

The Federal Democratic Republic of Ethiopia: Fifth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for The Federal Democratic Republic of Ethiopia

In the context of the fifth review under the three-year arrangement under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the fifth review under the three-year arrangement under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on **November 21, 2004**, with the officials of The Federal Democratic Republic of Ethiopia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on February 4, 2004.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Press Release summarizing the **views of the Executive Board as expressed during its January 27, 2004 discussion** of the staff report that completed the review.
- a statement by the Executive Director for The Democratic Republic of Ethiopia.

The document(s) listed below have been or will be separately released.

Joint Staff Assessment of the Poverty Reduction Strategy Paper
Annual Progress Report
Poverty Reduction Strategy Paper Annual Progress Report

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

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INTERNATIONAL MONETARY FUND

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

**Fifth Review Under the Three-Year
Arrangement Under the Poverty Reduction and Growth Facility**

Prepared by the African Department

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

Approved by Anupam Basu and G. Russell Kincaid

February 4, 2004

- Discussions on the fifth review under the third annual program, supported by a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), were held in Addis Ababa during November 4-21, 2003.
- The arrangement, in an amount of SDR 86.91 million (65 percent of quota), was approved on March 22, 2001. On the occasion of the second review on March 18, 2002, this amount was augmented by SDR 13.37 million (10 percent of quota) to mitigate the impact on the balance of payments of the continued deterioration of the terms of trade and the events of September 11, 2001. At the fourth review on August 27, 2003 the arrangement was extended to July 31, 2004.
- The Ethiopian representatives included Mr. Sufian Ahmed, Minister of Finance and Economic Development; Mr. Teklewold Atnafu, Governor of the National Bank of Ethiopia; Mr. Newai Gebre-Ab, Chief Economic Advisor to the Prime Minister; other ministers in charge of economic and social affairs; and other senior government officials. The mission also met with the Prime Minister, Mr. Meles Zenawi, as well as parliamentarians and representatives of the private sector, bankers, nongovernmental organizations, and donors.
- The staff team consisted of Mr. Tahari (head), Mr. Kyei (the Fund's Resident Representative), Mr. Powell, Mr. Erasmus, and Mr. Yamauchi (all AFR), Mr. Sobolev (PDR), and Ms. Ellis (Assistant-AFR). Mr. Milton, Advisor to the Executive Director for Ethiopia, and World Bank staff participated in part of the discussions.

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EXECUTIVE SUMMARY

The economy has recently been adversely affected by the drought that severely hit Ethiopia in 2001/02 and 2002/03—the worst since 1984/85. Real GDP in 2002/03 (July-June) declined by 3.8 percent, while inflation accelerated to 15 percent from - 7.2 percent in 2001/02, mainly because of food shortages. About 13.2 million people needed food assistance during 2003, compared with about 5 million in a normal crop year. The authorities' long-term food security strategy involves raising agricultural productivity, promoting voluntary resettlement, and developing safety nets.

The program for 2003/04 projects real GDP growth of 6.7 percent, spurred by a gradual agricultural recovery. The authorities, however, now expect a much higher level of real GDP growth, given the good rains so far. Food supply conditions are expected to return to a more normal level, and consumer price inflation is projected to decline to an average of 5.5 percent in 2003/04, with core inflation remaining at about 3 percent. The external current account deficit (excluding official transfers) is expected to increase to 14 percent of GDP, reflecting exceptional imports of aircraft by Ethiopian Airlines.

All the quantitative and structural performance criteria and benchmarks through end-November 2003 were observed. The government successfully maintained control over expenditures to ensure that domestic financing of the budget was kept within the program ceiling for end-September 2003. Regarding structural measures, the authorities have adopted and commenced implementation of a satisfactory restructuring plan for the Commercial Bank of Ethiopia (CBE) (end-November 2003 structural performance criterion). Good progress has also been made with the structural measures relating to strengthening public expenditure management, including consolidation of federal and regional budgets, and reconciling fiscal and monetary accounts.

The staff assessment stresses that the challenge for the authorities is to build on recent progress, and to take advantage of the confidence boost and additional resources that should result from reaching the HIPC Initiative completion point. For sustainable and higher growth to be achieved, however, monetary and fiscal policy should remain targeted at maintaining macroeconomic stability, while structural reforms need to be accelerated and the climate for private and foreign investment enhanced. It will be particularly crucial to ensure full implementation of all elements of the CBE restructuring plan.

Future external assistance should be sought, as far as possible, on grant terms, but it will be important for a medium-term expenditure framework to be developed that ensures that additional resources are spent effectively and macroeconomic stability and debt sustainability maintained and consolidated.

I. INTRODUCTION

1. The attached letter of intent (LOI) from the Minister of Finance and Economic Development of Ethiopia and the Governor of the National Bank of Ethiopia (NBE), dated December 31, 2003 (Appendix I), reviews recent economic developments and progress made so far under the third annual program (July 8, 2003-July 7, 2004) supported by the Poverty Reduction and Growth Facility (PRGF) arrangement,¹ and sets out the policies and measures to be implemented by the government during the remainder of the program.

2. On August 27, 2003, the Executive Board concluded the fourth review and approved the third annual program under the PRGF arrangement. Executive Directors welcomed the progress that had been made in adhering to the targets of the PRGF-supported program despite the significant adverse effects of the most severe drought since 1984/85. Directors urged the authorities to complete as planned a comprehensive restructuring plan for the Commercial Bank of Ethiopia (CBE), which would restore its profitability and ensure its operation on a commercial basis. They also agreed that the pace of structural reforms would have to be accelerated for Ethiopia to achieve a sustainable and higher real GDP growth.

3. The adoption of a satisfactory restructuring plan for the CBE and the commencement of its implementation was a key performance criterion for end-November 2003 under the PRGF arrangement and was a prior action for completing the discussions on the fifth PRGF review; this condition was met.

4. The IDA Executive Board discussed a new three-year Country Assistance Strategy (CAS) for 2002/03-2004/05 on April 17, 2003. The baseline scenario under the CAS envisages disbursements of up to US\$1.5 billion over a three-year period. However, this is conditional on Ethiopia's maintaining debt at a sustainable level over the medium term. The IDA Executive Board agreed, therefore, to restrain new lending until after the completion point under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative) had been reached, in order to ensure that IDA's projected financing program remained consistent with continued debt sustainability. In the meantime, IDA has been disbursing only new grants, in addition to already committed loans. A completion point document for the HIPC Initiative will be issued shortly.

¹ Availability of the sixth disbursement (SDR 10.43 million) under the arrangement is contingent on the completion of the fifth review, including observance of the end-September 2003 performance criteria. Ethiopia's outstanding use of Fund resources amounted to SDR 105.8 million (79.2 percent of quota) on December 31, 2003. The last Article IV consultation was concluded in September 2002. The next consultation is expected to take place at the same time as the final PRGF review, before end-July 2004.

II. ECONOMIC PERFORMANCE IN 2002/03²

5. **The economy has recently been adversely affected by the drought that severely hit Ethiopia in 2001/02 and 2002/03—the worst since 1984/85.** The most recent government estimates suggest that 13.2 million people needed food assistance during 2003, compared with about 5 million in a normal crop year. Food assistance needs were estimated at 1.85 million metric tons of cereals, almost all of which was delivered by donors. Real GDP in 2002/03 declined by 3.8 percent, owing to the sharp drop in agricultural production (Table 3)³. Inflation increased to 15 percent in 2002/03, from -7.2 percent in 2001/02, mainly reflecting the food shortages. The external current account deficit (including official transfers) narrowed from 5.7 percent of GDP in 2001/02 to 4.7 percent in 2002/03 (excluding official transfers, the deficit was 12.8 percent). Large-scale food aid imports, together with higher oil prices, resulted in an increase of total imports of 14.4 percent. However, exports of goods and nonfactor services performed strongly. Coffee exports (which accounted for 34 percent of merchandise exports in 2002/03) rose slightly, as a continued fall in coffee prices was offset by volume growth following the decision to suspend the export tax on coffee. Other exports of goods (including chat, gold, and oil seeds) and nonfactor services grew particularly strongly.

6. **The fiscal outcome in 2002/03 was weaker than had been projected at the time of the fourth review of the program (Table 4).** A stronger than initially expected impact from weak economic activity toward the end of 2002/03, including the effect on business activity of power outages in the final quarter, led total tax revenue to decline as a percent of GDP from 15.3 percent in 2001/02 to 14.5 percent in 2002/03, compared with the 16 percent projected under the program. Nontax revenues were also weaker than initially projected, partly reflecting lower dividends to the government, in particular from the CBE.

7. **The government curtailed expenditures in response to lower-than-projected receipts,** while making every effort to protect poverty-targeted spending (defined as all spending on health, education, agriculture, and roads), which increased to 15.1 percent of GDP in 2002/03 from 14.6 percent in 2001/02 (Table 5). However, they were lower than programmed by 2.7 percentage points of GDP largely owing to lower than projected external disbursements. Defense outlays were cut from 5 percent of GDP in 2001/02 to 4.1 percent, lower than had been projected under the program. Spending under the special demobilization and reconstruction programs financed by the World Bank was lower than expected. Total capital outlays (excluding special programs) amounted to 11.1 percent of GDP.

² For details of performance under the second annual program, see Country Report No. 03/272 (9/11/03).

³ Cereal production declined by about 6 percent in 2001/02 and 26 percent in 2002/03.

8. **Reflecting these developments, the overall fiscal deficit (including grants and emergency programs) fell from 9.3 percent of GDP in 2001/02 to about 8.4 percent in 2002/03, similar to the level programmed.** Excluding grants, the deficit widened from 14 percent of GDP to 16.4 percent. Smaller-than-expected external loan disbursements (including on special programs), however, led to a higher level of domestic bank financing of the budget in 2002/03 than had been projected under the program.⁴

9. **Broad money increased by 10.4 percent during 2002/03,** lower than projected under the program (Table 6). Total credit to the nongovernment sector declined by 7.7 percent, while credit to the government rose by 9.8 percent because of the higher-than-expected domestic bank financing during the final quarter of the year. Despite the increased sales of government securities to the banking system, the banks' excess reserves rose from 8.1 percent of deposits at end-2001/02 to 12.8 percent by July 7, 2003, reflecting continued weak credit demand. The excess liquidity in the banking system contributed to depressed yields in the treasury bill market, and the average weighted yield for three-month bills continued to be low, at 1.48 percent as of end-June 2003. The interest rate structure for deposits and loans of commercial banks has remained within the range of 3-14 percent, and, with core inflation at 3 percent, these levels are adequate.

10. **The authorities are continuing to implement reforms aimed at strengthening the CBE and improving the soundness of the financial sector.** Recent measures include (i) adopting and implementing a directive for the provisioning by banks for nonperforming loans (NPLs) and troubled debt in line with international best practices; (ii) signing a performance contract with the CBE to ensure that the bank is operated effectively on a commercial basis; and (iii) allowing private banks to enter into management contracts with foreign institutions. The CBE is government-owned and by far the largest commercial bank in Ethiopia (79 percent of total deposits and 63 percent of total loans at end-2002/03). An independent audit of the CBE, carried out according to international standards by KPMG, and finalized in May 2003, found that at end-June 2002 NPLs amounted to Br 5.8 billion (59 percent of total loans) and that the capital adequacy ratio was 8.3 percent. It recommended that the NPLs issue be addressed, that actions be taken to restore CBE profitability, and that credit risk and portfolio management be significantly strengthened.⁵ The audited financial statements as of end-June 2003 based on International Accounting Standards indicated that NPLs had been reduced to Br 4.6 billion (54 percent of total loans and advances), while the risk-weighted capital adequacy ratio had increased to 10 percent. During 2002/03, the CBE curtailed NPLs by Br 1.2 billion through cash collection, renewal and rescheduling, foreclosures, and write-offs, while raising its capital by withholding the dividends payment to the government. To minimize the risk of new NPLs emerging, the CBE

⁴ Due to the delay in completing the fourth review, the program did not contain formal quantitative performance criteria for end-2002/03.

⁵ For more details see Box 2 and para. 27 in Country Report No. 03/272 (9/11/03).

has (a) ceased all lending to borrowers with NPLs, (b) strengthened the credit approval and monitoring process for all new loans, (c) transferred lending authority from the board of the CBE to its management, (d) created an audit committee at the board to oversee financial performance, and (e) implemented the revised foreclosure law to speed up its application and improve its effectiveness.

11. **Regarding exchange rate policy**, during 2002/03, the value of the birr fell by about 12.5 percent in nominal effective terms (Figure 2). With the consumer price index (CPI) rising steeply, the real effective exchange rate reversed its path of steady depreciation. However, as core inflation⁶ was estimated at 3 percent, this is not thought to have had an impact on export competitiveness. At end-September 2003, net foreign assets of the National Bank of Ethiopia (NBE) were estimated at US\$760 million (around 3.5 months of imports of goods and services). Gross foreign reserves were estimated at about 4.5 months of import cover.

12. In other **structural areas** of the program, continued progress has been made, with World Bank assistance, in implementing reforms focused on improving public sector management and the functioning of agricultural input markets. Several small public entities, largely in the services sector, were brought to the point of sale in 2002/03, but the sale of larger public entities has proved more difficult, and the authorities have commissioned a study to determine the factors behind the slow progress with privatization.

13. **On the political front**, the Eritrean and Ethiopian authorities are discussing with the United Nations Mission to Eritrea and Ethiopia (UNMEE) the issue of the border demarcation between the two countries. Ethiopia is unhappy with the UNMEE decision regarding the allocation, which was meant to be binding, of certain areas to Eritrea. The demarcation process was supposed to have commenced in October 2003, but has been postponed.

III. REPORT ON DISCUSSIONS

14. **Discussions on the fifth review of the PRGF-supported program were conducted in the context of the strategy outlined in the authorities' full poverty reduction strategy paper (PRSP) and the first PRSP annual progress report**, thereby ensuring continued alignment of the PRGF and the PRSP. The discussions focused on (i) reviewing program implementation, especially with regard to the restructuring of the CBE; (ii) updating the macroeconomic framework; and (iii) establishing quantitative and structural performance criteria and benchmarks for the period through end-July 2004.

15. **The program for 2003/04 continues to project real GDP growth of 6.7 percent**, spurred by a gradual agricultural recovery following a two-year decline caused by the

⁶ Defined as consumer price inflation, excluding cereals and pulses.

prolonged drought. The authorities, however, indicated during the discussions that they now expected a much higher level of real GDP growth, given the good rains so far. Food supply conditions are expected to return to a more normal level, and consumer price inflation is projected to decline to an average of 5.5 percent in 2003/04, with core inflation remaining at about 3 percent. The government is developing a plan to guarantee a minimum price for maize, wheat, and sorghum by purchasing excess supply through the Ethiopian Grain Trade Enterprise (EGTE) if a strong harvest causes food prices to decline too sharply. The aim is to mitigate any negative impact on poor farmers. The authorities are still working on the details of the scheme but have assured the staff that they will put in place appropriate safeguards to limit potential costs of the envisaged scheme, and to avoid any direct budgetary costs. They indicated that the operation will be implemented by the EGTE, which will use its own resources and credit from the banking system. The EGTE will purchase cereals when prices decline and will sell them back to the market when shortfalls emerge. The staff cautioned the authorities against institutionalizing the scheme and urged that the underlying causes be addressed by improving performance in the agriculture sector and tackling market fragmentation.

A. Performance Through November 2003

16. **All the quantitative performance criteria under the third annual program through end-September 2003 were observed (Appendix I, Table 1).** Preliminary data indicate that, during the first quarter of 2003/04, total government revenue was higher by about 6 percent than during the first quarter of 2002/03, but slightly less than had been projected under the program. Direct taxes and domestic indirect taxes were higher by about 21 percent, compared with the first quarter of 2002/03, reflecting in part the successful introduction of the value-added tax (VAT) in January 2003. Import duties and taxes, however, were lower by 8 percent. Preliminary data indicate that, during the first quarter of 2003/04, capital spending financed by external loans and central treasury resources was lower than projected by about Br 0.7 billion, resulting in a smaller fiscal deficit than assumed under the program. Net bank credit to the government at end-September 2003 was within the program ceiling.

17. **The two end-November 2003 structural performance criteria were also observed (Appendix I, Table 2).** Consolidated federal and regional budgets for 2002/03 and 2003/04 were prepared during November 2003, including all the extrabudgetary funds and accounts. Progress has also been made with other agreed elements of the program. Understandings were reached on the restructuring plan of the CBE, which was finalized and adopted on November 28, 2003, in line with the agreed main features of reform outlined in the memorandum of economic and financial policies of July 2003, and taking into account recommendations made by a parallel joint IMF/World Bank technical assistance mission.⁷ The authorities started implementing the plan, and, as a prior action, they instituted on

⁷ See paras. 21-22 of the LOI (Appendix I).

January 1, 2004 a policy to limit the renewal or restructuring of any delinquent loan to two iterations.

B. Policies for the Remainder of 2003/04

Fiscal policy

18. **In the updated fiscal framework for 2003/04, the budget deficit (including grants) is projected at 7.1 percent of GDP**, about the same as in the original framework for the third year arrangement (EBS/03/109), and recourse to bank financing is maintained at the programmed level of Br 1 billion. Total revenue is projected at 19.5 percent of GDP, or 4.6 percent lower than the level in the original framework, largely because of lower projections for both tax and nontax revenues, reflecting the lingering impact of the drought. The lower revenue projection is fully offset, however, by lower defense spending. The authorities believe that the revised revenue target is achievable, in view of the expected strong rebound in economic activity this year following two years of drought, and the fact that revenue performance in the first quarter was in line with the annual target.⁸ They have also indicated that if revenues fall short of projections they will make compensating spending cuts.

19. **The measures being implemented are also expected to contribute to the achievement of the projected revenues.** The measures include efforts to collect tax arrears and implementation of the tax reform program, in particular by introducing the new computer system (including in the large-taxpayer office (LTO)), ensuring that the taxpayer identification number is implemented with priority for VAT payers,⁹ implementing self-assessment procedures, dedicating additional resources to collection enforcement and audit, and strengthening customs administration. The full computerization of VAT operations is now expected in early 2004. A preliminary poverty and social impact analysis of the introduction of the VAT, undertaken by the Fiscal Affairs Department (FAD), concluded that this reform had not had a major adverse impact on the poor. The VAT is progressive in its incidence, and the higher revenues brought about can provide additional funds for poverty-reducing spending (Box 1).

20. **Regarding expenditures**, poverty-targeted expenditure is to increase to 17.6 percent of GDP in 2003/04 from 15.1 percent in the previous year, and the government is committed to reducing defense outlays to 3.7 percent of GDP and containing the wage bill at 7.8 percent

⁸ Initially the authorities took the position that the original program target should be maintained.

⁹ With regard to integrating the VAT operations into the LTO, the staff has urged that this be done as soon as possible, although the authorities have indicated that they would rather wait until the LTO has been strengthened further.

of GDP. Externally financed capital spending projections under the program are based only on existing loan commitments from the World Bank. Regarding future disbursements from the World Bank, in line with the Country Assistance Strategy (CAS), at this stage the authorities have included in the budget only grants shown in IDA's CAS for 2003/04, in addition to disbursements from previously committed IDA loans. Following the completion point, any additional secured commitment of IDA loans will be added in a supplementary budget, provided that disbursements will be spent efficiently on poverty-related sectors and will not jeopardize debt sustainability. The authorities have also revised down their estimate of expected project grants during 2003/04, and thus total capital outlays are projected to increase to 13 percent of GDP.

