented
	• Strengthen customs and tax administration, by ensuring full implementation of ERCA's reform agenda	In progress
	• Introduce cash registry machines in all regions, and enhance taxpayer education	In progress
	• Maintain the momentum in the PFM reforms	In progress
	• Phase-out NBE's financing of the fiscal deficit	Not implemented
Monetary and Financial Sectors	• Maintain a cautious monetary stance	Implemented
	• Allow for flexible determination of nominal interest rates to activate the government securities market and enhance monetary policy transmission mechanism	Not implemented
	• Improve liquidity management	In progress
	• Phase out requirement for private banks to invest equivalent of 27 percent of new loan disbursements in NBE bonds	Not implemented
	• Enhance access to credit for private sector	In progress
	• Enhance access to foreign exchange for private sector	Not implemented
External Sector	• Improve market functioning and price setting mechanisms for the exchange rate, and increase exchange rate flexibility	Not implemented
	• Increase foreign exchange reserves to 3 months of imports in medium term	Partially implemented
Competitiveness and Business Climate	• Open up key sectors to domestic and foreign private investors	Not implemented
	• Increase efforts to attract FDI in export-oriented sectors	In progress
	• Implement reforms to encourage entrepreneurship	Not implemented

Annex III. Exchange Rate Assessment

1. **Developments in the current account, the real effective exchange rate, and the parallel foreign exchange market all point to a rising overvaluation of the *birr*.** Through June 2015, the CPI-based real effective exchange rate (REER) had appreciated by 21 percent (y-o-y). Considering that the 2014 Article IV assessment estimated an overvaluation of 10 to 13 percent, the further appreciation observed since then indicates even greater overvaluation. The evolution of the REER is in part explained by the recent strong appreciation of the US dollar (which serves as the anchor of Ethiopia's exchange rate policy) against the currencies of Ethiopia's other main trading partners. Moreover, Ethiopia continues to have a positive inflation differential relative to its trading partners. A further sign of overvaluation is that the premium in the parallel foreign exchange market has increased in recent months, and that importers do not have ready access to foreign currency (with waiting times up to several months). These developments have contributed to a further drag on competitiveness and to a widening of the current account deficit.

2. **The model underlying the Fund's new EBA-lite methodology for exchange rate assessments provides a fairly good fit for Ethiopia, but does not capture several country-specific developments.** Since 2000, the fitted current account tracks the actual values remarkably well, suggesting a REER undervaluation following the August 2010 devaluation and a steep appreciation thereafter. The current account deterioration since 2011, however, has been driven largely by equipment imports for large-scale public investment projects that are not captured by the model. The acceleration of these imports, as well as the Ebola-related shock to travel receipts in 2014/15, has led to an exacerbation of the current account deficit that cannot be attributed to movements in the real exchange rate. The current account norm in the quantitative analysis is therefore adjusted downward.



3. **An assessment using quantitative methods confirms the observed signs of REER overvaluation.** The new EBA-lite methodology yields an estimated overvaluation of 32.5 percent, in the range predicted by traditional CGER methodologies (Table II.1). While the results are not statistically significant, the joint significance level of the four approaches taken together is higher.

Table 1. Ethiopia: Estimates of Birr overvaluation

Approach	Current account gap (percent of GDP)	Overvaluation (in percent)	Real exchange rate elasticity
EBA-lite[1]	-2.5	32.5	-0.08
Macroeconomic Balance[1]	-1.6	20.1	-0.08
External Sustainability	-5.5	70.2	-0.08
Equilibrium Real Exchange Rate[2]	…	11.4	…

Source: IMF estimates.

[1] CA norm adjusted for country-specific factors.

[2] Sample period: 1993-2015 (to exclude civil war period and observations before Eritrean independence)

Annex IV. Reserve Adequacy Assessment

1. **Ethiopia is a low-income country with a high dependence on commodity exports, as well as imports of fuel and capital goods.** As a result, the economy is highly vulnerable to terms-of-trade shocks. Due to low foreign exchange reserves, Ethiopia has limited room to absorb such shocks.

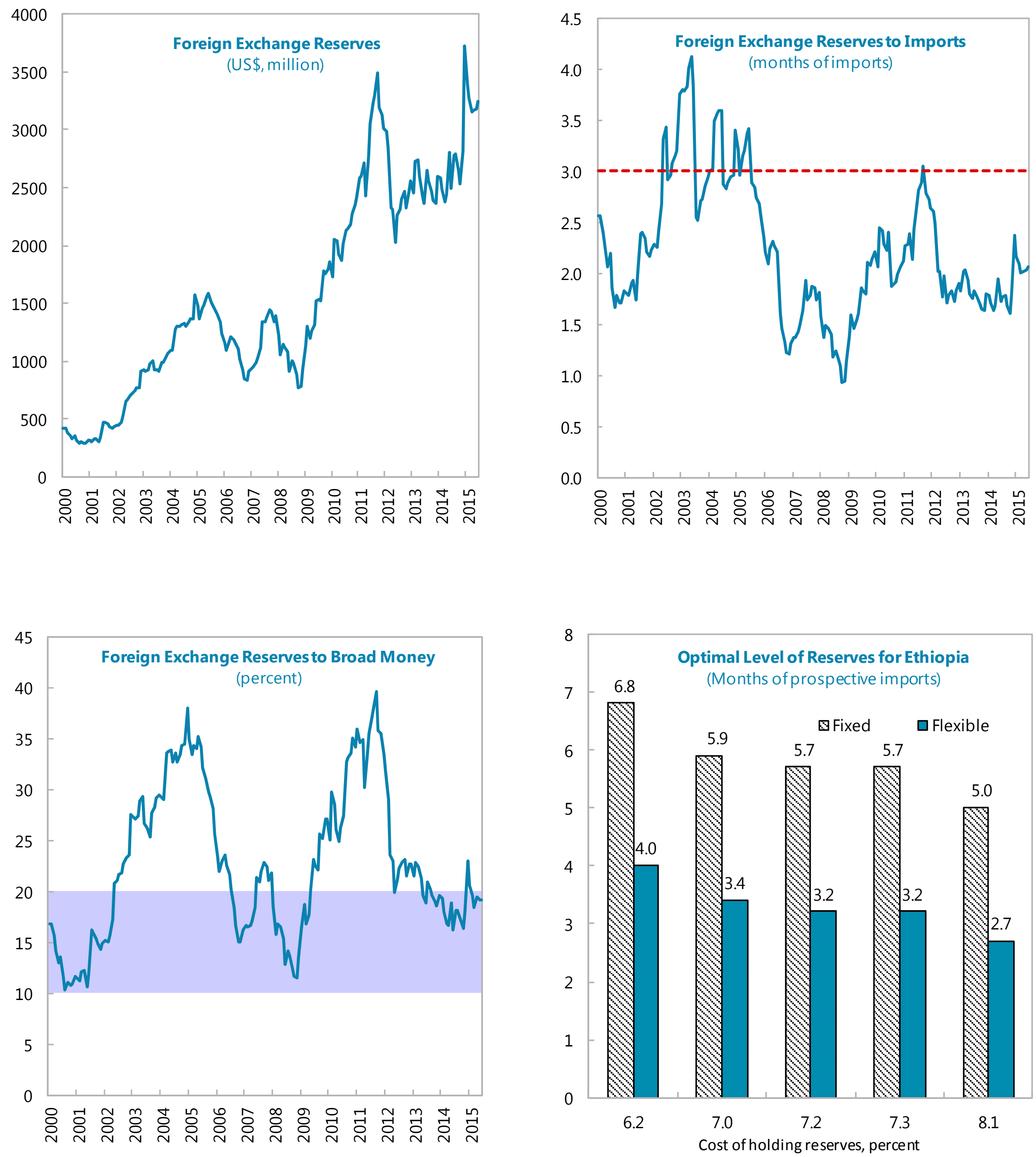
2. **Foreign reserves have stagnated at low levels of import coverage**. At the end of November 2014, reserves covered only about 1.8 months of prospective imports. A $1 billion Eurobond issued in December 2014 caused foreign reserves to spike to $3.4 billion. But as the Eurobond proceeds are spent by the government (with a high share expected to be used to import investment-related goods), the temporary accumulation is beginning to unwind. The ratio of foreign reserves to broad money has been falling, and was just below 20 percent in mid-2015.

3. **Ethiopia's foreign reserves do not provide adequate coverage of imports, given the country's managed float exchange rate regime.** A formal reserve adequacy assessment based on a cost-benefit analysis shows that for a country with a heavily managed float system (similar to a fixed exchange rate regime), the optimal reserve coverage is between 5 and 6.8 months of imports.[1] The model evaluates shocks in external demand, terms of trade, FDI, and aid flows for different cost levels of holding reserves (using the cost of borrowing as a proxy). The methodology has been updated to cover LICs and resource rich countries, and uses up-to-date data in the panel regression.

4. **Staff expect the adequacy of reserves to improve gradually over the medium term, though without reaching adequate levels**. Solid growth in cargo and passenger transport services as well as electricity exports, together with gradual growth in merchandise export volumes, offer some potential to bolster foreign reserves. However, as demand for imports—driven by high investment and rising consumption—is expected to remain strong, the reserves coverage of imports is forecast to remain well below three months through the medium term. Concerns about external stability are alleviated somewhat by the fact that in the absence of portfolio investment, the risk of sudden capital outflows is small

[1] Based on the 2014 Assessing Reserve Adequacy template and methodology.

Figure 1. Ethiopia: Reserve Adequacy Analysis



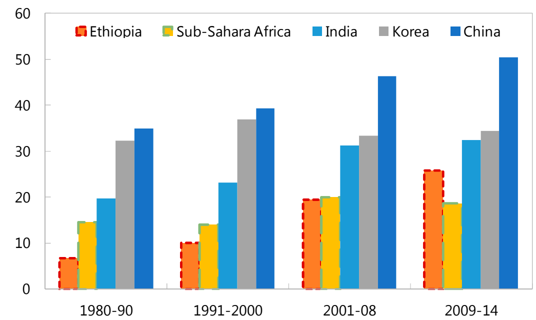
Annex V. Mobilizing Domestic Savings: The Experience of Asian Countries

1. **Financial sector development plays a critical role in mobilizing domestic savings, a critical prerequisite for higher investment and economic growth.**[1] As noted in the Addis Ababa Action Agenda, mobilization and effective use of domestic resources is central to the pursuit of sustainable development.

