May 2006
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The Federal Democratic Republic of Ethiopia: 2005 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for The Federal Democratic Republic of Ethiopia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2005 Article IV consultation with The Federal Democratic Republic of Ethiopia, the following documents have been released and are included in this package:

- the staff report for the 2005 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 22, 2005, 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 March 6, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of March 17, 2006 updating information on recent developments.
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its March 17, 2006 discussion of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for The Federal Democratic Republic of Ethiopia.

The document listed below has been or will be separately released.

Selected Issues Paper and Statistical Appendix

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

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

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INTERNATIONAL MONETARY FUND

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

Staff Report for the 2005 Article IV Consultation

Prepared by the Staff Representatives for the 2005 Consultation with
The Federal Democratic Republic of Ethiopia

Approved by Siddharth Tiwari and Carlo Cottarelli

March 6, 2006

- **Discussions for the 2005 Article IV consultation were held in Addis Ababa from October 11-24, 2005, and in Washington DC on December 20-22, 2005**. The mission met with Prime Minister Meles Zenawi, Minister of Finance Sufian Ahmed Governor Teklewold Atnafu, other senior government officials, and representatives of the private sector, civil society and the donor community.

- The staff team comprised of Messrs. Andrews (Head), Gilmour and Erasmus (all AFR), Mr. Mattina (FAD), Mr. Hallaert (PDR), and Ms. Mitchell Casselle (MFD).

- **Key issues discussed during the consultation included:** emerging risks to macroeconomic-stability, in particular pressures on the balance of payments; the need to anchor fiscal policy on maintaining debt sustainability; the importance of monitoring the operations of public enterprises; and the risks posed by a sustained rapid increase in domestic credit growth. The mission also discussed an Millennium Development Goal scenario, drawing on the results of the MDG Needs Assessment prepared by the Ministry of Finance and Economic Development (MOFED), and the policies to support higher inflows and raise growth.

- **Ethiopia's statistical base is broadly adequate to conduct effective surveillance**, but shortcomings affect the analysis of key areas. Given the increasing role of key public enterprises in infrastructure investment, it is recommended that their activities be closely monitored and, ideally, consolidated in fiscal reporting.

- **The authorities have indicated their willingness to accept the obligations under Article VIII,** but this will require elimination of four exchange restrictions.

- **The political scene remains unsettled** following disputed national election results and violent protests. The main opposition leaders have been imprisoned, and donors have suspended budget support. Tensions have also risen over the disputed border with Eritrea.

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Executive Summary

Background

- **Violent unrest broke out during November over the disputed May 2005 national election results, and the leaders of the main opposition party have been arrested.** Donors are re-evaluating their engagement with Ethiopia, and all of their direct budget support has been suspended.

- **Economic growth remained strong in 2004/05 at 8.8 percent**, driven by another increase in agricultural production. Staff expects growth to moderate to around 5 percent per annum this year. Inflationary pressures are rising, driven by both demand pressures and higher import costs. The real effective exchange rate has appreciated moderately.

- **Domestic credit growth has accelerated**, driven by strong demand from the government, public enterprises and the private sector. A high import content, particularly from public infrastructure investments, together with higher oil imports, has translated into widening trade and current account deficits, and emerging pressures on international reserves.

Key issues and staff recommendations

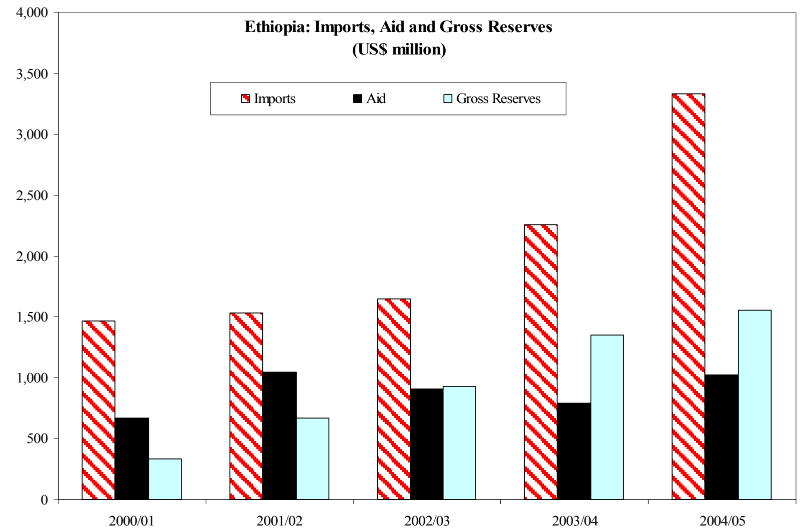
- **Staff and the authorities noted an urgent need to tighten the stance of macroeconomic policies to alleviate pressures on the balance of payments**. Staff recommended scaling back domestically financed infrastructure spending in the budget, and curbing domestic credit expansion through imposing ceilings on the credit operations of the Commercial Bank of Ethiopia. The authorities preferred to focus their response on delaying planned imports from public enterprise investments, both on and off budget.

- **The activities of major public enterprises, especially those involved in large infrastructure investment, should be included in regular fiscal reporting**. Strengthening public expenditure management is also key. Tax policy should be reviewed to ensure that its structure is conducive to expanding the tax base as the economy grows, and to cut distortionary exemptions.

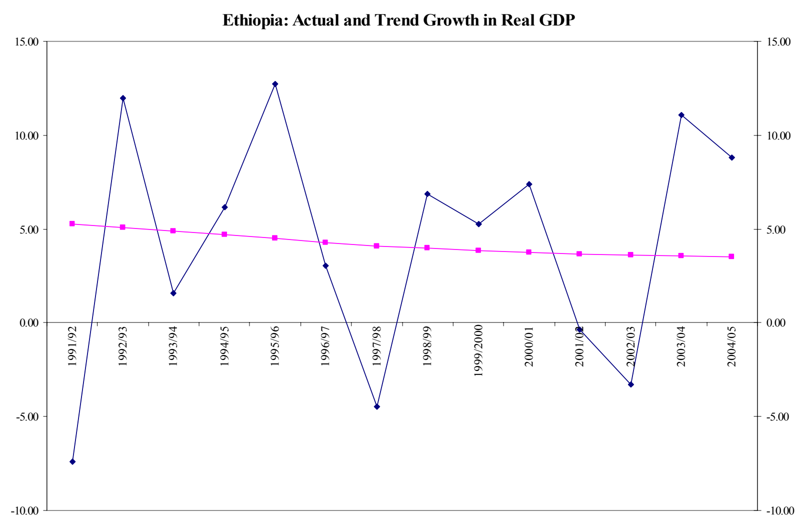
- **The pace of structural reforms to support rural and private sector development, including in the financial sector, should be accelerated** to support faster economic growth and meeting the MDGs. This will also require higher donor assistance.

I. Background and Recent Developments

1. **Following the cessation of hostilities with Eritrea in 2000, Ethiopia embarked on a PRGF-supported program, which ended in October 2004**. The program helped to restore macroeconomic stability, and supported the authorities' Sustainable Development and Poverty Reduction Program (SDPRP). Donor assistance rose rapidly, and Ethiopia reached the completion point under the enhanced Heavily Indebted Poor Country (HIPC) Initiative in April 2004 and qualified for debt relief under the Multilateral Debt Relief Initiative (MDRI) in December 2005. Initially, higher aid flows were largely saved and reflected in higher international reserves, but over the last two years imports have risen sharply.



2. **Ethiopia's largely agricultural economy remains vulnerable to climatic shocks,** which have resulted in wide swings in output, with severe adverse effects for the poor (Box 1). Average growth over the five years to 2004/05 of 4.6 percent has not been fast enough to significantly reduce poverty. World Bank reports suggest that the incidence of consumption poverty has not declined between 1990 and 2004.[1]

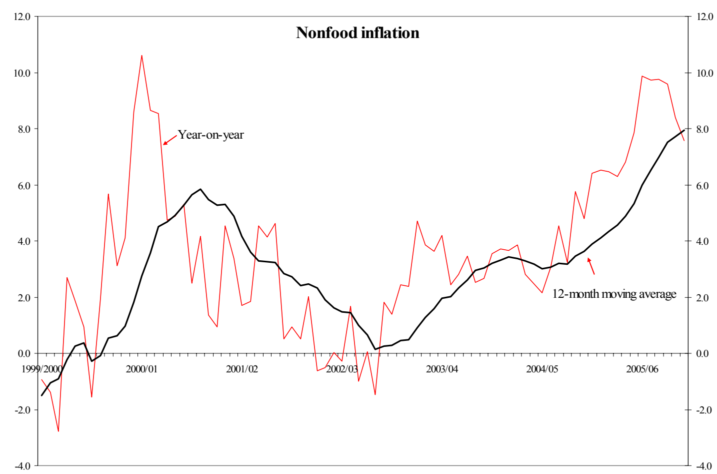


[1] World Bank (2005): Poverty Assesment. Well-Being and Poverty in Ethiopia: The Role of Agriculture, Aid and Agency.

Box 1. Food Security

While major crop producing areas are expected to see improvements in food security in 2006, pastoral areas of southern and southeastern Ethiopia are suffering from the effects of drought. The 2006 Humanitarian Appeal is seeking emergency assistance for 2.6 million people. After two successive years of good harvests, and favorable prospects for 2005/06, the number of people requiring emergency assistance is the lowest in over a decade. However, the Food Security Coordination Bureau has indicated that the total number of people needing humanitarian assistance will rise from 9 million in 2005 to 11 million in 2006, or around 15 percent of the population. In addition to those requiring emergency assistance, this includes 8.3 million people who are now considered chronically food insecure and are expected to receive assistance through the Productive Safety Net Program (PSNP). The PSNP—a multi-sectoral and multi-year program which implements intensive public works schemes using both cash and food for work mechanisms—has undergone a retargeting exercise that has raised the number of beneficiaries from 4.8 million in 2005.

3. **In the last two years, growth has been strong but there are emerging pressures on prices and, more acutely, the balance of payments.**



- In 2004/05, the economy grew by 8.8 percent, the second year of rapid expansion after the recent drought.[2] At the same time, inflationary pressures have risen. Although domestic petroleum prices were last adjusted in December 2004, non-food inflation rose to a 12-month average of 7.9 percent in December 2005. Special factors explain some of this increase, including higher imported and domestic prices for construction materials, but underlying demand pressures appear to be contributing to the highest nonfood inflation rate in a decade.

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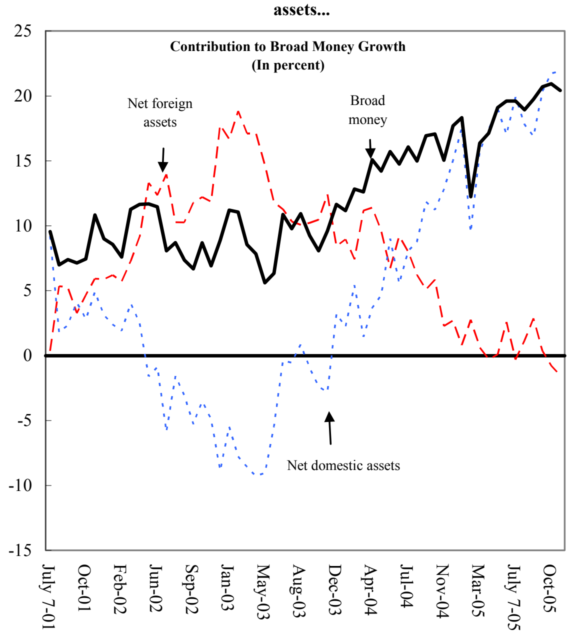
[2] The national accounts data have been revised and rebased, resulting in an upward revision to nominal GDP of over 20 percent in the new base year (1999/00). The Fund reviewed the sources and methodology for the revision, and concluded that the revised data better reflect the structure of production in Ethiopia.

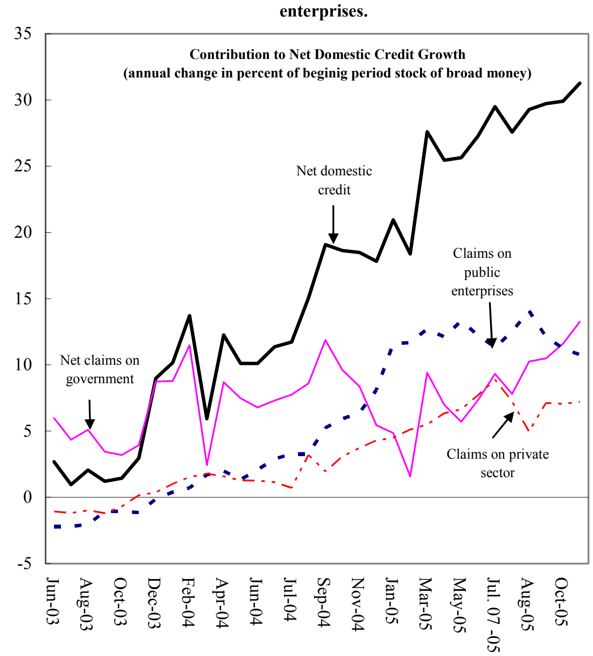
- Government's domestic borrowing rose to 3.5 percent of GDP in 2004/05—2 percent of GDP higher than budgeted—as a result of shortfalls in revenues and aid inflows, and the stock of government's domestic debt remained high at 35 percent of GDP. Capital spending rose sharply as the government began to scale up domestically-financed spending on infrastructure, which was also reflected in an increase in overall poverty spending.

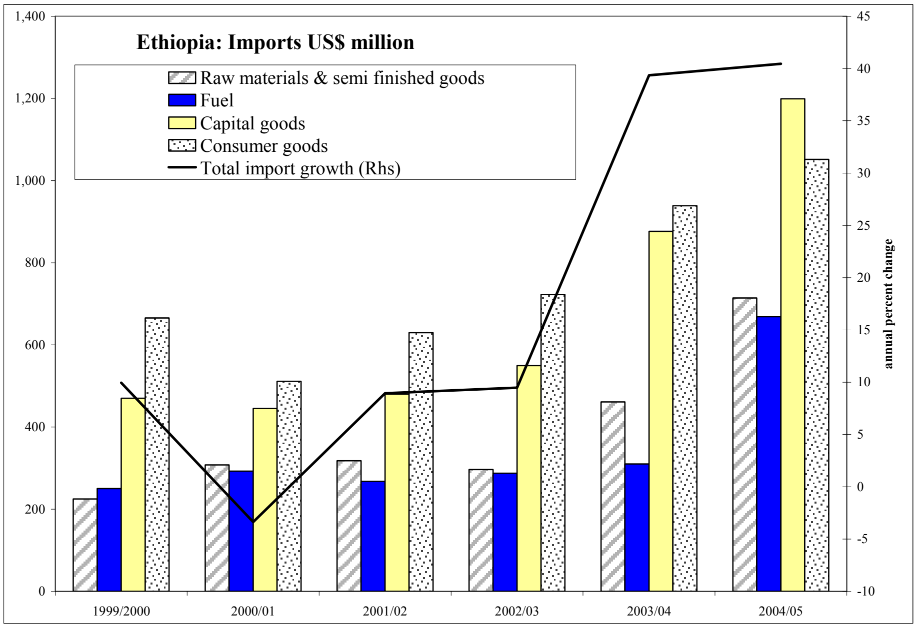
- During 2004/05, broad money grew more or less in line with nominal GDP. However, this growth was entirely due to an expansion of net domestic assets (NDA), including sharp increases in credit to the private sector and public enterprises. At the same time, commercial banks' excess reserves rose to over 30 percent of deposits as the National Bank of Ethiopia (NBE) met government's domestic financing needs, and the dominant Commercial Bank of Ethiopia (CBE) sharply reduced its holdings of treasury bills.

Broad money growth has been driven by rising net domestic assets...