Box 1. Poverty and Social Impact Analysis of the Introduction of the Value-Added Tax

The Fiscal Affairs Department carried out an assessment of the poverty and social impact of replacing the sales tax in Ethiopia with a value-added tax (VAT).¹ The analysis shows that the VAT is progressive when total expenditure is analyzed at the national level. However, because it has fewer exemptions and only one rate, and most of the exempt goods and services are consumed by wealthier households, the VAT is less progressive than the sales tax it replaced.

The progressivity of the VAT comes mainly from the high ratio of in-kind transactions for poorer households, but this share is expected to decrease as the economy moves into a stable growth track and becomes more market based. Therefore, the VAT in Ethiopia is likely to become less progressive in the future. Moreover, the VAT is regressive or at most neutral in urban areas. Considering the growing urbanization in Ethiopia and the fact that most urban immigrants are poor people, this could have significant consequences for the poor. Thus, the authorities should look for ways to adjust the VAT that would both yield sufficient revenue and increase its progressivity. This may require a restructuring of the VAT exemptions.

The replacement of the sales tax with the VAT has thus had an adverse impact on the poorest 40 percent of the population. However, the impact is very small (about 1 percent of their consumption). Thus, this reform has not had a major adverse effect on the poor when one takes account of the higher expenditures on poverty-reducing activities that can be financed out of these revenues. Estimates show that, if the additional revenues from the VAT were allocated for higher spending on primary education and health, the poorest 40 percent of the population would be net beneficiaries.

¹ WP/03/232.

21. **The authorities will continue to strengthen their budget management processes.** Following the preparation of the consolidated federal and regional budgets for both the past budget year and the current budget year—including all extrabudgetary funds and accounts—they also recognize the importance of preparing consolidated outturns for the fiscal accounts on a continuing basis. The reconciliation of the monetary and fiscal accounts for 2002/03 was completed during December 2003. In order to facilitate the consolidation of the federal and regional budgets for 2004/05 prior to the start of the fiscal year, the government intends to notify the regions of the regional transfer for 2004/05 by end-February 2004. Efforts are continuing, moreover, to improve the effectiveness, reporting, and monitoring of local

governments' expenditures, and to address outstanding issues related to the decentralization of fiscal powers outlined by recent FAD technical assistance missions.^{10 11}

Monetary and financial sector issues¹⁴

22. The monetary program for 2003/04 has been updated to reflect the 2002/03 outcome while maintaining the inflation and international reserves targets under the program. In order to achieve these targets while providing room for an adequate increase in credit to the nongovernment sector, the government will continue to limit its borrowing from the banking sector to Br 1 billion, as initially programmed. The money supply is projected to rise by 13.4 percent in 2003/04, slightly higher than nominal GDP. All interest rates remain market determined, with the exception of the minimum saving deposit rate, set at 3 percent. The exchange rate will continue to be market determined and the effectiveness of the interbank foreign exchange market will continue to be strengthened.

23. The authorities will continue to implement reforms aimed at strengthening the financial sector.¹⁵ In addition to the restructuring of the CBE, other measures include (i) full provisioning by banks for NPLs and other doubtful assets, in line with international best practices, by January 2004; (ii) the offering to the public for sale the shares of the Construction and Business Bank (CBB) by February 2004; and (iii) implementation of a restructuring of the NBE, based on the finalized comprehensive study of it, including as necessary, revising the Banking Act to increase the NBE's autonomy.¹⁶ Regarding measures

¹⁰ These include ensuring that (i) regional institutions' budget laws and regulations contain clear delineations of expenditure and revenue assignments; (ii) fiscal reporting from *woredas* (districts) is adequate, with the cost of decentralization and of the *woredas*' new employment structure identified; and (iii) the transparent responsibilities for capital and poverty-reducing spending at regional and *woreda* level are clearly delineated.

¹¹ An IMF/World Bank mission to reassess the HIPC Initiative expenditure tracking and action plan is scheduled for March 2004.

¹⁴ A more detailed description of the authorities' reform strategy for the financial system is provided in Country Report No. 03/272 (9/11/03), paras. 26-28.

¹⁵ See para. 20 of the LOI (Appendix I).

¹⁶ The NBE study was finalized at end-December 2003 and the authorities indicated that they have started its implementation.

to strengthen competition in the banking sector, the authorities have indicated that they will continue their efforts to enhance efficiency and competition in the financial sector, in order to lay the groundwork for progressive integration of the Ethiopian financial sector into the global financial market. However, the authorities reiterated their position that they are not ready now to take measures to allow entry of foreign banks into the financial sector, and that priority should be given to strengthening the financial sector and enhancing the supervisory capacity of the central bank.

24. **The authorities have agreed to implement all of the recommendations made in the safeguards assessment of the NBE**, including publication of the full financial statements in the annual report and establishing procedures to implement external and internal audit recommendations.

External sector and balance of payments outlook

25. **The balance of payments projections for 2003/04-2005/6 have been updated**, taking into account the most recent revisions to the World Economic Outlook (WEO), the latest available information on coffee exports, and food relief. Reflecting the projected decline in private transfers (due to the improved food security situation) and exceptional imports of aircraft by Ethiopian Airlines (EAL), the current account deficit, excluding official transfers, is projected to deteriorate slightly from 12.8 percent to 14.0 percent of GDP in 2003/04 (Table 7).¹⁷ Exports are projected to grow by 7.3 percent, driven almost equally by a continued expansion of noncoffee exports and a modest recovery in commodity prices. Imports (excluding aircraft purchases by EAL) are projected to increase by 4.3 percent in value terms as higher nonfood imports are partially offset by lower food-aid requirements. Reflecting smaller official transfers, the projected increase in the external current account deficit (including official transfers) would be more pronounced—from 4.7 percent to 7.9 percent of GDP for 2003/04. The current account deficit is expected to be fully covered by project loan disbursements, balance of payments support from the African Development Bank (AfDB) and IDA, aid for special programs, and assistance under the enhanced HIPC Initiative. Such external financial assistance should allow a further accumulation in international reserves to the equivalent of 4.6 months of imports.

¹⁷ As part of the fleet expansion program, EAL will lease 12 new planes over the next three years. The planes will be delivered in three tranches, in November 2003, July 2004, and July 2005, and will be financed by a \$350 million commercial loan, to be repaid over 12 years. Long-term financing operations of EAL will not be guaranteed by the government or financed by government borrowing. As in all Fund-supported programs since the early 1980s long-term financing operations of EAL are excluded from the program limit on new non-concessional external debt, on the grounds that EAL is a profitably run autonomous entity.

26. **Over the medium term, the current account deficit (including official transfers) is expected to narrow to 6.2 percent of GDP by 2005/06** as a result of the continued growth of both nontraditional and traditional exports. At the same time, the growth of total imports is expected to slow, reflecting lower food aid requirements. Sustained concessional lending, together with debt relief under the HIPC Initiative, will allow the maintenance of foreign exchange reserves at around 4.8 months of imports.

27. **The bilateral agreements following the Paris Club meetings in 2001 and 2002 have been signed with all but one of Ethiopia's Paris Club creditors.** The final agreement is expected to be signed shortly. Agreements have been signed with 2 non-Paris Club creditors and the authorities are awaiting a response from a number of others. The staff has encouraged the authorities to seek rescheduling of debt owed to all non-Paris Club creditors on terms at least comparable to those given by the Paris Club and consistent with the requirements of the HIPC Initiative. The staff has also urged the authorities to formulate and implement a comprehensive debt-management strategy that covers both domestic and external debt.

28. **A Diagnostic Trade Integration Study (DTIS) was undertaken by the government and donors during 2003** that analyzed the institutional framework for international trade and constraints on Ethiopia's integration into the global economy. The DTIS identified various constraints and opportunities in four key sectors to strengthen Ethiopia's participation in international trade: agriculture, livestock and meat, manufacturing, and tourism. The government remains committed to moving forward with trade policy recommendations identified in the DTIS.

Other structural reforms

29. **Progress is being made in implementing, with the assistance of the World Bank, a number of structural reforms to improve economic performance and reduce poverty (Box 2).** Structural reforms are also aimed at promoting growth in urban and rural areas, including improving the investment climate, infrastructure provisioning, the efficiency of institutions supporting private sector development, and the efficiency of domestic input and output markets, as well as at supporting public sector capacity-building efforts.

30. **In response to pervasive food insecurity, the authorities also developed a comprehensive food security strategy, which was discussed with donors during December 1-2, 2003.** The strategy, which has been introduced as a major new pillar of the Sustainable Development and Poverty Reduction Program (SDPRP), addresses food security and output volatility through a combination of increased agricultural productivity, voluntary resettlement, and the development of safety nets.¹⁸ With regard to financing this strategy, the

¹⁸ Details of the food security strategy are provided in the annual progress report (APR) Section 7.1, pp. 60-63, Country Report No. 04/37 (2/12/04).

authorities indicated that domestic resources would cover about 40 percent of the cost (US\$3 billion), and that for the remainder the government was counting on donor support. The staff has stressed the importance of integrating the food security program into a broader economic policy framework that would be consistent with maintaining macroeconomic stability. The staff has also encouraged donors to provide their support in terms of grants, and to make their commitments predictable and forward looking, because uncertainty in this regard would compound the uncertainty already inherent in drought situations.

Box 2. Structural Conditionality

Structural conditionality under the second annual program was summarized in Box 6 of EBS/03/109. Conditionality under the third annual program relates to (a) **restructuring the financial sector, in particular the Commercial Bank of Ethiopia (CBE)**; (b) **improving public expenditure management**, and (c) **enhancing the safeguards of the National Bank of Ethiopia (NBE)**. Structural conditionalities related to the CBE include (i) completing an audit by a reputable international audit firm; (ii) hiring a reputable international management consultant (both prior actions; done), and (iii) finalization and adoption of a financial restructuring plan (performance criterion; end-November 2003, done). An NBE directive requiring full provisioning by all commercial banks for nonperforming loans became fully effective in January 2004 (structural benchmark). On improving public expenditure management, two structural conditionalities, originally envisaged under the previous annual program, are included: consolidation of federal and regional budgets (performance criterion; end-November 2003, done) and reconciliation of monetary and fiscal accounts (structural benchmark; end-December 2003, done). Finalization and commencing implementation of a restructuring plan for the NBE (structural benchmark; end-December 2003) is designed to enhance the safeguards of the central bank.

Structural reforms supported by the World Bank

The World Bank supported Ethiopia's reform efforts through an **Economic Structural Adjustment Credit** approved in June 2002. Its conditionality concentrated in the following areas:

- private sector development and export competitiveness, including the approval by the Council of Ministers of a draft trade practice proclamation, a draft federal urban land lease proclamation, and a draft revised investment code; the adoption of a directive regulating shipping services, and of a directive regulating the implementation of the bonded manufacturing warehouse scheme; and the preparation of studies on markets for rawhides and skin, and on coffee marketing;
- civil service reform, including approval of the civil service grievance system and procedures by the Council of Ministers, the completion of a diagnostic survey of job classification and grading, and the launch of a labor market survey on wage differentials between private and public sector jobs; and
- public expenditure management and services delivery, including the closure and consolidation of federal and regional accounts up to 1998/99 and the initiation of financial audits for 1998/99, and the automation of 50 percent of all personnel records at the federal level, with an action plan for the reconciliation with payroll data.

In line with the **Country Assistance Strategy (CAS)** discussed by the Executive Board of the World Bank in April 2003, the World Bank will continue and strengthen its supports to Ethiopia's structural reform efforts. A major assistance vehicle envisaged in the CAS is the **Poverty Reduction Support Credit (PRSC)**. The PRSC will support reforms promoting growth in urban and rural areas, will support the development of social safety nets to reduce vulnerability, and will continue to support public expenditure management reforms initiated under the ESAC. Under the growth component, PRSC will support reforms to improve the investment climate, financial sector performance, better infrastructure provision, more efficient institutions supporting private sector development, and more efficient domestic input and output markets. In addition to PRSC, the **Public Sector Capacity Building Project (PSCAP)**, also under preparation, will support public sector capacity-building efforts to strengthen decentralized service delivery.

Statistical Issues

31. **The authorities have made good progress with the implementation of a number of initiatives aimed at improving the quality of macroeconomic data and timeliness of dissemination.** In addition to reconciling monetary and fiscal accounts for 2002/03¹⁹ and consolidating of federal and regional budgets, as noted above, the authorities are, in conjunction with technical assistance from the East Africa Regional Technical Assistance Center (AFRITAC), working to improve the compilation of real sector data and the balance of payments. Efforts to improve data on poverty and social indicators are also being undertaken with support from the World Bank.

IV. STAFF APPRAISAL

32. **Performance so far under the third annual PRGF-supported program has been satisfactory,** despite the negative impact on the economy of the worst drought since 1984/85.

33. **All the quantitative (through end-September 2003) and structural performance criteria and benchmarks (through January 2004), as well as the prior action on CBE, were observed.** The government successfully maintained control over expenditures to ensure that domestic financing of the budget was kept within the program ceiling for end-September 2003. However, the higher than programmed domestic borrowing requirement during the final quarter of 2002/03 highlights the need to base expenditure plans on conservative assumptions for external financing. Regarding structural measures, the authorities have adopted and commenced implementation of a restructuring plan for the CBE, and good progress has also been made with the structural measures aimed at strengthening public expenditure management.

34. **The challenge for the authorities is to build on recent progress, and to take advantage of the confidence boost and additional resources that should result from reaching the HIPC Initiative completion point.** For sustainable and higher growth to be achieved, however, monetary policy should remain targeted on maintaining macroeconomic stability supported by a prudent fiscal policy, while structural reforms need to be accelerated and the climate for private and foreign investment enhanced.

35. **Fiscal policy should continue to focus on enhancing revenues, strengthening public expenditure management, and reorienting spending programs towards poverty-related activities.** As far as possible additional financing should be sought on grant terms,

¹⁹ The benchmark on reconciling monetary and fiscal accounts by end-December 2003 was met.

but it will be important for a medium-term expenditure framework to be developed that ensures that additional resources are spent effectively, and that macroeconomic stability and debt sustainability are consolidated and maintained following the HIPC Initiative completion point. This requires the development of a comprehensive and prudent external and domestic debt strategy.

36. **Monetary policy should continue to aim at achieving the inflation and international reserves targets under the program.** Government borrowing from the banking sector during 2003/04 should be limited to the programmed level. If revenues start to fall short of projected levels, compensating spending cuts will need to be made. Interest rates and the exchange rate should continue to be market determined, and excess reserves of the commercial banks should be sterilized. The staff welcomes the authorities' commitment to implement all the recommendations of the safeguards assessment of the NBE and encourages them to expedite these measures.

37. **Regarding the financial sector and other structural reforms, it is welcome that the authorities have adopted a satisfactory restructuring plan for the Commercial Bank of Ethiopia,** but it will be crucial to ensure full implementation of all the elements of the plan. Other financial sector measures under the program aimed at strengthening the sector and improving competition, should also be vigorously pursued. Furthermore, it remains essential to persevere with implementation of all other elements of the structural reform agenda, including privatization, the strengthening of the legal and regulatory framework, capacity building, export promotion, and support for private sector development.

38. **The staff welcomes the food security strategy,** which addresses food security through a combination of increased agricultural productivity, voluntary resettlement, and safety nets. It will be important to develop further the details of the proposed measures and ensure that its costs are incorporated within the annual budgeting process, as well as incorporating the food security program into a broader economic policy framework consistent with macroeconomic stability. Regarding the plan to guarantee a minimum price for maize, wheat, and sorghum, the authorities are still working on the details of the scheme but have indicated that they will avoid any direct budgetary cost. Moreover, the staff urge the authorities not to institutionalize the scheme, and to address the underlying causes of price volatility by improving performance in the agriculture sector and tackling market fragmentation.

39. In view of the satisfactory implementation of the program, the staff recommends that the present review under the PRGF arrangement be completed.