2. **The financial reform experiences of China, India, and Korea seem particularly relevant for Ethiopia.** These countries had state-led development models with initially tightly managed financial sectors. In the 1980s and 1990s, they began phased financial reforms, with the aim of increasing domestic saving.[2] While the timing and sequence of reforms varied across countries, they included the following key elements:

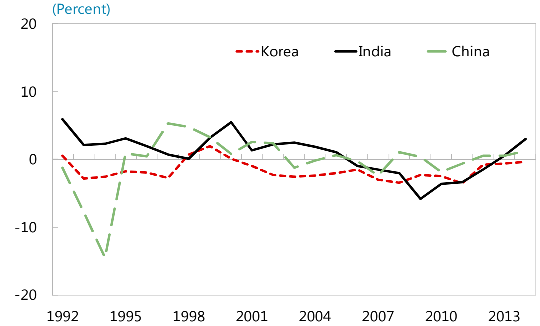
Gross National Savings

(Percent of GDP)



Sources: IMF World Economic Outlook.

(Percent)



Source: International Monetary Fund, *International Financial Statistics.*

Monetary and exchange rate policies

- liberalization of interest rates
- liberalization of credit allocation (while maintaining support for priority sectors)
- increased exchange rate flexibility
- a shift towards indirect monetary policy tools

Banking sector policies

- restructuring and privatization of state-owned banks
- gradual opening up to foreign banks
- enhanced regulatory and supervisory framework

Financial sector deepening

- introduction of new financial instruments (e.g., CDs, insurance and remittance products, mutual funds, corporate bonds, commercial paper)
- increased access to financial services to the underbanked (urban poor, rural households, youths)
- creation of an interbank market, corporate bond market, and equity market

3. **A critical prerequisite for mobilizing savings—especially longer-term—is to have positive real interest rates.** While negative interest rates imply cheap budget financing and lower borrowing costs for businesses, they undermine the efficiency of financial intermediation and discourage savings. Reducing inflation and allowing key policy rates to reflect market conditions can help bring real interest rates into positive territory.

[1] *Financing for Development: Revisiting The Monterrey Consensus*, IMF (2015) and *Rethinking Financial Deepening: Stability and Growth in Emerging Markets,* IMF Staff Discussion Note 15/8 (2015).

[2] *A Hundred Small Steps* mapped out a financial sector reform agenda for India (*Committee on Financial Sector Reforms, 2009*).

INTERNATIONAL MONETARY FUND

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

September 3, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by

The African Department
(In collaboration with other departments)

CONTENTS

FUND RELATIONS

(As of July 31, 2015)

Membership Status: Joined: December 27, 1945 Article XIV

General Resources Account:	**SDR Million**	**%Quota**
Quota	133.70	100.00
Fund holdings of currency	126.28	94.45
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	83.13	64.98

Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ESF Arrangement	146.4	109.50
ESF RAC Loan	26.74	20.00

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 the Fund[2/]

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

	Forthcoming				
	2015	2016	2017	2018	2019
Principal	14.71	37.44	37.44	37.44	34.09
Charges/Interest	0.01	0.02	0.28	0.19	0.10
Total	14.72	37.46	37.72	37.63	34.19

[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:

	Enhanced Framework
I. Commitment of HIPC assistance	Framework
Decision point date	November 2001
Assistance committed	
by all creditors (US$ million) [1/]	1,982.20
of which: 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
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 cannot 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	
Delivery Date	**GRA**	**PRGT**	**Total**
January 2006	N/A	112.07	112.07

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

Safeguards Assessment

The National Bank of Ethiopia (NBE) was subject to an update safeguards assessment with respect to the ESF arrangement approved on August 26, 2009.[1] The updated assessment found improved financial reporting and internal audit practices. Notwithstanding these developments, the assessment noted significant weakness. Recommendations focused on strengthening oversight of risks and controls, improving accounting records and the external audit process, and legal amendments to address safeguards weakness in the Law. As of now, some progress has been reported on the outstanding safeguards recommendations, particularly in the area of operations of audit committee and staff training. Staff has recently received audited financial statements for the previous years together with the management letters issued by the NBE’s external auditor. A full set of audited financial statements should also be made available to the public, and published on the NBE’s website.

Exchange Rate Arrangement

The de-facto exchange rate arrangement is classified as a crawl-like arrangement. The authorities describe their exchange rate regime as a managed float with no predetermined path for the exchange rate. The pace of depreciation of the nominal exchange rate, however, has been stable. The NBE continues to supply foreign exchange to the interbank market based on plans prepared at the beginning of each fiscal year, which take into account estimates of supply and demand. The transaction-weighted average interbank market exchange rate as of August 13, 2015, was Br 20.6698 = US$1.

[1] The assessment, completed on December 2009, followed up on an initial safeguards assessment from September 2001.

Ethiopia maintains four restrictions on payments and transfers for current international transactions, which relate to: (i) the tax certification requirement for repatriation of dividend and other investment income; (ii) restrictions on repayment of legal external loans and 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 the NBE to obtain import permits. These restrictions are inconsistent with Article VIII, Section 2(a), of the IMF's Articles of Agreement and remain unapproved.

Article IV Consultation

Ethiopia is on the standard 12-month consultation cycle, in accordance with the Decision on Article IV Consultation Cycles (Decision No, 14747-(10/96), 9/28/2010). The last consultation was concluded on September 24, 2014.

Technical Assistance (2012–present)

Department	Purpose	Time of Delivery
AFE	Strengthening Internal Audit Functions	February 2012
AFE	National Accounts Statistics	March 2012
AFE	Payments Systems	March 2012
AFE	Consumer Price Index	July 2012
AFE	Modernizing PFM Legal and Regulatory Frameworks	August 2012
AFE	Tax Policy	January 2013
FAD	Reform Review and Tax Policy	March 2013
FAD	Program-based Budgeting	March–April 2013
AFE	Solvency Framework for Insurers	May 2013
AFE	Strengthening the Medium-Term Expenditure Framework	August 2013
AFE	Cash Management	December 2013
AFE	Revenue Administration	February–March 2014
FAD	Tax Issues	April 2014
MCM	Debt Market Development	June 2014

Department	Purpose	Time of Delivery
AFE	National Accounts Statistics	June–July 2014
AFE	Banking Sector	August 2014
MCD	Medium-Term Debt Strategy	October 2014
FAD	Tax Issues	December 2014
AFE	Micro Stress-Testing	January 2015
AFE	Financial Analysis and Stress Testing of Insurers	April 2015
FAD	Tax Issues	April-May 2015
AFE	Liquidity Forecasting	May 2015
AFE	National Accounts Statistics	May 2015
AFE	Price Statistics	August-September 2015

Resident Representative

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

JOINT MANAGEMENT ACTION PLAN, JULY 2015–JUNE 2016

(As of July 14, 2015)

Title	Products	Provisional and actual timing of missions	Expected and actual delivery date
	A. Mutual information on relevant work program		
The World Bank work program in the next 12 months	**Economic policy analysis and advice**		
	• Ethiopia Economic Update (annual)	July 2015–June 2016	Q2 2016
	• Growth study	July 2015–June 2016	Q4 2015
	• Policy dialogue on economic reform issues	July 2015–June 2016	ongoing
	• Estimating returns to public investment	July 2015–June 2016	Q2 2016
	• Real exchange rate analysis	July 2015–June 2016	Q2 2016
	Technical Assistance		
	• Capacity building of the Central Statistical Agency	July 2015–June 2016	Ongoing (until Q2 2017)
The Fund work program in the next 12 months	**Macroeconomic policy analysis and advice**		
	• Article IV consultation	May/June 2016	June 2016
	Technical assistance		
	• PFM	Ongoing	
	• Statistical capacity (national accounts, CPI)	Ongoing	
	• Tax Administration	July 2015–June 2016	
	• Liquidity management	July 2015–June 2016	
	B. Mutual information on relevant work program		
Fund request to Bank	• Periodic update on all TA activities	Ongoing	
	• Macroeconomic and financial data to be shared regularly		
	• Participating in reviews of key analytical work		
Bank request to Fund	• Periodic update on all TA activities	Ongoing	
	• Macroeconomic and financial data to be shared regularly		
	C. Agreement on joint products and missions		
Joint products in the next 12 months	• Debt sustainability analysis		June 2016

STATISTICAL ISSUES

(As of August 26, 2015)

I. Assessment of Data Adequacy for Surveillance

General: Data provision has shortcomings that hamper surveillance. In 2014/15 some data reported to the Fund were subject to delays and there are data weaknesses and gaps reflecting capacity constraints which the authorities are seeking to address through technical assistance.

National Accounts: Although the authorities are continuing efforts to strengthen the national accounts methodology, deficiencies in the source data and compilation practices affect the accuracy and reliability of the GDP statistics. The reliance on various assumptions remains significant and the weaknesses are particularly evident in respect to the estimation of private consumption, saving, investment, and fixed capital formation. The statistical discrepancies between the expenditure categories and output remain large. Information provided to the Fund is subject to frequent revisions and discrepancies. Staff has stressed the need to further improve national accounts statistics. The authorities have been receiving TA in this area from AFRITAC East.

Government finance statistics: Despite recent improvements, government fiscal statistics continue to be affected by shortcomings in terms of coverage. Data on the consolidated fiscal operations of general government and wider public sector are lacking and hinder proper assessment of the overall public sector's borrowing needs and its capacity to repay.

Monetary statistics: Monetary survey data for commercial banks are subject to substantial revisions. Timely data collection and reporting continue to be crucial for policy making purposes and the authorities should strengthen efforts to reduce revisions.

Financial statistics: Information gaps about the financial sector have implications for conducting an in-depth assessment of financial sector health. Staff have not received commercial banks' income statements, information on distribution of non-performing loans, maturity of credit, net open position, and bank-by-bank financial soundness indicators.

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

II. Data Standards and Quality

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

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(As of August 18, 2015)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange rates	July 2015	August 2015	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1/]	June 2015	August 2015	M	M	M
Reserve/base money	June 2015	August 2015	M	M	M
Broad money	June 2015	August 2015	M	M	M
Central bank balance sheet	June 2015	August 2015	M	M	M
Consolidated balance sheet of the banking system[2/]	June 2015	August 2015	M	M	Q
Interest rates[3/]	April 2015	June 2015	M	M	M
Consumer price index	July 2015	August 2015	M	M	M
Revenue, expenditure, balance, and composition of financing[4/] – general government[5/]	April 2015	June 2015	Q	Q	A
Revenue, expenditure, balance, and composition of financing[4/] – central government[5/]	April 2015	June 2015	Q	Q	Q
Stocks of central government and central government-guaranteed debt[6/]	December 2015	June 2015	Q	Q	Q
External current account balance	June 2015	August 2015	Q	Q	Q
Exports and imports of goods and services	June 2015	August 2015	M	M	M
GDP/GNP	2013/14	June 2015	A	A	A
Gross external debt	2013/14	June 2015	A	A	A
International investment position[7/]	...	...	N/A	N/A	N/A

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

[2/] The authorities provide aggregate balance sheet items but not detailed enough for proper financial stability analysis.

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

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

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

[6/] Including currency and maturity composition.

[7/] Reflecting capacity constraints which the authorities are addressing through technical assistance.