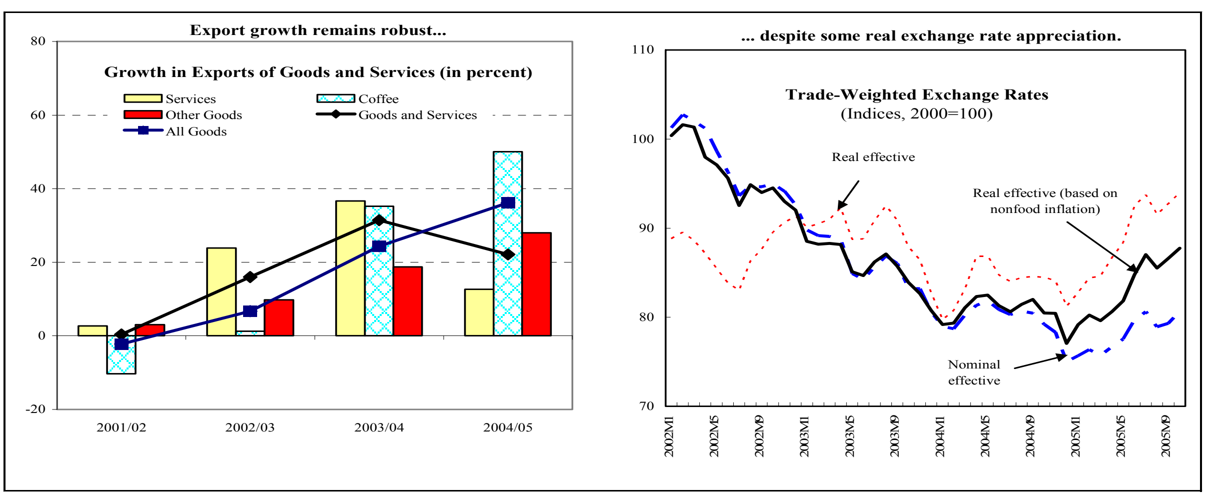


... reflecting in particular a rapid increase in credit to public enterprises.





- Ethiopia's terms of trade improved by 11 percent in 2004/05, reflecting surging coffee prices. However, the external current account deficit (after official transfers) widened by 4 percent of GDP, in spite of export growth of 36 percent. Imports—which are now almost four times larger than exports—rose by 40 percent or about US$1 billion, but only about a third of this increase reflected higher fuel costs. The overall balance moved into deficit, as reflected by the decline in net foreign assets of the banking system.



- Although the birr continued to depreciate gradually against the US dollar, the recent trend of real depreciation reversed during 2004/05, reflecting a relative strengthening of the US dollar and the pick up in Ethiopia's inflation.

- Following four years of reserve accumulation through 2004/05, NBE has begun to draw down its foreign reserves, and import cover has dropped to around 3 months during the first half of 2005/06.

4. **The mission took place against a tense political background.** The results of the May 2005 election remain in dispute. The main opposition party, the Coalition for Unity and Democracy (CUD), which officially won 109 of the 547 seats, boycotted the new parliament that was sworn in on October 10, 2005, although some opposition parliamentarians have since taken their seats. In November, violent unrest erupted again and the leaders of the CUD were jailed, and face charges that include treason. Donors have reacted by suspending their budget support. Future disbursements and aid modalities are under review;[3] donors have stressed that governance and human rights issues will be central to Ethiopia's future partnership with the international community. They have also expressed concerns that a prolonged period of political uncertainty could have adverse consequences for the business climate, investment, and private sector development. Tension has also mounted on the disputed border with Eritrea.

5. **The authorities place a high priority on maintaining macroeconomic stability and have welcomed past Fund advice in this area.** However, they have consistently argued for higher revenue projections and greater domestic financing, arguing that the latter would not jeopardize macroeconomic stability. The authorities are, for the most part, following Fund advice in strengthening revenue and customs administration, and expenditure management. The authorities remain unconvinced by the Fund's policy advice on the need for greater financial sector liberalization.

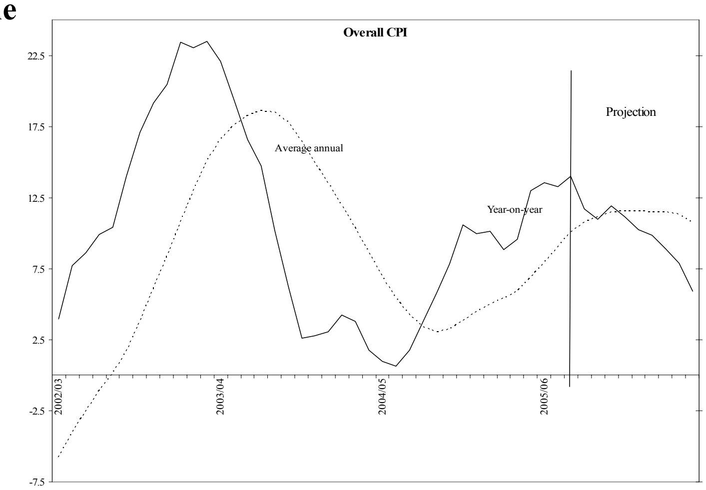
II. Prospects and the Policy Stance for 2005/06

6. **After two years of strong agricultural expansion, the staff expects the overall growth rate to ease to just over 5 percen**t. This mainly reflects an expected slowdown in crop production growth to 6.8 percent, and the likely adverse impact of recent political unrest. The agricultural assessment assumes modest growth in area under cultivation, and yield growth in line with the average rate seen in the last 14 years. However, the authorities considered that agricultural production would be stronger, noting the recent rapid increase in fertilizer imports and early crop forecasts for the main season harvest, and projected GDP growth of 7 percent for 2005/06.

[3] Donors are working to develop new modalities under which assistance would be targeted to support regional social service delivery.

7. **Food prices are expected to decline during 2005/06** from the high levels that prevailed in 2004/05 despite good harvests. However, taking into account the impact of the expected phased pass through of world market petroleum prices, the non-food index is projected to remain higher, bringing the average increase in consumer prices to 10.8 percent in 2005/06. The authorities noted that they were projecting an average inflation rate of 9.5 percent.

8. **The initial focus of discussions was on the policy response to emerging pressures on the balance of payments.** The authorities agreed that such pressures reflected a higher oil bill, large public infrastructure investments and, since November 2005, lower donor support. Initial projections in October suggested that full implementation of the budget—including an increase in capital spending of over 4 percent of GDP—and the investment programs of public enterprises, would contribute to import growth of at least 24 percent in 2005/06. Although export growth was expected to remain strong, given the small size of the export base, export receipts would finance only a small proportion of this import growth and the trade deficit would widen by around US$630 million (4.9 percent of GDP). Staff initially identified a financing gap of around US$390 million (3 percent of GDP), assuming import cover was maintained at 3 months. This was later revised up to US$600 million (4.6 percent of GDP) to reflect lower donor support.



9. **Against this background the mission saw an urgent need to tighten the policy stance, while protecting basic services.** The authorities confirmed their intention to pass on higher oil prices to consumers during 2005/06 although the timing would depend on the availability of external support for a targeted social safety net (Box 2). The focus of discussions was on containing import growth stemming from public infrastructure investments. In December 2005, the authorities indicated that for 2005/06 public enterprise imports would be lower by US$240 million (2 percent of GDP) than initially envisaged, as a result of agreed cuts in the investment programs of the electricity and telecommunications corporations (EEPCo, ETC) which could be made without breaking contractual obligations (Box 3). Consistent with these steps, planned domestic bank financing of these public enterprises would be correspondingly reduced.

Box 2. Poverty and Social Impact Assessment (PSIA) of Removing Fuel Price Subsidies

Work undertaken by the World Bank, and supported by the Fund's PSIA Unit, has concluded that there is a strong case for removing fuel subsidies as they are not pro-poor, and tie up funds which could be used for other purposes. Analysis has shown that petroleum product subsidies, including kerosene, are captured disproportionately by the rich. The lowest income quintile receives less than 10 percent of total subsidies, while the top (richest) quintile receives about 44 percent.

Retail prices for petroleum products have not been adjusted since December 2004, leading to an increasing subsidy during 2005. Removing this subsidy would not immediately affect the budget, as it is currently financed from domestic bank borrowing by the Ethiopian Petroleum Enterprise (EPE) following the depletion of the Fuel Stabilization Fund in 2004/05. Nonetheless, this debt will have to be paid out of government funds, reducing that available for other purposes.

Actual and Unsubsidized Prices for September 2005

(Birr/Litre)

	Gasoline Addis	Gasoline Outside Addis	Kerosene	Diesel oil	Light fuel oil	Heavy fuel oil	Jet fuel
Unsubsidized price (inc. taxes)	6.33	7.07	4.77	5.39	3.71	3.61	4.80
Actual fixed price (inc. taxes)	5.50	5.29	3.00	4.31	3.52	3.34	3.91
Required increase (%)	15.1	33.6	59.0	25.1	5.4	8.1	22.8

Source: World Bank

Note: The annual cost of the subsidy is running at around 2 percent of GDP. This is currently being financed by EPE domestic borrowing, incuring a large contingent liability for the government.

Annualized, the estimated amount of subsidies currently going to the top quintile is Birr 760 million. This amount could fund an additional 2.1 million people under the Safety Net Program, or 50,000 additional nurses, 3.5 times the current total.

Box 3. Public Investment Program

A key element of Ethiopia's medium-term growth strategy is to rapidly scale up infrastructure investment. This involves substantially higher on-budget capital spending for roads, food security and rural electrification. In addition, the power and telecom companies (EEPCo and ETC) have embarked on ambitious programs to expand access to basic services. Table 1 illustrates that on-budget capital spending is increasing sharply across a range of sectors. Moreover, the domestically-financed share of capital outlays has increased significantly since 2002/03.

Table 1. Ethiopia: On-budget Capital Spending

	2002/03	2003/04	2004/05	2005/06	
	Act.	Act.	Act.	Budget	Adjust.
Capital spending (as a share of GDP)	**9.3**	**9.9**	**11.9**	**16.5**	**14.4**
Selected sectors:					
Health and education	2.2	2.4	2.5	3.4	3.4
Roads	2.8	2.2	2.8	3.4	3.4
Food security and agriculture	2.2	2.7	4.2	4.9	4.9
Universal Access to Electricity Program (UAEP)	0.0	0.0	0.0	2.2	1.1
Financing (as a share of total capital spending)					
External project support	49	34	26	27	26
Own resources (incl. budget support grants and domestic borrowing)	51	66	74	73	74

Fiscal and macro policy risks are mounting as the main public utilities domestically finance large infrastructure investments. The increase in import demand fueled by these investments has contributed to significant pressure on the balance of payments. The government has also guaranteed bonds in 2004/05 issued by ETC and EEPCo totaling 3.1 percent of GDP, exposing the budget to potentially large contingent liabilities. Even after agreed cuts in 2005/06, planned large recourse to domestic financing could squeeze private sector credit and stoke inflationary pressures.

Table 2. Ethiopia: Major Public Enterprise Investment Programs
(as a share of GDP)

	2004/05	2005/06		Full Cost 1/
	Act.	Budget	Adjust.	Proj.
EEPCo: Universal Access to Electricity Program				
Projected investment outlays	**...**	**8.9**	**7.8**	**30.3**
Financing				
Own resources (to meet local currency needs)	...	2.5	2.5	8.5
Domestic financing (incl. bonds)	0.8	2.6	2.6	5.6
Budget contribution	0.0	2.2	1.1	6.6
External project financing	1.8	1.6	1.6	9.7
Import content	**1.8**	**4.5**	**3.4**	**15.2**
(in millions of US dollars)	**200**	**574**	**433**	**1,949**
ETC: Expanding fiber optics and rural connectivity				
Projected investment outlays	**2.3**	**3.6**	**2.8**	**...**
Financing				
Own resources (operating revenue plus domestic borrowing)	...	1.2	1.2	...
Domestic financing (incl. bonds)	2.3	2.4	1.6	...
Import content	**2.3**	**2.1**	**1.4**	**8.4**
(in millions of US dollars)	**255**	**274**	**174**	**1,074**
TOTAL IMPORT DEMAND	**4.1**	**6.6**	**4.7**	**23.6**
(in millions of US dollars)	**455**	**848**	**607**	**3,023**

Sources: EEPCo, ETC, NBE, and Fund staff estimates.
1/ Expressed relative to 2005/06 GDP. The full cost of EEPCo's program covers the 2005/06-2009/10 period. The ETC program covers the 2005/06-2008/9 period, and assumes imports of about $250-300 million per annum.

10. **Most of these cutbacks would take place off-budget.** However, staff also identified a financing gap of 4.5 percent of GDP in the 2005/06 budget. The authorities intend to cover this through cutting federally financed capital spending on rural electrification in the budget by Birr 1.25 billion (1.1 percent of GDP); a budgeted one-off transfer of accumulated profits from the NBE totaling 2.2 percent of GDP, and increased recourse to domestic financing to 4 percent of GDP. However, after including MDRI relief from the Fund, which was not approved when discussions concluded, domestic financing would be held to just over 3 percent of GDP.[4] In addition, they noted that any shortfall in regional revenue collection would lead to an equivalent cut in their expenditure. Staff welcomed the decision to contain capital spending, and recognized that raising domestic financing was, in principle, an appropriate response, provided the decline in aid flows was temporary. However, staff noted that higher domestic financing from the NBE and the profit transfer would involve issuing base money. To address this concern, as well as to help reduce excess reserves in the banking system, the authorities indicated that they would rely predominantly on issuing treasury bills to commercial banks to fund the budget deficit.

Ethiopia: General Government Operations, 2002/03-2005/06
(In percent of GDP)

	2002/03	2003/04	2004/05	2005/06		
	Act.	Act.	Prelim. Est.	Budget	Pre-adjust. Staff Proj.	Adjust. 1/ Scenario
Total revenue and grants	23.0	21.4	20.7	25.2	21.2	23.5
Revenue	16.4	16.6	16.0	19.0	16.5	18.1
Grants	6.7	4.8	4.7	6.2	4.7	5.4
Total expenditure and net lending (cash basis)	29.1	24.1	25.4	30.5	30.5	28.4
Recurrent expenditure	19.9	14.3	13.5	14.1	14.1	14.1
Capital expenditure	9.3	9.9	11.9	16.5	16.5	14.4
Special programs	1.0	0.3	0.2	0.0	0.3	0.3
Unidentified financing						
or measures to be identifies (- over financing)	-1.1	-2.4	-1.1	0.0	4.5	0.0
Overall balance						
Including grants	-8.1	-5.5	-6.0	-5.3	-5.1	-5.2
Excluding grants	-14.8	-10.2	-10.7	-11.5	-9.8	-10.7
Excluding Multilateral Debt Relief Initiative (IMF)	...	...	...	...	...	-6.1
Financing	8.1	5.5	6.0	5.3	5.1	5.2
Net external financing	5.7	2.9	2.5	1.8	2.1	2.1
Total net domestic financing	2.4	2.6	3.5	3.5	3.0	3.1
Domestic (net)	2.4	2.6	3.5	3.5	3.0	4.0
Multilateral Debt Relief Initiative, account held at NBE	...	...	...	...	...	-0.9
Memorandum items:						
Poverty-reducing expenditure 2/	12.6	12.1	14.5	17.0	17.0	17.0

Sources: Ethiopian authorities; and Fund staff estimates and projections. The Ethiopian fiscal year ends July 7.
1/ Reflects the authorities' measures to address staff's identified financing gap, and receipt of Fund MDRI relief.
2/ Poverty-reducing spending is defined consistently with the SDPRP to include total spending on health, education, agriculture, roads and food security

11. **Based on five months of import data, the authorities also revised down the 2005/06 oil bill by US$200 million over that projected in October 2005, to**

[4] Total MDRI relief from the Fund, equivalent to 0.9 percent of GDP, is included in the 2005/06 data. However, its use is not included in the projections, as discussions are continuing on the appropriate spending of this relief. The authorities have indicated that they plan to address the use of all MDRI resources, including from the World Bank and African Development Fund, in their budget planning exercise for 2006/07.

US$700 million. This reflects an exceptional increase in oil import volumes in 2004/05, and results in projected oil imports which are around 5 percent higher than the previous three-year average. Taking all these elements into account, they considered that reserves would be held at over 3 months of import cover, and macroeconomic stability maintained.