Figure 1. Ethiopia: Selected Economic Indicators, 1999/2000-2005/06 1/

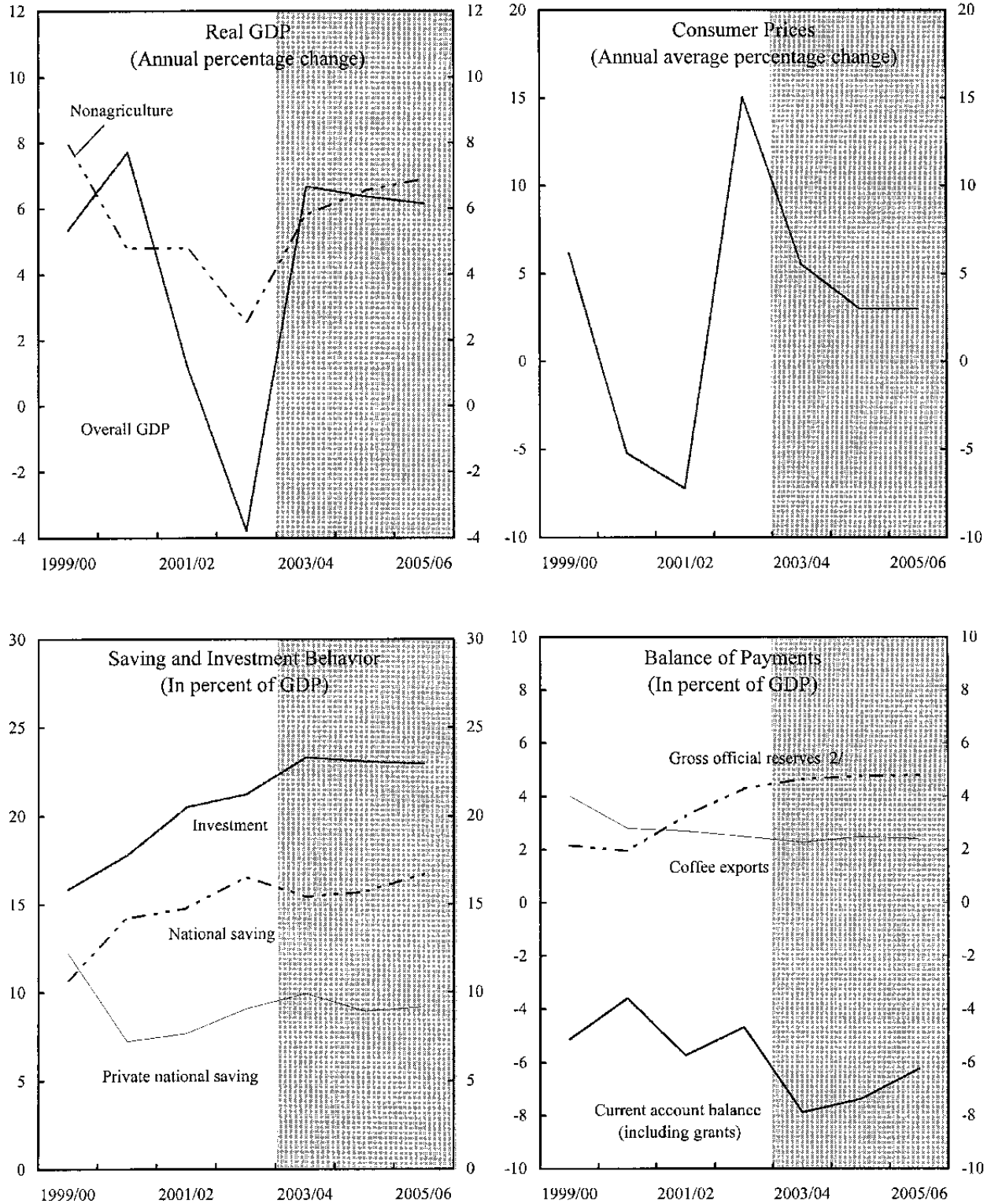
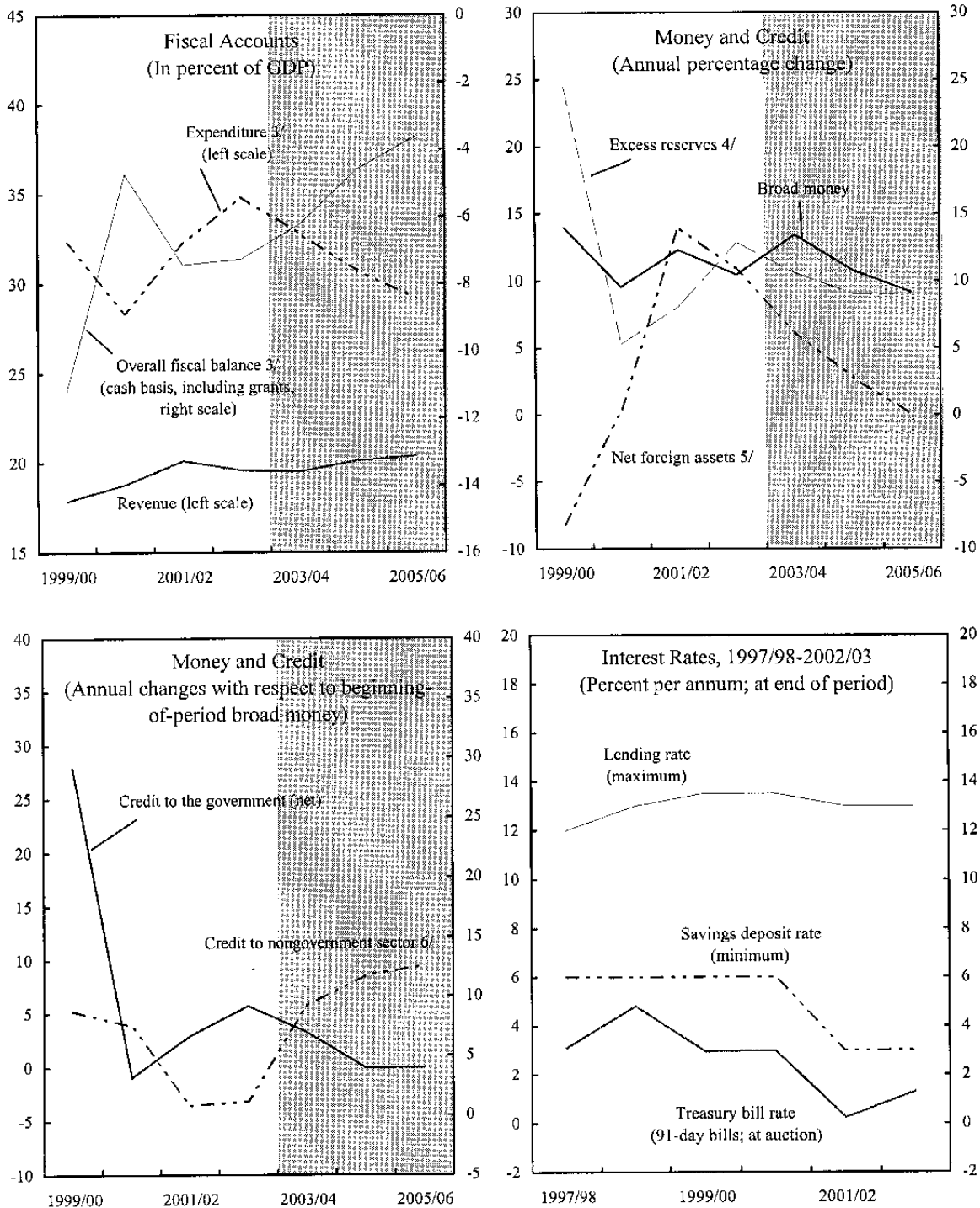


Figure 1. Ethiopia: Selected Economic Indicators, 1999/2000-2005/06 1/ (concluded)



Sources: Ethiopian authorities; and staff estimates and projections.

1/ All data pertain to the period July 8-July 7. Shaded area indicates program period.

2/ In months of imports of goods and nonfactor services of the following year.

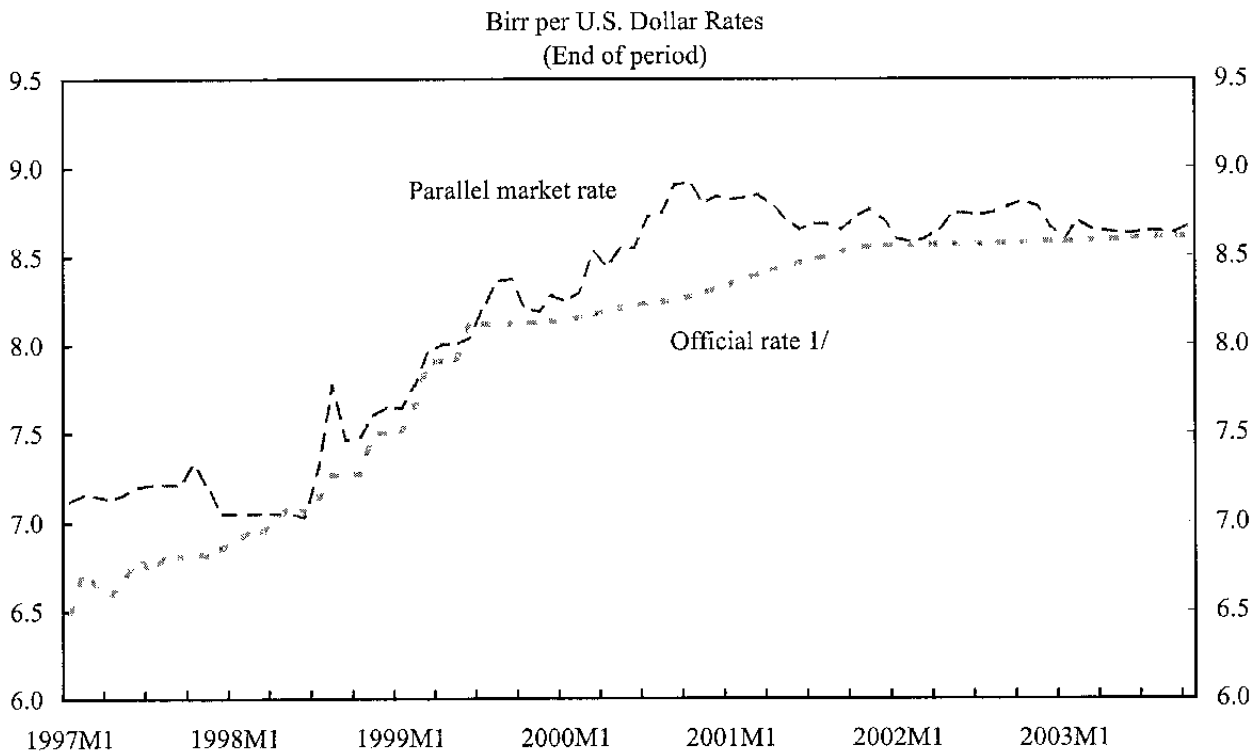
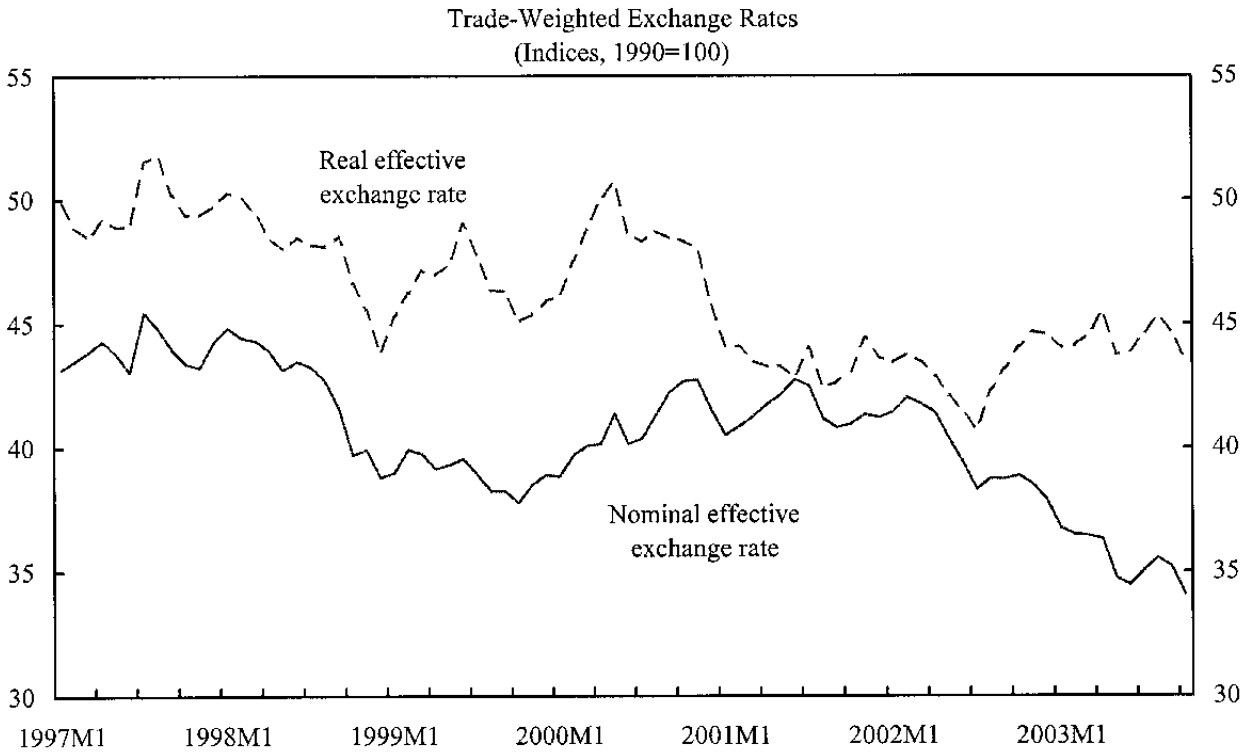
3/ Excluding special programs.

4/ In percent of deposits.

5/ Change in percent of beginning-of-period broad money.

6/ Includes credit to public enterprises and the private sector.

Figure 2. Ethiopia: Exchange Rate Developments, January 1997-October 2003



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

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

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

| | Position on December 31, 2003 | 2004 | | 2005 | |
|--|----------------------------------|-----------|-----------|-----------|-----------|
| | | Jan.-June | July-Dec. | Jan.-June | July-Dec. |
| (In millions of SDRs) | | | | | |
| Net use of Fund resources | | | | | |
| Repayments | ... | 4.4 | 4.4 | 2.9 | 2.9 |
| Projected disbursements | ... | 20.8 | 0.0 | 0.0 | 0.0 |
| Fund resources outstanding (end of period) | 105.8 | 122.2 | 117.8 | 114.9 | 112.0 |
| (In percent of quota) 1/ | | | | | |
| Net use of Fund resources | | | | | |
| Repayments | ... | 3.3 | 3.3 | 2.2 | 2.2 |
| Projected disbursements | ... | 15.6 | 0.0 | 0.0 | 0.0 |
| Fund resources outstanding (end of period) | 79.2 | 91.4 | 88.1 | 85.9 | 83.8 |

Source: Fund staff calculations and projections.

1/ Quota of SDR 133.7 million.

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

| | Amount | | Availability | Conditions Include: |
|-------|------------|------------------|-------------------|--|
| | SDRs | Percent of quota | | |
| | 10,429,000 | 7.8 | February 25, 2004 | Completion of fifth review and observance of performance criteria through end-November 2003. |
| | 10,429,000 | 7.8 | July 15, 2004 | Completion of sixth review and observance of performance criteria through end-June 2004. |
| Total | 20,858,000 | 15.6 | | |

Table 3. Ethiopia: Selected Economic and Financial Indicators, 2000/01-2005/06 1/

| | 2000/01 | 2001/02 | 2002/03 | | 2003/04 | | 2004/05 | | 2005/06 | |
|---|---------|---------|------------|-----------|------------|------------|------------|------------|------------|------------|
| | | | EBS/03/109 | Rev. Est. | EBS/03/109 | Rev. Prog. | EBS/03/109 | Rev. Proj. | EBS/03/109 | Rev. Proj. |
| (Annual percentage change) | | | | | | | | | | |
| National income and prices | | | | | | | | | | |
| GDP at constant prices (at factor cost) | 7.7 | 1.2 | -3.8 | -3.8 | 6.7 | 6.7 | 6.4 | 6.4 | 6.1 | 6.1 |
| GDP deflator | -6.3 | -6.3 | 13.3 | 14.5 | 5.2 | 5.2 | 3.4 | 3.7 | 3.2 | 3.2 |
| Consumer prices (period average) | -5.2 | -7.2 | 14.6 | 15.1 | 5.5 | 5.5 | 3.0 | 3.0 | 3.0 | 3.0 |
| External sector | | | | | | | | | | |
| Exports, f.o.b. | -4.8 | -2.2 | 8.6 | 6.7 | 9.8 | 7.3 | 10.3 | 11.5 | 8.9 | 9.5 |
| Imports, c.i.f. | -3.4 | 8.9 | 16.5 | 14.4 | 6.4 | 9.3 | 1.4 | 1.8 | 1.5 | 1.3 |
| Export volume | 0.3 | 11.1 | 7.8 | 10.1 | 7.7 | 3.8 | 7.5 | 7.1 | 7.3 | 7.8 |
| Import volume | -1.8 | 9.8 | 12.6 | 7.0 | 2.1 | 2.9 | 1.7 | 1.7 | 1.4 | 1.4 |
| Terms of trade (deterioration -) | -3.6 | -11.1 | -2.7 | -9.4 | -2.2 | -2.6 | 3.0 | 4.2 | 1.3 | 1.6 |
| Nominal effective exchange rate (end of period) | 6.5 | -7.8 | -7.5 | -12.5 | ... | ... | ... | ... | ... | ... |
| Real effective exchange rate (end of period) | -12.0 | -3.3 | 9.0 | 5.9 | ... | ... | ... | ... | ... | ... |
| (In percent of beginning-period stock of broad money, unless otherwise indicated) | | | | | | | | | | |
| Money and credit | | | | | | | | | | |
| Net foreign assets | 0.3 | 14.0 | 8.5 | 10.8 | 5.9 | 6.2 | 2.8 | 2.7 | 0.4 | 0.0 |
| Net domestic assets | 9.2 | -1.7 | 2.8 | -0.4 | 7.5 | 7.2 | 8.1 | 8.0 | 9.1 | 9.1 |
| Net claims on the government | -0.9 | 2.9 | 1.8 | 5.7 | 3.3 | 3.3 | 0.0 | 0.0 | 0.0 | 0.0 |
| Credit to the nongovernment sector | 3.8 | -3.5 | 2.0 | -3.2 | 5.8 | 5.8 | 8.6 | 8.6 | 9.5 | 9.5 |
| Broad money | 9.5 | 12.3 | 11.3 | 10.4 | 13.4 | 13.4 | 10.9 | 10.7 | 9.5 | 9.2 |
| Velocity (GDP/broad money) | 2.2 | 1.9 | 1.8 | 1.9 | 1.8 | 1.9 | 1.8 | 1.9 | 1.8 | 1.9 |
| Interest rates (in percent at end of period) | | | | | | | | | | |
| Savings deposits (minimum rate) | 6.0 | 3.0 | 3.0 | 3.0 | ... | ... | ... | ... | ... | ... |
| Lending rates (maximum rate) | 13.5 | 13.0 | 13.0 | 13.0 | ... | ... | ... | ... | ... | ... |
| Treasury bill (91-day maturity) | 3.0 | 0.2 | 2.0 | 1.3 | ... | ... | ... | ... | ... | ... |
| (In percent of GDP, unless otherwise indicated) | | | | | | | | | | |
| Financial balances | | | | | | | | | | |
| Gross domestic saving | 3.1 | 2.5 | 0.5 | 1.8 | 3.5 | 3.8 | 4.8 | 5.4 | 6.8 | 7.1 |
| Government saving | 2.0 | 0.8 | 0.9 | 0.4 | 0.3 | 0.5 | 2.8 | 2.7 | 4.3 | 4.1 |
| Private saving | 1.1 | 1.7 | -0.4 | 1.4 | 3.2 | 3.3 | 1.9 | 2.6 | 2.5 | 3.0 |
| Gross domestic investment | 17.8 | 20.5 | 21.2 | 21.2 | 23.3 | 23.3 | 22.6 | 23.1 | 22.7 | 22.9 |
| Government investment | 8.5 | 11.5 | 11.5 | 10.5 | 13.5 | 11.9 | 11.7 | 11.6 | 11.1 | 11.0 |
| Private investment | 9.3 | 9.0 | 9.6 | 10.7 | 9.8 | 11.4 | 10.9 | 11.5 | 11.6 | 11.9 |
| Resource gap | -14.7 | -18.0 | -20.6 | -19.4 | -19.8 | -19.5 | -17.9 | -17.7 | -15.9 | -15.8 |
| External current account balance, including official transfers | -3.6 | -5.7 | -6.1 | -4.7 | -8.3 | -7.9 | -7.6 | -7.4 | -6.3 | -6.2 |
| Saving-investment (government) | -1.5 | -4.4 | -2.6 | -3.0 | -8.1 | -6.4 | -4.6 | -4.8 | -3.1 | -3.5 |
| Saving-investment (private) | -2.0 | -1.3 | -3.5 | -1.7 | -0.3 | -1.5 | -3.0 | -2.5 | -3.2 | -2.8 |
| External current account balance, excluding official transfers | -9.7 | -12.9 | -15.2 | -12.8 | -14.4 | -14.0 | -12.8 | -12.4 | -10.7 | -10.6 |
| Government finances | | | | | | | | | | |
| Revenue | 18.8 | 20.1 | 21.7 | 19.6 | 20.8 | 19.5 | 21.4 | 20.1 | 21.6 | 20.4 |
| Tax revenue | 13.7 | 15.3 | 16.0 | 14.5 | 16.5 | 15.5 | 17.3 | 16.2 | 17.6 | 16.6 |
| Nontax revenue | 5.0 | 4.8 | 5.7 | 5.1 | 4.3 | 4.1 | 4.1 | 3.9 | 3.9 | 3.8 |
| External grants | 4.8 | 4.7 | 8.8 | 8.0 | 8.5 | 7.1 | 6.2 | 6.0 | 5.0 | 5.2 |
| Expenditure and net lending 2/ | 28.4 | 32.2 | 37.5 | 34.8 | 35.7 | 32.8 | 32.3 | 30.7 | 30.5 | 29.2 |
| Fiscal balance, excluding grants (cash basis) 2/ | -9.6 | -12.1 | -15.8 | -15.3 | -14.9 | -13.3 | -10.9 | -10.6 | -8.9 | -8.8 |
| Fiscal balance, including grants (cash basis) 2/ | -4.8 | -7.4 | -7.0 | -7.3 | -6.5 | -6.2 | -4.7 | -4.6 | -3.9 | -3.6 |
| Special programs 3/ | 0.7 | 1.9 | 1.5 | 1.1 | 1.0 | 0.8 | 0.6 | 1.1 | 0.0 | 0.3 |
| Fiscal balance, including grants and special programs | -5.5 | -9.3 | -8.5 | -8.4 | -7.5 | -7.1 | -5.3 | -5.6 | -3.9 | -3.9 |
| Total financing | 5.5 | 9.3 | 8.5 | 8.4 | 7.5 | 7.1 | 5.3 | 5.6 | 3.9 | 3.9 |
| External financing | 3.8 | 9.5 | 7.6 | 6.8 | 5.5 | 5.1 | 4.7 | 5.1 | 3.4 | 3.3 |
| Domestic financing (including residual) | 0.9 | -0.3 | 0.9 | 1.6 | 1.8 | 1.8 | 0.4 | 0.4 | 0.4 | 0.4 |
| Privatization receipts | 0.7 | 0.1 | 0.0 | 0.0 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 |
| Domestic debt 4/ | 37.4 | 39.8 | 37.5 | 39.1 | 35.2 | 36.4 | 32.4 | 33.3 | 29.8 | 30.7 |
| External debt (including to Fund) | 86.3 | 109.8 | 98.7 | 98.7 | 91.9 | 94.3 | 86.8 | 92.5 | 81.0 | 89.5 |
| Net present value (NPV) of external debt-to-exports ratio (including to Fund) 5/ | 169.6 | 183.7 | 191.6 | 239.7 | 203.4 | 246.1 | 210.5 | 244.4 | 210.0 | 246.9 |
| NPV of external debt-to-revenue ratio (including to Fund) 6/ | 133.3 | 148.1 | 145.2 | 190.7 | 155.9 | 188.1 | 155.7 | 184.7 | 151.0 | 181.5 |
| External debt-service ratio 7/ | 22.7 | 17.0 | 15.0 | 14.9 | 15.8 | 18.5 | 16.2 | 16.8 | 15.3 | 16.0 |
| External debt-service ratio 8/ | ... | 11.0 | 6.9 | 7.3 | 7.4 | 9.3 | 8.1 | 7.1 | 7.6 | 7.1 |
| Overall balance of payments (in millions of U.S. dollars) | -64 | 305 | 53 | 161 | -131 | -121 | -160 | -194 | -149 | -189 |
| Gross official reserves (in millions of U.S. dollars) | 337 | 664 | 874 | 931 | 988 | 1,043 | 1,039 | 1,084 | 1,032 | 1,076 |
| (in months of imports of goods and nonfactor services of following year) | 2.0 | 3.3 | 4.1 | 4.3 | 4.5 | 4.6 | 4.7 | 4.8 | 4.6 | 4.8 |
| GDP at current market prices (in millions of birr) | 54,211 | 51,761 | 56,192 | 56,958 | 63,139 | 64,277 | 69,681 | 71,197 | 76,582 | 78,177 |
| Exchange rate (birr per U.S. dollar; period average rate) | 8.34 | 8.54 | ... | 8.58 | ... | ... | ... | ... | ... | ... |