INTERNATIONAL MONETARY FUND

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

September 3, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

Approved By

Michael Atingi-Ego and Masato Miyazaki (IMF) and John Panzer (IDA)

Prepared jointly by staff of the International Monetary Fund (IMF) and the International Development Association (IDA)

Ethiopia's external debt remains sustainable, but the risk of external debt distress has increased from "low" to "moderate" due to weak export performance and higher than expected non-concessional borrowing, reflecting faster execution of the government's investment program. Over the longer term, a recovery in exports and a moderation of non-concessional borrowing would improve external debt indicators. In assessing the risk of external debt distress, the DSA calls for the use of judgment, focusing in particular on capacity to repay. In this regard, the fact that external loans are being used primarily to finance growth-enhancing infrastructure helps reduce the risk of debt distress. However, uncertainties related to foreign demand and foreign financing for investment present downside risks to export growth. Total public sector debt (domestic and external) also remains sustainable, though vulnerable to risks. To enhance debt sustainability, it remains essential to promote the growth and diversification of exports. Ensuring an appropriate pace of public borrowing—especially from external, non-concessional sources—is also critical to ensure that public investment does not undermine debt sustainability. These findings highlight the importance of having a medium-term debt management strategy, and of increasing oversight of state-owned enterprises, which have been in the lead for major infrastructure projects and thus have contracted much of the external, non-concessional debt.

BACKGROUND AND KEY ASSUMPTIONS

1. Ethiopia's large-scale public investment in infrastructure has been financed by significant borrowing, which has resulted in higher public debt. Ethiopia reached the completion point under the Heavily Indebted Poor Countries (HIPC) Initiative in 2004 and benefited from debt relief under the Multilateral Debt Relief Initiative (MDRI) in 2006.[1] Public and publicly guaranteed (PPG) external debt[2] fell in the years that followed, reaching a low of 18 percent of GDP in mid-2012.[3] It rose to 23 percent of GDP by mid-2014 (and total public debt was 42 percent of GDP).

2. The Debt Sustainability Analysis (DSA) prepared in 2014 concluded that Ethiopia's risk of external debt distress was "low", though on the cusp of "moderate". No indicative threshold was breached in the baseline. However, the indicator showing the ratio of the present value of debt to exports (PVDE) temporarily breached the 150 percent threshold under the most extreme shocks scenarios.[4] With other risk indicators far below their respective thresholds, Ethiopia was considered a borderline case, for which the use of the probability approach was warranted. This analysis indicated a very low probability of debt distress, which underpinned the final assessment that Ethiopia's risk of external debt distress was "low". Incorporating remittances to determine the risk of debt distress did not change the final assessment.

3. Since last year, there has been a significant increase in disbursements of non-concessional external loans. The government issued a US$1 billion Eurobond in December 2014 (which had not been anticipated in the 2014 DSA), and disbursement of commercial loans to state-owned enterprises (SOEs) accelerated. In total, SOEs borrowed $4.1 billion during 2013-15, broadly as expected in the 2014 DSA. As SOE commercial borrowing is expected to remain significant in the coming years, the grant element of total public borrowing will fall further. However, as the large-scale public investment program begins to wind down and associated external financing for public enterprises declines, the non-concessional share of

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[1] While Ethiopia has received debt relief from most of its creditors, it has not been able to reach agreement with a few bilateral creditors (Bulgaria, Libya, and FR Yugoslavia) and commercial creditors from Italy, the former Czechoslovakia, India, and FR Yugoslavia. These outstanding loans (US$382.9 million) accounted for 3.2 percent of the debt stock in 2013/14. HIPC terms are assumed for these loans. While negotiations with Russia on outstanding loans (US$161.6 million) have not completed, the debt service on these loans is assumed to be given HIPC comparable treatment.

[2] PPG debt includes the debt of the federal government, regional governments, and major state-owned enterprises *except* Ethiopian Airlines (EAL). EAL meets the criteria for exclusion set out in the 2013 Staff Guidance Note on the DSF for LICS (Annex 3) because it is run on commercial terms, has a sizeable profit margin (as reflected in audited accounts published annually), enjoys managerial independence, and borrows without government guarantee.

[3] The Ethiopian fiscal year runs from July 8 to July 7.

[4] Based on its 2014 Country Policy and Institutional Assessment (CPIA) score (3.4), Ethiopia is classified as a medium performer. The thresholds for the debt burden for medium performers are 150, 40, and 250 percent for the PV of debt to exports, GDP, and revenue, respectively; a 10 percent band is applied to the thresholds to determine if the country is a borderline case; debt service thresholds are 20 and 30 percent of exports and revenue, respectively. In the scenarios that include workers' remittances, the corresponding threshold for the PV of debt to exports and remittances is 120 percent, and is 16 percent for debt service to exports and remittances; the PV of debt to GDP and remittances is 36 percent.

external financing is expected to fall for total external debt (general government and SOEs). Other key assumptions include:

- Non-concessional loan disbursements will average about US$1.7 billion per year in the next five years, and around US$750 million per year over the entire projection period (FY2015/16–FY2034/35).

- The maturity on all new external loans will average 26 years, and 13-16 years for new non-concessional loans.

- The interest rate on all new external loans will average 2.2 percent, and 3-5 percent on new non-concessional loans.

4. The accelerated disbursement of previously contracted commercial loans to state-owned enterprises reflects the ramping up of Ethiopia's infrastructure development. Total non-concessional borrowing in 2014/15 is estimated at US$4 billion. The DSA projects such borrowing to average US$1.9 billion over the next two years. Major ongoing projects include the following:

- **Ethiopian Railway Corporation**: Awash Woldia / Hara Gebeya Railway Projects, the Addis Ababa Light Railway. Commercial disbursements are projected at US$2 billion through 2016/17.

- **Ethio Telecom**: purchased US$1.1 billion of equipment using commercial loans during 2014/15.

- **Power related projects (mostly in electricity transmission)**: disbursements for the Genale Dawa dam and the final phase of the Gilgel Gibe III dam could reach US$0.6 billion.

- **US$1 billion Eurobond** and other loans to support development of industrial parks, the sugar industry, and power transmission infrastructure; also expansion of the road network and Bole International airport in Addis Ababa.

5. IDA has reduced Ethiopia's ceiling for new non-concessional borrowing to US$750 million for 2015/16 and, in principle, for 2016/17. The ceiling was lowered in July 2015 (from the US$1 billion ceiling that had been in place for 2012/13-2014/15) in light of rising risks of external debt distress. The reduced ceiling was seen as striking a good balance between encouraging the authorities to focus on concessional financing for public investment, while leaving room to tap non-concessional financing sources. At the same time, IDA revoked the 5 percent volume cut introduced for FY15 given that the authorities contained new non-concessional borrowing within the IDA limit of US$1 billion. IDA will continue to support Ethiopia on regular credit term.

6. The medium-term macroeconomic outlook remains broadly unchanged compared to the assumptions used in the 2014 DSA, though the outlook for exports is somewhat weaker (Box 1). Real GDP growth is estimated at 8.7 percent in 2014/15 and projected at 8.1 percent in 2015/16, reflecting strong public infrastructure investment and favorable agricultural production. The projected long-run GDP growth rate is maintained at 6.5 percent. Compared to the 2014 DSA, the outlook for the level of exports is lower, reflecting underperformance in 2014/15. Exports of goods and services are projected to rebound in 2015/16—growing at 19.5 percent—and sustain healthy growth over the following years, reflecting improved product diversification (for example in light manufacturing, horticulture, and electricity). Export growth is expected to taper off to 8.3 percent in the longer run. This fairly optimistic outlook faces downside risks if structural reforms are not sufficiently ambitious to address Ethiopia's considerable competitiveness challenges. The uncertain global outlook presents another downside risk to export growth. Weaker economic growth in Ethiopia's major trading partners could depress exports, and tighter global financing conditions could weaken FDI growth.[1] With respect to China, slower economic growth is a risk for Ethiopia. However, a rebalancing of China's demand towards consumption could boost Ethiopia's exports to China, which so far have been primarily vegetable products.

Box 1. Ethiopia: Macroeconomic Assumptions for the Baseline Scenario

Real GDP growth is projected at 8.7 percent in 2014/15, 8.1 percent in 2015/16, and at 6.5 percent over the longer term. CPI Inflation is projected at 8.5 percent in the long run. The primary deficit of the public sector is projected to average 2.7 percent of GDP during the next five years, with better tax collection largely offsetting large public investment and current expenditures. An improvement in the fiscal balance is constrained by the slow pace of improvement in revenue as a share of GDP, reflecting a narrow tax base, significant tax exemptions and tax expenditures, and tax administration challenges. Also, as import growth slows, revenue from customs duties may also decline as a share of GDP.

The external current account deficit (before official transfers) is estimated at 14.7 percent of GDP in 2014/15. Improved export performance, a slowdown in capital imports and steady remittances will lead to a gradual decline of the deficit over the longer term. Economic transformation is expected to ameliorate the large external imbalances, with more dynamic and diversified exports and a phase down in the imports of capital goods.

Exports of goods and services are estimated to have declined by 5.9 percent in 2014/15. Exposure to volatile commodity prices—especially for gold and oilseeds—largely offset gains in export volumes. A recovery in traditional exports and the development of new exports could raise average growth to 16–17 percent over the next three years, and 11.3 percent in the long run. Investments in industrial parks and targeted sectors that receive government support are expected to contribute to export growth and diversification. Imports of goods and services are projected to slow down but increase well above GDP in the medium term as demand for imported capital goods is expected to remain strong during the second phase of the GTP. In the long run, imports are expected to grow in line with domestic output.

Remittances have played a key role in supporting the balance of payments and in 2014/15 are estimated at 7.4 percent of GDP. Economic stability in Ethiopia and solid growth in developed countries is expected to keep remittances rising in dollar terms but declining to 2.7 percent as a share of GDP by 2034/35.

Foreign direct investment is projected to increase from 3.6 percent of GDP in 2014/15 to 5.0 percent in the medium term, reflecting improved competitiveness and policies to attract foreign investment.

The exchange rate is expected to remain determined by the NBE's crawl-like arrangement with the real effective exchange rate remaining constant over time. Export growth will be driven by FDI, domestic investment, competitiveness reforms, better infrastructure, and labor productivity gains.

See the staff report at http: www.imf.org which provides a more detailed discussion of export projections for Ethiopia, and downside risks.

7. The authorities requested that Ethio Telecom be excluded from the DSA. In their view, Ethio Telecom meets most of the conditions for exclusion of an SOE: it is run as a commercial entity, its external commercial loans are not guaranteed by the government, and audited financial statements indicate its profitability. While some audited reports for Ethio Telecom have now been made available to staff, they are only through 2012, and do not provide sufficient information to assess whether there may be remaining contingent liabilities that could pose risk for the government. The government expects to have more recent audited financial reports for Ethio Telecom available in the coming year. The 2015 DSA includes Ethio Telecom's external debt (as was done in the 2014 DSA).