12. **Staff was of the view that the authorities' revised scenario still involved significant risks for the balance of payments.** Oil imports may be higher than projected, particularly if fuel prices are not raised. In addition, despite the proposed cuts in public enterprise spending, sustained rapid domestic credit growth could have adverse implications for the balance of payments, prices and public domestic debt levels. In this connection, staff noted the combination of higher domestic financing of the budget deficit, the planned recourse to domestic bank credit by public enterprises in 2005/06, and continued strong growth in credit to the private sector credit. Moreover, without the assumed pass through of higher oil prices, credit to the EPE to fund the subsidy would crowd-out financing for the private sector.

13. **The authorities stressed that they would take additional measures as necessary to defend the reserve position at 3 months,** and noted their success in doing so during past difficult times. Staff welcomed this commitment, but cautioned that recourse to administrative controls should be avoided to prevent any adverse impact on the private sector.

III. BASELINE MEDIUM TERM SCENARIO

14. **Discussions on medium term prospects and policies took place around two scenarios,** which were drawn from the preliminary frameworks presented in the authorities' draft Plan for Accelerated and Sustained Development to End Poverty (PASDEP).[5] [6]

- **Staff's baseline scenario**, which is not explicitly geared to attaining the MDG, assumes that growth averages just over 5 percent, consistent with the low case scenario in the PASDEP, and slightly above the trend rate in the last ten years; an annual average inflation of 6 percent, and the restoration of reserve cover to around 3.4 months of imports. While prospects for aid flows remain highly uncertain, the baseline scenario assumes that aid flows begin to rise again in 2006/07, and return to

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[5] The PASDEP, the second generation PRSP, will replace the Sustainable Development and Poverty Reduction Program which covered the three years to 2003/04.

[6] During the October mission both a baseline and an MDG scenario were discussed based on the then existing Macroeconomic and Fiscal Framework (MEFF), and the draft MDG Needs Assessment Synthesis Report. Subsequently the draft PASDEP was issued with a revised MEFF drawn from the Needs Assessment and showing financing gaps. In December, the authorities agreed that the two frameworks needed to be updated; discussions on the medium term scenarios were concluded in February through the Fund's resident representative in Addis Ababa.

the levels originally budgeted for in 2005/06. Thus, the baseline implicitly assumes sufficient progress is made in addressing donors' concerns to allow such a resumption in aid flows.

- **The MDG scenario** draws upon the Needs Assessment, which estimated the costs of reaching the MDGs. In addition to incorporating faster growth of 7 percent on average—required to halve poverty by 2015—the scenario includes a large expansion in spending on key services and infrastructure, and a corresponding increase in aid. The key elements of this scenario, and the policy framework to support it, are summarized in Box 4.[7]

A. Fiscal Policy

15. **Staff noted that the baseline scenario in the PASDEP entailed significant financing risks.** These stemmed from planned increases in expenditure, especially capital spending (by nearly 9 percent of GDP between 2004/05-06/07) and very ambitious revenue projections, which entailed risk that recourse to domestic financing would increase over the already high levels planned (as occurred in 2004/05).

16. **Staff recommend that the authorities develop a fiscal framework which shows how expenditure will be prioritized on the basis of likely resource availability and in line with the growth strategy.** Although such a prioritization is not yet available, staff's baseline scenario presented here assumes lower expenditure than in the PASDEP to produce a fully financed medium-term fiscal framework that allows for increased pro-poor spending, and is consistent with declining domestic debt levels. Thus, while the PASDEP shows financing gaps needed to be filled to support planned expenditures (Tables 2, 3, 4), staff's baseline scenario[8] reflects the authorities' commitment to cut nonpriority spending (and maintain reserve cover). The path of domestically financed capital spending thus reflects the available fiscal space, including shifts in NBE profit transfers and assumed increases in tax revenues. The latter reflects buoyant international taxes, a recovery in business income taxes, and expected administrative improvements.

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[7] See the accompanying selected issues paper for a fuller presentation.

[8] In line with staff's lower revenue projections; recommendations on domestic borrowing, and policy discussions in October.

Box 4. An MDG Scenario

Discussions on strategies for achieving the MDGs formed an integral part of the 2005 Article IV consultation, and served to update work started on an MDG scenario during the 2004 consultation. The updated scenario incorporates the lower bound estimate of total public sector costs (US$58 billion), presented in the MDG Needs Assessment Synthesis Report prepared by MOFED, and an annual expenditure framework guided by simulations produced by the World Banks' MAMS model, which provides for a front-loading of infrastructure investments in line with the authorities strategy.

Discussions with the authorities focused on the policies and macroeconomic framework to accommodate higher aid inflows and promote faster growth. Key challenges identified included:

- increasing agricultural productivity, and ensuring that supporting policies are in place to achieve the expected private sector productivity response to improved infrastructure provision, necessary to raise GDP growth rates;

- raising fiscal revenues by over 5 percentage points of GDP in order to cover the recurrent costs of higher spending, and allow for an exit strategy from high aid dependence;

- strengthening public expenditure management and capacity building to ensure the effective implementation of expenditure plans, including infrastructure investments of public enterprises;

- addressing potential labor market constraints through appropriate investment and training in order to ease pressures on wages;

- managing the sequence of spending to mitigate potential pressures on the real exchange rate through an initial focus on import heavy infrastructure investment which results in productivity gains, and eases labor constraints at a later date when the emphasis shifts to recurrent spending.

Box 5. UN and World Bank Assessment of Progress Towards the MDGs

An assessment by the government, United Nations Country Team, and World Bank considers that a sub-set of the MDG Goals 1, 3 and 7 are likely to be achieved under current trends, while Goal 2 could be achieved even before 2015. Achievement of all MDGs by 2015 will require improved policies to strengthen institutions and support efforts to raise real GDP growth in a sustainable manner, as well as significantly higher aid flows.

Ethiopia: Millennium Development Goals - recent trends, and required growth

	Average 1990-2000	Required growth 2001-2015
Goal 1 - eradicate extreme poverty and hunger		
Poverty headcount (%)	-0.8	-4.5
Population below minimum level of dietary energy consumption (%) 1/	-3.2	-3.4
Goal 2 - achieve universal primary education		
Gross primary enrollment ratio (% of relevant age group)	6.7	3.3
Proportion of pupils starting grade 1 who reach grade 5	12.8	4.1
Goal 3 - promote gender equality and empower women		
Ratio of boys to girls in primary and secondary education	2.9	1.9
Goal 4 - reduce child mortality		
Reduce under-5 child mortality rate by two-thirds (per 1,000)	-0.5	-2.7
Goal 5 - improve maternal health		
Reduce by three-quarters maternal mortality rate (per 100,000 live births)	3.9	-1.9
Goal 6 - combat HIV/AIDS, malaria and other diseases		
Halt spread of HIV/AIDS (% of population)	...	0.0
Halt incidence of other major diseases - tuberculosis (per 100,000 people)	9.6	0.0
Goal 7 - ensure environmental sustainability		
Access to an improved water source (%)	9.9	5.7
Access to improved sanitation	3.2	19.7

1/ 1995-2000;

Source: World Bank Development Indicators, April 2005; Millennium Development Goals Report: Vol. 1, Ministry of Finance and Economic Development and United Nations Country Team, March 2004; and staff calculations

17. **The mission argued that the medium-term fiscal projections, including under the MDG scenario, should be anchored by the need to ensure domestic debt sustainability**. Ethiopia's domestic debt is high compared with other countries in sub-Saharan Africa although, as a result of very high levels of excess reserves in the banking system, interest rates are negative in real terms, and therefore servicing this debt does not place a heavy burden on the budget. However, over the medium term, it would be prudent to expect interest rates on government debt to become positive in real terms as excess reserves decline and competition in the financial sector increases. In addition, targeting a gradual reduction in the domestic debt stock is important to provide the flexibility to respond to unforeseen shocks,

particularly climatic shocks that call for additional expenditures and adversely affect revenue performance.[9] The baseline thus projects a decline in domestic financing of the budget from 4 percent of GDP in 2005/06 to 3 percent by 2008/09, allowing a small reduction in the debt stock to about 32 percent of GDP by 2009/10.

Regional Comparisons of Revenue Performance

	Revenue	Tax revenue	VAT collection	Income tax collection	Customs duties	Excises
Tanzania	12.7	11.7	4.4	3.2	1.2	1.9
Kenya	21.7	19.6	5.3	7.3	1.9	3.4
Mozambique	12.3	11.5	4.7	2.6	1.7	2.2
Uganda	12.6	11.7	3.9	3.4	1.0	3.4
Zambia	18.4	17.7	5.3	7.9	2.1	2.4
Ethiopia-Old GDP	**19.2**	**15.2**	**2.3**	**4.2**	**6.8**	**0.6**
Ethiopia-New GDP	**16.0**	**12.7**	**1.9**	**3.5**	**5.7**	**0.5**

Ratios are calculated on the basis of data for 2003/04 for Kenya, Tanzania and Uganda and calendar year 2004 for Mozambique and Zambia. Ethiopia data is 2004/05.

18. **The mission and authorities agreed that the lower tax ratio resulting from the upward revision to GDP provides a more realistic picture of Ethiopia's revenue effort**. This underlined the need to improve the buoyancy of the tax regime, both through strengthening tax administration, and a review of tax policy. In addition, large revenue increases will be required to match increases in recurrent spending on infrastructure, as well as a potential increase in service delivery related to the MDGs, in order to provide for an orderly exit from potentially higher aid inflows. In this context, the authorities have requested technical assistance from the Fund to review tax policy.

19. **Regarding tax administration, the mission recommended a focus on the following areas**:

- strengthening the functional organization and capacity of revenue administration;
- encouraging regions to centralize revenue administration;
- further strengthening of customs administration; and
- avoiding future tax amnesties to avoid undermining taxpayer compliance, and maintain equitable burden sharing across taxpayers.

[9] For an analysis of domestic debt in fiscal policy and macroeconomic stabilization see the accompanying selected issues paper.

B. Monitoring Public Enterprises

20. **The mission noted that fiscal reporting should include the activities of major public enterprises.** The budget has on-lent significant external financing to key public enterprises, and has guaranteed substantial new domestic financing from the banking system. To account for these heightened fiscal risks, and to better measure the impact of public investment on the broader economy, key public enterprises could be consolidated into fiscal reporting and the budget. Alternatively, the budget could include a detailed annex outlining the activities of the largest public enterprises, including an overview treatment of new borrowing guaranteed by the government.

21. **The authorities did not support the proposal of consolidating public enterprises into the budget.** They agreed that monitoring public enterprises was important and noted that this was already undertaken by various government agencies, principally on the basis of audited reports. In response, staff stressed that what was needed was more than just monitoring individual enterprises. Their operations need to be pulled together and placed within a broader macroeconomic context so as to allow for an assessment of their macroeconomic consequences – the recent import pressure stemming from the operations of EEPCo and ETC attested to the importance of such work.

C. Strengthening Public Expenditure Management

22. **The mission reiterated the importance of reforms to strengthen public expenditure management and reporting.**[10] Key steps include:

- rolling-out the budget disbursement and accounting system;
- implementing performance-based budgeting, and undertaking regular and timely reconciliation of the fiscal and monetary accounts.

23. **In addition, the Fiscal Decentralization Strategy poses particular challenges,** in that subnational governments are responsible for executing the bulk of social spending. Given their key role in providing essential services, the adequacy of federal transfers should be carefully assessed to avoid any unfunded mandates in pro-poor sectors.

24. **The mission stressed that timely fiscal reporting is essential for fiscal and macro policy management, and to enable budget appropriations to be linked to past performance.** Priority measures include:

- Prompt dissemination of quarterly budget execution reports, and clearing the backlog of federal fiscal accounts to be finalized and audited by end-2005/06.

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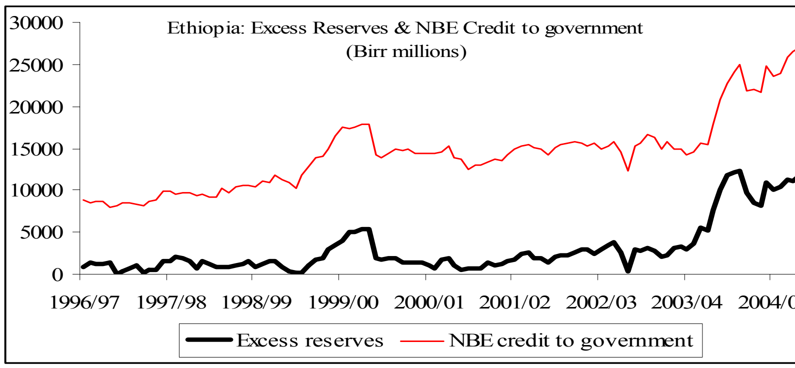
[10] Ethiopia has met only 7 out of the 16 benchmarks under the 2004 Assessment and Action Plan framework, although staff consider there has been some improvements since then.

- Strengthening assistance to regional governments in order to expedite the clearing of the average 2-year backlog of sub national accounts.

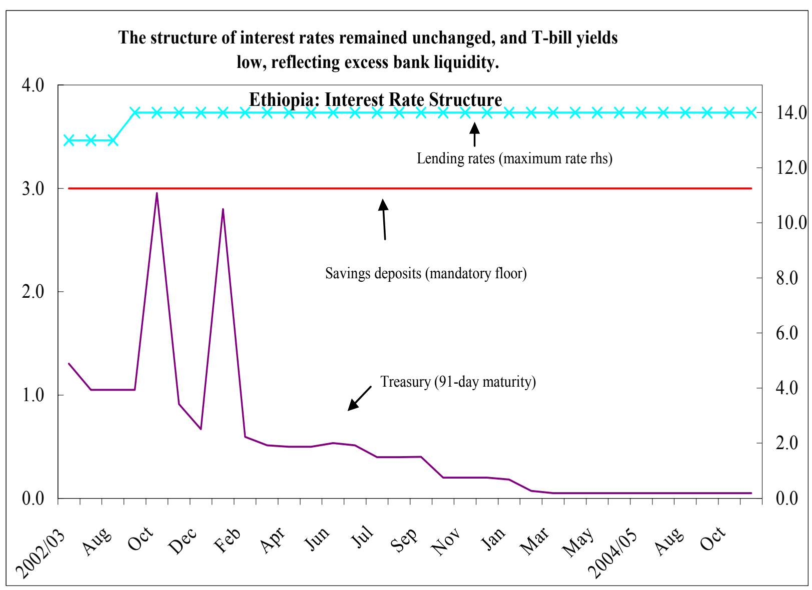
- The regular inclusion in fiscal reports of all the extra budgetary funds, and more timely consolidation of budget reporting by woredas and regions.

The authorities concurred on the importance of strengthening PEM, and have requested technical assistance from the Fund.

D. Monetary and Exchange Rate Policy



25. **Discussions on monetary policy focused on the risks posed by a sustained rapid increase in domestic credit growth to public enterprises and the private sector.** The mission noted that some restraint appeared necessary to moderate import demand and inflationary pressures. In this context, high levels of commercial bank excess reserves were a particular concern. As well as precluding the effective use of indirect monetary instruments, these excess reserves enabled banks, particularly the CBE, to expand credit rapidly, particularly to public enterprises.

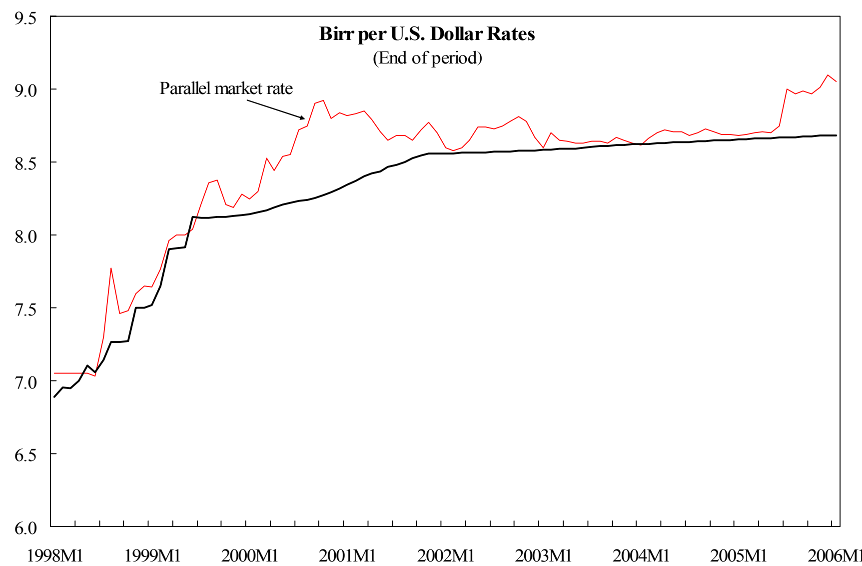


26. **Against this background, the mission proposed that, despite the risks that it could give rise to distortions, imposing a direct ceiling on the credit operations of CBE provided the most reliable means of guarding against excessive credit expansion.** At the same time, staff recommended that government's domestic borrowing requirement be met principally through recourse to commercial bank financing, rather than the NBE, to avoid adding to excess reserves. The large infrastructure financing plans of public enterprises also argued for a

closer coordination and monitoring of such activities with fiscal and monetary policy to ensure monetary stability. In this context the staff recommended that adoption of the Integrated Monetary Data Base (IMD)[11] should be a priority.