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

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

2/ Excluding special programs.

3/ Demobilization and reconstruction.

4/ Whole series was revised.

5/ After enhanced HIPC relief. Exports of goods and services used.

6/ After enhanced HIPC relief. Revenues exclude grants.

7/ Before debt relief; on an accrual basis; in percent of exports of goods and nonfactor services.

8/ After enhanced HIPC relief.

Table 4. Ethiopia: General Government Operations, 2001/02-2005/06 1/
(In millions of birr)

| | 2001/02 | 2002/03 | | 2003/04 | | 2004/05 | | 2005/06 | |
|--|---------|------------|--------|------------|------------|------------|------------------|------------|------------------|
| | | EBS/03/109 | Est. | EBS/03/109 | Rev. Proj. | EBS/03/109 | Rev. Proj. 2/ | EBS/03/109 | Rev. Proj. 2/ |
| Total revenue and grants | 12,833 | 17,130 | 15,702 | 18,476 | 17,084 | 19,240 | 18,585 | 20,335 | 20,014 |
| Revenue | 10,409 | 12,174 | 11,149 | 13,140 | 12,542 | 14,904 | 14,323 | 16,516 | 15,928 |
| Tax revenue (incl. measures) | 7,926 | 8,994 | 8,244 | 10,432 | 9,932 | 12,038 | 11,511 | 13,501 | 12,963 |
| Direct taxes | 3,120 | 3,255 | 3,010 | 3,023 | 3,673 | 4,704 | 4,282 | 5,200 | 4,873 |
| Indirect taxes | 4,806 | 5,739 | 5,233 | 6,508 | 6,259 | 7,334 | 7,230 | 8,301 | 8,090 |
| Domestic indirect taxes | 1,498 | 1,862 | 1,668 | 2,280 | 2,150 | 2,811 | 2,807 | 3,350 | 3,253 |
| Import duties and taxes | 3,280 | 3,874 | 3,564 | 4,228 | 4,109 | 4,498 | 4,423 | 4,921 | 4,838 |
| Export taxes | 28 | 3 | 1 | 0 | 0 | 25 | 0 | 30 | 0 |
| Nontax revenue | 2,483 | 3,180 | 2,906 | 2,708 | 2,610 | 2,867 | 2,812 | 3,015 | 2,965 |
| Grants | 2,425 | 4,956 | 4,553 | 5,336 | 4,542 | 4,336 | 4,262 | 3,819 | 4,086 |
| Total expenditure and net lending (cash basis) 3/ | 16,680 | 21,063 | 19,840 | 22,563 | 21,093 | 22,521 | 21,836 | 23,357 | 22,809 |
| Recurrent expenditure 3/ | 10,550 | 14,285 | 13,527 | 13,310 | 12,752 | 13,707 | 13,097 | 13,939 | 13,379 |
| Defense spending | 2,610 | 3,000 | 2,341 | 3,000 | 2,400 | 3,000 | 2,400 | 3,000 | 2,400 |
| Poverty-targeted expenditure | 3,093 | 3,853 | 3,672 | 4,446 | 4,446 | 4,893 | 4,893 | 5,338 | 5,338 |
| Education | 1,777 | 2,172 | 2,276 | 2,513 | 2,513 | 2,700 | 2,700 | 3,100 | 3,100 |
| Health | 522 | 622 | 526 | 711 | 711 | 819 | 819 | 832 | 832 |
| Agriculture | 675 | 808 | 750 | 1,038 | 1,038 | 1,164 | 1,164 | 1,190 | 1,190 |
| Roads | 119 | 161 | 139 | 183 | 183 | 210 | 210 | 216 | 216 |
| Interest payments (after traditional debt-relief mechanism) | 1,005 | 1,280 | 1,239 | 1,406 | 1,447 | 1,526 | 1,509 | 1,531 | 1,564 |
| Domestic interest and charges | 572 | 686 | 625 | 773 | 773 | 768 | 818 | 762 | 864 |
| External interest payments (after traditional debt-relief mechanism) | 433 | 594 | 594 | 633 | 675 | 758 | 691 | 769 | 699 |
| Emergency assistance (food and other emergency aid) | 1,006 | 3,010 | 2,890 | 876 | 874 | 896 | 902 | 906 | 914 |
| Others | 2,837 | 3,142 | 3,406 | 3,583 | 3,583 | 3,393 | 3,393 | 3,164 | 3,164 |
| Capital expenditure 3/ | 6,130 | 6,778 | 6,313 | 9,252 | 8,341 | 8,814 | 8,740 | 9,418 | 9,430 |
| Central treasury | ... | 3,511 | 3,265 | 4,507 | 4,442 | 4,304 | 4,483 | 4,671 | 5,127 |
| External assistance | ... | 1,363 | 1,196 | 2,162 | 1,326 | 1,882 | 1,894 | 1,857 | 1,873 |
| External loans | ... | 1,905 | 1,852 | 2,583 | 2,574 | 2,628 | 2,362 | 2,890 | 2,430 |
| Of which: poverty-targeted expenditure | 4,460 | 6,088 | 4,921 | 6,841 | 6,841 | 7,550 | 7,550 | 8,573 | 8,573 |
| Balance, excl. special programs (cash basis) | | | | | | | | | |
| Including grants | -3,847 | -3,933 | -4,138 | -4,087 | -4,009 | -3,281 | -3,251 | -3,022 | -2,795 |
| Excluding grants | -6,272 | -8,889 | -8,691 | -9,423 | -8,551 | -7,617 | -7,513 | -6,841 | -6,881 |
| Special programs 4/ | 971 | 863 | 653 | 644 | 535 | 424 | 767 | 0 | 217 |
| Overall balance 2/ | | | | | | | | | |
| Including grants | -4,818 | -4,796 | -4,793 | -4,731 | -4,544 | -3,705 | -4,019 | -3,022 | -3,012 |
| Excluding grants | -7,243 | -9,752 | -9,346 | -10,067 | -9,086 | -8,041 | -8,281 | -6,841 | -7,098 |
| Financing | 4,818 | 4,796 | 4,793 | 4,731 | 4,545 | 3,705 | 4,019 | 3,022 | 3,012 |
| External (net) | 4,905 | 4,284 | 3,865 | 3,469 | 3,283 | 3,305 | 3,618 | 2,622 | 2,613 |
| Gross borrowing | 5,172 | 4,162 | 3,608 | 3,455 | 3,336 | 3,517 | 3,599 | 2,890 | 2,647 |
| HIPC Initiative relief | 429 | 779 | 531 | 819 | 695 | 733 | 815 | 784 | 822 |
| Unpaid debt under negotiation | 0 | 0 | 283 | 0 | 0 | 0 | 0 | 0 | 0 |
| Amortization repayment (after traditional debt-relief mechanism) | -696 | -657 | -557 | -805 | -748 | -945 | -796 | -1,052 | -856 |
| Domestic (net) | 309 | 500 | 1,653 | 1,162 | 1,162 | 300 | 300 | 300 | 300 |
| Banking system | 723 | 500 | 1,651 | 1,000 | 1,000 | 0 | 0 | 0 | 0 |
| Noubank sources | -414 | 0 | 2 | 162 | 162 | 300 | 300 | 300 | 300 |
| Privatization | 68 | 13 | 8 | 100 | 100 | 100 | 100 | 100 | 100 |
| Float/unidentified financing 5/ | -464 | 0 | -733 | 0 | 0 | 0 | 0 | 0 | 0 |
| Memorandum items: | | | | | | | | | |
| Poverty-targeted expenditure | 7,553 | 9,941 | 8,592 | 11,287 | 11,287 | 12,443 | 12,443 | 13,911 | 13,911 |
| Wages and salaries | 3,789 | 4,385 | 4,443 | 4,925 | 4,925 | 5,435 | 5,553 | 5,973 | 6,098 |
| HIPC Initiative relief on interest | 235 | 420 | 286 | 328 | 339 | ... | ... | ... | ... |
| HIPC Initiative relief on amortization | 190 | 359 | 245 | 479 | 298 | ... | ... | ... | ... |
| Gross domestic product | 51,761 | 56,192 | 56,958 | 63,139 | 64,277 | 69,681 | 71,197 | 76,582 | 78,177 |

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

1/ Fiscal year ending July 7.

2/ Projections for overall balance will change after IDA's lending program is reassessed at the HIPC completion point.

3/ Excluding special programs (demobilization and reconstruction).

4/ Demobilization and reconstruction.

5/ This item does not reflect the reconciliation exercise for the 2002/03 fiscal and monetary accounts completed in December 2003.

Table 5. Ethiopia: General Government Operations, 2001/02-2005/06 1/
(In percent of GDP)

| | 2001/02 | 2002/03 | | 2003/04 | | 2004/05 | | 2005/06 | |
|--|---------|------------|-------|------------|------------|------------|------------------|------------|------------------|
| | | EBS/03/109 | Est. | EBS/03/109 | Rev. Proj. | EBS/03/109 | Rev. Proj. 2/ | EBS/03/109 | Rev. Proj. 2/ |
| Total revenue and grants | 24.8 | 30.5 | 27.6 | 29.3 | 26.6 | 27.6 | 26.1 | 26.6 | 25.6 |
| Revenue | 20.1 | 21.7 | 19.6 | 20.8 | 19.5 | 21.4 | 20.1 | 21.6 | 20.4 |
| Tax revenue (incl. measures) | 15.3 | 16.0 | 14.5 | 16.5 | 15.5 | 17.3 | 16.2 | 17.6 | 16.6 |
| Direct taxes | 6.0 | 5.8 | 5.3 | 6.2 | 5.7 | 6.8 | 6.0 | 6.8 | 6.2 |
| Indirect taxes | 9.3 | 10.2 | 9.2 | 10.3 | 9.7 | 10.5 | 10.2 | 10.8 | 10.3 |
| Domestic indirect taxes | 2.9 | 3.3 | 2.9 | 3.6 | 3.3 | 4.0 | 3.9 | 4.4 | 4.2 |
| Import duties and taxes | 6.3 | 6.9 | 6.3 | 6.7 | 6.4 | 6.5 | 6.2 | 6.4 | 6.2 |
| Export taxes | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Nontax revenue | 4.8 | 5.7 | 5.1 | 4.3 | 4.1 | 4.1 | 3.9 | 3.9 | 3.8 |
| Grants | 4.7 | 8.8 | 8.0 | 8.5 | 7.1 | 6.2 | 6.0 | 5.0 | 5.2 |
| Total expenditure and net lending (cash basis) 3/ | 32.2 | 37.5 | 34.8 | 35.7 | 32.8 | 32.3 | 30.7 | 30.5 | 29.2 |
| Recurrent expenditure 3/ | 20.4 | 25.4 | 23.7 | 21.1 | 19.8 | 19.7 | 18.4 | 18.2 | 17.1 |
| Defense spending | 5.0 | 5.3 | 4.1 | 4.8 | 3.7 | 4.3 | 3.4 | 3.9 | 3.1 |
| Poverty-targeted expenditure | 6.0 | 6.9 | 6.4 | 7.0 | 6.9 | 7.0 | 6.9 | 7.0 | 6.8 |
| Education | 3.4 | 3.9 | 4.0 | 4.0 | 3.9 | 3.9 | 3.8 | 4.0 | 4.0 |
| Health | 1.0 | 1.1 | 0.9 | 1.1 | 1.1 | 1.2 | 1.2 | 1.1 | 1.1 |
| Agriculture | 1.3 | 1.6 | 1.3 | 1.6 | 1.6 | 1.7 | 1.6 | 1.6 | 1.5 |
| Roads | 0.2 | 0.3 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Of which: HIPC poverty-targeted expenditure | 0.0 | 0.1 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 |
| Interest payments (after traditional debt-relief mechanism) | 1.9 | 2.3 | 2.1 | 2.2 | 2.3 | 2.2 | 2.1 | 2.0 | 2.0 |
| Domestic interest and charges | 1.1 | 1.2 | 1.1 | 1.2 | 1.2 | 1.1 | 1.1 | 1.0 | 1.1 |
| External interest payments (after traditional debt-relief mechanism) | 0.8 | 1.1 | 1.0 | 1.0 | 1.0 | 1.1 | 1.0 | 1.0 | 0.9 |
| Emergency assistance (food and other emergency aid) | 1.9 | 5.4 | 5.1 | 1.4 | 1.4 | 1.3 | 1.3 | 1.2 | 1.2 |
| Others | 5.5 | 5.6 | 6.0 | 5.7 | 5.6 | 4.9 | 4.8 | 4.1 | 4.0 |
| Capital expenditure 3/ | 11.8 | 12.1 | 11.1 | 14.7 | 13.0 | 12.6 | 12.3 | 12.3 | 12.1 |
| Of which: poverty-targeted expenditure | 8.6 | 10.8 | 8.6 | 10.8 | 10.6 | 10.8 | 10.6 | 11.2 | 11.0 |
| Balance, excl. special programs (cash basis) | | | | | | | | | |
| Including grants | -7.4 | -7.0 | -7.3 | -6.5 | -6.2 | -4.7 | -4.6 | -3.9 | -3.6 |
| Excluding grants | -12.1 | -15.8 | -15.3 | -14.9 | -13.3 | -10.9 | -10.6 | -8.9 | -8.8 |
| Special programs 4/ | 1.9 | 1.5 | 1.1 | 1.0 | 0.8 | 0.6 | 1.1 | 0.0 | 0.3 |
| Overall balance 2/ | | | | | | | | | |
| Including grants | -9.3 | -8.5 | -8.4 | -7.5 | -7.1 | -5.3 | -5.6 | -3.9 | -3.9 |
| Excluding grants | -14.0 | -17.4 | -16.4 | -15.9 | -14.1 | -11.5 | -11.6 | -8.9 | -9.1 |
| Financing | 9.3 | 8.5 | 8.4 | 7.5 | 7.1 | 5.3 | 5.6 | 3.9 | 3.9 |
| External (net) | 9.5 | 7.6 | 6.8 | 5.5 | 5.1 | 4.7 | 5.1 | 3.4 | 3.3 |
| Gross borrowing | 10.0 | 7.4 | 6.3 | 5.5 | 5.2 | 5.0 | 5.1 | 3.8 | 3.4 |
| HIPC Initiative relief | 0.8 | 1.4 | 0.9 | 1.3 | 1.1 | 1.1 | 1.1 | 1.0 | 1.1 |
| Unpaid debt under negotiation | 0.0 | 0.0 | 0.5 | | | | | | |
| Amortization repayment (after traditional debt-relief mechanism) | -1.3 | -1.2 | -1.0 | -1.3 | -1.2 | -1.4 | -1.1 | -1.4 | -1.1 |
| Domestic (net) | 0.6 | 0.9 | 2.9 | 1.8 | 1.8 | 0.4 | 0.4 | 0.4 | 0.4 |
| Banking system | 1.4 | 0.9 | 2.9 | 1.6 | 1.6 | 0.0 | 0.0 | 0.0 | 0.0 |
| Nonbank sources | -0.8 | 0.0 | 0.0 | 0.3 | 0.3 | 0.4 | 0.4 | 0.4 | 0.4 |
| Privatization | 0.1 | 0.0 | 0.0 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 |
| Float/unidentified financing 5/ | -0.9 | 0.0 | -1.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | -0.0 |
| Memorandum items: | | | | | | | | | |
| Poverty-targeted expenditure | 14.6 | 17.7 | 15.1 | 17.9 | 17.6 | 17.9 | 17.5 | 18.2 | 17.8 |
| Wages and salaries | 7.3 | 7.8 | 7.8 | 7.8 | 7.8 | 7.8 | 7.8 | 7.8 | 7.8 |
| HIPC Initiative relief on interest | 0.5 | 0.7 | 0.5 | 0.5 | 0.5 | ... | ... | ... | ... |
| HIPC Initiative relief on amortization | 0.4 | 0.6 | 0.4 | 0.8 | 0.7 | ... | ... | ... | ... |

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

1/ Fiscal year ending July 7.

2/ Projections for overall balance will change after IDA's lending program is reassessed at the HIPC completion point.