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

8. The 2015 DSA projects external debt to peak as a share of GDP in 2017/18. The present value (PV) of PPG external debt increases to 18.8 percent of GDP in 2014/15, and reaches 24.5 percent of GDP by 2017/18, reflecting the assumed sharp increase in disbursements to finance public investment projects. It would decline after that, falling below 10 percent of GDP in the long run.

9. Under the baseline scenario, the ratio of the present value of debt-to-exports (PVDE) breaches the indicative threshold (Table 1 and Figure 1). The PVDE ratio is estimated at 192 percent by end-June 2015. Despite the expected recovery in exports, it is projected to continue increasing, peaking at 220 percent in 2016/17. This would entail a baseline breach of 7 years, until 2020/21. All other debt indicators remain below their indicative thresholds in the baseline scenario. For the indicators related to debt service, the peaks in 2024/25 reflect the assumption that the Eurobond is repaid in full.

10. Looking at alternative scenarios, a terms-of-trade shock appears to present the largest risk to external debt sustainability. The breach of the indicative threshold for the PVDE ratio would last three more years, and extend to 2023/24. A depreciation shock would also have a significant impact, in particular on the debt service to revenue indicator (with a large share of imports exempt from customs duties, depreciation would not lead to as much of an increase in the birr value of customs duties than might otherwise be the case). As in the baseline, no other indicator breaches its indicative threshold in the alternative scenarios.

Table 1. Ethiopia: Comparison of PPG External Debt Baseline Scenario, 2015–35

Fiscal year ending July 7	2015	2016	2017	2018	2019	2020	2025	2035
			(Percent, unless otherwise indicated)					
			PV of Debt to Exports Ratio					
2015DSA	192.3	212.3	220.4	213.9	192.0	174.5	99.0	34.2
2014DSA	135.9	141.9	141.1	131.9	120.1	110.7	70.8	...
			PV of Debt to GDP Ratio					
2015DSA	18.8	21.7	23.8	24.5	23.2	21.8	15.0	6.5
2014DSA	18.9	21.0	21.9	21.3	20.4	19.4	14.1	...
			PV of Debt to Revenue Ratio					
2015DSA	114.8	134.8	144.4	146.0	136.9	128.1	90.7	39.1
2014DSA	131.5	147.1	154.6	149.4	140.8	132.3	96.3	...
			Debt Service to Exports Ratio					
2015DSA	11.9	13.0	13.4	13.0	12.6	12.8	13.9	3.3
2014DSA	9.0	8.8	8.7	8.4	8.6	8.4	7.3	...
Memorandum items:								
			Grant Element of New External Borrowing					
2015DSA	19.4	18.4	19.1	28.0	40.1	40.0	38.9	38.1
2014DSA	21.8	22.9	25.6	33.0	34.1	37.2	35.7	...
			New Commercial Loan Disbursements (billions of U.S. dollars)					
2015DSA	3.327	3.104	2.916	1.502	0.589	0.654	0.700	0.750
2014DSA	2.707	2.271	1.745	0.930	0.820	0.655	0.700	...
			Real GDP Growth (annual percent change)					
2015DSA	8.7	8.1	7.6	7.5	7.5	7.5	6.5	6.5
2014DSA	8.5	8.5	8.0	8.0	7.5	7.5	6.5	...
			Current Account Balance to GDP Ratio					
2015DSA	-12.8	-9.9	-9.1	-8.1	-7.3	-6.6	-4.0	-2.7
2014DSA	-7.3	-6.7	-5.8	-5.5	-6.2	-5.3	-4.0	...

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

11. In assessing the risk of external debt distress, the DSA calls for the use of judgment, focusing in particular on capacity to repay. In the case of Ethiopia, external loans are being used primarily to finance infrastructure investment, which are expected to have growth pay-offs that will boost tax revenue and enhance debt repayment capacity. Large investments in energy, railroads, and roads will enhance competitiveness, boost export revenue, and promote economic diversification. While this is to some extent factored into the baseline growth projections, staff's assumptions are fairly conservative in this regard. The DSA provides for additional tools to evaluate the risk of external debt distress. Results from this extended, judgment-based analysis indicated the following:

- **Probability approach.** This approach assesses the evolution of the probability of debt distress over time, taking into account past economic performance. For Ethiopia, no indicator breaches the threshold in the baseline, and the breach of the threshold for the PVDE ratio in one shock scenario is short-lived (2 years) and less than 3 percentage points from the threshold (Figure 2). In the historical scenario, the debt indicators would be lower than under the baseline. This reflects persistently high real GDP growth in the recent past and the better export performance prior to the recent stagnation, which lowers the debt ratios in the first years of the forecast and increases them in the outer years.

- **Including remittances.**[1] In Ethiopia, strong and relatively stable remittances play an important role in bolstering external stability. When remittances are included in the DSA, the breach of the augmented indicator (namely the ratio of the PV of debt to exports of goods and services *plus* remittances) reaches a maximum value of 149.8 percent and lasts 5 years (Figure 3). Other indicators are well below the revised thresholds even under the most extreme shocks.

12. This augmented analysis indicates that Ethiopia has greater resilience to debt distress than suggested by the standard methodology. Supported by robust past economic performance, the path of debt and debt service indicate that only in the most extreme shock (to exports) would the PVDE probability ratio be pushed above its policy threshold. These results support the assessment of Ethiopia's risk of external debt distress as "moderate".

13. The increased risk of external debt distress calls for caution going forward regarding the pace of foreign borrowing. Projects should be assessed carefully to ensure that they meet stringent economic and/or social rate of return assessments, in particular if they are being financed on non-concessional terms. Priority should also be given to those projects with solid growth-enhancing effects. Policies that promote exports will also be essential to bolster Ethiopia's foreign exchange earnings, which remains a weakness for the economy overall. A more competitive exchange rate, better access to credit for the private sector, and fewer structural bottlenecks would all help in this regard

PUBLIC DEBT SUSTAINABILITY ANALYSIS

14. The projected path of total public sector debt-to-GDP has essentially remained the same as forecast in the 2014 DSA: rising in the coming years, and falling after that. This reflects large domestic and external borrowing by SOEs to finance infrastructure investment. As these projects reach completion, total public sector expenditure would revert to lower levels in the long run.

15. The PV of debt-to-GDP ratio remains below the threshold in the baseline. However, there is a five-year threshold breach under the most extreme shock (a one-time depreciation). This is explained largely by the fact that Ethiopia has increased its exposure to external commercial debt. The breach provides additional evidence of a heightened risk of public debt distress.

16. Debt stock related indicators are relatively flat and most extreme shocks do not alter significantly the results. All debt indicators show a mild increase in the medium term, before returning to

[1] Remittances must be presented as the *base case* in the DSA if they are both greater than 10 percent of GDP and greater than 20 percent of exports of goods and services. Both ratios should be measured on a backward-looking, three-year average basis. While remittances in Ethiopia do not meet this criterion, they are large: in 2014/15 they accounted for about half of exports of goods and services and 5.5 percent of GDP.

levels similar to 2014/15. This result is predicated on the continuation of robust GDP growth, moderate public sector primary deficits, and—most crucially—low domestic interest rates (such that real interest rates remain mildly negative, as inflation is forecast at 8.5 percent in the long run).

17. Public sector debt would grow in the long run as a result of a permanent negative shock to GDP growth, but debt service-to-revenue could absorb this shock (Figure 4). The scenario that fixes the primary balance at its 2014/15 level shows a particularly sharp deterioration because of the unusually large primary deficit in that particular year, reflecting the high level of investment activity. The other two alternative scenarios (a shock to real GDP growth and primary balance at the historic average) show trajectories with no important changes in the debt ratios over the DSA horizon.

18. The baseline scenario understates the public debt burden for the economy, because it is based on nominal interest rates on public sector borrowing remaining significantly below inflation. Like in the 2014 DSA, with inflation projected to remain at a single-digit level, under current policies interest rates on SOEs' domestic borrowing would be negative in real terms. Ethiopia's relatively benign public sector debt outlook hinges strongly on the continuation of these financing conditions. If the actual cost of borrowing were to rise above inflation, the debt indicators would worsen or fiscal adjustment would be required to maintain sustainability.

19. This assessment, with a moderate risk of debt distress, assumes the acceleration of external borrowing to achieve the investment required for the development plan. The ongoing large public investment projects rely heavily on domestic financing and would lead to a large accumulation of public debt. Without an appropriate balance in the financing and pacing of the public investment projects in the GTP, resources for the private sector could be squeezed. Monitoring the operations of the consolidated public sector, including contingent liabilities arising from financial transactions among public entities, is thus important.

CONCLUSION

20. Ethiopia's risk of external debt distress has increased from "low" to "moderate". This finding reflects the use of judgment in assessing the likely impact of Ethiopia's external public borrowing on growth, and hence on its capacity to repay. The risk assessment remains vulnerable to further delays in the recovery of exports, a terms-of-trade shock, higher external borrowing, and deterioration in external borrowing conditions. The exposure to a terms-of-trade shock is reflected in a more protracted breach in the PV of debt-to-exports ratio under the most extreme shock. However, robust economic performance and a continued favorable outlook help to reduce the probability of debt distress.