27. **The authorities acknowledged the emerging pressures in the economy, and agreed with the proposed shift to commercial bank financing of the budget**. However, they felt that the proposed cuts in public infrastructure investments were sufficient, and that there was no need to introduce credit ceilings at CBE. Further they stressed that they would use all applicable measures to maintain monetary stability and reserve targets, if and when necessary.

28. **The recent modest appreciation of the real exchange rate does not appear to be affecting competitiveness.** Annual export volume growth averaged close to 20 percent during 2003/04-04/05, and is projected at 16 percent in 2005/06. The authorities are actively pursing a policy of export diversification which is yielding results, and of strengthening infrastructural support for industry and agriculture in general. In addition, Ethiopia's terms of trade have improved. While rising imports are a concern, they currently mainly reflect the activities of public enterprises and higher oil prices.



29. **The mission noted that the exchange rate remained tightly managed, and that its recent evolution appeared more representative of a crawling peg against the US dollar than the official policy of a managed float**. In addition, de facto intervention had increased in recent months as the NBE had made foreign exchange available for imports; gross reserves declined by US$320 million in the first half of 2005/06, to around 3 months import cover. Following recent political unrest a premium averaging around 4 percent, has also emerged in the parallel market.

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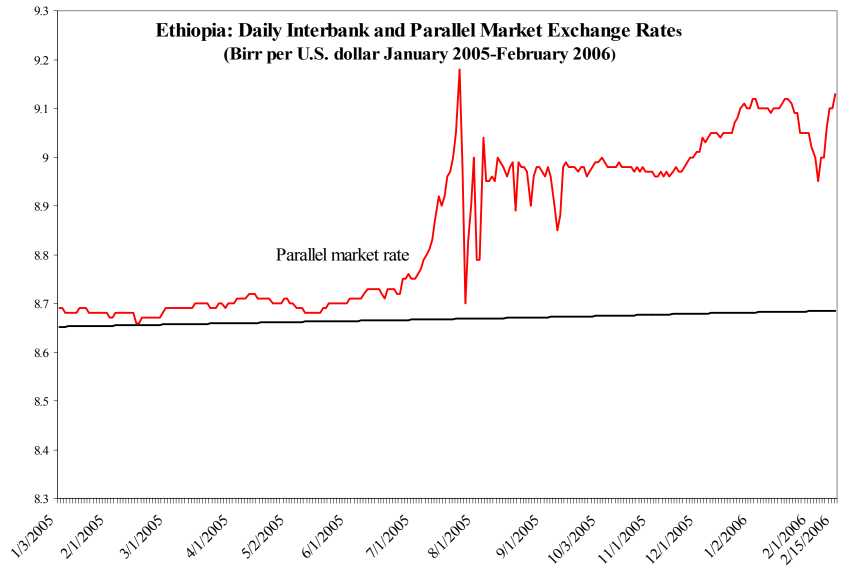
[11] The IMD has been developed with the Funds statistical department to remedy data classification problems in the existing monetary survey, and to improve the quality and coverage of monetary data.



30. **These developments raised questions about the desirability of maintaining such tight exchange rate management.** In this context staff argued that, although the current level of the exchange rate did not appear to be presenting immediate competitiveness problems, the rigidity of the exchange rate policy did involve considerable risks for the balance of payments in a forward looking perspective. Staff argued that greater flexibility was therefore needed to allow the exchange rate to reflect balance of payments developments, and avoid the risk of an unsustainable real appreciation. The authorities agreed that greater exchange rate flexibility could play a role in responding to balance of payments developments, and indicated that the exchange rate would be allowed to adjust during 2005/06 as part of a coordinated response to any additional balance of payments pressures that may emerge.

E. Financial Sector

31. **The authorities confirmed that they are continuing to implement the financial sector strategy as outlined in 1998**. This aims to direct resources through the state dominated banking system to priority sectors, primarily through the Development Bank of Ethiopia; to link the financial sector to the strategy of Agricultural Development Led Industrialization—principally through development of the MFI sector—and to develop a sound financial system that can sustain liberalization in due course. In the meantime, market forces will play a limited role in setting interest and exchange rates, and foreign bank entry will not be allowed. The authorities also confirmed that they view excess reserves of commercial banks as "savings" which can, and should, be mobilized in support of public infrastructure development.

Box 6. Banking Sector Soundness

The banking sector continued to show signs of improvements during 2004/05. Reported NPLs showed a steady decline as a percentage of total loans, and all banks reported capital adequacy ratios (CAR) above the minimum required ten percent, except the state owned Construction and Business Bank (CBB) at 9.7 percent. The authorities indicated that a decision was pending as to how to deal with CBB's capital shortfall, including a possible sale of the bank.

Bank Soundness Indicators

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Capital adequacy ration	9.9	12.4	13.0	11.9	11.7	11.1
NPL to total loans	23.0	28.2	43.8	40.5	26.4	19.9
of which: public banks	24.3	32.6	50.5	51.9	35.4	27.4

(see Table 8 for additional data and sources).

The CBE continued to implement its financial restructuring program and met the plan's NPL and CAR targets for 2004/05. The plan aims to reduce the NPL ratio to 15.6 percent by end 2006/07 through a combination of cash collection, rescheduling/renewals and foreclosures, and to maintain a CAR above 10 percent.

CBE Financial Restructuring Plan

	2003/04		2004/05	
	Plan	Actual	Plan	Actual
NPL ratio	37.5	39.1	29.2	27.2
Capital adequacy ratio	10.8	11.7	11.5	10.8

While welcoming the encouraging performance, the mission cautioned that the rate of increase in bank credit to the non-government sector raises some concerns, particularly if sustained. Although the NPL ratio has declined, there has been some increase in the nominal stock of NPLs of private banks. Efforts are needed to preserve bank's asset quality, and NBE should look to undertake comprehensive examinations for loan quality and risk management practices at all banks on a more timely basis.

(i) Does not include data for DBE or the Cooperative Bank, which commenced operations in March 2005.

32. **The mission recommended that further financial sector reform be considered over the medium term,** and reiterated that increasing competition in the banking system, along with a reduction in the relative size of CBE, remains central to improving the environment for the implementation of monetary policy**.** Further, without a clear strategy, there is a risk that the gains from a potential scaling up of expenditure will not translate into a sustained private sector response. The forthcoming World Bank Financial Sector Capacity Building Project,[12] will help prepare the ground for broader policy reform in due course, and in support of this, the Fund is providing technical assistance in the areas of bank supervision and payment systems.

F. Infrastructure Spending, Productivity, and Private Sector Development

33. **The mission agreed with the authorities that improving Ethiopia's infrastructure was essential to enhance growth prospects**. Substantial investments would be required to bring key indicators of Ethiopia's infrastructure even to average levels seen in sub-Saharan Africa. However, the beneficial effects of such investment—including the "crowding-in" of private investment and a lagged improvement in total factor productivity consistent with higher growth performance—would depend on the choice and quality of the investments, as well as a policy environment conducive to private sector development.

Ethiopia: Infrastructure Gap Indicators

	Access to water source (% of population)	Road Density (km/sq. km of land)	Installed electrical capacity per 1,000 persons (kW)	Electricity consumption per capita (kWh)	Average telephone mainlines per 1,000 persons
Year	2000	1999	2001	2001	2002
Developed countries	99	0.43	2,044	8,421	585
Sub-Saharan Africa	58	0.07	105	456	15
Low income countries	76	0.18	n/a	317	28
Least developed countries: UN classification	62	0.06	n/a	89	7
Ethiopia	**24**	**0.03**	**8**	**22**	**5**

Source: World Development Indicators.

[12] The authorities confirmed that support for the newly formed Financial Public Enterprise Agency would center on corporate governance, and that the agency would not be taking over supervisory responsibility for state owned public financial institutions from the NBE.

34. **The mission also noted that the economic contribution of the private sector remains limited.** Recent positive developments, such as the resumption of the privatization program, an easing the regulatory burden, and the introduction of a competition policy, are welcome, but further reforms are needed. A comparison of the business climate in Ethiopia with that in Vietnam (see Box 7)—which shares some elements of the growth strategy that Ethiopia is following— confirms that the business environment remains difficult. In addition, there is a risk that recent political developments may impede private sector development, and adversely affect private investment, including foreign direct investment (FDI).

Box 7. Investment Climate: Ethiopia and Vietnam: A Comparison

A comparison of the two countries' business environments reveals some significant differences. Ethiopia is rated 106th out of 117 countries by the World Economic Forum's 2004/05 Global Competitiveness Report; Vietnam is rated 81st. While Ethiopia compares relatively well in terms of providing a supportive regulatory environment, it is much more costly to start a business, and gain access to credit than in Vietnam. Ethiopia also compares unfavorably on most governance indicators, and in the supply of skilled labor and infrastructure services. These factors may help explain why FDI in Vietnam – typically in the form of a joint venture between foreign partners and a state owned enterprise - has played a larger role than in Ethiopia.

Table 1. The Cost of Doing Business, 2004

	Ethiopia	Vietnam
Starting a Business		
Number of procedures	7	11
Time (days)	32	56
Cost (% of income per capita)	77.4	28.6
Minimum capital (% of income per capita)	1821.9	0
Registering Property		
Number of procedures	15	5
Time (days)	56	78
Cost (% of property value)	11.0	5.5
Getting Credit		
Cost to create collateral (% of income per capita)	10.6	2.0
Legal rights index 1/	5	4
Credit information index 2/	0	3
Protecting Investors		
Disclosure Index 3/	2	1
Enforcing Contracts		
Number of procedures	30	37
Time (days)	420	404
Cost (% of debt)	14.8	30.1
Closing a Business		
Time (years)	2.4	5.5
Cost (% of estate)	8	18
Recovery Rate (cents on the dollar)	40	16

1/ The index range from 1-10, with higher value indicating that collateral and and bankruptcy laws are better designed to expand access to credit.
2/ Index ranges from 0-6, with higher value indicating that more credit information is available from either public registry, or private bureau to facilitate lending decisions.
3/ Index ranges from 0-7, with higher value indicating more disclosure.

Source: World Bank-http://rru.worldbank.org/doingbusiness/.

Figure 1. Governance Indicators: 2004
(Percentile rank)

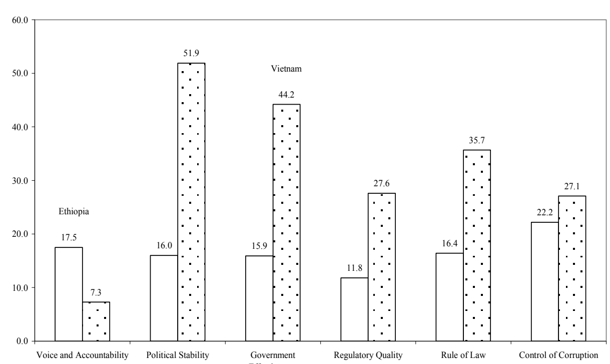


Table 2. Supply of skilled labor and infrastructure

	Ethiopia	Vietnam
Primary completion rate (percent of relevant age group)	39	95
Improved water source (percent of population with access)	22	73
Rail lines (total route-kilometers)	681	2,454
Electricity production (millions of kwh)	2,045	35,796
Paved roads (percentage of total roads)	12	25
Telephone mainlines (per 1,000 people)	6	54

Source: World Bank, World Development Indicators 2005.

35. **While admiring of Vietnam's performance, the authorities indicated that their interventionist strategy was guided more by the East Asian experience of the 1970s**,[13] and noted that this involved less liberalization than currently pursued by Vietnam. They restated their view that the export sector would not develop without state intervention, and noted priority sectors — horticulture, floriculture, textiles, garments and leather. Support for these sectors is being provided through the establishment of training institutes, access to land at reduced prices, long term credit, tariff exemptions, and tax holidays. However, the authorities also stressed that work was underway, supported by the World Bank, to improve private sector development, including efforts to improve government service delivery, and address issues around access to credit.

36. **Staff noted that historically, growth in agricultural production has been driven by increases in cultivated land, rather than improvements in productivity**. Given pressures on land, sustaining higher rates of growth in agriculture production will require substantial improvements in productivity.

G. Trade Policy

37. **Trade policy discussions focused on tariff structure and exemptions.** Ethiopia's average tariff rate of 17 percent is just above the average for sub-Saharan Africa. However, the top bands of 30 and 35 percent apply to about half of all imports and provide higher rates of protection to the manufacturing sector. In addition, a "second schedule" grants almost 700 partial or full exemptions to selected industries. Staff recommended that the authorities consider lowering, or merging at a lower level, the top two tariff bands, noting that the resulting revenue losses could be significantly reduced by removing the exemptions covered by the second schedule which gives rise to widespread distortions. The authorities recognized the importance of such issues, and confirmed their willingness to review such trade policy, while noting their desire to use trade instruments to achieve industrial policy objectives.

38. **The mission noted that a tariff reduction would also ease the move towards the COMESA FTA**. However, the authorities indicated that they are not yet ready to join due to concerns over the impact on revenue and competitiveness. They also expressed a reluctance to alter the trade regime just as the Memorandum on the Foreign Trade regime is about to be sent to the WTO.

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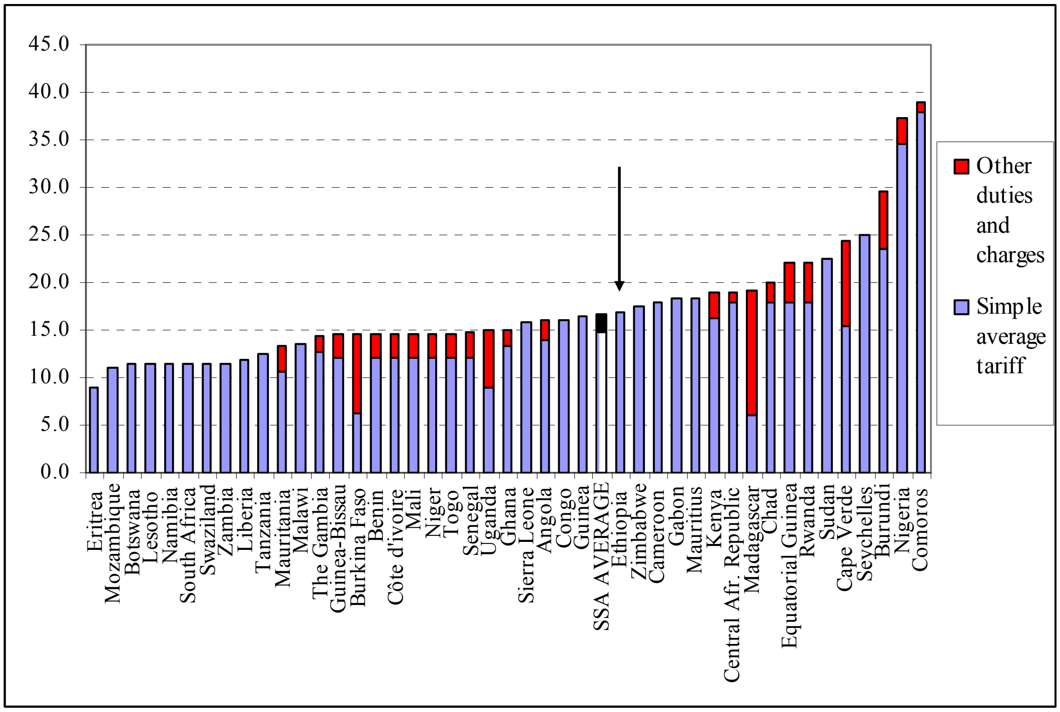
[13] The growth strategies in South Korea and Taiwan Province of China during this period were seen as including a heavy reliance on public enterprises, an extensive set of industrial policies that took the form of directed credit, trade protection, export subsidization, tax incentives, and other interventions, with neither country undertaking significant deregulation or liberalization of their trade and financial systems until well in the 1980s.