3/ Excluding special programs (demobilization and reconstruction).

4/ Demobilization and reconstruction.

5/ This item does not reflect the reconciliation exercise for the 2002/03 fiscal and monetary accounts completed in December 2003.

Table 6. Ethiopia: Monetary Survey, 2001/02-2005/06 1/

| | 2001/02 | 2002/03 | | 2003/04 | | 2004/05 | | 2005/06 | |
|--|---------|------------|--------|------------|------------|------------|------------|------------|------------|
| | | EBS/03/109 | Act. | EBS/03/109 | Rev. Prog. | EBS/03/109 | Rev. Prog. | EBS/03/109 | Rev. Prog. |
| (In millions of birr) | | | | | | | | | |
| Net foreign assets | 8,295 | 10,645 | 11,290 | 12,452 | 13,168 | 13,421 | 14,115 | 13,562 | 14,129 |
| National Bank of Ethiopia (NBE) | 4,225 | 6,047 | 6,273 | 7,134 | 7,395 | 7,633 | 7,848 | 7,715 | 7,938 |
| Assets | 5,692 | 7,514 | 8,003 | 8,804 | 9,333 | 9,369 | 9,850 | 9,402 | 9,887 |
| Liabilities | 1,467 | 1,468 | 1,731 | 1,670 | 1,938 | 1,736 | 2,002 | 1,687 | 1,948 |
| Commercial banks | 4,070 | 4,598 | 5,018 | 5,318 | 5,773 | 5,787 | 6,267 | 5,847 | 6,190 |
| Assets | 5,729 | 6,262 | 6,731 | 7,043 | 7,556 | 7,533 | 8,077 | 7,610 | 8,314 |
| Liabilities | 1,659 | 1,664 | 1,713 | 1,725 | 1,783 | 1,745 | 1,809 | 1,763 | 2,123 |
| Net domestic assets | 19,327 | 20,094 | 19,216 | 22,397 | 21,424 | 25,232 | 24,189 | 28,756 | 27,682 |
| Domestic credit | 27,617 | 28,664 | 28,332 | 31,447 | 31,094 | 34,436 | 34,060 | 38,098 | 37,710 |
| Claims on government (net) 2/ | 16,268 | 16,768 | 17,855 | 17,768 | 18,855 | 17,768 | 18,855 | 17,768 | 18,855 |
| NBE | 9,006 | 9,506 | 9,804 | 10,506 | 10,804 | 10,506 | 10,804 | 10,506 | 10,804 |
| Commercial banks | 7,262 | 7,262 | 8,052 | 7,262 | 8,052 | 7,262 | 8,052 | 7,262 | 8,052 |
| Claims on nongovernment | 11,349 | 11,896 | 10,477 | 13,679 | 12,239 | 16,668 | 15,205 | 20,330 | 18,854 |
| NBE | 394 | 394 | 114 | 394 | 114 | 394 | 0 | 394 | 0 |
| Commercial banks | 10,955 | 11,502 | 10,364 | 13,285 | 12,125 | 16,274 | 15,205 | 19,936 | 18,854 |
| Other items (net) | -8,290 | -8,570 | -9,117 | -9,050 | -9,671 | -9,204 | -9,871 | -9,342 | -10,028 |
| Broad money | 27,622 | 30,739 | 30,506 | 34,849 | 34,592 | 38,653 | 38,305 | 42,318 | 41,810 |
| Money | 15,457 | 16,671 | 16,815 | 19,401 | 19,591 | 21,092 | 21,081 | 22,071 | 22,027 |
| Currency outside banks | 6,536 | 7,292 | 7,726 | 9,315 | 10,001 | 9,626 | 10,069 | 8,852 | 9,379 |
| Demand deposits | 8,921 | 9,379 | 9,089 | 10,086 | 9,591 | 11,466 | 11,012 | 13,219 | 12,648 |
| Quasi money | 12,166 | 14,068 | 13,691 | 15,448 | 15,001 | 17,561 | 17,224 | 20,247 | 19,783 |
| Savings deposits | 11,071 | 12,896 | 12,529 | 13,916 | 13,771 | 15,820 | 15,812 | 18,239 | 18,161 |
| Time deposits | 1,094 | 1,172 | 1,162 | 1,532 | 1,230 | 1,742 | 1,412 | 2,008 | 1,622 |
| (Annual change in percent of beginning-period broad money, unless otherwise indicated) | | | | | | | | | |
| Net foreign assets | 14.0 | 8.5 | 10.8 | 5.9 | 6.2 | 2.8 | 2.7 | 0.4 | 0.0 |
| Net domestic assets | -1.7 | 2.8 | -0.4 | 7.5 | 7.2 | 8.1 | 8.0 | 9.1 | 9.1 |
| Domestic credit | -0.6 | 3.8 | 2.6 | 9.1 | 9.1 | 8.6 | 8.6 | 9.5 | 9.5 |
| Claims on government (net) | 2.9 | 1.8 | 5.7 | 3.3 | 3.3 | 0.0 | 0.0 | 0.0 | 0.0 |
| Claims on nongovernment | -3.5 | 2.0 | -3.2 | 5.8 | 5.8 | 8.6 | 8.6 | 9.5 | 9.5 |
| Broad money | 12.3 | 11.3 | 10.4 | 13.4 | 13.4 | 10.9 | 10.7 | 9.5 | 9.2 |
| Money | 6.8 | 4.4 | 4.9 | 8.9 | 9.1 | 4.9 | 4.3 | 2.5 | 2.5 |
| Quasi money | 5.5 | 6.9 | 5.5 | 4.5 | 4.3 | 6.1 | 6.4 | 6.9 | 6.7 |
| Memorandum items: | | | | | | | | | |
| Quasi money/broad money (in percent) | 44.0 | 45.8 | 44.9 | 44.3 | 43.4 | 45.4 | 45.0 | 47.8 | 47.3 |
| Velocity (GDP/broad money) | 1.87 | 1.83 | 1.87 | 1.81 | 1.86 | 1.80 | 1.86 | 1.81 | 1.87 |
| Gross official foreign reserves (in millions of U.S. dollars) | 664 | 874 | 931 | 988 | 1,043 | 1,039 | 1,084 | 1,032 | 1,076 |
| Net foreign assets of the banking system (in millions of U.S. dollars) | 968 | 1,239 | 1,313 | 1,398 | 1,471 | 1,489 | 1,554 | 1,489 | 1,538 |
| Excess reserves (in percent of deposits) | 8.1 | 13.0 | 12.8 | 10.6 | 10.6 | 9.0 | 9.0 | 9.0 | 9.0 |

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

1/ Year ending July 1.

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

Table 7. Ethiopia: Balance of Payments, 2001/02-2005/06 1/
(In millions of U.S. dollars, unless otherwise indicated)

| | 2001/02 | 2002/03 | | 2003/04 | | 2004/05 | | 2005/06 | |
|--|---------|------------|-----------|------------|------------|------------|------------|------------|------------|
| | | EBS/03/109 | Rev. Est. | EBS/03/109 | Rev. Prog. | EBS/03/109 | Rev. Proj. | EBS/03/109 | Rev. Proj. |
| Trade balance | -1,244 | -1,508 | -1,458 | -1,589 | -1,602 | -1,565 | -1,580 | -1,547 | -1,553 |
| Exports of goods | 452 | 468 | 483 | 514 | 518 | 567 | 578 | 617 | 632 |
| Coffee | 163 | 142 | 165 | 161 | 167 | 175 | 196 | 185 | 206 |
| Other | 289 | 326 | 318 | 353 | 351 | 392 | 382 | 433 | 426 |
| Imports of goods | 1,696 | 1,976 | 1,940 | 2,103 | 2,120 | 2,132 | 2,158 | 2,164 | 2,186 |
| Fuel | 268 | 288 | 288 | 298 | 305 | 289 | 296 | 290 | 293 |
| Cereals | 155 | 295 | 273 | 150 | 120 | 110 | 110 | 80 | 80 |
| Aircraft | 11 | 12 | 17 | 117 | 117 | 117 | 117 | 117 | 117 |
| Imports, excl. fuel, cereals, aircraft | 1,262 | 1,381 | 1,362 | 1,538 | 1,578 | 1,617 | 1,635 | 1,676 | 1,696 |
| Nonfactor services (net) | 153 | 159 | 167 | 162 | 169 | 175 | 183 | 200 | 200 |
| Exports of nonfactor services | 530 | 607 | 657 | 635 | 650 | 662 | 717 | 693 | 750 |
| Imports of nonfactor services | 377 | 448 | 490 | 473 | 481 | 487 | 534 | 493 | 551 |
| Income (net) | -40 | -55 | -55 | -40 | -51 | -36 | -47 | -30 | -42 |
| Of which: gross official interest payments 2/ | -52 | -72 | -72 | -71 | -81 | -71 | -82 | -70 | -82 |
| Private transfers (net) | 349 | 407 | 495 | 429 | 456 | 432 | 463 | 469 | 489 |
| Current account balance, excl. official transfers | -782 | -997 | -850 | -1,038 | -1,028 | -994 | -982 | -907 | -907 |
| (in percent of GDP) | -12.9 | -15.2 | -12.8 | -14.4 | -14.0 | -12.8 | -12.4 | -10.7 | -10.6 |
| Excluding Ethiopian Airlines (EAL) imports | ... | ... | ... | -12.8 | -12.4 | -11.3 | -11.0 | -9.3 | -9.2 |
| Official transfers (net) | 435 | 600 | 540 | 437 | 449 | 400 | 400 | 374 | 374 |
| Current account balance, incl. official transfers | -347 | -397 | -310 | -601 | -579 | -594 | -582 | -532 | -533 |
| (in percent of GDP) | -5.7 | -6.1 | -4.7 | -8.3 | -7.9 | -7.6 | -7.4 | -6.3 | -6.2 |
| Excluding EAL imports | ... | ... | ... | -6.7 | -6.3 | -6.1 | -5.9 | -4.9 | -4.9 |
| Capital account balance (incl. errors and omissions) | 652 | 450 | 472 | 470 | 459 | 434 | 388 | 383 | 344 |
| Foreign direct investment (net) | 0 | 20 | 14 | 20 | 20 | 50 | 50 | 70 | 70 |
| Other investment (net) | 508 | 430 | 349 | 450 | 439 | 384 | 338 | 313 | 274 |
| Official long-term loans | 489 | 447 | 353 | 466 | 456 | 396 | 351 | 326 | 287 |
| Disbursements | 574 | 537 | 443 | 567 | 562 | 503 | 464 | 436 | 406 |
| EAL loan | 0 | 0 | 0 | 117 | 117 | 117 | 117 | 117 | 117 |
| Amortization 2/ | 86 | 90 | 90 | 101 | 106 | 107 | 113 | 111 | 119 |
| Other public sector long-term loans (net) 3/ | 19 | -17 | -4 | -16 | -17 | -12 | -13 | -12 | -13 |
| Errors and omissions | 144 | 67 | 108 | 0 | 0 | 0 | 0 | 0 | 0 |
| Overall balance | 305 | 53 | 161 | -131 | -121 | -160 | -194 | -149 | -189 |
| Financing | -305 | -53 | -161 | 131 | 121 | 160 | 194 | 149 | 189 |
| Central bank (net; increase -) | -297 | -210 | -236 | -97 | -97 | -46 | -38 | 0 | 0 |
| Reserves (increase -) | -327 | -210 | -266 | -114 | -112 | -51 | -42 | 7 | 8 |
| Liabilities (increase -) | 30 | 0 | 30 | 17 | 15 | 5 | 4 | -7 | -8 |
| Of which: Fund credit (net) | 42 | 0 | 4 | 17 | 15 | 5 | 4 | -7 | -8 |
| Commercial banks (net; increase -) | -97 | -60 | -108 | -62 | -62 | -45 | -45 | 0 | 16 |
| Changes in arrears | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Debt relief (Paris Club II and III, Naples terms) 4/ | 89 | 150 | 183 | 18 | 25 | 0 | 0 | 0 | 0 |
| Financing gap | 0 | 0 | 0 | 272 | 253 | 251 | 277 | 150 | 173 |
| Exceptional financing 5/ | 0 | 0 | 0 | 176 | 146 | 152 | 152 | 50 | 50 |
| Traditional debt relief | 0 | 0 | 0 | 6 | 27 | 21 | 24 | 20 | 23 |
| HIPC relief | 0 | 0 | 0 | 91 | 81 | 78 | 100 | 80 | 100 |
| Residual gap | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Memorandum items: | | | | | | | | | |
| Exports of goods (percent change) | -2.2 | 8.6 | 6.7 | 9.8 | 7.3 | 10.3 | 11.5 | 8.9 | 9.5 |
| Export price index (percent change) | -12.0 | 0.7 | -3.1 | 1.9 | 3.4 | 2.6 | 4.1 | 1.4 | 1.5 |
| Export volume index (percent change) | 11.1 | 7.8 | 10.1 | 7.7 | 3.8 | 7.5 | 7.1 | 7.3 | 7.8 |
| Total imports of goods (percent change) | 8.9 | 16.5 | 14.4 | 6.4 | 9.3 | 1.4 | 1.8 | 1.5 | 1.3 |
| Import price index (percent change) | -1.0 | 3.5 | 7.0 | 4.2 | 6.2 | -0.3 | -0.1 | 0.1 | -0.1 |
| Import volume index (percent change) | 9.8 | 12.6 | 7.0 | 2.1 | 2.9 | 1.7 | 1.7 | 1.4 | 1.4 |
| Gross official reserves | 664 | 874 | 931 | 988 | 1,043 | 1,039 | 1,084 | 1,032 | 1,076 |
| (in months of imports of goods and nonfactor services of following year) | 3.3 | 4.1 | 4.3 | 4.5 | 4.6 | 4.7 | 4.8 | 4.6 | 4.8 |
| Excluding EAL aircraft imports | ... | 4.3 | 4.5 | 4.7 | 4.9 | 4.9 | 5.0 | 4.6 | 4.8 |
| Terms of trade index (percent change; 1996/97 = 100) | -11.1 | -2.7 | -9.4 | -2.2 | -2.6 | 3.0 | 4.2 | 1.3 | 1.6 |

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

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

2/ Includes debt service to Russia on ruble-denominated debt after up-front discount.

3/ Ethiopian Airlines and other public enterprises.

4/ Includes 1997 and 2001 Paris Club rescheduling agreements (including Russia) under Naples terms, 2002 Paris Club topping up to Cologne terms, and HIPC interim relief including estimates of relief beyond HIPC and relief on non-Paris Club debt under negotiation.

5/ Balance of payments support from the World Bank (Poverty Reduction Support Credit) and African Development Bank (structural adjustment loan).

Table 8. Ethiopia: Projected Payments to the Fund, 2003/04-2012/13 1/
(in millions of SDRs, unless otherwise indicated)

| | 2003/04 | 2004/05 | 2005/06 | 2006/07 | 2007/08 | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 |
|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Obligations from existing drawings | 10.4 | 7.5 | 6.2 | 9.6 | 15.2 | 14.7 | 13.3 | 13.2 | 8.3 | 1.2 |
| PRGF/ESAF/SAF repayments | 9.6 | 6.9 | 5.5 | 9.0 | 14.7 | 14.3 | 12.9 | 12.9 | 8.0 | 1.0 |
| Charges and interest 2/ | 0.7 | 0.7 | 0.6 | 0.6 | 0.5 | 0.5 | 0.4 | 0.3 | 0.3 | 0.3 |
| Obligations from prospective drawings | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 2.0 | 3.9 | 3.8 | 3.8 |
| PRGF/ESAF/SAF repayments | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 1.9 | 3.8 | 3.8 | 3.8 |
| Charges and interest 2/ | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 |
| Total obligations | 10.4 | 7.6 | 6.3 | 9.7 | 15.3 | 14.8 | 15.3 | 17.1 | 12.2 | 5.1 |
| PRGF/ESAF/SAF repayments | 9.6 | 6.9 | 5.5 | 9.0 | 14.7 | 14.3 | 14.8 | 16.7 | 11.8 | 4.8 |
| Charges and interest 2/ | 0.8 | 0.8 | 0.7 | 0.7 | 0.6 | 0.6 | 0.5 | 0.4 | 0.3 | 0.3 |
| Outstanding Fund credit 3/ | 104.2 | 107.7 | 102.2 | 93.2 | 78.5 | 64.2 | 49.4 | 32.7 | 20.9 | 16.1 |
| In percent of: | | | | | | | | | | |
| Exports of goods and nonfactor services | 12.1 | 12.4 | 11.0 | 9.3 | 7.2 | 5.5 | 3.9 | 2.4 | 1.4 | 1.0 |
| External public debt | 2.0 | 2.2 | 2.0 | 1.8 | 1.4 | 1.1 | 0.9 | 0.6 | 0.3 | 0.3 |
| Gross official reserves | 13.6 | 14.8 | 14.2 | 10.8 | 7.4 | 5.3 | 3.7 | 2.2 | 1.3 | 1.0 |
| GDP | 1.9 | 2.0 | 1.8 | 1.5 | 1.2 | 0.9 | 0.6 | 0.4 | 0.2 | 0.2 |
| Quota | 77.9 | 80.6 | 76.4 | 69.7 | 58.7 | 48.0 | 37.0 | 24.5 | 15.6 | 12.1 |
| Total obligations | 10.4 | 7.6 | 6.3 | 9.7 | 15.3 | 14.8 | 15.3 | 17.1 | 12.2 | 5.1 |
| In percent of: | | | | | | | | | | |
| Exports of goods and nonfactor services | 1.2 | 0.9 | 0.7 | 1.0 | 1.4 | 1.3 | 1.2 | 1.2 | 0.8 | 0.3 |
| External public debt | 0.2 | 0.2 | 0.1 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.2 | 0.1 |
| Gross official reserves | 1.4 | 1.0 | 0.9 | 1.1 | 1.5 | 1.2 | 1.1 | 1.2 | 0.8 | 0.3 |
| GDP | 0.2 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 |
| Quota | 7.8 | 5.7 | 4.7 | 7.3 | 11.5 | 11.1 | 11.4 | 12.8 | 9.1 | 3.8 |
| Memorandum item: | | | | | | | | | | |
| Projected disbursements | 10.4 | 10.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

Source: Fund staff estimates and projections.

1/ Year ending July 7.

2/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the General Resources Account, and on current interest rates for the Enhanced Structural Adjustment Facility (ESAF)/Structural Adjustm

3/ Under assumptions of the medium-term balance of payments projections.