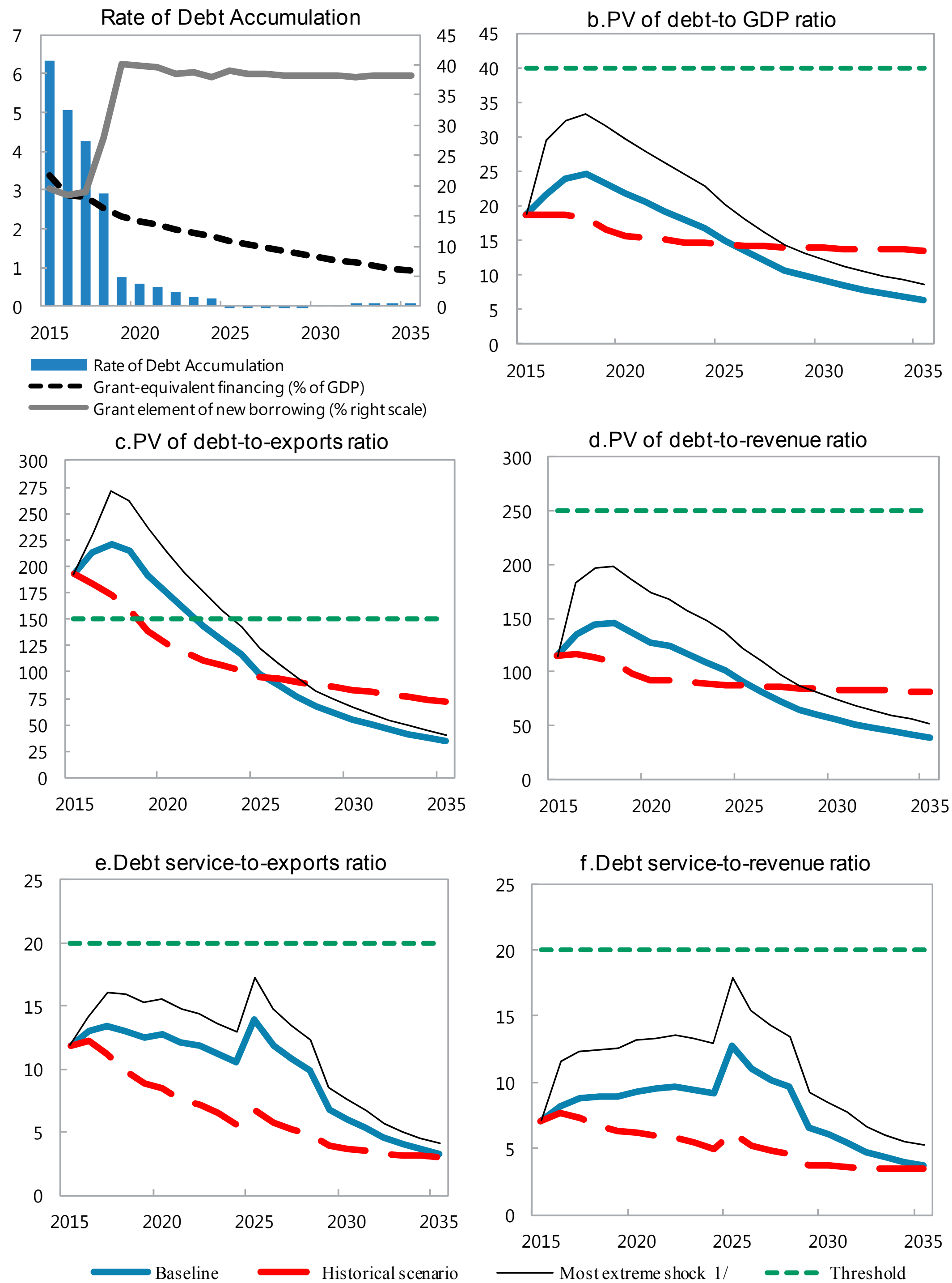
21. Containing the risk of debt distress will depend critically on bolstering export performance. Addressing competitiveness concerns, facilitating greater access to credit and foreign exchange for the private sector, and continued macroeconomic stability will play important roles in promoting export growth and export diversification. A more competitive exchange rate would also reduce headwinds for exporters, and contribute to increased availability of foreign exchange to finance imports of critical capital and intermediate goods.

22. Ensuring that public sector borrowing is consistent with debt sustainability is also essential. The authorities need to monitor closely the debt levels and the terms of the new loans, especially those on commercial terms. A dedicated agency that monitors the financial positions of SOEs would increase transparency regarding their overall impact on public finances, and reduce fiscal risks. The authorities are also encouraged to increase non-debt sources of financing for GTP II. For example, private-public partnerships could bring in valuable equity financing while maintaining state control. The authorities should also ensure adequate concessionality of new external loans.

23. As advised in previous DSAs, the authorities are encouraged to systematically update their medium-term debt management strategy (including SOEs) and to start monitoring the overall debt (external and domestic) of the consolidated public sector. A joint work from the World Bank and the IMF in collaboration with UNCTAD on medium-term debt management strategy advised Ethiopia on the growing vulnerabilities derived from SOEs borrowing strategy, including substantial domestic borrowing from the state-dominated banking system.

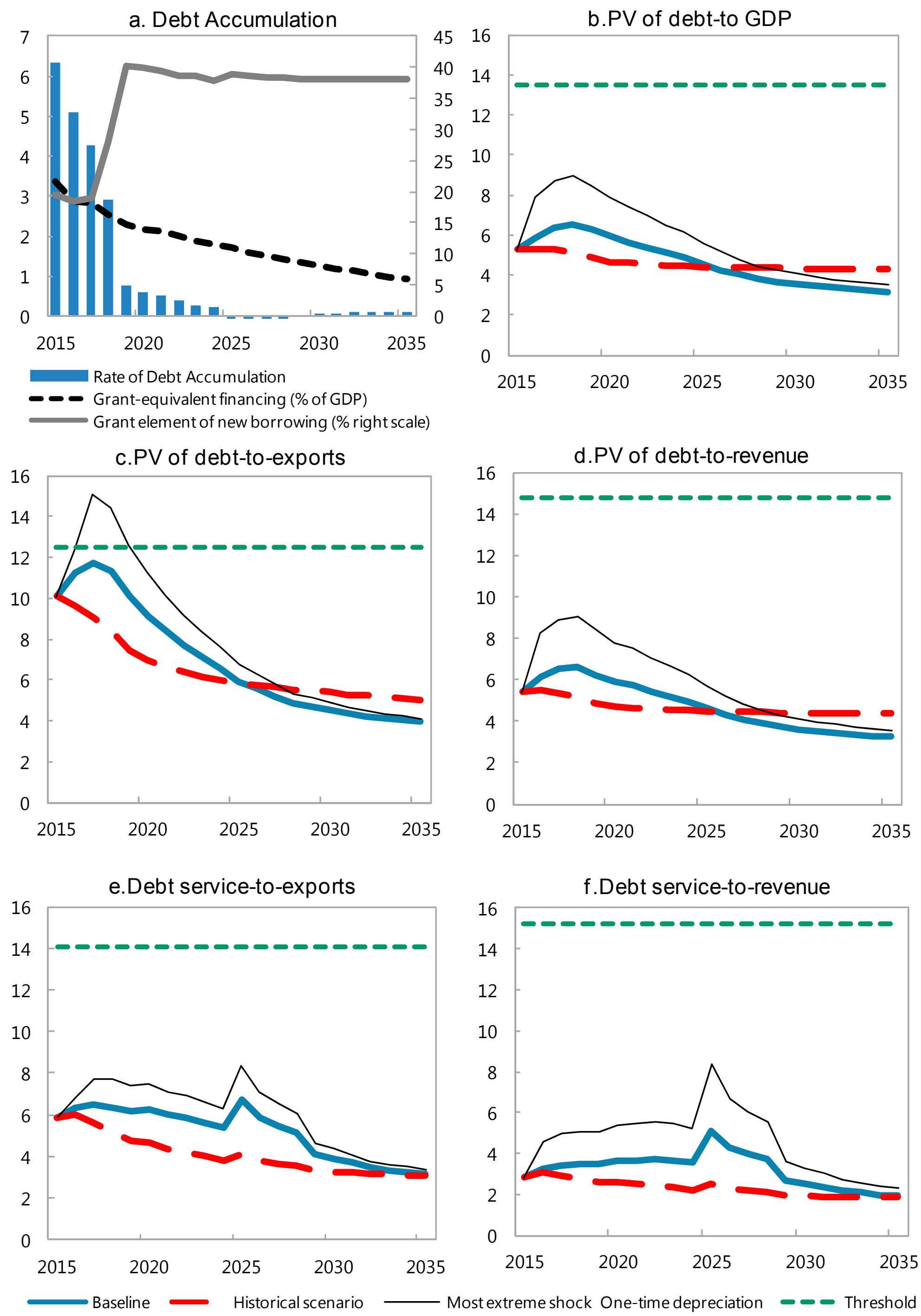
24. The authorities disagreed with the DSA's finding of an increased risk of external debt distress. In their view, this assessment does not accurately reflect the Ethiopian government's capacity and commitment to repay its external debts, emphasizing that the financing is being used for growth-enhancing investments, which should bolster exports and tax revenue. They also noted that the deterioration in the debt indicators was due in large part to the very poor export performance in 2014/15, which they expected to reverse in the coming years. They also argued for the exclusion of Ethio Telecom from the DSA, noting that it is run on a commercial basis, is profitable, has audited financial accounts (though only through 2012), and borrows externally without a government guarantee. Staff noted that including SOEs was the norm for DSAs, and that Ethio Telecom did not yet meet the conditions required for exclusion (which include regular publication of audited financial accounts).

Figure 1. Ethiopia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2015–35[1]



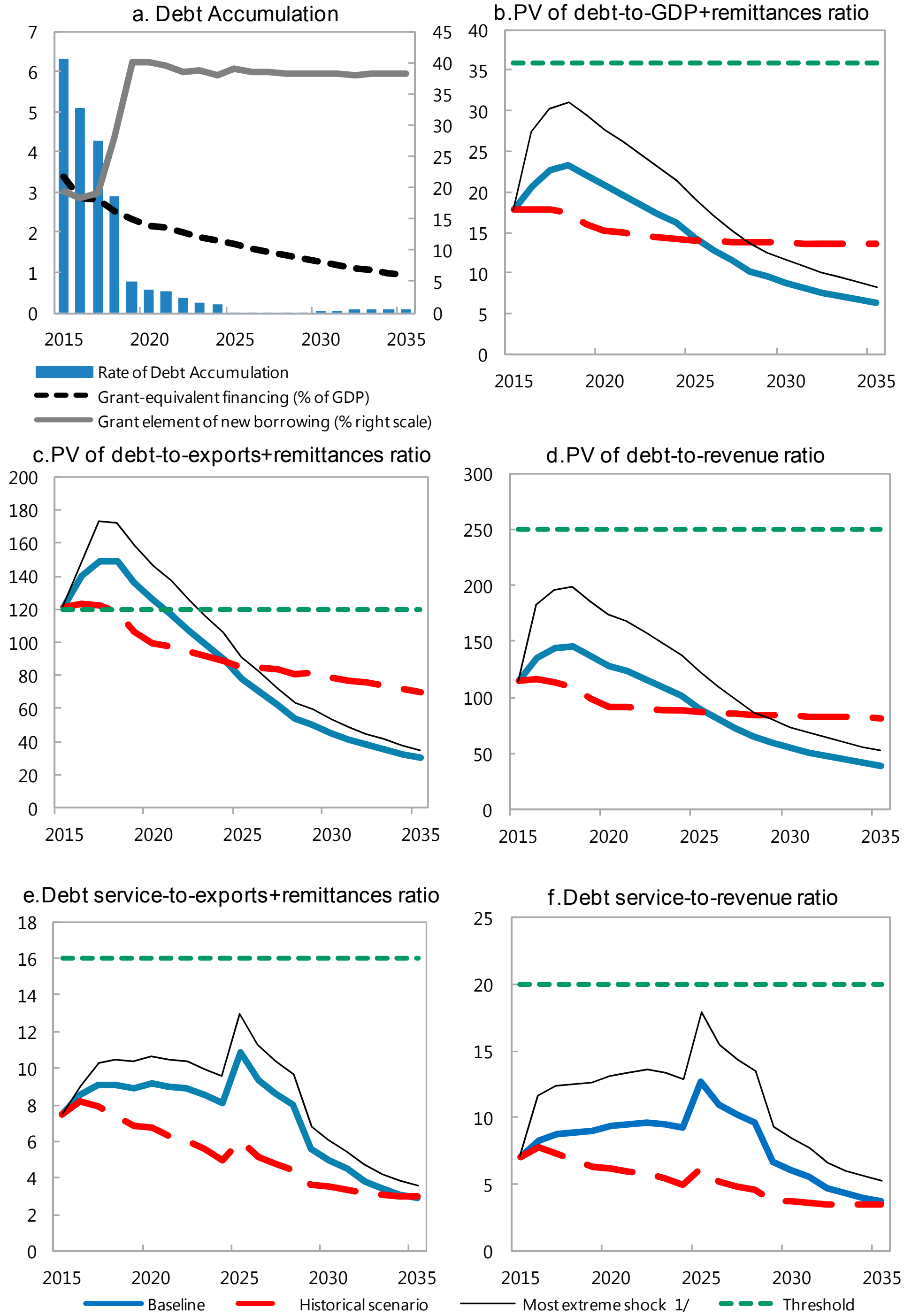
Sources: Ethiopian authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a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