SSA average tariff on imports based on the Fund's Trade Policy Database



H. External Outlook and Debt Sustainability

39. **Prospects for the balance of payments depend crucially on levels of external assistance and timely policy responses to any pressures.** While export prospects are positive, they remain vulnerable to exogenous shocks. In addition, managing a timely slowdown in import growth commensurate with available foreign exchange may be a challenge, putting the projected level of reserve cover at risk.

40. **Staff updated the joint Fund-Bank debt sustainability analysis** (see Annex 1), and included Fund[14] debt relief under the MDRI.While the external ratios have improved with the delivery of debt relief—and will do so further once MDRI relief from the World Bank and African Development Fund is approved—the analysis implies a moderate risk of debt distress, and highlights the necessity of securing grant financing and containing domestic borrowing. In this context, staff stressed that development of a comprehensive public debt management strategy, to specifically include public enterprise debt and contingent liabilities, remains a priority.

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[14] This amounts to approximately US$114 million.

IV. Technical Assistance, Data Issues, and Article VIII

41. **Recent assistance has focused on fiscal and monetary policy formulation, strengthening bank supervision, and improvements in the quality and timeliness of core data that are considered key for surveillance purposes**. As well as previously mentioned requests in the fiscal area, the authorities expressed interest in technical assistance in the areas of the consumer prices index[15] and measurement of FDI. The authorities indicated that the IMD will be adopted during 2006, and the move to the balance of payments manual five reporting finalized.

42. **The mission enquired about the status of remaining current account exchange restrictions which the Fund considers to be inconsistent with Article VII**I, Section 2(a) of the IMF's Articles of Agreement (see Appendix I, IX). The authorities maintained their position that these measures did not, in their view, constitute current account restrictions, and expressed interest in further discussion and clarification of these issues between NBE and the Fund's legal department.

V. Future Relationship with the Fund

43. **The authorities expressed their desire to maintain a close dialogue and relationship with the Fund**. They noted that access to Fund financing was not the main consideration, but that they needed the Fund's signal to donors on the suitability of their macro-framework for an effective use of a scaling up of aid. In this context they considered the Fund as a partner in their efforts to reach the MDG's with donor support. The authorities indicated that they would consider the various options open in terms of future relations with the Fund, including the new Policy Support Instrument.

VI. Staff Appraisal

44. **Ethiopia's recent growth performance has been encouraging, but sustaining this at levels needed to meet the MDGs will be difficult without an acceleration of reforms**. In particular, agricultural growth has been driven by increases in area under cultivation, not yields, highlighting the need address constraints to productivity gains. In addition, the focus on public enterprises and state determined priority sectors, risks thwarting the emergence of a dynamic private sector needed to provide incomes and boost growth.

45. **Achieving the MDGs will require significantly higher levels of external assistance**. Such inflows could be facilitated by a resolution of both the current domestic political tensions, and the border dispute with Eritrea, as well accelerated structural reforms and strengthened public expenditure management. Introducing timely fiscal reporting is

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[15] The authorities indicated that they thought the Addis Ababa CPI provided a better reflection of price developments.

particularly important ahead of scaling up public spending. External support should also largely be in the form of grants to ensure debt sustainability is maintained.

46. **The current strategy of scaling up domestically financed infrastructure, including through drawing on CBE's excess reserves, risks jeopardizing macro economic stability**, and in particular the balance of payments position. The authorities should thus look to manage the pace and level of such domestically financed spending within a broader macroeconomic and fiscal framework that ensures stability. In the current context, this requires some initial scaling back, as well as greater recourse to external funding.

47. **Even with proposed cuts in infrastructure imports, pressures on official reserves could remain high.** While the authorities commitment to take remedial measures is welcome, it would be preferable to act sooner rather than later to forestall any drop below 3 months import cover. If a large rebuilding of reserves becomes necessary, this will squeeze the room for non-inflationary domestic bank credit growth, dampening growth prospects.

48. **Fiscal policy should be anchored by the need to avoid adverse macroeconomic consequences from large recourse to domestic bank finance**, **and to ensure debt sustainability**. The adjustment measures introduced this year are welcome, but the resulting policy stance still involves significant risks for the balance of payments. Beyond 2005/06, planned recourse to domestic borrowing should be reduced to contain debt levels and provide room to respond to shocks, as well as mitigate any pressures on reserves. At the same time efforts are needed to improve the buoyancy of the tax regime to ensure revenue growth keeps up with recurrent expenditures. Staff thus welcome the authorities' request for technical assistance from the Fund in the area of tax and customs policy, including on the structure and level of tariff exemptions. Staff also highly recommend that the activities of key public enterprises be closely monitored, and ideally consolidated into fiscal reporting.

49. **The proposal to pass through higher oil prices is welcome,** and staff recommend that this be implemented as a priority during 2005/06, followed by the reintroduction of the automatic pricing mechanism. Given the limited impact on the poor and the mounting costs, delays in securing additional external support should not detract from moving ahead with domestic price increases.

50. **Monetary and exchange rate policy will need to be geared to preserving international reserves and containing inflationary pressures**. In the absence of effective indirect instruments, direct controls on the operations of CBE may be the most effective way to curb excessive credit growth. Staff consider that external competitiveness does not seem to be an immediate problem. However, looking forward, greater flexibility is needed to allow the exchange rate to reflect balance of payments developments and avoid the risk of an unsustainable real appreciation. Moreover, the authorities should follow through on the option of allowing greater flexibility as part of a timely and coordinated response to additional balance of payments pressures that may emerge.

51. **Differences of view remain over financial sector reforms**. The authorities' MDG scenarios entail a significant private sector response to reforms and infrastructure development, which staff consider will need to be supported by a more dynamic and market orientated financial sector than currently envisaged. In the meantime, the Fund will collaborate with the forthcoming World Bank Financial Sector Capacity Building project and will provide targeted technical assistance consistent with the aim of advancing broader policy reforms in due course.

52. **Data provision to the Fund remains adequate for surveillance purposes, but shortcomings affect the analysis of key areas.** In particular, in light of their increasing role in infrastructure investment, the authorities are encouraged to consolidate key public enterprises in fiscal reporting and the budget. The adoption of the IMD is also a priority.

53. **It is recommended that the next Article IV consultation with Ethiopia take place on the standard 12-month cycle.**

Table 1. Ethiopia: Selected Economic and Financial Indicators, 2002/03-2005/06 1/

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
		Est.	Prel. Est.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Annual percentage change)							
National income and prices								
GDP at constant prices (at factor cost)	-3.3	11.1	8.8	5.2	5.4	5.5	5.5	5.5
GDP deflator	13.0	9.4	6.2	11.6	5.8	5.4	5.7	5.5
Consumer prices (period average)	15.1	8.6	6.8	10.8	6.0	6.0	6.0	6.0
Consumer prices (end period)	23.5	1.7	13.0	6.0	6.0	6.0	6.0	6.0
External sector								
Exports, f.o.b.	6.7	24.4	36.2	27.7	9.1	6.5	4.7	4.8
Imports, c.i.f.	9.5	39.3	40.4	11.4	4.1	7.7	10.6	7.8
Export volume	6.1	28.0	10.9	16.0	9.2	9.7	6.7	6.5
Import volume	1.9	26.3	28.9	5.1	2.5	7.1	10.6	6.4
Terms of trade (deterioration -)	-6.5	-14.8	10.8	5.1	-1.6	-3.8	-2.1	-3.1
Nominal effective exchange rate (end of period)	-12.5	-4.0	-1.5	...	...	...	...	...
Real effective exchange rate (end of period)	5.9	-4.6	9.2	...	...	...	...	...
	(In percent of beginning-period stock of broad money, unless otherwise indicated)							
Money and credit								
Net foreign assets	11.3	9.2	-0.3	-3.2	3.6	3.0	5.8	3.9
Net domestic assets	-0.4	5.6	19.9	22.7	12.7	11.2	11.4	11.1
Net claims on the government	6.0	7.3	9.3	8.1	8.7	7.6	6.8	6.5
Credit to the nongovernment sector	-3.3	4.1	20.2	13.1	7.4	6.6	7.4	7.1
Broad money	10.9	14.7	19.6	19.5	16.3	14.1	17.3	15.0
Velocity (GDP/broad money)	2.3	2.5	2.4	2.4	2.3	2.2	2.1	2.1
Interest rates (in percent at end of period)								
Savings deposits (minimum rate)	3.0	3.0	3.0	…	…	…	…	…
Lending rates (maximum rate)	13.0	14.0	14.0	…	…	…	…	…
Treasury bill (91-day maturity)	1.3	0.5	0.1	…	…	…	…	…
	(In percent of GDP, unless otherwise indicated)							
Financial balances								
Gross domestic saving	7.5	4.1	3.6	7.6	8.2	8.6	8.5	9.0
Government saving	0.4	2.6	1.8	2.6	1.4	1.4	1.8	1.6
Private saving	7.2	1.5	1.8	5.1	6.8	7.1	6.7	7.4
Gross domestic investment	22.7	21.3	26.3	28.1	27.3	27.2	27.7	28.1
Government investment	8.8	9.1	10.9	13.1	12.3	11.9	12.4	12.7
Private investment	14.0	12.1	15.4	15.0	15.0	15.3	15.3	15.4
Resource gap	-15.2	-17.2	-22.7	-20.4	-19.1	-18.7	-19.3	-19.1
External current account balance, including official transfers	-2.2	-5.1	-9.1	-7.5	-4.3	-2.9	-3.6	-3.9
External current account balance, excluding official transfers	-9.8	-10.9	-15.8	-13.1	-10.8	-10.2	-10.8	-10.8
Government finances								
Revenue	16.4	16.6	16.0	18.1	16.8	16.5	16.5	16.5
Tax revenue	12.1	13.0	12.7	13.2	13.4	13.7	14.0	14.2
Nontax revenue	4.3	3.6	3.3	4.9	3.4	2.7	2.5	2.3
External grants	6.7	4.8	4.7	5.4	5.3	5.4	6.3	6.7
Expenditure and net lending 2/	29.1	24.1	25.4	28.4	27.4	27.0	27.7	28.2
Fiscal balance, excluding grants (cash basis)	-14.8	-10.2	-10.7	-10.7	-11.1	-10.5	-11.2	-11.7
Fiscal balance, including grants (cash basis)	-8.1	-5.5	-6.0	-6.1	-5.8	-5.1	-4.9	-5.0
Total financing	8.1	5.5	6.0	6.1	5.8	5.1	4.9	5.0
External financing	5.7	2.9	2.5	2.1	2.3	1.9	1.9	2.0
Domestic financing (including residual)	2.4	2.6	3.5	4.0	3.5	3.3	3.0	3.0
Domestic debt 3/	39.0	35.0	34.8	32.7	32.8	32.7	32.1	31.7
External debt (including to Fund)	85.4	75.7	53.9	47.4	48.1	47.5	46.0	45.3
Net present value (NPV) of external debt-to-exports ratio (including to Fund) 4/	150.0	126.2	107.8	102.2	105.1	108.8	122.4	132.3
External debt-service ratio 5/	14.9	15.1	14.2	12.7	11.8	11.0	10.3	9.5
External debt-service ratio 6/	7.3	6.3	7.1	5.2	4.4	4.2	4.0	5.2
Overall balance of payments (in millions of U.S. dollars)	275	227	-101	-357	130	111	301	203
Gross official reserves (in millions of U.S. dollars)	931	1,350	1,555	1,264	1,394	1,506	1,807	2,009
(in months of imports of goods and nonfactor services of following year)	3.5	3.7	3.9	3.0	3.1	3.0	3.3	3.4
GDP at current market prices (in millions of birr)	68,144	83,892	96,676	113,611	126,769	141,405	158,679	177,697
Exchange rate (birr per U.S. dollar; period average rate)	8.58	8.62	8.65	...	...	...	...	...

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

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

Table 2. Ethiopia: General Government Operations, 2002/03-2009/10
(In millions of birr)

2/9/2006 12:00	2002/03	2003/04 1/	2004/05	2005/06 4/			2006/07	2007/08	2008/09	2009/10
					Pre-adjust.	Adjust.	Baseline	Baseline	Baseline	Baseline
	Act.	Act.	Act.	Budget	Staff proj.	Scenario	Scenario	Scenario	Scenario	Scenario
Total revenue and grants	15,702	17,918	20,031	28,633	24,059	26,732	27,980	30,903	36,124	41,179
Revenue	11,149	13,917	15,466	21,594	18,749	20,549	21,289	23,281	26,168	29,333
Tax revenue	8,244	10,906	12,265	15,692	14,947	14,947	16,955	19,440	22,215	25,233
Direct taxes	3,010	3,431	3,930	5,200	4,902	4,902	5,469	6,384	7,299	8,352
Indirect taxes	5,233	7,476	8,335	10,492	10,045	10,045	11,486	13,056	14,916	16,881
Domestic indirect taxes	1,668	2,200	2,589	3,604	3,158	3,158	3,625	4,184	4,760	5,509
Import duties and taxes	3,564	5,276	5,746	6,887	6,887	6,887	7,861	8,872	10,155	11,373
Nontax revenue	2,906	3,010	3,202	5,902	3,802	5,602	4,334	3,841	3,953	4,100
Grants	4,553	4,001	4,565	7,039	5,310	6,183	6,691	7,622	9,955	11,846
Emergency assistance (food and non food aid)	2,890	699	721	586	586	586	586	586	635	711
Program grants	467	2,255	2,331	3,506	1,777	1,777	3,041	3,914	5,083	6,338
Multilateral Debt Relief Initiative (IMF) 8/	...	...	...	...	...	1,013	0	0	0	0
Project grants	1,196	1,047	1,513	2,947	2,947	2,808	3,064	3,122	4,237	4,798
Total expenditure and net lending (cash basis) 2/	19,840	20,232	24,551	34,699	34,698	32,315	34,789	38,132	43,972	50,042
Recurrent expenditure 2/	13,527	11,961	13,036	16,000	16,000	16,000	17,690	19,413	22,024	25,032
Defense spending	2,341	2,452	2,920	3,000	3,000	3,000	3,000	3,000	3,397	3,804
Poverty-reducing expenditure 6/	3,672	4,045	4,839	6,153	6,153	6,153	6,980	7,786	8,911	10,164
Education	2,276	2,511	2,901	3,511	3,511	3,511	4,177	4,659	5,403	6,063
Health	526	532	677	892	892	892	989	1,103	1,238	1,454
Agriculture	730	870	1,123	1,596	1,596	1,596	1,636	1,825	2,048	2,389
Roads	139	132	138	154	154	154	178	199	223	259
Interest payments	1,219	1,080	1,011	1,385	1,385	1,385	1,674	2,031	2,195	2,713
Domestic interest and charges	625	576	525	846	846	846	1,128	1,472	1,871	2,345
External interest payments 7/	594	504	486	539	539	539	546	559	324	368
Emergency assistance (food and other emergency aid)	2,890	699	721	586	586	586	586	586	635	711
Other recurrent expenditure	3,406	3,685	3,545	4,876	4,876	4,876	5,451	6,010	6,887	7,641
Capital expenditure 2/	6,313	8,271	11,515	18,698	18,698	16,315	17,099	18,720	21,948	25,010
Central treasury	3,265	5,403	8,548	13,720	13,720	11,477	11,720	12,980	14,951	17,004
External project grants	1,196	1,047	1,513	2,947	2,947	2,808	3,064	3,122	4,237	4,798
External project loans	1,852	1,821	1,454	2,030	2,030	2,030	2,314	2,617	2,759	3,208
Of which: poverty-reducing expenditure 6/	4,921	6,130	9,175	13,148	13,148	13,148	14,578	16,262	18,407	20,790
Special programs 3/	655	272	224	0	362	362	515	0	0	0
Unidentified financing or measures to be identified (- over financing)	-734	-1,986	-1,046	0	5,166	0	0	0	0	0
Overall balance										
Including grants	-5,526	-4,572	-5,789	-6,066	-5,835	-5,946	-7,323	-7,229	-7,848	-8,863
Excluding grants	-10,079	-8,573	-10,354	-13,105	-11,145	-12,129	-14,014	-14,851	-17,804	-20,709
Excluding Multilateral Debt Relief Initiative (IMF) 8/	...	...	...	...	...	-6,959	...	...	...	...
Financing	5,526	4,572	5,789	6,066	5,835	5,946	7,323	7,229	7,848	8,863
Net external financing	3,865	2,400	2,384	2,065	2,427	2,427	2,886	2,633	3,088	3,532
Gross borrowing	3,608	2,555	2,507	2,030	2,392	2,392	2,829	2,617	3,267	3,736
Capital budget	1,852	1,821	1,454	2,030	2,030	2,030	2,314	2,617	2,759	3,208
Program loans	1,101	293	780	0	0	0	0	0	508	528
Special programs	655	441	273	0	362	362	515	0	0	0
HIPC debt relief 7/	531	678	728	1,015	1,015	1,015	1,128	1,221	0	0
Unpaid debt under negotiation	283	0	0	0	0	0	0	0	0	0
Amortization repayment 7/	-557	-833	-851	-980	-980	-980	-1,071	-1,205	-179	-204
Total net domestic financing	1,661	2,172	3,405	4,001	3,408	3,519	4,437	4,596	4,760	5,331
Domestic (net)	1,653	2,161	3,395	4,001	3,408	4,531	4,437	4,596	4,760	5,331
Banking system	1,651	2,155	3,156	4,001	3,188	4,311	4,246	4,380	4,380	4,904
Nonbank sources	2	6	239	0	220	220	350	381	381	426
Multilateral Debt Relief Initiative, account held at NBE 8/	...	...	...	...	...	-1,013	...	...	...	...
Privatization	8	11	10	0	0	0	0	0	0	0
Memorandum items:										
Poverty-reducing expenditure 6/	8,593	10,175	14,014	19,301	19,301	19,301	21,558	24,047	27,318	30,954
Multilateral debt relief initiative (IMF, millions of US dollars) 8/	...	...	...	...	...	114.0	...	...	...	...
External grants and loans (US dollars per capita)	14	11	11	14	12	13	13	13	16	18
Primary fiscal balance, including grants	-4,308	-3,492	-4,778	-4,681	-4,450	-4,561	-5,650	-5,198	-5,654	-6,150
Domestic fiscal balance, including grants	-2,159	-2,244	-4,910	-7,003	-9,847	-5,804	-6,989	-7,967	-9,849	-11,624
Gross domestic government debt 5/	26,545	29,370	33,660	37,661	37,068	37,179	41,616	46,211	50,972	56,302
Wages and salaries	4,001	5,162	5,917	...	7,157	7,157	8,113	9,191	10,314	11,550
Gross domestic product	68,144	83,892	96,676	113,611	113,611	113,611	126,769	141,405	158,679	177,697
Real GDP growth	-3.3	11.1	8.8	7.0	5.2	5.2	5.4	5.5	5.5	5.5