Table 9. Ethiopia: Social Indicators

| | Latest Single Year | | | Sub-Saharan Africa | Low-Income Countries |
|--|--------------------|---------|-----------|-----------------------|-------------------------|
| | 1970-75 | 1980-85 | 1993-2001 | | |
| Population | | | | | |
| Total population, midyear (millions) | 33.0 | 43.4 | 65.8 | 673.9 | 2,505.8 |
| Growth rate (percent; annual average) | 2.6 | 2.8 | 2.3 | 2.3 | 1.8 |
| Urban population (percent of population) | 9.5 | 11.7 | 15.9 | 32.3 | 30.8 |
| Total fertility rate (births per woman) | 5.9 | 7.0 | 5.6 | 5.1 | 3.5 |
| Income | | | | | |
| Gross National Income (GNI) per capita (U.S. dollars) | ... | 120 | 100 | 460 | 430 |
| Consumer price index (1995/96 (July 8-July 7) =100) | 17 | 51 | 100 | 131 | 138 |
| Food price index (1995/96 (July 8-July 7) =100) | ... | 52 | 47 | ... | ... |
| Income/consumption distribution | | | | | |
| Gini index 1/ | ... | ... | 57.2 | ... | ... |
| Lowest quintile (percent of income or consumption) 1/ | ... | 8.6 | 2.5 | ... | ... |
| Highest quintile (percent of income or consumption) 1/ | ... | 41.3 | 60.8 | ... | ... |
| Public expenditure | | | | | |
| Health (percent of GDP) 1/ | ... | ... | 4.6 | 6.0 | 4.3 |
| Education (percent of GNI) 1/ | ... | 3.0 | 4.8 | 3.4 2/ | 3.3 |
| Social security and welfare (percent of GDP) | ... | 1.4 | ... | ... | ... |
| Net primary school enrollment rate (percent of age group) | | | | | |
| Total 1/ | ... | 29 | 47 | ... | ... |
| Male | ... | 33 | 53 | ... | ... |
| Female | ... | 25 | 41 | ... | ... |
| Access to safe water (percent of population) | | | | | |
| Total 1/ | ... | ... | 24 | 58 | 76 |
| Urban | ... | ... | 81 | 83 | 90 |
| Rural | ... | ... | 12 | 46 | 70 |
| Immunization rate (percent under 12 months) | | | | | |
| Measles | ... | 12 | 52 | 58 | 60 |
| DPT | ... | 6 | 56 | 53 | 61 |
| Life expectancy at birth (years) | | | | | |
| Total | 42 | 44 | 42 | 46 | 59 |
| Male | 40 | 42 | 41 | 45 | 58 |
| Female | 43 | 45 | 43 | 47 | 60 |
| Mortality | | | | | |
| Infant (per thousand live births) | 151 | 143 | 116 | 105 | 80 |
| Under 5 (per thousand live births) | 239 | 213 | 172 | 171 | 121 |
| Adult (15-59) | | | | | |
| Male (per thousand of population) 1/ | 482 | 491 | 594 | 520 | 312 |
| Female (per thousand of population) 1/ | 411 | 401 | 535 | 461 | 256 |

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

1/ The numbers for the period 1993-2001 are as of 2000.

2/ Latest available data are as of 1999.

December 31, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

1. The government of Ethiopia, in cooperation with staff of the IMF, has evaluated the implementation so far of the third annual program for the period July 8, 2003–July 7, 2004, in accordance with the provisions of the three-year arrangement (approved on March 22, 2001), under the Poverty Reduction and Growth Facility (PRGF). This letter reviews progress in implementing the program through November 2003 and updates the objectives and policies to be pursued during the remainder of the third annual program and over the medium-term, in light of the objectives set forth in the memorandum on economic and financial policies for 2003/04, dated July 22, 2003. The government wishes to make the content of this letter available to the public and authorizes you to arrange for the letter to be posted on the IMF website, subsequent to Executive Board completion of the fifth review under the PRGF arrangement.

2. Notwithstanding the protracted impact of a severe drought during 2001/02-2002/03, and continued deterioration of the terms of trade, performance under the third annual program was satisfactory. All the quantitative performance criteria under the third annual program (Table 1) and structural performance criteria and benchmarks through end-November 2003 (Table 2) have been observed. In particular, the government finalized and adopted on November 30, 2003 a detailed restructuring plan for the Commercial Bank of Ethiopia (CBE), and has consolidated the federal and regional budgets for 2002/03 and 2003/04, including all extrabudgetary accounts. The government is also determined to meet the remaining performance criteria and benchmarks through July 7, 2004. Following the completion of the fifth review under the PRGF arrangement by the Executive Board, the government requests the sixth disbursement of SDR 10.429 million under the arrangement.

3. As envisaged in the memorandum of July 2003, understandings were reached on quantitative performance criteria for end-March 2004 and structural performance criteria and benchmarks through July 7, 2004. Quantitative benchmarks for July 7, 2004 were also established. While the government believes that the policies and measures described in this letter and in the letter and memorandum of July 2003 are adequate for achieving the revised objectives of the program, the government stands ready, during the period of the arrangement, to take additional measures that may become necessary for this purpose.

Developments during 2002/03

4. As noted in the July 2003 memorandum, recent economic developments have been adversely affected by a severe drought. Real GDP in 2002/03 is estimated to have declined by 3.8 percent, mainly as a result of a 12 percent drop in agricultural production. Inflation accelerated to 15 percent in 2002/03, from -7.2 percent in 2001/02, mainly because of food shortages. The most recent estimates suggest that 13.2 million people were in need of food assistance in 2003, compared with about 5 million in a normal crop year. Food assistance needs for 2003 have been estimated at 1.85 million metric tons of cereals. As of end-October 2003, 1.77 million metric tons have been pledged and 1.44 million metric tons delivered.

5. The **external current account deficit** (including official transfers) declined from 5.7 percent of GDP in 2001/02 to 4.7 percent in 2002/03 (excluding official transfers, the deficit remained at 12.9 percent). Coffee exports (which accounted for 34 percent of merchandise exports in 2002/03) rebounded somewhat as a continued decline of coffee prices was more than offset by volume growth. Moreover, exports of nonfactor services and other commodities, including chat, gold, and other agricultural goods, grew strongly. Imports rose by 14.4 percent, partly reflecting large-scale food aid imports.

6. In the **fiscal area**, the outcome for 2002/03 was less satisfactory than projected in the July 2003 memorandum. There was a shortfall in revenue, which was offset by lower spending. The overall fiscal deficit (including grants and emergency programs) fell from 9.3 percent of GDP in 2001/02 to about 8.4 percent in 2002/03, close to the programmed 8.5 percent. Excluding grants, the deficit widened from 14 percent of GDP to 16.4 percent, reflecting emergency assistance equivalent to 5.1 percent of GDP received in the form of grants. The lower-than-estimated external loan disbursements were covered by higher-than-projected domestic bank financing.

7. On the revenue side, the government continued its efforts to improve tax administration and collection, as well as fully implement the value-added tax (VAT) introduced in January 2003. Other measures taken with continued support of technical assistance from the IMF include strengthening the large taxpayers office, computerization and introduction of tax identification numbers, and the establishment of an enforcement unit to enhance the collection of tax arrears. However, in spite of these efforts, and largely as a result of weak economic activity due to the drought, total tax revenues declined to 14.5 percent of GDP in 2002/03 from 15.3 percent in 2001/02, compared with 16 percent projected under the program. Nontax revenues rose to 5.1 percent of GDP in 2002/03 from 4.8 percent in 2001/02, compared with 5.7 percent projected under the program, partly reflecting lower dividends.

8. On the spending side, the government followed a cautious expenditure management policy in response to the lower-than-budgeted revenue receipts, while making every effort to increase poverty-targeted spending. Poverty-targeted spending (health, education, agriculture, and roads) increased to 15.1 percent of GDP in 2002/03 from 14.6 percent in 2001/02.

Defense outlays declined to 4.1 percent of GDP in 2002/03, lower than projected under the program, from 5 percent in 2001/02, and the total wage bill was contained to 7.8 percent of GDP in 2002/03. Spending under the special programs also declined. Capital spending amounted to 11.1 percent of GDP in 2002/03.

9. Regarding **monetary and exchange rate policies**, the government sterilized some excess liquidity and continued to allow greater market determination of the exchange rate. However, the financial market remains dominated by the CBE. Broad money increased by 10.4 percent in 2002/03, compared with 11.3 percent projected under the program, and 12.3 percent in 2001/02. Partly reflecting weak economic activity, extensive collection of bank loans, which surpassed the fresh loans disbursement, conversion of CBE loans to a government bond and write-off of bad loans of CBE, total credit to the nongovernment sector declined by 7.7 percent, compared with a 4.8 percent increase projected under the program. Credit to the government rose by 9.8 percent, more than the increase of 3.1 percent projected under the program. Despite increased sales of government securities to the banking system, the banks' excess reserves rose from 8.1 percent of deposits on July 7, 2002 to 12.8 percent by end-2002/03 largely because of weak credit demand. Continued excess liquidity in the banking system contributed to depressed yields in the treasury bill market, and the average weighted yield for three-month bills continued to be low at 1.48 percent as of end-June 2003. Meanwhile, the interest rate structure of commercial banks for deposits and loans remains within the range of 3-14 percent.

10. In the area of **financial sector reforms**, several measures were taken to strengthen the banking system and to improve the competitiveness of the financial sector, including the adoption of a directive for the provisioning by banks for NPLs and troubled debt in line with international best practices in August 2002 (to be fully implemented by January 2004), and the signing of a performance contract with the CBE to ensure that the CBE is operated effectively on a commercial basis. Regarding the privatization of the Construction and Business Bank (CBB), earlier problems relating to asset valuation and tax issues have now been resolved, while the financial statements for 2001, 2002, and 2003 are being audited. The restructuring of the Development Bank of Ethiopia (DBE) was completed in November 2003 and included a reduction of NPLs by Birr 237 million and raising the authorized capital of the bank from Birr 250 million to Birr 600 million. A comprehensive study of the National Bank of Ethiopia (NBE) was submitted to the NBE Board in November 2003 for their comment.

11. During the 2002/03 fiscal year, the nominal value of the birr has depreciated by about 0.4 percent against the dollar to reach Birr 8.6 per US dollar at end-2002/03. At end-September 2003, net foreign assets of the National Bank of Ethiopia (NBE) stood at US\$760 million (around 3.5 months of following-year imports of goods and services), higher than programmed. Gross foreign reserves were the equivalent of 4.5 months of following-year imports.

The Third Annual Program for 2003/04: Performance during the first quarter and policies during the remainder of the year

12. As described in the July 2003 memorandum, the third annual PRGF-supported program has been designed taking into account the development strategy outlined in the Sustained Development and Poverty Reduction Program (SDPRP or full PRSP) and the impact of the recent drought. The medium-term objectives for 2003/04-2005/06 set in the July 2003 memorandum are (i) to achieve an annual average real GDP growth rate of about 6 percent; (ii) to maintain core inflation at a low rate of about 3 percent; and (iii) to reduce the external current account deficit (including official transfers) to 6.2 percent of GDP (10.6 percent, excluding official transfers) by 2005/06. The policy stance to achieve these objectives remains that outlined in the July 2003 memorandum.

13. The macroeconomic projections for 2003/04 and the medium-term have been updated to take into account the outcome of 2002/03 and the most recent price projections. The program continues to project real GDP growth of 6.7 percent for 2003/04 spurred by a gradual agricultural recovery following a two-year decline caused by the prolonged drought. The authorities, however, expect a much higher real GDP growth given the good rains so far. Consumer price inflation is projected to decline from an average of 15 percent in 2002/03 to 5.5 percent in 2003/04, as food supply conditions return to a more normal level. The government intends to guarantee a minimum price for maize, wheat, and sorghum by purchasing excess supply through the Ethiopian Grain Trade Enterprise (EGTE), should a better-than-expected harvest cause food prices to sharply decline, so as to mitigate any negative impact on farmers. This will be implemented in a way that avoids any direct budgetary consequences. EGTE will purchase cereals when prices decline using its own resources and credit from the banking system and will sell cereals back when shortfalls emerge. The external current account deficit (including official transfers and aircraft imports for Ethiopian Airline (EAL)²⁰ is now projected to increase from 4.7 percent of GDP in 2002/03 to 7.9 percent in 2003/04. Exports are expected to grow by 7.3 percent reflecting higher coffee prices, as well as continued strong performance of other exports. Imports would also continue to grow in response to both volume and price increases, despite a decline in food aid imports. Both private and official transfers are projected to fall from their drought-related peak in 2002/03. Continued external support will allow a further build up in foreign reserve cover to about 4.6 months of following year imports of goods and services.

14. **Fiscal policy** will continue to focus on prudent public expenditure management and enhanced revenue mobilization. The fiscal framework for 2003/04, however, had to be

²⁰ As part of the fleet expansion program, EAL will lease 12 new planes over the next three years. The planes will be delivered in three tranches starting in November 2003, July 2004, and July 2005, and will be financed by a \$350 million commercial loan to be repaid over 12 years. Long-term financing operations of EAL will not be guaranteed by the government or financed by government borrowing.

updated to take into account recent developments, but it remains broadly consistent with that presented in the memorandum of July 2003, in particular with regard to the ceiling on bank borrowing by the government. Total revenue is now projected at 19.5 percent of GDP, slightly lower than in the original framework, largely because of lower projections for both tax and nontax revenues to reflect the lingering impact of the drought. Domestic indirect tax receipts are nonetheless projected to register a strong increase in 2003/04 reflecting the reform measures being implemented, especially with regard to the VAT. The lower revenue projections will be fully offset by lower defense spending. Moreover, should revenues fall short of the projections compensating spending cuts will be made. The total outlays (including special programs) are now targeted to increase to 33.6 percent of GDP in 2003/04, lower than in the original framework. As a result, the budget deficit (including grants) is projected at 7.1 of GDP, the same as in the original framework, and recourse to bank financing will be maintained at the level initially programmed.

15. During the first quarter of 2003/04, government revenue rose by 6 percent, slightly lower than projected while spending was much lower, resulting in a smaller deficit. Net bank credit to the government was within the program ceiling.

16. To achieve the revised tax revenue target of 15.5 percent of GDP in 2003/04, the government will continue to implement the tax reform program, in particular by continuing to strengthen the functioning of the large taxpayer unit (LTO), enhancing activities of the tax reform task force, and the computerization of the tax identification number and of the VAT. Measures are also being put in place to collect tax arrears, including strengthened enforcement powers and special units to deal with arrears. The authorities will aim at eventually integrating the VAT operations into the LTO. The Ministry of Revenue is also benefiting from IMF and East AFRITAC's technical assistance in the area of customs administration.

17. The government will pursue a prudent expenditure policy, focusing on poverty-reduction activities identified in the SDPRP. Food emergency assistance is projected at 1.4 percent of GDP. Defense outlays will be reduced to 3.7 percent of GDP. Poverty-targeted spending is to increase to 17.6 percent of GDP (including 1.2 percent from interim HIPC relief). The total wage bill is to be limited to 7.8 percent of GDP. Capital outlays are projected at 13 percent of GDP, taking into account only existing loan commitments from the World Bank and including planned spending on resettlement and water harvesting. Regarding future disbursements from the World Bank, as noted in the July 2003 memorandum, in line with the Country Assistance Strategy (CAS), only grants shown in IDA's CAS for 2003/04, in addition to disbursements from already committed IDA loans, have been included in the budget at this stage. At the time of the completion point, Ethiopia's debt sustainability will be reassessed and the amount of any additional debt relief will be determined. At that time, any additionally secured commitments of IDA loans will be added in a supplementary budget, provided that disbursements will be spent efficiently on poverty-related sectors and will not jeopardize macroeconomic stability or debt sustainability. Any additional HIPC assistance granted at the time of the completion point will also be reflected in the supplementary budget. In order to facilitate the consolidation of the federal and

regional government budgets for 2004/05, prior to the start of the fiscal year, the government will provide the regions with notification of the regional transfer by end-February 2004.

18. **Monetary policy** will remain geared to achieving the inflation and international reserve targets under the program. To help achieve these targets while providing room for an adequate increase in credit to the nongovernment sector, the government will limit recourse to borrowing from the banking sector to Birr 1 billion. Money supply is projected to rise by about 13.4 percent in 2003/04. During the first quarter of the year net foreign assets rose by more than programmed; net claims on the government declined by 2.9 percent since end-2002/03 instead of rising as programmed; and credit to the nongovernment sector continued to fall reflecting a further decline in credit from the CBE. As a result, money supply rose by 8.9 percent on annual basis, lower than projected under the program.

19. The government will continue sterilizing the excess reserves held by commercial banks. With core inflation at about 3 percent, the commercial banks' interest rates for deposits and loans, which are presently in the range of 3-14 percent, remain adequate. However, interest rate policy will remain under review. The exchange rate will continue to be market determined and the effectiveness of the interbank foreign exchange market will continue to be strengthened.

20. The government attaches strong importance to reforms aimed at strengthening the **financial sector** and improving its competitiveness. Measures during 2003/04 include (a) full provisioning by banks for NPLs and other doubtful assets in line with international best practices by January 2004; (b) offering for sale the CBB's shares to the public by end-February 2004; and (c) starting to implement the restructuring of the NBE by end-2003, based on the finalized comprehensive study of the NBE, including as necessary, revising the existing Banking Act to increase NBE's autonomy.

21. On the **CBE**, the authorities finalized a detailed financial restructuring plan on November 30, 2003, in line with the agreed main features of reform outlined in the memorandum of economic and financial policies of July 2003 (para. 24), and based on the financial audit by the KPMG for end-June 2002. The restructuring plan also takes into account recommendations of the joint IMF/World Bank technical assistance mission. A financial audit for end-June 2003 was conducted by the Audit Service Corporation, in conformity with international accounting standards. The audit found that (i) NPLs (including cofinanced loans with the DBE and loans of the Djibouti branch) amounted to Birr 4.6 billion (53.5 percent of total loans and advances) at end-June 2003, down from Birr 5.8 billion as of end-June 2002 (58.6 percent of total loans and advances); and that (ii) the profits of the CBE amounted to Birr 540 million in 2002/03, a strong recovery from a loss of Birr 471 million in 2001/02. The CBE did not pay dividends to the government during 2002/03 and used the net profit for strengthening its capital base. As a result, the risk-weighted capital adequacy ratio increased to 10 percent at end-June 2003 from 8.3 percent at end-June 2002. If the capital adequacy ratio falls below 10 percent, no annual dividends will be paid until the ratio again reaches at least 10 percent. The loan loss provisions were increased by Br 80 million

during 2002/03 to Br 2.5 billion, exceeding the level required by the NBE provisioning directive.

22. The restructuring plan of the CBE includes, in particular, (i) a time-bound plan for reducing NPLs to 20 percent of total loans by end-June 2007; (ii) a business plan to keep the capital adequacy ratio over 10 percent with no capital injection envisaged from the government; (iii) strengthening of credit risk and portfolio management, with the assistance of consultants from the Bank of Scotland, through improved credit guidelines, organizational restructuring, and staff training; and (iv) the establishment of a mechanism to follow up the implementation of the restructuring plan. To ensure its success, the restructuring plan includes the following measures: (i) institute by January 1, 2004 a policy to limit the renewal or restructuring of any delinquent loan to two iterations; (ii) eliminate by end-June 2004 the maximum annual write-off limit; (iii) target a level in write-off of Birr 375 million in 2004/05 and Birr 400 million each year for 2005/06-2006/07; (iv) transfer by end-June 2004 the cofinanced loans (Birr 1.03 billion) from the CBE to the DBE in exchange for a government guaranteed bond at a discount factor which will reduce the large loan exposure of the CBE; (v) require that the CBE prepare a quarterly progress report to the CBE Board and the Ministry of Finance and Economic Development (MoFED); and (vi) require that the Banking Supervision Department of the NBE monitor on a monthly basis steps being taken to implement the CBE's restructuring plan and report to the NBE's Board and MoEFD. It is estimated that the fiscal impact of the restructuring plan would be limited to less than 1 percent of GDP over the next four years through lower dividend payments by the CBE to the government.