Figure 2. Ethiopia: Probability of Debt Distress of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2015–35[1]



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

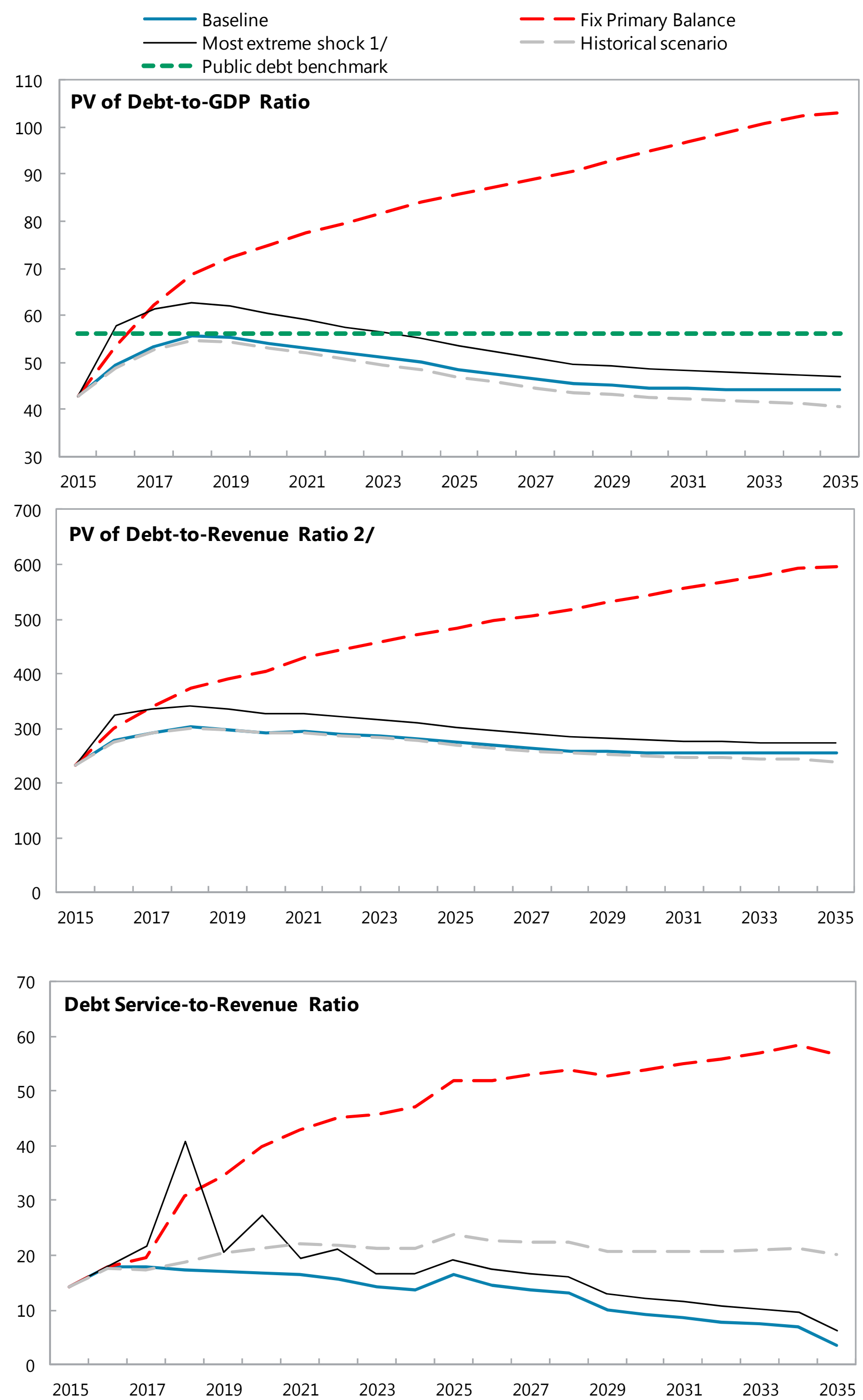
Figure 3. Ethiopia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios (Including Remittances), 2015–35[1]



Sources: Ethiopian authorities; and staff estimates and projections.

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

Figure 4. Ethiopia: Indicators of Public and Publicly Guaranteed Debt (Domestic and External) Under Alternative Scenarios, 2015–35[1]



Sources: Ethiopian authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. It corresponds to a one-time depreciation shock.
2/ Revenues are defined inclusive of grants.

Table 2. Ethiopia: External Debt Sustainability Framework, Baseline Scenario, 2012–35[1]

	Actual			Historical 6/	Standard 6/	Projections									
				Average	Deviation							2015-2020			2021-2035
	2012	2013	2014			2015	2016	2017	2018	2019	2020	Average	2025	2035	Average
External debt (nominal) 1/	**20.3**	**23.3**	**25.5**			**30.0**	**32.9**	**35.0**	**35.6**	**33.9**	**32.1**		**23.7**	**13.1**	
of which: public and publicly guaranteed (PPG)	18.1	20.3	22.1			26.2	29.3	31.6	32.3	30.8	29.3		21.4	10.4	
Change in external debt	-5.2	3.0	2.1			4.5	2.9	2.2	0.5	-1.7	-1.8		-2.2	-0.7	
Identified net debt-creating flows	-2.7	1.5	2.3			7.3	3.7	2.4	1.0	-0.1	-0.7		-1.7	-0.5	
Non-interest current account deficit	**6.2**	**5.7**	**7.8**	**5.3**	**2.2**	**12.3**	**9.3**	**8.3**	**7.2**	**6.4**	**5.8**		**3.4**	**2.5**	3.5
Deficit in balance of goods and services	17.8	16.4	17.8			21.8	19.0	17.8	16.3	14.9	13.8		10.5	6.4	
Exports	13.8	12.5	11.7			9.8	10.2	10.8	11.5	12.1	12.5		15.1	19.0	
Imports	31.7	28.9	29.5			31.6	29.2	28.6	27.7	26.9	26.3		25.6	25.4	
Net current transfers (negative = inflow)	-11.7	-10.7	-10.0	-13.2	1.8	-9.4	-9.6	-9.3	-9.1	-8.7	-8.3		-6.9	-3.9	-5.9
of which: official	-4.1	-3.2	-2.7			-2.0	-1.7	-1.8	-1.6	-1.5	-1.4		-1.2	-0.7	
Other current account flows (negative = net inflow)	0.0	0.0	0.0			-0.1	-0.1	-0.2	0.0	0.2	0.2		-0.2	0.0	
Net FDI (negative = inflow)	**-2.5**	**-2.6**	**-2.7**	**-2.7**	**0.7**	**-3.6**	**-4.1**	**-4.5**	**-4.7**	**-4.9**	**-5.0**		**-4.2**	**-2.4**	-3.6
Endogenous debt dynamics 2/	**-6.4**	**-1.6**	**-2.8**			**-1.5**	**-1.5**	**-1.5**	**-1.5**	**-1.5**	**-1.5**		**-0.9**	**-0.6**	
Contribution from nominal interest rate	0.2	0.3	0.3			0.4	0.7	0.8	0.9	0.9	0.9		0.6	0.3	
Contribution from real GDP growth	-1.6	-1.8	-2.1			-2.0	-2.2	-2.3	-2.4	-2.4	-2.3		-1.6	-0.8	
Contribution from price and exchange rate changes	-5.0	-0.1	-1.0			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-2.5**	**1.6**	**-0.2**			**-2.7**	**-0.8**	**-0.2**	**-0.5**	**-1.6**	**-1.1**		**-0.4**	**-0.2**	
of which: exceptional financing	-0.3	-0.2	-0.1			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	18.1			22.6	25.3	27.3	27.8	26.3	24.7		17.2	9.2	
In percent of exports	...	...	154.1			230.9	247.9	252.6	242.6	217.5	197.2		113.6	48.5	
PV of PPG external debt	**...**	**...**	**14.7**			**18.8**	**21.7**	**23.8**	**24.5**	**23.2**	**21.8**		**15.0**	**6.5**	
In percent of exports	**...**	**...**	**125.6**			**192.3**	**212.3**	**220.4**	**213.9**	**192.0**	**174.5**		**99.0**	**34.2**	
In percent of government revenues	**...**	**...**	**102.0**			**114.8**	**134.8**	**144.4**	**146.0**	**136.9**	**128.1**		**90.7**	**39.1**	
Debt service-to-exports ratio (in percent)	**6.6**	**8.5**	**10.5**			**16.9**	**18.2**	**18.6**	**18.1**	**17.4**	**17.5**		**16.2**	**3.9**	
PPG debt service-to-exports ratio (in percent)	**4.9**	**6.5**	**7.0**			**11.9**	**13.0**	**13.4**	**13.0**	**12.6**	**12.8**		**13.9**	**3.3**	
PPG debt service-to-revenue ratio (in percent)	**5.0**	**5.5**	**5.7**			**7.1**	**8.2**	**8.8**	**8.9**	**9.0**	**9.4**		**12.7**	**3.8**	
Total gross financing need (Billions of U.S. dollars)	2.0	2.0	3.5			6.4	4.9	4.4	3.8	3.2	2.9		2.5	2.7	
Non-interest current account deficit that stabilizes debt ratio	11.4	2.7	5.6			7.8	6.4	6.1	6.7	8.0	7.6		5.6	3.1	
Key macroeconomic assumptions															
Real GDP growth (in percent)	8.7	9.8	10.3	10.8	1.1	8.7	8.1	7.6	7.5	7.5	7.5	7.8	6.5	6.5	6.7
GDP deflator in US dollar terms (change in percent)	24.2	0.3	4.5	7.5	12.3	3.7	3.5	1.8	1.6	1.5	1.5	2.3	1.5	1.5	1.5
Effective interest rate (percent) 5/	1.2	1.4	1.4	1.0	0.3	2.0	2.5	2.8	2.9	2.8	2.8	2.6	2.5	2.1	2.3
Growth of exports of G&S (US dollar terms, in percent)	11.8	-0.5	8.4	16.0	9.3	-5.9	16.7	16.0	16.0	15.0	12.9	11.8	12.8	11.0	11.3
Growth of imports of G&S (US dollar terms, in percent)	35.5	0.7	17.7	19.7	16.1	20.7	3.2	7.4	6.0	6.0	6.7	8.3	6.0	8.5	8.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	19.4	18.4	19.1	28.0	40.1	40.0	27.5	38.9	38.1	38.4
Government revenues (excluding grants, in percent of GDP)	13.6	14.8	14.4			16.4	16.1	16.5	16.8	17.0	17.0		16.5	16.6	16.6
Aid flows (in Billions of US dollars) 7/	2.8	2.7	2.7			2.3	2.3	2.5	2.5	2.5	2.6		2.9	3.4	
of which: Grants	1.8	1.5	1.5			1.2	1.2	1.3	1.3	1.4	1.4		1.8	2.2	
of which: Concessional loans	1.0	1.2	1.2			1.1	1.1	1.2	1.1	1.1	1.1		1.1	1.2	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			3.4	2.9	2.8	2.5	2.3	2.2		1.7	0.9	1.5
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			36.7	36.2	39.0	52.1	67.1	66.3		68.7	70.2	68.5
Memorandum items:															
Nominal GDP (Billions of US dollars)	43.1	47.5	54.8			61.8	69.1	75.7	82.8	90.3	98.5		148.1	324.0	
Nominal dollar GDP growth	35.0	10.2	15.3			12.7	11.9	9.5	9.3	9.1	9.1	10.3	8.1	8.2	8.3
PV of PPG external debt (in Billions of US dollars)			7.9			11.4	14.5	17.4	19.6	20.3	20.8		21.4	20.3	
(PVt-PVt-1)/GDPt-1 (in percent)						**6.3**	**5.1**	4.3	2.9	0.8	0.6	3.3	-0.6	0.1	0.0
Gross workers' remittances (Billions of US dollars)	1.9	2.5	3.0			3.5	3.7	3.9	4.2	4.5	4.8		6.2	8.8	
PV of PPG external debt (in percent of GDP + remittances)	...	...	14.0			17.8	20.6	22.6	23.3	22.1	20.8		14.4	6.3	
PV of PPG external debt (in percent of exports + remittances)	...	...	85.9			121.6	139.9	149.2	148.5	136.2	125.7		77.6	29.9	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	4.8			7.5	8.6	9.1	9.0	8.9	9.2		10.9	2.9	