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

1/ The fiscal accounts include municipal spending by Addis Ababa beginning from 2003/04.
2/ Excluding special programs (demobilization and reconstruction).
3/ Demobilization and reconstruction.
4/ The consolidated budget column presents an estimate based on the actual federal budget and projections for subnational governments.
5/ The domestic debt series has been revised starting from 2000/01 to reflect gross rather than net debt. The non-interest bearing component is approximately Birr 9.4 billion, of which Birr 8.7 billion reflects NBE advances maturing in 2030 to finance expenditures in connection with the Eritrea conflict.
6/ Poverty-reducing spending is defined consistently with the SDPRP to include total spending on health, education, agriculture, roads and food security.
7/ External interest and amortization are presented before HIPC debt relief from the World Bank and African Development Bank up to 2007/08 for comparability with the authorities' medium-term fiscal framework.
8/ Debt relief from the IMF under the MDRI is recorded in 2005/06. Pending discussion with the authorities, additional MDRI-funded expenditures are not included in the baseline projections.

Table 3. Ethiopia: General Government Operations, 2002/03-2009/10
(In percent of GDP)

	2002/03	2003/04 1/	2004/05	2005/06 4/			2006/07	2007/08	2008/09	2009/10
	Act.	Act.	Prelim. Est.	Budget	Pre-adjust. Staff proj.	Adjust. Scenario	Baseline Scenario	Baseline Scenario	Baseline Scenario	Baseline Scenario
Total revenue and grants	23.0	21.4	20.7	25.2	21.2	23.5	22.1	21.9	22.8	23.2
Revenue	16.4	16.6	16.0	19.0	16.5	18.1	16.8	16.5	16.5	16.5
Tax revenue	12.1	13.0	12.7	13.8	13.2	13.2	13.4	13.7	14.0	14.2
Direct taxes	4.4	4.1	4.1	4.6	4.3	4.3	4.3	4.5	4.6	4.7
Indirect taxes	7.7	8.9	8.6	9.2	8.8	8.8	9.1	9.2	9.4	9.5
Domestic indirect taxes	2.4	2.6	2.7	3.2	2.8	2.8	2.9	3.0	3.0	3.1
Import duties and taxes	5.2	6.3	5.9	6.1	6.1	6.1	6.2	6.3	6.4	6.4
Nontax revenue	4.3	3.6	3.3	5.2	3.3	4.9	3.4	2.7	2.5	2.3
Grants 4/	6.7	4.8	4.7	6.2	4.7	5.4	5.3	5.4	6.3	6.7
Emergency assistance (food and non food aid)	4.2	0.8	0.7	0.5	0.5	0.5	0.5	0.4	0.4	0.4
Program grants	0.7	2.7	2.4	3.1	1.6	1.6	2.4	2.8	3.2	3.6
Multilateral Debt Relief Initiative (IMF)	...	...	...	...	...	0.9	...	...	...	...
Project grants	1.8	1.2	1.6	2.6	2.6	2.5	2.4	2.2	2.7	2.7
Total expenditure and net lending (cash basis) 2/	29.1	24.1	25.4	30.5	30.5	28.4	27.4	27.0	27.7	28.2
Recurrent expenditure 2/	19.9	14.3	13.5	14.1	14.1	14.1	14.0	13.7	13.9	14.1
Defense spending	3.4	2.9	3.0	2.6	2.6	2.6	2.4	2.1	2.1	2.1
Poverty-reducing expenditure 6/	5.4	4.8	5.0	5.4	5.4	5.4	5.5	5.5	5.6	5.7
Education	3.3	3.0	3.0	3.1	3.1	3.1	3.3	3.3	3.4	3.4
Health	0.8	0.6	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Agriculture	1.1	1.0	1.2	1.4	1.4	1.4	1.3	1.3	1.3	1.3
Roads	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Interest payments	1.8	1.3	1.0	1.2	1.2	1.2	1.3	1.4	1.4	1.5
Domestic interest and charges	0.9	0.7	0.5	0.7	0.7	0.7	0.9	1.0	1.2	1.3
External interest payments 7/	0.9	0.6	0.5	0.5	0.5	0.5	0.4	0.4	0.2	0.2
Emergency assistance (food and other emergency aid)	4.2	0.8	0.7	0.5	0.5	0.5	0.5	0.4	0.4	0.4
Other recurrent expenditure	5.0	4.4	3.7	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Capital expenditure 2/	9.3	9.9	11.9	16.5	16.5	14.4	13.5	13.2	13.8	14.1
Central Treasury	4.8	6.4	8.8	12.1	12.1	10.1	9.2	9.2	9.4	9.6
External project grants	1.8	1.2	1.6	2.6	2.6	2.5	2.4	2.2	2.7	2.7
External project loans	2.7	2.2	1.5	1.8	1.8	1.8	1.8	1.9	1.7	1.8
Of which: poverty-reducing expenditure 6/	7.2	7.3	9.5	11.6	11.6	11.6	11.5	11.5	11.6	11.7
Special programs 3/	1.0	0.3	0.2	0.0	0.3	0.3	0.4	0.0	0.0	0.0
Unidentified financing or measures to be identified (- over financing)	-1.1	-2.4	-1.1	0.0	4.5	0.0	0.0	0.0	0.0	0.0
Overall balance										
Including grants	-8.1	-5.5	-6.0	-5.3	-5.1	-5.2	-5.8	-5.1	-4.9	-5.0
Excluding grants	-14.8	-10.2	-10.7	-11.5	-9.8	-10.7	-11.1	-10.5	-11.2	-11.7
Excluding Multilateral Debt Relief Initiative (IMF)	...	...	...	...	...	-6.1	...	...	...	...
Financing	8.1	5.5	6.0	5.3	5.1	5.2	5.8	5.1	4.9	5.0
Net external financing	5.7	2.9	2.5	1.8	2.1	2.1	2.3	1.9	1.9	2.0
Gross borrowing	5.3	3.0	2.6	1.8	2.1	2.1	2.2	1.9	2.1	2.1
Capital budget	2.7	2.2	1.5	1.8	1.8	1.8	1.8	1.9	1.7	1.8
Program loans	1.6	0.3	0.8	0.0	0.0	0.0	0.0	0.0	0.3	0.3
Special programs	1.0	0.5	0.3	0.0	0.3	0.3	0.4	0.0	0.0	0.0
HIPC debt relief 7/	0.8	0.8	0.8	0.9	0.9	0.9	0.9	0.9	0.0	0.0
Unpaid debt under negotiation	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization repayment 7/	-0.8	-1.0	-0.9	-0.9	-0.9	-0.9	-0.8	-0.9	-0.1	-0.1
Total net domestic financing	2.4	2.6	3.5	3.5	3.0	3.1	3.5	3.3	3.0	3.0
Domestic (net)	2.4	2.6	3.5	3.5	3.0	4.0	3.5	3.3	3.0	3.0
Banking system	2.4	2.6	3.3	3.5	2.8	3.8	3.3	3.0	2.8	2.8
Nonbank sources	0.0	0.0	0.2	0.0	0.2	0.2	0.2	0.2	0.2	0.2
Multilateral Debt Relief Initiative, account held at NBE	...	...	...	...	...	-0.9	0.0	0.0	0.0	0.0
Memorandum items:										
Poverty-reducing expenditure 6/	12.6	12.1	14.5	17.0	17.0	17.0	17.0	17.0	17.2	17.4
Multilateral debt relief initiative (IMF, millions of US dollars)	...	...	...	...	...	114	...	...	...	...
External grants and loans (US dollars per capita)	14	11	11	14	12	13	13	13	16	18
Primary fiscal balance, including grants	-6.3	-4.2	-4.9	-4.1	-3.9	-4.0	-4.5	-3.7	-3.6	-3.5
Domestic fiscal balance, including grants	-3.2	-2.7	-5.1	-6.2	-8.7	-5.1	-5.5	-5.6	-6.2	-6.5
Gross domestic government debt 5/	39.0	35.0	34.8	33.1	32.6	32.7	32.8	32.7	32.1	31.7
Wages and salaries	5.9	6.2	6.1	...	6.3	6.3	6.4	6.5	6.5	6.5
Real GDP growth	-3.3	11.1	8.8	7.0	5.2	5.2	5.4	5.5	5.5	5.5

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

1/ The fiscal accounts include municipal spending by Addis Ababa beginning from 2003/04.
2/ Excluding special programs (demobilization and reconstruction).
3/ Demobilization and reconstruction.
4/ The consolidated budget column presents an estimate based on the actual federal budget and projections for subnational governments.
5/ The domestic debt series has been revised starting from 2000/01 to reflect gross rather than net debt. The non-interest bearing component is approximately Birr 9.4 billion, of which Birr 8.7 billion reflects NBE advances maturing in 2030 to finance expenditures in connection with the Eritrea conflict.
6/ Poverty-reducing spending is defined consistently with the SDPRP to include total spending on health, education, agriculture, roads and food security.
7/ External interest and amortization are presented before HIPC debt relief from the World Bank and African Development Bank up to 2007/08 for comparability with the authorities' medium-term fiscal framework.
8/ Debt relief from the IMF under the MDRI is recorded in 2005/06. Pending discussion with the authorities, additional MDRI-funded expenditures are not included in the baseline projections.

Table 4. Ethiopia: Medium-term Fiscal Framework
(In millions of Birr)

	2005/06		PASDEP baseline framework				Baseline scenario			
	Budget	Baseline	2006/07	2007/08	2008/09	2009/10	2006/07	2007/08	2008/09	2009/10
Revenue and grants	**28,633**	**26,732**	**30,650**	**34,105**	**38,189**	**43,224**	**27,980**	**30,903**	**36,124**	**41,179**
Tax revenue	15,692	14,947	19,397	22,500	26,325	30,537	16,955	19,440	22,215	25,233
Nontax revenue	5,902	5,602	4,334	3,766	3,953	4,100	4,334	3,841	3,953	4,100
Grants	7,039	6,183	6,919	7,839	7,911	8,587	6,691	7,622	9,955	11,846
Expenditure	**34,698**	**32,678**	**45,783**	**49,529**	**51,858**	**56,681**	**35,304**	**38,132**	**43,972**	**50,042**
Recurrent expenditure	16,000	16,000	19,590	21,895	22,566	25,338	17,690	19,413	22,024	25,032
Capital spending	18,698	16,315	26,193	27,634	29,292	31,343	17,099	18,720	21,948	25,010
Special programs	0	362	0	0	0	0	515	0	0	0
Financing gap 1/	**0**	**0**	**8,109**	**7,405**	**4,486**	**2,946**	**0**	**0**	**0**	**0**
Budget balance										
Including grants	**-6,066**	**-5,946**	**-15,133**	**-15,424**	**-13,669**	**-13,457**	**-7,324**	**-7,229**	**-7,848**	**-8,863**
Excluding grants	**-13,105**	**-12,129**	**-22,052**	**-23,263**	**-21,580**	**-22,044**	**-14,015**	**-14,851**	**-17,804**	**-20,709**
Financing	**6,066**	**5,946**	**7,024**	**8,019**	**9,183**	**10,511**	**7,323**	**7,229**	**7,848**	**8,863**
Net external financing	2,065	2,427	2,371	2,633	3,088	3,532	2,886	2,633	3,088	3,532
Net domestic financing	4,001	3,519	4,653	5,386	6,095	6,979	4,437	4,596	4,760	5,331
			(as a percent of GDP)							
Revenue and grants	**25.2**	**23.5**	**24.2**	**24.1**	**24.1**	**24.3**	**22.1**	**21.9**	**22.8**	**23.2**
Tax revenue	13.8	13.2	15.3	15.9	16.6	17.2	13.4	13.7	14.0	14.2
Nontax revenue	5.2	4.9	3.4	2.7	2.5	2.3	3.4	2.7	2.5	2.3
Grants	6.2	5.4	5.5	5.5	5.0	4.8	5.3	5.4	6.3	6.7
Expenditure	**30.5**	**28.8**	**36.1**	**35.0**	**32.7**	**31.9**	**27.8**	**27.0**	**27.7**	**28.2**
Recurrent expenditure	14.1	14.1	15.5	15.5	14.2	14.3	14.0	13.7	13.9	14.1
Capital spending	16.5	14.4	20.7	19.5	18.5	17.6	13.5	13.2	13.8	14.1
Special programs	0.0	0.3	0.0	0.0	0.0	0.0	0.4	0.0	0.0	0.0
Financing gap 1/	**0.0**	**0.0**	**6.4**	**5.2**	**2.8**	**1.7**	**0.0**	**0.0**	**0.0**	**0.0**
Budget balance										
Including grants	**-5.3**	**-5.2**	**-11.9**	**-10.9**	**-8.6**	**-7.6**	**-5.8**	**-5.1**	**-4.9**	**-5.0**
Excluding grants	**-11.5**	**-10.7**	**-17.4**	**-16.5**	**-13.6**	**-12.4**	**-11.1**	**-10.5**	**-11.2**	**-11.7**
Financing	**5.3**	**5.2**	**5.5**	**5.7**	**5.8**	**5.9**	**5.8**	**5.1**	**4.9**	**5.0**
Net external financing	1.8	2.1	1.9	1.9	1.9	2.0	2.3	1.9	1.9	2.0
Net domestic financing	3.5	3.1	3.7	3.8	3.8	3.9	3.5	3.3	3.0	3.0
Miscellaneous										
Nominal GDP (millions of birr)	113,611	113,611	126,769	141,405	158,679	177,697	126,769	141,405	158,679	177,697
Total external financing (millions of US dollars)	1,025	969	987	1,070	1,082	1,147	1,018	1,048	1,283	1,456
Grants	792	696	735	801	778	813	711	779	979	1,122
Net external financing	232	273	252	269	304	334	307	269	304	334
Total external financing (US dollars per capita)	13.7	12.9	12.8	13.5	13.3	13.8	13.2	13.2	15.8	17.5

Note:
1/ Positive financing gaps indicate insufficient financing.