23. **In the external sector**, as noted earlier, the government projects an increase in the external current account deficit (including official transfers and aircraft imports by EAL) to 7.9 percent of GDP in 2003/04. This will be fully covered by project loan disbursements, balance of payment support from the AfDB (US\$26 million), World Bank balance of payments support grant (US\$120 million), reconstruction and demobilization programs (US\$61 million), and by assistance under the enhanced HIPC Initiative (US\$81 million). Over the medium term, the current account deficit (including transfers and aircraft imports by EAL) is projected to decline to 6.2 percent of GDP by 2005/06, as a result of continued growth of nontraditional and traditional exports and nonfactor services. At the same time, total import growth is expected to decline, reflecting lower food aid requirements. Sustained concessional lending together with debt relief under the HIPC Initiative will allow maintenance of foreign exchange reserves at about 4.8 months of imports by 2005/06.

24. The government remains committed to trade liberalization in the context of the frameworks of the Common Market for Eastern and Southern Africa (COMESA). Under a new Investment Code passed in April 2003 to promote foreign investment, the sole operation by government has been reduced to the transmission and distribution of electricity in main national lines, postal services excluding fast postal service, and aircraft that transport over 20 passengers. A draft Diagnostic Trade Integration Study (DTIS) has been prepared and a workshop was held in November 2003 to provide the opportunity for various stakeholders, both government and nongovernment organizations, to review the findings and policy

recommendations in the DTIS, including technical assistance action plans. The DTIS is a preliminary step in the Integrated Framework for Trade Development in the Least Developed Countries and will provide the mechanism to mainstream trade within the framework of the PRSP process.

25. Following the Paris Club meetings on April 5, 2001 and April 12, 2002, the government has signed bilateral agreements with all but one Paris Club creditor, and the last agreement is being finalized. It is also seeking rescheduling of debt owed to non-Paris Club creditors on terms at least comparable to those given by the Paris Club, and consistent with assumptions under the HIPC Initiative. Agreements have been signed with two non-Paris Club creditors and the authorities are awaiting a response from a number of others. Additional debt relief provided beyond that assumed under the Initiative has also financed additional poverty-targeted expenditure. Due to practical difficulties in implementing the mechanism agreed at the HIPC decision point for disbursing and tracking payments from the HIPC account at the NBE, the government will agree with creditors on a simplified method for disbursement that ensures that such resources continue to be spent in a timely manner on poverty-related activities, and which is consistent with the government's monitoring systems, including the Public Expenditure Review.

26. The exchange rate will remain market determined and the government will rely on prudent macroeconomic policies to maintain the current account in line with the prospective availability of foreign grants, concessional loans, and debt relief. The authorities will also ensure the implementation of the recommendations made in the recent Safeguards Assessment of the NBE.

27. With the assistance of the World Bank and other donors, the government will continue to implement other **structural reforms** that are conducive to growth and poverty reduction, including agricultural reform and food security, private sector development and export promotion, civil service reform, and public expenditure management and services delivery. In the area of agricultural reform and food security, the government has recently prepared a food security strategy for a vulnerable population, focusing on increased food production, strengthened safety net, and improved access to land, which was presented to donors in a consultative group meeting held on December 1-2, 2003. Regarding private sector development, the government continues to improve the investment climate and promote foreign and domestic investment, through, inter alia, a simplification of business licensing, a land-leasing reform, liberalizing the telecommunication sector, as well as further revising the investment code. The privatization program will also be enhanced by bringing 114 public entities to the point of sale through end-2005/06. In the civil service reform, the government, with support from the World Bank, will strengthen the training of civil servants, improve public service delivery in the context of ongoing decentralization, and streamline administrative process in the bureaucracy. On land tenure issues, the government has initiated a reform of urban land-leasing with support from the World Bank and established a land certification process in several areas with the aim of strengthening security of tenure and the potential use of land certificates as a collateral for borrowers.

28. **On statistics**, with the support of technical assistance from AFRITAC, an action plan has been adopted to improve the compilation of real sector and balance of payments data. With regard to the revision of monetary statistics and the coverage of international reserves, comments on draft formats and manuals have been received from commercial banks and implementation will commence in July 2004.

The First Annual Progress Report of the SDPRP

29. Ethiopia's full Poverty Reduction Strategy Paper (PRSP)—the Sustainable Development and Poverty Reduction Program (SDPRP)—was endorsed by the Executive Boards of the IMF and the World Bank in September 2002, and its first annual progress report (APR) will be submitted to the IMF and the World Bank soon. The progress report includes a poverty and social impact analysis (PSIA) of the introduction of the VAT prepared with IMF assistance. The APR, which was discussed during the December 1-2, 2003 Consultative Group meeting, has benefited from contributions by nongovernmental organizations (NGOs), civil society, representatives of the private sector and donors. In addition to the baseline scenario, the APR presents two alternative growth scenarios to take into account risks and vulnerabilities of the Ethiopian economy. One scenario is a high growth scenario presented in the initial SDPRP, with real GDP growth averaging around 7 percent per annum, while the other is a low growth scenario, based on a lower growth rate of about 4 percent. Nonetheless, the government believes that the growth projections under the baseline scenario is realistic, given policies to be pursued under the SDPRP, although continued donor assistance is essential in achieving the growth target.

Enhanced HIPC Initiative

30. The government looks forward to the consideration by the Executive Boards of the IMF and the World Bank in early 2004 of the completion point under the enhanced HIPC Initiative. Under the trigger measures for reaching the completion point, the value-added tax (VAT) was introduced in January 2003, and concrete measures for the financial restructuring of the CBE and increasing competitiveness of the financial sector are expected to have been implemented by January 2004, when the new directive on provisioning for nonperforming loans becomes fully effective. The reconciliation of monetary and fiscal accounts is an ongoing process. The reconciliation for 2001/02 has been completed with technical assistance from the IMF in August 2003 while that for 2002/03 is scheduled to be completed by end-December 2003. The consolidation of federal and regional budgets for 2002/03 and 2003/04, including all extrabudgetary funds and accounts, has been completed in November 2003, although it will not be until the 2004/05 budget that the consolidation will be done prior to the beginning of the fiscal year. It will also be important to prepare consolidated outturns for the fiscal accounts. In the assessment of the World Bank, the triggers on health and HIV/AIDS were achieved.

31. On agriculture, the government will implement a series of actions as agreed with the World Bank, including withdrawal of the agricultural extension service from input distribution and input credit management, and strengthening of farmers' cooperatives. On

education, the gross enrollment rate of girls have reached the target by 2001/02, and the repetition rate declined to 6.8 percent in 2002/03 from 9 percent in 1999/2000. Consistent with an indicator under the Millennium Development Goals, completion rate of primary education has risen to 31 percent in 2001/02 from 25 percent in 1999/2000.

32. The authorities, with staffs of the IMF and the World Bank, conducted the detailed loan-by-loan debt sustainability analysis (DSA) in preparation for the HIPC completion point. At the time of the decision point, it had been projected that the NPV debt/exports ratio would be about 174 percent at end-2002/03. Preliminary results of the DSA indicate that on the basis of interest and exchange rates prevailing at end-2002/03 and outturns for exports and external borrowing, the actual NPV debt/exports ratio at end- 2002/03 was 240 percent. Virtually all of the increase of NPV of debt/exports ratio from the decision point is due to the change in the interest and exchange rates prevailing at end-2002/03. The government hopes that Ethiopia will benefit from topping up at the completion point.

Sincerely yours,

/s/

/s/

Sufian Ahmed
Minister of Finance and
Economic Development

Teklewold Atnafu
Governor of the National Bank of Ethiopia

Attachments (2)
Quantitative Benchmarks and Performance Criteria
Structural Benchmarks and Performance Criteria

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

(In millions of birr, unless otherwise indicated)

| | 2003 | | | | | | 2004 | | | |
|--|---------------------|-------------------|-------------|-------------------------|--------|-----------|----------------------|-----------------------|-------------------|-----------------|
| | July 7 | | September | | | December | | March | | July 7 |
| | Estimate (Stock) | Actual (Stock) | Perf. Crit. | Adjusted Perf. Crit. | Actual | Benchmark | Revised Benchmark | Indicative Targets | Perf. Crit. 3/ | Benchmark 4/ |
| I. Quantitative benchmarks and performance criteria | | | | | | | | | | |
| Floor on net foreign assets of the National Bank of Ethiopia 5/ 6/ | 6,047 | 6,267 | -136 | -223 | 266 | -283 | 128 | 712 | 820 | 831 |
| Ceiling on net domestic assets of the National Bank of Ethiopia 7/ 8/ | 6,961 | 6,972 | 319 | 406 | -799 | 370 | 370 | -336 | -336 | 991 |
| Ceiling on net domestic financing of the general government (incl. privatization receipts) 8/ 9/ 10/ | 18,122 | 19,211 | 269 | 356 | -327 | 460 | 460 | -236 | -236 | 1,262 |
| Ceiling on outstanding external payments arrears of the public sector (in million of US\$) 11/ | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Ceiling on new nonconcessional external debt contracted or guaranteed by the public sector 12/ | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| II. Indicative target | | | | | | | | | | |
| Floor on net foreign liquid reserves of the National Bank of Ethiopia 5/ 6/ | 5,467 | 5,748 | -136 | -223 | 374 | -283 | 128 | 712 | 820 | 831 |
| III. Triggers for adjustment of quantitative benchmark and performance criteria | | | | | | | | | | |
| Disbursed nonproject external financing (in million of U.S. dollars) 13/ | 313 | 271 | 37 | 17 | 17 | 74 | 95 | 261 | 282 | 355 |

Source: Ethiopian authorities.

1/ For 2003/04, cumulative flows from July 8, 2003. Program exchange rate of 8.5937 Birr/USD used.

2/ Established as a benchmark in the context of the fifth review.

3/ Established as a performance criterion in the context of the fifth review.

4/ Established as a benchmark in the context of the fifth review.

5/ Adjusted upward for external assistance (nonproject, excluding enhanced HIPC interim assistance) that exceeds programmed amounts (paragraph 12 of the Technical Memorandum (TM) dated July 2003).

6/ Adjusted downward for 50 percent of any shortfall in programmed external assistance (nonproject, excluding enhanced HIPC interim assistance) up to a maximum of US\$50 million (paragraph 15 of the TM dated July 2003).

7/ Adjusted downward for external assistance (nonproject, excluding enhanced HIPC interim assistance) that exceeds programmed amounts (paragraph 13 of the TM dated July 2003).

8/ Adjusted upward for 50 percent of any shortfall in programmed external assistance (nonproject, excluding enhanced HIPC interim assistance) up to a maximum of US\$50 million (paragraph 15 of the TM dated July 2003).

9/ Adjusted downward for external assistance (nonproject, excluding enhanced HIPC interim assistance) that exceeds programmed amounts (paragraph 14 of the TM dated July 2003).

10/ Stocks at March 31, 2003 and July 7, 2003 reflect domestic government borrowing, but excludes privatization receipts. The estimated figure for July 7, 2003 was revised.

11/ There shall be a continuous performance criterion on the nonaccumulation of new external arrears.

12/ This limit applies not only to debt as defined in Point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted by the IMF on August 24, 2000,

but also to commitments contracted or guaranteed for which the value has not been received. Excluded from this limit are short-term import credits and long-term financing operations of Ethiopian Airlines.

13/ Excluding fertilizer projects.

Table 2. Ethiopia: Prior Actions for Completing the Fifth Review, Structural Benchmarks, and Performance Criteria Under the Third Annual Program Supported by the Three-Year PRGF Arrangement

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

Ethiopia: Relations with the Fund

(As of December 31, 2003)

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

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

| III. SDR Department | SDR Million | Percent of allocation |
|---------------------------|-------------|-----------------------|
| Net cumulative allocation | 11.16 | 100.00 |
| Holdings | 0.02 | 0.54 |

| IV. Outstanding Purchases and Loans | SDR Million | Percent of quota |
|---|-------------|------------------|
| Structural Adjustment Facility (SAF) | 2.82 | 2.11 |
| Enhanced Structural Adjustment Facility (ESAF) and Poverty Reduction and Growth Facility (PRGF) | 103.01 | 77.05 |

V. Latest Financial Arrangements

| Type | Approval Date | Expiration Date | Amount Approved (SDR million) | Amount Drawn (SDR million) |
|------|---------------|-----------------|-------------------------------|----------------------------|
| PRGF | 03/22/2001 | 07/31/2004 | 100.28 | 79.42 |
| ESAF | 10/11/1996 | 10/22/1999 | 88.47 | 29.49 |
| SAF | 10/28/1992 | 11/08/1995 | 49.42 | 49.42 |

VI. Projected Obligations to Fund Under the Repurchase Expectations Schedule

Forthcoming; in SDR million

| | 2004 | 2005 | 2006 | 2007 | 2008 |
|------------------|------|------|------|------|------|
| Principal | 8.7 | 5.9 | 7.6 | 12.3 | 16.8 |
| Charges/interest | 0.7 | 0.7 | 0.7 | 0.6 | 0.5 |
| Total | 9.4 | 6.6 | 8.3 | 12.9 | 17.2 |

VII. Implementation of HIPC Initiative

| | |
|--|--------------------|
| Commitment of HIPC assistance | Enhanced Framework |
| Decision point date | Nov. 2001 |
| Assistance committed (NPV terms) ²¹ | end-2000/01 |
| Total assistance by all creditors (US\$ Million) | 1,275 |

²¹NPV terms at the decision point under the enhanced framework.

| | |
|--|----------|
| <i>Of which:</i> IMF Assistance (SDR Million) | 26.93 |
| Completion point date | Floating |
| Delivery of Fund assistance (SDR Million) | |
| Amount disbursed | 10.28 |
| Interim assistance | 10.28 |
| Completion point | 0.00 |
| Amount applied against member's obligations (cumulative) | 8.59 |

VIII. Safeguards Assessment

Under the Fund's safeguards assessment policy, the National Bank of Ethiopia (NBE) is subject to a full safeguards assessment with respect to the Poverty Reduction and Growth Facility arrangement approved on March 22, 2001, which is scheduled to expire on July 31, 2004. An off-site safeguards assessment of the NBE was completed on May 4, 2001. The assessment concluded that high risks may exist in financial reporting and in the system of internal controls and recommended an on-site assessment. The on-site assessment was completed on September 12, 2001. The staff's findings and recommendations are reported in Appendix V of EBS/02/37 (3/4/02). The NBE will implement the outstanding recommendations under the safeguards assessment.

IX. Exchange Rate Arrangement

Effective October 24, 2001, NBE terminated the weekly wholesale foreign exchange auctions for the birr (Br) and moved all foreign exchange operations to the interbank market. The current exchange rate regime is classified as managed floating. The transaction-weighted average interbank market exchange rate on December 31, 2003 was Br 8.621 = US\$1.

In March 2001, the authorities eliminated previously existing restrictions on the purchase of foreign exchange for holiday travel and education purposes. Since then, exporters have been allowed to retain 10 percent of their export proceeds in foreign exchange for an indefinite period. The rest may be retained for a period of 28 days, after which it has to be converted into local currency by the customer's bank using the prevailing transaction rate, unless an exporter spends it on eligible imports within 28 days. The multiple currency practice that might have arisen from the NBE's weekly foreign exchange auction was lifted with the replacement of the auction by the interbank foreign exchange market. However, a few current account exchange restrictions that existed prior to the PRGF arrangement remain with respect to Article VIII, Sections 2, 3, and 4 of the IMF's Articles of Agreement. These restrictions relate to (a) the tax certification requirement for repatriation of investment income; (b) restrictions on repayment of legally entered into external loans and supplies and foreign partner's credits; (c) rules for issuance of import permits; and (d) the requirement to provide a clearance certificate from NBE to obtain import permits.

X. Article IV Consultation

Ethiopia is on the 24-month cycle for members with Fund arrangements in accordance with the provisions of the decision on consultation cycles approved on July 15, 2002. The Executive Board concluded the last Article IV consultation on September 23, 2002, concurrently with the completion of the third review under the second annual PRGF-supported program (EBS/02/158).

XI. Technical Assistance (2001 - present)

| Department | Purpose | Time of Delivery |
|-------------------|--|-------------------------|
| FAD/LEG | Tax administration and VAT legislation | January-February 2001 |
| MAE | Monetary and banking reforms | February-March 2001 |
| FAD | Tax administration | April 2001 |
| MAE | Bank supervision | April-May 2001 |
| MAE | Monetary and banking reforms | May 2001 |
| MAE | Interbank foreign exchange market | June-July 2001 |
| LEG | Income tax legislation | September 2001 |
| FAD | Tax administration | September-November 2001 |
| MAE | Bank supervision | September-October 2001 |
| LEG | Review of compliance with Article VIII | November 2001 |
| STA | Consumer price index | November-December 2001 |
| STA | Multisector | January 2002 |
| MAE | Bank supervision | February 2002 |
| FAD | Tax administration | February 2002 |
| STA | Fiscal and monetary accounts | May 2002 |
| LEG | VAT law | May 2002 |
| MAE | Payment system | May-June 2002 |
| FAD | Public expenditure management | July 2002 |
| FAD | Tax administration | July 2002 |
| MAE | Accounting and internal audit of central bank | August 2002 |
| FAD | Tax administration | November 2002 |
| MAE | Accounting and internal audit of central bank | November-December 2002 |
| STA | Reconciliation of fiscal and monetary accounts | August 2003 |
| MFD | Restructuring plan of the CBE | November 2003 |

XII. Resident Representative

Mr. Alexander Kyei assumed the post in August 2001

Ethiopia: Relations with the World Bank

(As of January 2004)

A. Partnership in Ethiopia's Development Strategy

1. In July 2002, the government of Ethiopia finalized its full Poverty Reduction Strategy Paper (PRSP) or Sustainable Development and Poverty Reduction Program (SDPRP). This was discussed in September 2002 by the Boards of the World Bank and the Fund, along with a Joint Staff Assessment of the SDPRP strategy. The first Annual Progress Report (APR) on SDPRP implementation was finalized by the Government in December 2003.
2. The IMF has taken the lead in helping Ethiopia maintain macroeconomic stability, under a three year Poverty Reduction and Growth Facility (PRGF) arrangement approved in March 2001. The PRGF addresses issues related to fiscal consolidation and structural reforms that are key to maintaining macroeconomic stability and fostering growth. The PRGF's structural conditionality has focused on the following areas: the financial sector, budget consolidation and reconciliation, and public expenditure management.
3. The Bank leads the policy dialogue on structural reforms relevant to economic growth and poverty reduction, including rural development, infrastructure, private sector development (PSD), human development, governance, and vulnerability. The Bank and Fund share joint responsibility in supporting financial sector, taxation, decentralization, and public expenditure reforms.

B. Key Areas of Common Interest to Bank and Fund

4. **Preparation and Implementation of the PRSP.** The World Bank and the IMF have collaborated in providing support to the government in the preparation of the PRSP, including preparing joint comments on an early draft of the PRSP and the Joint Staff Assessment. The Bank and the IMF are collaborating on the preparation of the Joint Staff Assessment of the first APR on SDPRP implementation, to be discussed by the Boards of the Bank and the Fund.
5. Through lending and analytical work, the Bank and the Fund jointly support implementation of the SDPRP's policy reforms, including the following main areas:
6. **Macroeconomic policy, PSD, and the financial sector.** There is close cooperation between the World Bank and the IMF in discussing macroeconomic policy with the government. Complementing the PRGF's focus on macroeconomic issues, one of the key focus areas of the Bank's forthcoming Poverty Reduction Support Credit (PRSC) will be structural policy reforms to support pro-poor growth. The World Bank will also cooperate closely with the Fund on macroeconomic analytical work to analyze the requirements for a pro-poor growth macroeconomic framework, and investigate policy instruments to address macro and fiscal volatility.