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

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

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

Table 3. Ethiopia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–35

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
PV of debt-to GDP ratio								
Baseline	19	22	24	25	23	22	**15**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	19	19	19	18	17	16	**14**	14
A2. New public sector loans on less favorable terms in 2015-2035 2	19	22	26	27	26	25	**20**	12
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	19	21	22	23	22	20	**14**	6
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	19	22	25	25	24	23	**15**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	19	23	27	28	26	24	**17**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	19	21	24	24	23	21	**15**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	19	21	22	23	22	20	**14**	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	19	30	32	33	32	30	**20**	9
PV of debt-to-exports ratio								
Baseline	192	212	220	214	192	175	**99**	34
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	192	184	173	159	138	126	**95**	72
A2. New public sector loans on less favorable terms in 2015-2035 2	192	220	239	232	216	201	**132**	65
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	192	205	213	207	185	168	**95**	33
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	192	231	272	262	235	214	**122**	41
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	192	205	213	207	185	168	**95**	33
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	192	207	218	211	189	172	**97**	33
B5. Combination of B1-B4 using one-half standard deviation shocks	192	212	228	221	198	180	**102**	35
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	192	205	213	207	185	168	**95**	33
PV of debt-to-revenue ratio								
Baseline	115	135	144	146	137	128	**91**	39
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	115	117	113	109	98	92	**87**	82
A2. New public sector loans on less favorable terms in 2015-2035 2	115	140	156	159	154	147	**120**	74
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	115	128	135	136	128	119	**84**	36
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	115	134	150	151	141	132	**94**	39
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	115	142	162	164	153	143	**101**	43
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	115	132	143	144	135	126	**89**	38
B5. Combination of B1-B4 using one-half standard deviation shocks	115	129	134	136	127	119	**84**	36
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	115	184	196	199	186	174	**122**	52

Table 3. Ethiopia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–35 (concluded)

(percent)

	Debt service-to-exports ratio							
Baseline	12	13	13	13	13	13	**14**	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	12	12	11	10	9	8	**7**	3
A2. New public sector loans on less favorable terms in 2015-2035 2	12	13	12	12	12	12	**10**	4
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	12	13	13	13	13	13	**14**	3
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	12	14	16	16	15	16	**17**	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	12	13	13	13	13	13	**14**	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	12	13	13	13	13	13	**14**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	12	14	15	14	14	14	**15**	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	12	13	13	13	13	13	**14**	3
	Debt service-to-revenue ratio							
Baseline	7	8	9	9	9	9	**13**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	7	8	7	7	6	6	**6**	3
A2. New public sector loans on less favorable terms in 2015-2035 2	7	8	8	9	9	9	**9**	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	7	8	8	9	9	9	**12**	4
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	7	8	9	9	9	10	**13**	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	7	9	10	10	10	11	**15**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	7	8	9	9	9	9	**13**	4
B5. Combination of B1-B4 using one-half standard deviation shocks	7	8	9	9	9	9	**12**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	7	12	12	13	13	13	**18**	5
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	30	30	30	30	30	30	**30**	30

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly a
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 4. Ethiopia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012–35

(percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2012	2013	2014	Average 5/	Standard Deviation 5/	2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	32.8	37.0	41.2			50.3	57.0	61.2	63.4	62.8	61.6		55.1	47.9	
of which: foreign-currency denominated	18.1	20.3	22.1			26.2	29.3	31.6	32.3	30.8	29.3		21.4	10.4	
Change in public sector debt	-5.4	4.2	4.2			9.1	6.7	4.2	2.3	-0.6	-1.2		-1.8	-0.3	
Identified debt-creating flows	-7.0	3.2	2.8			3.8	-1.7	-2.9	-3.3	-3.6	-3.6		-3.1	-3.5	
Primary deficit	3.7	5.9	7.4	4.0	2.2	8.1	3.3	2.2	2.2	2.1	2.3	3.4	2.2	2.3	2.3
Revenue and grants	17.7	18.1	17.1			18.4	17.8	18.3	18.4	18.5	18.5		17.7	17.3	
of which: grants	4.1	3.2	2.7			2.0	1.7	1.8	1.6	1.5	1.4		1.2	0.7	
Primary (noninterest) expenditure	21.4	24.0	24.5			26.4	21.1	20.5	20.6	20.6	20.7		19.9	19.6	
Automatic debt dynamics	-10.3	-2.6	-4.6			-4.3	-5.0	-5.2	-5.5	-5.7	-5.8		-5.3	-5.7	
Contribution from interest rate/growth differential	-6.4	-3.1	-4.2			-3.8	-4.8	-5.2	-5.6	-5.8	-5.9		-5.4	-5.8	
of which: contribution from average real interest rate	-3.4	-0.1	-0.8			-0.6	-1.1	-1.2	-1.3	-1.4	-1.6		-1.9	-2.8	
of which: contribution from real GDP growth	-3.1	-2.9	-3.5			-3.3	-3.8	-4.0	-4.3	-4.4	-4.4		-3.5	-3.0	
Contribution from real exchange rate depreciation	-3.9	0.5	-0.3			-0.4	-0.1	0.0	0.1	0.1	0.1		...	...	
Other identified debt-creating flows	-0.4	-0.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.4	-0.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	1.6	1.0	1.4			5.3	8.4	7.1	5.6	3.0	2.4		1.3	3.2	
Other Sustainability Indicators															
PV of public sector debt	...	...	33.8			42.9	49.4	53.4	55.7	55.2	54.2		48.6	44.0	
of which: foreign-currency denominated	...	...	14.7			18.8	21.7	23.8	24.5	23.2	21.8		15.0	6.5	
of which: external	...	...	14.7			18.8	21.7	23.8	24.5	23.2	21.8		15.0	6.5	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	5.5	8.1	9.4			10.7	6.5	5.5	5.4	5.3	5.4		5.2	2.9	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	197.7			233.7	277.6	292.4	302.2	298.4	293.0		274.5	254.9	
PV of public sector debt-to-revenue ratio (in percent)	...	...	234.2			261.7	307.4	323.9	331.3	325.6	317.8		294.5	265.4	
of which: external 3/	...	...	102.0			114.8	134.8	144.4	146.0	136.9	128.1		90.7	39.1	
Debt service-to-revenue and grants ratio (in percent) 4/	10.2	12.1	11.9			14.3	18.0	17.9	17.4	17.0	16.7		16.5	3.6	
Debt service-to-revenue ratio (in percent) 4/	13.3	14.7	14.1			16.1	19.9	19.8	19.1	18.5	18.1		17.7	3.8	
Primary deficit that stabilizes the debt-to-GDP ratio	9.1	1.7	3.2			-1.0	-3.5	-1.9	-0.1	2.7	3.5		4.0	2.6	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	8.7	9.8	10.3	10.8	1.1	8.7	8.1	7.6	7.5	7.5	7.5	7.8	6.5	6.5	6.7
Average nominal interest rate on forex debt (in percent)	1.1	1.4	1.2	0.9	0.3	2.0	2.5	2.8	2.9	2.8	2.8	2.6	2.4	1.5	2.0
Average real interest rate on domestic debt (in percent)	-20.9	1.1	-3.5	-10.3	8.2	-3.6	-5.5	-5.4	-5.6	-5.8	-6.0	-5.3	-6.4	...	-6.4
Real exchange rate depreciation (in percent, + indicates depreciation)	-18.9	2.9	-1.9	-3.5	11.0	-2.1	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	33.5	5.4	9.8	16.1	10.2	8.9	9.7	8.9	8.8	8.6	8.6	8.9	8.6	8.6	8.6
Growth of real primary spending (deflated by GDP deflator, in percent)	8.9	23.0	12.9	4.5	7.9	17.2	-13.8	4.7	8.1	7.6	8.1	5.3	6.2	5.7	6.3
Grant element of new external borrowing (in percent)	...	...	...	...	...	19.4	18.4	19.1	28.0	40.1	40.0	27.5	38.9	38.1	...

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or 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/ Revenues excluding grants.