Table 5 . Ethiopia: Monetary Survey - Baseline, 2001/02-2005/06 1/

2/9/06 12:00	2002/03	2003/04	2004/05	2005/06 3/	2006/07	2007/08	2008/09	2009/10
			Rev. Proj.	Rev. Proj.	Proj.	Proj.	Proj.	Proj.
(In millions of birr)								
Net foreign assets	11,290	14,000	13,896	12,587	14,338	16,006	19,749	22,702
National Bank of Ethiopia (NBE)	6,273	9,181	9,670	8,675	10,270	11,779	15,357	18,139
Assets	8,003	11,665	13,477	11,664	13,379	15,009	18,713	21,625
Liabilities	1,731	2,484	3,807	2,989	3,109	3,230	3,356	3,486
Commercial banks	5,018	4,820	4,227	3,912	4,068	4,227	4,392	4,563
Assets	6,731	6,713	6,133	5,955	6,193	6,434	6,685	6,946
Liabilities	1,713	1,893	1,906	2,043	2,125	2,208	2,294	2,383
Net domestic assets	18,185	19,822	26,556	35,757	41,878	48,151	55,475	63,833
Domestic credit	28,332	31,681	41,659	50,225	57,974	65,926	75,033	85,302
Claims on government (net) 2/	17,855	20,009	23,165	26,424	30,611	34,857	39,236	44,141
NBE	9,804	9,383	19,071	19,054	20,310	22,220	23,972	25,934
Commercial banks	8,052	10,627	4,094	7,371	10,302	12,637	15,265	18,207
Claims on nongovernment	10,477	11,672	18,493	23,801	27,363	31,069	35,797	41,161
NBE	114	54	0	0	0	0	0	0
Commercial banks	10,364	11,618	18,493	23,801	27,363	31,069	35,797	41,161
Public enterprises	1,291	2,144	5,964	...	...	...	...	...
Private sector	9,186	9,527	12,529	...	...	...	...	...
Other items (net)	-10,147	-11,859	-15,103	-14,468	-16,096	-17,776	-19,558	-21,468
Broad money	29,475	33,822	40,452	48,344	56,216	64,156	75,224	86,535
Money	15,784	18,137	21,430	25,598	30,024	33,656	38,941	43,935
Currency outside banks	6,696	7,891	10,067	11,421	15,672	18,362	21,553	24,439
Demand deposits	9,089	10,246	11,363	14,177	14,351	15,294	17,388	19,496
Quasi money	13,691	15,684	19,022	22,746	26,193	30,500	36,283	42,600
Savings deposits	12,529	14,447	17,403	20,900	24,166	28,210	33,600	39,495
Time deposits	1,162	1,237	1,619	1,846	2,027	2,290	2,684	3,105
ange in percent of beginning period broad money;unless otherwise								
Net foreign assets	11.3	9.2	-0.3	-3.2	3.6	3.0	5.8	3.9
Net domestic assets	-0.4	5.6	19.9	22.7	12.7	11.2	11.4	11.1
Domestic credit	2.7	11.4	29.5	21.2	16.0	14.1	14.2	13.7
Claims on government (net)	6.0	7.3	9.3	8.1	8.7	7.6	6.8	6.5
Claims on nongovernment	-3.3	4.1	20.2	13.1	7.4	6.6	7.4	7.1
Broad money	10.9	14.7	19.6	19.5	16.3	14.1	17.3	15.0
Money	5.1	8.0	9.7	10.3	9.2	6.5	8.2	6.6
Quasi money	5.7	6.8	9.9	9.2	7.1	7.7	9.0	8.4
Memorandum items:								
Reserve money growth	30.1	13.2	73.9	1.8	11.1	12.0	16.9	12.4
Money multiplier	2.5	2.6	1.8	2.1	2.2	2.2	2.2	2.3
Velocity (GDP/broad money)	2.3	2.5	2.4	2.4	2.3	2.2	2.1	2.1
Gross official foreign reserves (in millions of U.S. dollars)	931	1,350	1,555	1,264	1,394	1,505	1,806	2,009
Net foreign assets of the banking system (in millions of U.S. dollar:	1,313	1,621	1,603	1,364	1,494	1,605	1,906	2,109
Excess reserves (in percent of deposits)	12.8	11.7	33.1	25.1	18.6	16.7	16.5	15.6

Sources: National Bank of Ethiopia; and Fund staff estimates and projections.
1/ Year ending July 7. Including commercial bank claims and liabilities with Eritrea
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.
3/ For 2005/06 government deposits at NBE reflect the transfer of Fund MDRI relief into a government account, while NBE foreign liabilties have been reduced by a similar amount.

Table 6. Ethiopia: Balance of Payments, 2002/03-2009/10
(In millions of U.S. dollars, unless otherwise indicated) 1/

	2002/03	2003/04	2004/05	2005/06		2006/07	2007/08	2008/09	2009/10
			Prel. Est.	Rev. Proj. No Adjustment	Rev. Proj. Adjustment	Rev. Proj.	Rev. Proj.	Rev. Proj.	Rev. Proj.
Trade balance	-1,374	-1,986	-2,815	-3,446	-3,003	-3,075	-3,327	-3,750	-4,080
Exports of goods	483	600	818	1,044	1,044	1,139	1,213	1,270	1,331
Coffee	165	223	335	429	429	439	423	414	413
Other	318	377	483	615	615	701	790	857	919
Imports of goods	1,856	2,587	3,633	4,490	4,047	4,215	4,540	5,020	5,412
Fuel	288	311	669	902	700	787	835	879	936
Cereals	189	206	160	100	100	90	90	80	80
Aircraft	17	126	139	124	124	25	30	240	240
Imports excl. fuel,cereals,aircraft	1,362	1,944	2,666	3,363	3,123	3,313	3,585	3,821	4,156
of which Public investment related imports 2/	368	480	951	1,393	1,121	1,072	1,125	1,299	1,361
Nonfactor services (net)	167	314	277	392	392	507	630	745	867
Exports of nonfactor services	657	898	1,011	1,163	1,163	1,339	1,533	1,727	1,936
Imports of nonfactor services	490	584	734	771	771	832	903	982	1,068
Income (net)	-66	-64	-36	-17	-17	-11	-11	-16	-27
Of which : gross official interest payments 3/	-72	-62	-51	-53	-53	-54	-58	-79	-104
Private transfers (net)	495	671	811	952	952	1,125	1,236	1,330	1,424
Current account balance, excl. official transfers	-778	-1,065	-1,763	-2,119	-1,676	-1,454	-1,471	-1,691	-1,816
(in percent of GDP)	-9.8	-10.9	-15.8	-16.6	-13.1	-10.8	-10.2	-10.8	-10.8
excluding EAL imports	-9.6	-9.6	-14.5	-15.6	-12.1	-10.6	-10.0	-9.3	
Official transfers (net)	600	567	750	722	722	879	1,050	1,131	1,157
Current account balance, incl. official transfers	-178	-499	-1,013	-1,397	-955	-575	-421	-560	-659
(in percent of GDP)	-2.2	-5.1	-9.1	-10.9	-7.5	-4.3	-2.9	-3.6	-3.9
excluding EAL imports	-2.0	-3.8	-7.8	-10.0	-6.5	-4.1	-2.7	-2.0	-2.5
Capital account balance (incl. errors and omissions)	454	725	912	598	598	705	533	861	862
Foreign direct investment (net)	114	101	150	170	170	180	190	200	210
Other investment (net)	294	427	471	428	428	525	343	661	652
Official long-term loans	360	407	409	428	428	525	343	667	661
Disbursements	443	512	483	464	464	573	400	724	748
EAL loan	0	212	125	13	13	0	0	240	240
Amortization 3/	84	105	74	36	36	48	57	56	87
Other public sector long-term loans (net) 4/	-4	46	68	0	0	0	0	-6	-10
Other (net)	-61	-26	-6	0	0	0	0	0	0
Errors and omissions	45	198	291	0	0	0	0	0	0
Overall balance	275	227	-101	-799	-357	130	111	301	203
Financing	-275	-227	101	799	357	-130	-111	-301	-203
Central bank (net; increase -)	-236	-334	-54	200	290	-130	-111	-301	-203
Reserves (increase -)	-266	-420	-205	202	291	-130	-111	-301	-203
Liabilities (increase +)	30	86	151	-1	-1	0	0	0	0
Fund credit (net)	4	15	7	-1	-1	0	0	0	0
Commercial banks (net; increase -)	-108	25	71	0	67	0	0	0	0
Changes in arrears	0	0	0	0	0	0	0	0	0
Debt relief (Paris Club II and III, Naples terms, HIPC) 5/	69	82	84	0	0	0	0	0	0
Financing gap	0	0	0	599	0	0	0	0	0
Exceptional financing	0	0	0	0	0	0	0	0	0
Residual gap	0	0	0	599	0	0	0	0	0
Memorandum items:									
Exports of goods (percent change)	6.7	24.4	36.2	27.7	27.7	9.1	6.5	4.7	4.8
Export price index (percent change)	0.6	-3.6	25.3	11.7	11.7	0.0	-3.2	-2.1	-1.7
Export volume index (percent change)	6.1	28.0	10.9	16.0	16.0	9.2	9.7	6.7	6.5
Imports of goods (percent change)	9.5	39.3	40.4	23.6	11.4	4.1	7.7	10.6	7.8
Import price index (percent change)	7.6	13.1	11.6	6.3	6.3	1.7	0.6	0.0	1.5
Import volume index (percent change)	1.9	26.3	28.9	17.3	5.1	2.5	7.1	10.6	6.4
Import volume index (excluding cereals, aircraft) (percent change)	0.3	15.3	36.3	21.7	8.4	5.6	7.2	6.3	6.9
Imports excl. fuel, cereal, aircraft and Public investment related import	10.2	47.3	17.1	14.9	16.8	11.9	9.8	2.5	10.8
Gross official reserves	931	1,350	1,555	1,354	1,264	1,394	1,506	1,807	2,009
(in months of imports of goods and nonfactor services of following y	3.5	3.7	3.9	3.0	3.0	3.1	3.0	3.3	3.4
Terms of trade index % change(1996/97 = 100)	-6.5	-14.8	10.8	5.1	5.1	-1.6	-3.8	-2.1	-3.1
MDRI (IMF) US$ million				114	114				

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

1/ Data pertain to the period July 8-July 7.
2/ Assuming an import content of 50 percent except for ETC (65 percent).
3/ From 2005/06, incorporates debt relief under HIPC (including topping up and additional bilateral voluntary cancellations) and MDRI.
4/ Public enterprises.
5/ Includes 1997 and 2001 Paris Club rescheduling agreements (including Russia) under Naples terms, and 2002 Paris Club topping up to Cologne terms, and HIPC relief (including interim relief including estimates of relief beyond HIPC & relief on non-Paris Club debt under negotiation).
6/ Foreign aid is defined as official transfers and inflows of loans to the government.

Table 7. Ethiopia: Projected Payments to the Fund, 2003/04-2013/14 1/
(In millions of SDRs, unless otherwise indicated)

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Obligations from existing drawings 2/	5.3	1.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
PRGF/ESAF/SAF repayments	4.5	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.8	0.6	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
On Fund credit	0.6	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
On use of SDRs	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Obligations from prospective drawings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
PRGF/ESAF/SAF repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations	5.3	1.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
PRGF/ESAF/SAF repayments	4.5	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.8	0.6	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
On Fund credit	0.6	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
On use of SDRs	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Outstanding Fund credit	115.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
In percent of:													
Exports of goods and nonfactor services	9.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External public debt	2.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross official reserves	10.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Quota	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations	5.3	1.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
In percent of:													
Exports of goods and nonfactor services	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External public debt	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross official reserves	0.5	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Quota	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:													
Projected disbursements		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Fund staff estimates and projections.

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

Table 8. Ethiopia: The Core Set of Financial Soundness Indicators, June 1999-June 2005 1/
(In percent, unless otherwise indicated)

	1999/00 Jun	2000/01 Jun	2001/02 Jun	2002/03 Jun	2003/04 Jun	2004/05 Jun
Regulatory capital to risk-weighted assets	9.9	12.4	13.0	11.9	11.7	11.1
of which: public banks	8.5	11.0	11.3	10.4	11.7	10.7
Nonperforming loans to total gross loans	23.0	28.2	43.8	40.5	26.4	19.9
of which: public banks	24.3	32.6	50.5	51.9	35.4	27.4
Nonperforming laons net of provisions to capital	80.8	110.3	167.8	121.7	70.6	56.7
of which: public banks	87.6	137.7	211.4	155.0	64.1	49.5
Sectoral distribution of loans to total loans 2/						
Agriculture	8.5	8.1	8.7	8.5	6.5	8.7
Industry	13.3	15.1	15.8	17.2	23.7	22.9
Domestic trade	13.5	11.5	10.4	10.9	12.4	12.1
International trade	18.8	18.2	16.9	14.4	19.1	22.7
Export	6.2	6.2	4.9	4.8	5.3	8.8
Import	12.7	12.1	12.0	9.6	13.8	13.9
Hotels and tourism	1.9	2.3	2.6	2.1	1.8	1.5
Transport and construction	5.7	5.5	4.5	3.4	4.4	3.9
Housing and construction	9.8	9.8	9.6	11.0	11.5	9.8
Mines, power, and water resources	0.1	0.1	0.1	0.2	0.1	0.1
Others	24.1	25.9	28.4	29.5	17.9	16.4
Personal	0.1	0.1	0.2	0.3	0.3	0.3
Interbank lending	4.0	3.1	2.9	2.6	2.3	1.6
Return on assets	1.9	0.4	-1.4	1.9	1.3	1.8
of which: public banks	2.0	0.1	-1.9	2.1	1.2	1.7
Return on equity	25.4	4.5	-18.6	29.4	21.7	33.2
of which: public banks	30.3	1.4	-31.5	40.4	21.4	38.5
Interest margin to gross income	44.8	41.0	24.7	34.3	35.7	31.4
of which: public banks	45.8	41.2	19.5	32.5	32.1	25.4
Noninterest expenses to gross income	26.0	46.9	86.6	30.9	27.8	15.4
of which: public banks	23.6	50.2	105.4	25.5	41.7	24.5
Liquid assets to total assets	36.8	32.8	39.3	53.5	52.4	47.3
of which: public banks	37.2	33.3	40.4	59.0	58.5	52.5
Liquid assets to short-term liabilities	48.7	40.9	48.8	67.4	65.3	60.7
of which: public banks	49.3	41.4	50.1	74.5	71.8	67.9

Source: National Bank of Ethiopia.
1/ Only commercial banks, namely excluding the Development Bank of Ethiopia (DBE). The DBE is not a deposit-taking bank.
2/ Data is for March 2004/05

Table 9. Ethiopia: Social Indicators

	Latest Single Year			Sub-Saharan	Low-Income
	1970-75	1980-85	1993-2003	Africa	Countries
Population					
Total population, midyear (millions)	33.0	43.4	68.6	704.5	2,311.8
Growth rate (percent; annual average)	2.6	2.8	2.1	2.2	1.8
Urban population (percent of population)	9.5	11.7	16.6	36.5	30.4
Total fertility rate (births per woman)	5.9	7.0	5.6	5.2	3.7
Income					
Gross National Income (GNI) per capita (U.S. dollars)	...	130	90	500	440
Consumer price index (1995/96 (July 8-July 7) =100)	16	47	110	146	142
Food price index (1995/96 (July 8-July 7) =100)	...	49	92	...	...
Income/consumption distribution					
Gini index 1/	...	...	30.0	...	...
Lowest quintile (percent of income or consumption) 1/	...	8.6	9.1	...	...
Highest quintile (percent of income or consumption) 1/	...	41.3	39.4	...	...
Public expenditure					
Health (percent of GDP) 2/	...	...	2.6	2.6	1.5
Education (percent of GDP) 3/	...	3.0	4.6	3.3 1/	3.2 1/
Social security and welfare (percent of GDP)	...	1.4	...	...	...
Net primary school enrollment rate (percent of age group)					
Total 2/	...	29	47	...	...
Male	...	33	52	...	...
Female	...	25	42	...	...
Access to safe water (percent of population)					
Total 2/	...	...	22	58	75
Urban	...	...	81	82	89
Rural	...	...	11	46	70
Immunization rate (percent under 12 months)					
Measles	...	12	52	61	65
DPT	...	6	56	59	67
Life expectancy at birth (years)					
Total	42	44	42	46	58
Male	40	42	41	45	57
Female	43	45	43	46	59
Mortality					
Infant (per thousand live births)	151	143	112	101	80
Under 5 (per thousand live births)	239	213	169	171	123
Adult (15-59)					
Male (per thousand of population) 1/	482	491	594	519	319
Female (per thousand of population) 1/	411	401	535	461	268

Sources: World Bank, *World Development Indicators,* 2005; and National Bank of Ethiopia.