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

8. **Public expenditure management.** (i) *Public Expenditure Review.* The Fund has been an active participant in Bank-coordinated annual public expenditure reviews, which have provided an objective analysis of the government's public expenditure strategy, as well as an opportunity to study issues in public finance management of common interest and concern. The 2001 PER was the first review of public expenditure at the regional level. The 2002 PER focused on (a) spending in the social sectors; and (b) an update on overall spending patterns, budget systems issues, and fiscal decentralization developments. The Bank is providing support to strengthen public expenditure management through the PSCAP. (ii) *Institutional and Governance Review.* In the future, in addition to looking at expenditure composition and expenditure tracking with the Fund in the context of a planned annual joint Government-donor budget review, the Bank will increasingly deal with institutional issues in expenditure management through an Institutional and Governance Review (IGR), working closely with AFRITAC. (iii) *Tracking Poverty-Reducing Public Spending.* In the context of HIPC, the government, IDA and the IMF are tracking the use of savings arising from HIPC interim assistance.

9. **Debt sustainability analysis and the Enhanced HIPC Initiative.** Bank and Fund staff have jointly monitored progress by the Government toward meeting the HIPC triggers necessary to reach the completion point. At the time of the HIPC Decision Point in November 2001, the World Bank and the Fund jointly conducted a debt sustainability analysis (DSA). In preparation for the CAS, discussed by the Bank's Board in April 2003, the World Bank and the Fund, together with the Government of Ethiopia, updated the DSA to assess the impact on debt sustainability of additional disbursements envisaged under the CAS. A joint Bank-Fund mission visited Addis Ababa in November 2003 to gather information on Ethiopia's outstanding debt obligations for an updated DSA, which will be presented to the Boards of the Fund and the Bank at HIPC Completion Point.

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

C. Bank Group Strategy

11. The World Bank has aligned its Country Assistance Strategy (CAS) for FY03-FY05 with SDPRP objectives. The CAS was produced in consultation with the Government and

other key stakeholders. As part of the consultation process, workshops were held on three key themes; (i) capacity building (March 2002), (ii) decentralization and service delivery (May 2002), and (iii) private sector development and pro-poor growth (July 2002).

12. The CAS—which was discussed by the Executive Board of the World Bank on April 17, 2003 envisages new Bank commitments of around US\$1.5 billion in the base case, with up to 40 percent provided in grants under IDA13. However, due to debt sustainability concerns, the Bank has halted all new lending, and will provide financial support through IDA grants only, until a decision is made on the amount of debt relief which Ethiopia will receive at Completion Point under the Enhanced HIPC Initiative. The CAS proposes a shift away from more traditional project-based lending to programmatic approaches, including a PRSC, which is expected to be delivered in FY04 in the form of an IDA grant.

13. World Bank support to the SDPRP is framed around three inter-related objectives:

- Enhancing pro-poor growth—including rural growth, urban growth with a particular focus on PSD (including infrastructure), financial markets, export growth, and macroeconomic stability;
- Enhancing human development outcomes by improving governance—including public sector reform, decentralization, civil society empowerment, education, health, and water;
- Reducing vulnerability—including safety nets, managing terms of trade shocks, access to finance, rural/agricultural risk mitigation, HIV/AIDS, environment, and targeted support to vulnerable groups.

14. The CAS comprises a mixture of lending and analytical instruments which are designed to meet the evolving institutional structures of Ethiopia and reflects lessons learned from previous experience. First, the Bank's seeks to support Government's efforts to build a capable and accountable state. Hence, *capacity building* within the public and private sector, and in civil society will be a critical underpinning of the Bank's assistance. Second, *PRSCs* will support policy reforms and the financing of essential investments and services. Providing crucial *capital investment funds* to Federal, regional, and local governments for rehabilitating and creating new infrastructure is the third main element for achieving CAS objectives. Last but not least, the *analytical agenda* will address the fundamental policy questions which Ethiopia and her partners will need to unlock to successfully move the development and poverty agendas forward.

15. As of 7 January 2004, Ethiopia's portfolio of IDA operations comprised 19 active projects, with total net commitments of US\$ 1,845 million and an undisbursed balance of US\$ 889 million. This compares with 14 projects, commitments of US\$1,382 million, and an undisbursed amount of US\$946 million at the beginning of FY 2000.

Ethiopia: Statistical Issues

General

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

Real sector

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

Public finances

3. Monthly federal government accounts are reported with a six- to eight-week lag. Under the three-year PRGF arrangement, progress was made in 2002/03 in improving the quality and coverage of reporting on the consolidated general government. The consolidation of federal and regional budgets, inclusive of all extrabudgetary funds and accounts, for the past year and the budget year was a performance criterion under the Third Annual Program of the PRGF, as well as a trigger for reaching the completion point under the HIPC Initiative. However, with the ongoing decentralization of fiscal powers to woredas (districts), ensuring the integrity of the consolidated budget reporting will be an ongoing task. Progress was also made in 2002/03 in significantly reducing discrepancies between data on the domestic and foreign financing of the budget deficit and the monetary accounts. With the assistance of an STA mission which visited Addis Ababa in August 2003, the joint reconciliation committee, composed of the Ministry of Finance and Economic Development (MOFED) and the National Bank of Ethiopia (NBE), established a short-term work program to achieve the reconciliation of provisional quarterly fiscal and monetary data for 2001/02 and 2002/03, as well as an ongoing reconciliation program. This action was also a performance criterion

under the third annual program of the PRGF and trigger for the completion point under the HIPC Initiative.

Monetary accounts

4. The monetary survey is comprehensive and normally reported with a six-week lag. A STA multisector technical assistance mission in January 2002 found that Ethiopia's money and financial statistics are broadly adequate for policy and analytical purposes, although their quality is compromised by various methodological problems. The mission recommended correcting a number of instances of misclassification of accounting data. Regarding international reserves, the mission recommended that the NBE limit its coverage to liquid foreign assets only. Finally, based on its examination of the draft version of the new report form, the mission recommended that the NBE introduce the new report form without delay.

Balance of payments

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

Social indicators

6. Data on poverty **are derived** from several household surveys regularly conducted by the Central Statistical Authority (CSA).²² In addition, the World Bank has produced reports

²² Examples of existing surveys include the Household Income, Consumption, and Expenditure Survey (1995/96 and 1999/2000) and the Welfare Monitoring Survey (1996, 1997, 1998, and 1999). Additional household and consumption surveys were carried out by the University of Addis Ababa in collaboration with Oxford University.

on Education and Health Sector Development Programs, as well as the Poverty and Policies for the New Millennium Report (1999), that contain data on the poverty situation in Ethiopia. On the basis of this information, the government, with assistance from the World Bank, has constructed welfare indicators for measuring poverty reduction, including income and expenditure per capita, income inequality, literacy, malnutrition, and infant/child mortality measures. For 2003/04, a Participatory Poverty Assessment will be conducted with support from the World Bank. Adequate data do not exist on prevalence rates of HIV/AIDS, especially among the rural population, and it is not clear whether there is sufficient monitoring of food consumption among people living in drought-prone areas.

Ethiopia: Survey of Reporting of Main Statistical Indicators
(As of December 31, 2003)

| | Exchange Rates | Net Foreign Assets of the Banking System | Reserve/ Base Money | Central Bank Balance Sheet | Broad Money | Interest Rates ¹ | Consumer Price Index (CPI) | Exports and Imports ² | Current Account Balance | Overall Federal Government Balance | GDP | External Debt/Debt Service |
|----------------------------|---------------------------|--|---------------------------|----------------------------|---------------------------|-----------------------------|-------------------------------|----------------------------------|---------------------------|------------------------------------|--|--|
| Date of latest observation | December 12, 2003 | September 2003 | September 2003 | September 2003 | September 2003 | August 2003 | November 2003 | July 2003 | July 2003 | September 2003 | 2002/03 | July 2003 |
| Date received | December 2003 | November 2003 | November 2003 | November 2003 | November 2003 | October 2003 | December 2003 | November 2003 | November 2003 | November 2003 | November 2003 | November 2003 |
| Frequency of data | Daily | Monthly | Monthly | Monthly | Monthly | Monthly | Monthly | Quarterly | Quarterly | Monthly | Annual | Quarterly |
| Frequency of reporting | Daily | Monthly | Monthly | Monthly | Monthly | Monthly | Monthly | Quarterly | Quarterly | Monthly | On mission | On mission |
| Source of data | National Bank of Ethiopia | National Bank of Ethiopia | National Bank of Ethiopia | National Bank of Ethiopia | National Bank of Ethiopia | National Bank of Ethiopia | Central Statistical Authority | National Bank of Ethiopia | National Bank of Ethiopia | Ministry of Finance | Ministry of Finance and Economic Development | Ministry of Finance and Economic Development |
| Mode of reporting | Electronic | Fax | Fax | Fax | Fax | Electronic | Electronic | On mission | On mission | On mission | On mission | On mission |
| Frequency of publication | Daily | Monthly | Monthly | Monthly | Monthly | Monthly | Monthly | Quarterly | Quarterly | Annually | Annually | Irregularly |
| Confidential | No | No | No | No | No | No | No | No | No | No | No | No |

¹ Savings and time deposits and lending rates. Yields on treasury bills at the auction are reported every two weeks.

² Export and import data are based on customs records.



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FOR IMMEDIATE RELEASE
March 1, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Fifth Review Under Ethiopia's PRGF Arrangement and Approves US\$15 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed the fifth review of Ethiopia's performance under an SDR 100.28 million (about US\$148 million) Poverty Reduction and Growth Facility (PRGF) Arrangement (see [Press Release No. 03/145](#)). The completion of the review enables the release to Ethiopia of the equivalent of SDR 10.43 million (about US\$15 million), which would bring the total amount drawn under the arrangement to the equivalent of SDR 89.85 million (about US\$133 million).

The Board also reviewed the first annual progress report of the Poverty Reduction Strategy Paper (PRSP) and determined that it continues to provide a sound basis for Fund concessional financial assistance.

The PRGF is the IMF's concessional facility for qualifying low-income countries. The purpose of the PRGF is to support programs to strengthen substantially and in a sustainable manner a country's balance of payments position and to foster durable growth, leading to higher living standards and a reduction in poverty. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year grace period.

After the Executive Board's discussion on Ethiopia, Takatoshi Kato, Deputy Managing Director and Acting Chairman, stated:

“Ethiopia's performance under the third annual PRGF-supported program has so far been commendable, despite the adverse impact on the economy of the recent drought. Growth is now recovering, food supply conditions are returning to a more normal level, and consumer price inflation is coming down.

“Ethiopia is making good progress in implementing a comprehensive and participatory poverty reduction strategy. The Executive Board looks forward to early consideration of Ethiopia's completion point under the enhanced HIPC Initiative, which will help ensure continued strong support by the international community to assist the authorities with their reform efforts.

“All performance criteria and structural benchmarks for the completion of the fifth review under the arrangement have been met. The authorities have adopted and commenced implementation of a restructuring plan for the Commercial Bank of Ethiopia (CBE), and good progress has also been made in strengthening public expenditure management. A directive has been implemented to ensure full provisioning by commercial banks for non-performing loans, in line with international best practices. Interest and exchange rates remain appropriately flexible and market-determined, with monetary policy aimed at further lowering inflation.

“Fiscal policy under the program will continue to focus on enhancing revenues, strengthening public expenditure management, and reorienting spending programs towards poverty-related activities. For 2003/04, the overall fiscal deficit (including grants) is projected to be reduced to some 7 percent of GDP. Going forward, the authorities are encouraged to continue to carefully prioritize their expenditure plans.

“Financial sector reform remains an important priority of the program. The restructuring plan for the Commercial Bank of Ethiopia is being implemented to restore its profitability and sound management, and measures are being taken to strengthen the organizational structure and finances of the National Bank of Ethiopia.

“Ethiopia has developed a strategy to address food security through a combination of increased agricultural productivity, voluntary resettlement, and safety nets. Further elaboration of the strategy will help to ensure that its costs are incorporated within the annual budgeting process, and that the strategy is integrated into a broader economic policy framework consistent with macroeconomic stability,” Mr. Kato said.

**Statement by Ismaila Usman, Executive Director for
The Federal Democratic Republic of Ethiopia
February 27, 2004**

Introduction

Ethiopia recently experienced its severest drought since 1984/85, which affected almost 13.2 million people. Its impact on the economy was widespread; real GDP declined by 3.8 percent in 2002/03, and inflation, primarily as a result of food shortages, rose to 15.1 percent. Thanks to efforts of the authorities and substantial donor support, the hardship suffered by the Ethiopian people has considerably been eased.

Despite the many difficulties posed by the drought, however, the authorities have managed to keep the program on track, and all structural performance criteria and benchmarks through end-November 2003 were observed. The authorities have, consequently, looked to the prospects of reaching the completion point early in 2004. They are, therefore, naturally disappointed that the completion point could not coincide with today's discussion. They expressed the hope that the issues surrounding the delay in the Executive Board completion point discussions will be resolved as early as possible to minimize possible disruption to their reform agenda.

Growth Outlook

Growth performance over the last fiscal year has been far below the original program target of 6 percent, mainly as a result of the drought. The slowdown is attributed to the 12.2 percent decline in agricultural production, although, modest growth rates were achieved in the non-agricultural sector. A growth rate of 6.7 percent is projected in the program, given the good rains during the current season, and the authorities are optimistic that the growth performance could even be higher than projected.

Fiscal Policy

Fiscal performance suffered as a result of the drought in 2002/03. Both tax and non-tax revenues were lower than projected and the authorities lowered the revenue estimates in the 2003/04 budget to reflect this occurrence. Various measures have been implemented to ensure that the revenue for the current fiscal year is met; including efforts to enhance collection of tax arrears, providing additional resources to improve enforcement and audit, and strengthening customs administration. The authorities expect indirect taxes to improve as they implement the needed reforms, especially in the area of VAT by strengthening the functions of the large taxpayer unit, and implementing the computerization of the tax identification numbers.

Since the revenue performance was weaker than programmed, the authorities have lowered expenditures; particularly military expenditures to ensure the overall fiscal position remains broadly on track. The authorities have reiterated their commitment to pursue a prudent expenditure policy, while increasing poverty reduction expenditures, identified in the

SDPRP. The expenditure program for 2003/04 will ensure resources for food assistance, increased poverty-targeted spending, while reducing military expenditure, and limiting the wage bill to 7.8 percent of GDP.

The authorities have finalized the consolidation of federal and regional budgets for 2002/03 and 2003/04. Reconciliation of monetary and fiscal accounts has been done for 2001/02 with technical assistance from the IMF while reconciliation of 2002/03 accounts has also been started.

Monetary and Exchange Rate Policy

Inflation rose sharply to 15.1 percent, compared to negative 7.2 percent last fiscal year, as the drought continued to affect food prices. Non-food price index, however, after rising to 1.2 percent in August 2002, dropped to 0.5 percent by the end of the fiscal year.

As regards foreign exchange market operations, the daily inter bank foreign exchange market, which began in October 24, 2001 has continued to operate smoothly. Accordingly, US\$160.4 million was traded in this market, of which US\$51.7 million or 32 percent was transacted among banks. This indicates that despite the growing role of banks, the NBE's intervention to stabilize the market continues to be an essential element. The Birr continued to steadily depreciate, albeit slowly and, by end 2002/03, the average weighted exchange rate reached Birr 8.5809/US\$ from Birr 8.5425/US\$ in the preceding year, showing a nominal annual depreciation rate of 0.45 percent.

External Sector Issues

Regarding developments in the external sector, merchandise export is estimated to have reached US\$42.7 million during 2002/03 about 7 percent higher than the previous year. Receipts from coffee increased by 1.4 percent largely due to higher volume of coffee exports despite depressed prices in the world market, as a result largely of the existence of large stock from previous year, removal of coffee price differential and waiver of the 6.5 percent export tax on coffee. Non-coffee exports have also shown robust growth of about 10 percent as receipts from oilseeds, sugar and molasses, chat, gold and cotton depicted annual increases, despite slight declines in other types of export commodities.

The external current account deficit (including official transfers) is expected to increase to 7.9 percent of GDP during 2003/04, however, it is expected that the deficit will be fully covered by project loan disbursements, balance of payments support from the AfDB and IDA, aid for special programs, and assistance under the enhanced HIPC initiative. Accordingly, it is expected that reserves would increase to about 4.6 months cover of imports of goods and non-factor services compared with 4.1 months program estimate.

During 2003, the authorities initiated a diagnostic trade integration study (DTIS) with the assistance of donors and are determined to implement the main conclusions of the study to enhance Ethiopia's integration in the global trade. The DTIS identified opportunities in four

key sectors to enhance Ethiopia's international trade; namely agriculture, livestock manufacturing, and tourism.

Financial Sector Issues

In previous Board discussions on Ethiopia, Directors have encouraged the authorities to open up the financial sector to foreign competition, as well as to enhance the competitiveness of the domestic financial market. The authorities have always stated that they had, in principle, no objection to foreign competition in the financial sector, but that the domestic financial sector and the supervisory capacity of the NBE should be strengthened first. Considerable progress has been made to strengthen the domestic financial sector over the last few years, including the restructuring of the CBE.

The National Bank of Ethiopia's (NBE) restructuring plan has been approved by the NBE Board towards the end of last year and the management have started its implementation. Meanwhile, all banks are closely monitored and supervised in line with the full provisioning for NPLs and other doubtful assets as per the revised NBE directives.

PRSP Annual Progress Report

The Ethiopian authorities finalized the First PRSP Annual Progress Report during December 2003 following broad-based consultation and support from the donor community. The Joint Staff Assessment (JSA) completed by the staffs of the Fund and the World Bank, indicates that notwithstanding the worst drought since 1984, the authorities made every effort to implement the SDPRP. To this end the SDPRP document became the basis of the government's policies and programs, and should increasingly be used by donors as a basis to provide support.

In early December 2003, the authorities launched the Partnership for a new Coalition for Food Security in Ethiopia. This initiative became a new pillar in the authorities' PRSP process, for the purpose of reducing food insecurity and output volatility within five years by increasing agricultural productivity, assisting with voluntary resettlements and providing safety nets. In this regard, the authorities are determined to encourage voluntary resettlement without jeopardizing the welfare of the settlers, and they will provide from domestic sources some of the resources for the food security initiative, while counting on significant donor support for the balance to ensure its success. Weaknesses of the current PRSP as highlighted in par. 25 of the JSA, will be addressed. The authorities view PRSP as a process to be subjected to constant review and improvement based on lessons learnt from its implementation. They are also fully committed to constantly engage civil society, the donor community and all other stakeholders in the process.

Conclusion

The Ethiopians are grateful for the Fund's support and for staff assistance under the Fund-supported program. They are also extremely grateful to the donor community for all their support and especially during the period of the last drought. The successful conclusion of

today's discussion will, as in previous occasions, serve as a further incentive and encouragement to the Ethiopian authorities to persevere and stay the difficult and painful path of adjustment and reform which they have been following for several years.