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

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

Table 5. Ethiopia: Sensitivity Analysis for Key Indicators of Public Debt, 2015–35
(percent)

	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
PV of Debt-to-GDP Ratio								
Baseline	43	49	53	56	55	54	49	44
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	43	49	53	55	54	53	47	41
A2. Primary balance is unchanged from 2015	43	53	62	69	72	75	86	104
A3. Permanently lower GDP growth 1/	43	50	54	56	56	55	51	51
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	43	49	51	53	52	51	44	37
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	43	52	59	61	60	59	52	46
B3. Combination of B1-B2 using one half standard deviation shocks	43	50	55	56	55	53	45	37
B4. One-time 30 percent real depreciation in 2016	43	57	61	63	62	61	55	50
B5. 10 percent of GDP increase in other debt-creating flows in 2016	43	58	61	63	62	60	54	47
PV of Debt-to-Revenue Ratio 2/								
Baseline	234	278	292	302	298	293	274	255
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	234	275	291	300	296	291	270	244
A2. Primary balance is unchanged from 2015	234	300	340	373	391	405	484	604
A3. Permanently lower GDP growth 1/	234	278	294	305	303	299	289	296
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	234	273	280	287	282	274	247	214
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	234	291	323	330	324	317	294	267
B3. Combination of B1-B2 using one half standard deviation shocks	234	281	303	307	298	289	255	213
B4. One-time 30 percent real depreciation in 2016	234	323	333	340	335	329	310	288
B5. 10 percent of GDP increase in other debt-creating flows in 2016	234	325	336	340	335	327	302	273
Debt Service-to-Revenue Ratio 2/								
Baseline	14	18	18	17	17	17	17	4
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	14	18	17	19	20	21	24	20
A2. Primary balance is unchanged from 2015	14	18	20	31	34	40	52	57
A3. Permanently lower GDP growth 1/	14	18	18	18	17	17	18	9
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	14	18	17	16	15	14	13	-1
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	14	18	19	26	27	21	19	5
B3. Combination of B1-B2 using one half standard deviation shocks	14	18	18	22	24	17	13	-1
B4. One-time 30 percent real depreciation in 2016	14	20	22	22	23	23	27	10
B5. 10 percent of GDP increase in other debt-creating flows in 2016	14	18	22	41	21	27	19	6

Sources: Ethiopian authorities; and staff estimates and projections.

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

2/ Revenues are defined inclusive of grants.

Statement by Ms. Kapwepwe, Executive Director for The Federal Democratic Republic of Ethiopia, Mr. Tucker, Senior Advisor to the Executive Director, and Ms. Gasasira-Manzi, Advisor to the Executive Director
September 21, 2015

1. The Ethiopian authorities are appreciative of the constructive engagement with the Fund over recent years. They thank staff for the frank and constructive dialogue during the 2015 Article IV mission, which will help inform implementation of their macroeconomic policy and development agenda. They remain committed to pursuing prudent macroeconomic policies and further deepening their structural reform agenda in support of their Growth and Transformation Plan (GTP).

2. Consistently strong economic growth over the past decade and a broadly stable macroeconomic environment has placed Ethiopia among the top performing economies in Sub-Saharan Africa. With broad-based expansion and increased diversification of the economy, growth has been rendered increasingly inclusive and employment-generating. Poverty has reduced significantly and the income gap narrowed substantially. Implementation of the authorities' GTP is on course to deliver remarkable socio-economic gains, and the authorities are committed to mobilizing the required financing for sustainable development. The economic outlook continues to be greatly favorable, reflecting the country's huge economic potential, prudent macroeconomic management, and productivity-enhancing reforms.

Recent economic developments

3. The Ethiopian economy continues on a strong growth trajectory, supported by the successful implementation of the GTP I, over the last five years. Real growth averaged 10.1 percent between FY2010/11 – FY2013/14 on account of favorable outturns in all key economic sectors, notably industry (20.0 percent), services (10.7 percent), and agriculture (6.6 percent). The growth momentum continued in FY2014/15, with real GDP estimated to have expanded by 8.7 percent.

4. Monetary policy has been geared towards achieving single digit inflation, with the National Bank of Ethiopia (NBE) appropriately calibrating its policy instruments to achieve this objective. Accordingly, reserve money growth has been kept in line with growth in nominal GDP and well within its annual target of 20 percent. However, to address short-term liquidity challenges during FY 2014/15, the NBE certificates of deposits held by the Commercial Bank of Ethiopia, which were issued in March 2013 following the lowering by NBE of the reserve requirement ratio, were redeemed. Moreover, the NBE extended short-term credit facility to several banks against NBE-bills. Inflationary pressures, exerted mainly by the higher food prices, drove inflation to low double digits, recording 11.8 percent in July 2015. The balance of payments came under immense pressures, reflecting a widening of the current account deficit. The exchange rate depreciated against the US dollar, though it appreciated markedly in real terms.

5. Fiscal policy implementation has remained prudent, with the authorities mobilizing most of the anticipated revenues and grants during FY2014/15. Tax collection increased in real terms with the tax-to-GDP ratio estimated at 12.9 percent. Budget execution kept in pace with the realized revenues, thus containing the deficit below the authorities' target of 3 percent of GDP. To further strengthen execution, the authorities continued implementation of program-based budgeting and the rolling of the integrated financial management information system to all federal budgetary agencies.

Medium-term outlook and policies

6. The policy interventions over the medium term will be defined by the priorities set out in the authorities' second Growth and Transformation Plan (GTP II) which aims to elevate the country to middle income status by 2025. Broadly speaking, policies will focus on attaining high and sustainable economic growth, within a stable macroeconomic environment. Continued scaling up of investment in critical infrastructure, with due consideration to debt sustainability, and enhanced delivery of basic social services, coupled with increasing private sector participation, will form an integral part of the strategy. To this end, the authorities will seek to achieve an average real GDP growth rate of 11 percent and address underlying macroeconomic imbalances to support their medium-term objective.

Fiscal policy

7. Implementation of the authorities' fiscal program for FY2015/16 and over the medium term will largely focus on attaining the priorities identified in the Sustainable Development Goals (SDGs) which is a major ambition of the authorities' five-year GTP. To this end, over 70 percent of the total federal government's budget has been allocated to key priority areas, including education, agriculture, health, rural electrification and urban development. On the revenue front, the authorities will continue efforts to enhance domestic revenue mobilization through strengthening tax administration and streamlining tax policies. In this context, the Ethiopian Revenue and Customs Authority will vigorously pursue its reform program which seeks to, among other things, improve technical tax collection capacity and increase awareness against tax evasion and fraud. While mindful of the financial implications of tax incentives, which are mainly in the form of export promotion duty waivers, the authorities consider these schemes crucial to accelerating industrial growth and improving foreign exchange earnings needed for investment and development.

Debt sustainability

8. My authorities note the updated joint Debt Sustainability Analysis(DSA) undertaken by the Fund and World Bank staff which indicates that Ethiopia's risk of external debt distress has increased from 'low' to 'moderate', though external debt remains sustainable. While acknowledging the downside risks to export growth including from uncertainties related to foreign demand, the authorities disagree with staffs' overall assessment of an increased risk of external debt distress. They believe that the growth-enhancing benefits of the significant public investments primarily directed at critical infrastructure were not adequately taken into consideration. In this vein, the authorities underscore the fact that proceeds from the successful issuance of 1 billion in Eurobonds on international capital

markets will go towards developing critical infrastructure, including industrial parks, and are confident that as all these projects come on stream, the country's exports and tax revenues will be strengthened, thus eliminating any doubts about the Ethiopian government's capacity and commitment to repay its external debt. Further, the authorities reiterate their view that the inclusion of the debts of Ethio Telecom in the DSA is unwarranted given that the enterprise does not generate contingent financial liabilities on the central government. They emphasize that it continues to be profitably operated and maintains audited financial accounts in line with international standards.

Monetary and exchange rate policies

9. Monetary policy will aim at maintaining price and exchange rate stability so as to create a macroeconomic environment that is conducive to rapid and sustained economic growth. To achieve these objectives, the NBE will, over the medium term, maintain a monetary targeting regime, with reserve money target set consistent with developments in the other key sectors. The NBE remains committed to containing inflationary pressures and considers the recent spike in inflation (year-on-year) to low double digits in July 2015 as driven by seasonal factors. An appropriate mix of monetary and fiscal policies will be employed going forward to keep inflation within single digits. In addition, the NBE's direct financing of the government will be placed on a declining path over the medium term. Furthermore, the authorities are determined to ramp up efforts at managing domestic liquidity by adopting a robust liquidity forecasting and management framework and introducing indirect monetary instruments.

10. On the exchange rate, the authorities recognize the need for greater flexibility of the exchange rate, in terms of benefits as an absorber of exogenous shocks, in supporting external competitiveness, and in strengthening foreign exchange reserves. However, while sharing staff's view that the birr may be overvalued in real terms, the authorities are inclined to pursue a path of gradual depreciation given the weak export responsiveness to real effective exchange rate movements but yet pronounced pass through into inflation.

Financial sector policies

11. The NBE will continue to strengthen its financial stability monitoring tools to preserve the stability and soundness of the banking system which is assessed to be liquid, adequately capitalized and profitable. To this end, the recently-adopted risk-based supervisory framework combined with regular on-site examination will be utilized to mitigate any emerging financial risks. To mobilize savings and promote greater access to finance, the authorities will continue to build on the recent initiatives to promote financial inclusion, including development of national financial education and consumer protection strategy and implementation framework. The expansion of bank branch networks and the development of more innovative savings instruments will remain policy priorities going forward. The authorities emphasize that the current funding mechanism of the Development Bank of Ethiopia (DBE) has served the economy well by providing much-needed long-term

financial resources. Nonetheless, they undertake to continue exploring additional funding options that will further enhance the DBE's lending capacity.

Structural reforms

12. The authorities are cognizant of the fact that attaining their goal of structurally transforming the economy and delivering equitable growth would require steadfast implementation of far-reaching structural reforms. To this end, they welcome the focus of the accompanying selected issues paper on poverty reduction and the macro-social impacts of policies on income distribution. The authorities intend to give due consideration to the policy recommendations when refining their pro-poor policy interventions, which already have proven to be effective and highly successful. Additionally, they are committed to enhancing the role of the private sector in the development process by providing greater access to credit and creating a favorable business climate. Finally, addressing the underlying impediments to increased external competiveness will remain at the center of the authorities' policy strategy.

Conclusion

13. The Ethiopian authorities recognize the challenges of macroeconomic management in the midst of scaled up investments in infrastructure and social development and are committed to instituting appropriate measures to address emerging macroeconomic imbalances and mitigate potential downside risks to the growth outlook. They are determined to persevere with efforts at structurally transforming their economy through enhanced domestic resource mobilization, increased investment in infrastructure, and more broad-based, pro-poor growth. Finally, the authorities consider the Fund's policy advice and technical assistance useful as they proceed with implementation of their development agenda.