1/ Latest available data are as of 2000.
2/ Latest available data are as of 2002.
3/ Latest available data are as of 2001.

Table 10. Ethiopia: Millennium Development Goals

	1990	1994	1997	2000	2003
Goal 1: Eradicate extreme poverty and hunger					
Percentage share of income or consumption held by poorest 20%	..	..	..	9.1	..
Population below $1 a day (%)	..	31.3	..	23	..
Population below minimum level of dietary energy consumption (%)	..	..	61	..	46
Poverty gap ratio at $1 a day (incidence x depth of poverty)	..	7.9	..	4.8	..
Poverty headcount, national (% of population)	..	..	45.5	44.2	..
Prevalence of underweight in children (under five years of age)	..	..	..	47.2	..
Goal 2: Achieve universal primary education					
Net primary enrollment ratio (% of relevant age group)	23.3	..	35.8	43.9	47.4
Primary completion rate, total (% of relevant age group)	..	14.9	20.6	28.9	39.2
Proportion of pupils starting grade 1 who reach grade 5	18.3	..	55.8	61.3	61.5
Youth literacy rate (% ages 15-24)	..	..	..	..	57.4
Goal 3: Promote gender equality and empower women					
Proportion of seats held by women in national parliament (%)	..	..	2	2	8
Ratio of girls to boys in primary and secondary education (%)	68.2	..	61.5	68	69.3
Ratio of young literate females to males (% ages 15-24)	..	..	..	..	82.2
Share of women employed in the nonagricultural sector (%)	39.9	..	..	..	..
Goal 4: Reduce child mortality					
Immunization, measles (% of children ages 12-23 months)	38	54	49	52	52
Infant mortality rate (per 1,000 live births)	131	123	..	116	112
Under 5 mortality rate (per 1,000)	204	192	..	176	169
Goal 5: Improve maternal health					
Births attended by skilled health staff (% of total)	..	..	..	5.6	..
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	850	..
Goal 6: Combat HIV/AIDS, malaria, and other diseases					
Contraceptive prevalence rate (% of women ages 15-49)	4.3	..	..	8.1	..
Incidence of tuberculosis (per 100,000 people)	123.6	203.4	260	308.7	356.1
Number of children orphaned by HIV/AIDS	..	..	..	560,000	720,000
Prevalence of HIV, total (% of population aged 15-49)	..	..	..	4.1	4.4
Tuberculosis cases detected under DOTS (%)	..	16.2	23.3	34.7	36.3
Goal 7: Ensure environmental sustainability					
Access to an improved water source (% of population)	25	..	..	..	22
Access to improved sanitation (% of population)	4	..	..	..	6
Access to secure tenure (% of population)	..	..	..	..	..
CO2 emissions (metric tons per capita)	0.1	0.1	0.1	0.1	..
Forest area (% of total land area)	..	..	..	4.6	..
GDP per unit of energy use (2000 PPP $ per kg oil equivalent)	2.1	2	2.3	2.3	2.4
Nationally protected areas (% of total land area)	..	..	..	..	16.9
Goal 8: Develop a global partnership for development					
Aid per capita (current US$)	19.8	19.5	9.7	10.8	21.9
Debt service (% of exports)	38	15	10	12	7
Fixed line and mobile phone subscribers (per 1,000 people)	2.6	2.6	2.6	3.9	7.7
Internet users (per 1,000 people)	..	0	0	0.2	1.1
Personal computers (per 1,000 people)	..	..	0.6	0.9	2.2
Unemployment, youth female (% of female labor force ages 15-24)	..	..	..	..	..
Unemployment, youth male (% of male labor force ages 15-24)	..	..	..	..	..
Unemployment, youth total (% of total labor force ages 15-24)	..	..	..	..	..

Source: World Development Indicators database, April 2005

The Federal Democratic Republic of Ethiopia--Joint Fund-World Bank Debt Sustainability Analysis

1. **Ethiopia's risk of debt distress is moderate**. Ethiopia's external debt burden indicators under the baseline scenario remain below the relevant policy-dependent indicative thresholds. However, as illustrated by the "historic scenario", the favorable evolution of the debt indicators under the baseline is contingent on a strong performance compared to the country's historic track-record. Furthermore, stress tests reveal that the favorable outlook under the baseline does not provide sufficient comfort against adverse developments, in particular to less favorable terms for external financing and to exports shocks. This assessment remains valid when domestic debt is incorporated in the analysis.

2. **This Debt Sustainability Analysis (DSA) has been prepared jointly by IDA and IMF staff using the debt sustainability framework for low income countries approved by the Boards of both institutions.**[1] The framework takes into account revised data for 2004/05, along with new information received in the context of the 2005 Article IV consultation discussions, including revised GDP data, strong exports growth, and information received from donors. As noted in the staff report, political tensions have introduced a greater than usual degree of uncertainty to current projections, including for donor support levels. The macroeconomic scenario underlying this DSA is the baseline scenario discussed in the main body of the staff report and outlined in the supporting tables. Estimated debt outstanding and disbursed as of end-FY2004/05, provides the basis for debt projections.[2] The DSA assumes full delivery of debt relief under the Enhanced HIPC Initiative, including topping up, and takes into account IMF debt relief to Ethiopia under the MDRI.[3] The baseline does not incorporate debt relief under the MDRI by IDA and AfDF as the Boards of both institutions have yet to approve its implementation. However, an alternative baseline explores the impact of the delivery of MDRI debt relief by the three institutions. The results of the alternative baseline suggest that the MDRI debt relief from IDA and the AfDB would lead to a sharp reduction of Ethiopia's debt burden indicators which may warrant a reassessment of Ethiopia's risk of debt distress once the Boards of these institutions approve the delivery of MDRI.

3. **The salient features of the revised macro framework are the revision of the GDP series as described in the staff report as well as a strong growth in exports revenue.**

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[1] A debt sustainability analysis for Ethiopia using the LIC DSA template was presented in the context of the 2004 Article IV consultation (IMF Country Report No. 05/27).

[2] For IDA and the IMF, actual end-FY2004/05 debt figures were used. For all other creditors, end-FY2004/05 estimates are based on the end-FY2002/03 debt outstanding and disbursed –which was reconciled at the time of the completion point– updated for actual disbursements and repayments over FY2003/04 – FY2004/05.

[3] IMF debt relief to Ethiopia under the MDRI amounts to US$114 million excluding remaining assistance under the Enhanced HIPC Initiative.

I. External Debt Sustainability Analysis[4]

4. **Ethiopia's NPV of debt-to-exports ratio as of end-2004/05 is estimated at 108 percent.** This represents a reduction of 45 percentage points compared to projections made for the 2004 Article IV Consultation (Table 1). Most of the decrease (about 37 percentage points) is due to higher growth in exports (exports of goods and services increased by 31 percent in 2003-04 compared to 20 percent estimated in the staff report for the 2004 Article IV Consultation and grew by 22 percent in 2004-05 while the 2004 Article IV projected a decline of about ½ percent). This increase in exports is due to both a rebound in export prices (Ethiopian export prices increased by 25 percent in 2004/05 driven largely by a 46 percent increase in coffee prices) coupled by a pick up in exports volume thanks to a good performance of agricultural production in both 2003/04 and 2004/05. Debt relief provided by the IMF under the MDRI is estimated to have reduced the ratio of about 7 percentage points. On the other hand, unanticipated new borrowing would have increased the ratio by about 8 percentage points, most of this was due to higher than expected disbursements.

Table 1. Ethiopia: NPV of debt-to-exports ratio as of end-FY 2004/2005 [1/ 2/]
(in percentage points)

2004 Article IV Projection	**153.3**
Total change (+) increase (-) decrease	**-45.5**
1. Due to changes in exchange rates	-7.3
2. Due to unanticipated new borrowing	8.4
o/w due to higher disbursements	5.4
o/w due to lower concessionality	3.0
3. Due to provision of MDRI by the IMF	-6.6
4. Due to unanticipated changes in exports	-37.1
5. Other factors 3/	-2.9
Actual	**107.8**
Memorandum item:	
Decrease due to provision of MDRI by IDA and the AfDB	-57.8

Source: Staff estimates.

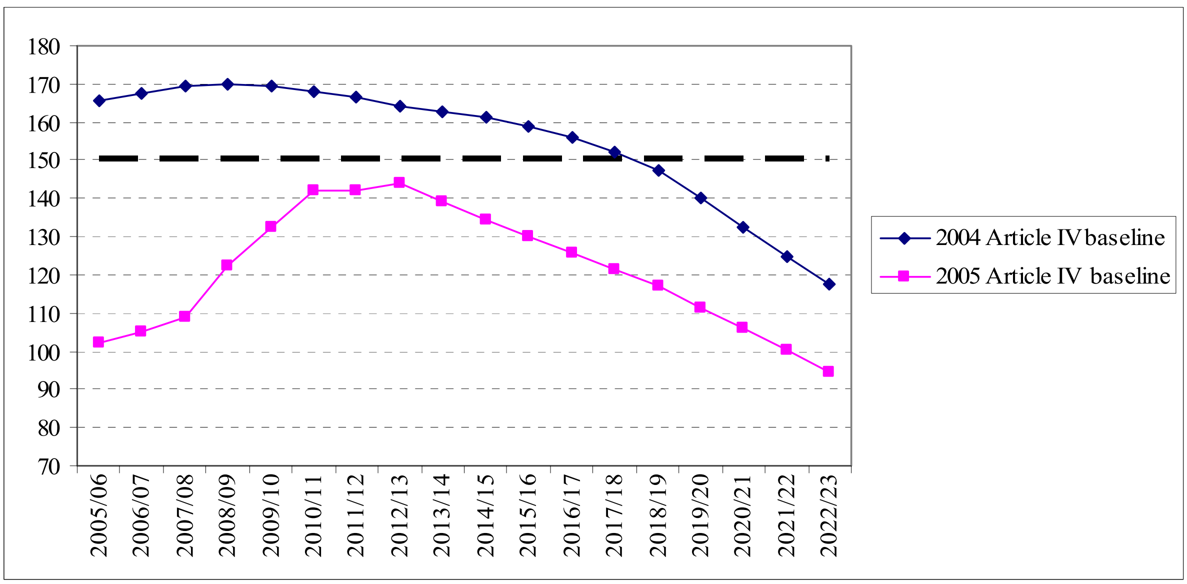
1/ Refers to medium and long-term public and publicly guaranteed external debt and current year exports of goods and services.
2/ Refers to the Ethiopian fiscal year that runs from July 7 to July 6.
3/ Captures updates on the schedule for the delivery of debt relief under the HIPC Initiative and differences between actual and projected repayments during 2003/04 - 2004/05.

5. **Under the baseline scenario, Ethiopia's debt burden indicators remain below the relevant policy-dependent indicative thresholds.**[5] The main results of the external DSA are as follows (Text Table 1 and Figure 1):

[4] All the figures presented in the external DSA correspond to medium and long-term public and publicly guaranteed debt.

- **Although lower than projected during the 2004 Article IV Consultation, the NPV of debt-to-GDP and the NPV of debt-to-exports ratios are expected to rise somewhat in the initial years**. They would reach 29 percent and 144 percent in 2012/13, respectively; and are then projected to gradually decline. External debt service absorbs on average about 6 percent of export revenues over the next 20 years. It increases from 5 percent to about 8 percent in 2011/12 – 2013-14 before declining to 5 percent at the end of the projection period. This patterns is largely driven by the impact on the debt service of the USD 1.2 billion loan contracted by Ethiopian Airlines for the purchase of aircrafts and by the significant "front-loading" of the debt service reduction to Ethiopia under different debt relief initiatives (Enhanced HIPC, topping-up, and IMF relief under the MDRI).

Figure 1. Ethiopia: NPV of debt-to-exports ratio (in percent)



- **The favorable evolution of Ethiopia's debt indicators under the baseline scenario is contingent upon a relatively ambitious macroeconomic performance.** Under the "historic scenario", all debt indicators show a significant deterioration compared to the baseline. Despite the significant debt reduction achieved in recent years, the NPV of debt-to-exports ratios would breach its indicative threshold within the next five years and w remain above

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[5] According to the latest World Bank's Country Policy and Institutional Assessment (CPIA), Ethiopia ranks as a "medium performer". The relevant indicative thresholds for this category are: 40 percent for the NPV of debt-to-GDP ratio, 150 percent for the NPV of debt-to-exports ratio, 250 percent for the NPV of debt-to-revenue ratio, 20 percent for the debt service-to-exports ratio and 30 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed external debt.

that level thereafter. Although rising quickly, the ratio of NPV of debt-to-GDP would only breach its indicative threshold in 2014/15.

- **The stress tests also reveal that Ethiopia's external debt indicators are particularly sensitive to the terms of new borrowing[6] and negative export shocks.[7]** Although the NPV of debt-to-exports ratio deteriorates under most stress tests, it is when new borrowing is assumed to be contracted on less favorable terms and under the simulated export shock that the adverse impact is most significant. Under the less favorable financing scenario, the NPV of debt-to-exports ratio increases rapidly by as much as 55-60 percentage points compared to the baseline and is above the appropriate indicative benchmark within the next five years. A shock to exports, whereby exports would grow one standard deviation below its historical average during 2006/07 and 2007/08, could result in a NPV of debt-to-exports ratio above 200 percent by 2014/15. Given Ethiopia's historical vulnerability, such a shock has a non-negligible probability of occurrence.[8]

6. **These results underscore the importance Ethiopia to follow a comprehensive debt management strategy and a prudent borrowing policies.** New borrowing should be on highly concessional terms and with an increased reliance on grant financing. This will be crucial to keep Ethiopia's risk of debt distress within acceptable levels**.** In that regard, it will be important to monitor closely the evolution of Ethiopia's debt burden indicators to ensure that the terms of external financing are consistent with the country's repayment capacity and take into consideration its vulnerability to external shocks. Additionally, achieving debt sustainability will require a continued focus on a prioritization of public investment, and fostering growth and diversified exports.

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[6] Under this scenario, external financing is assumed to be provided in less concessional terms than in the baseline. This scenario could also be assimilated to a sharp decline in grant financing that is compensated by loans.

[7] The standard stress tests performed under the framework for low income countries consider only a first order impact on macroeconomic variables. Therefore, the projected path of the debt burden indicators under the tests do not reflect a fully consistent macroeconomic scenario.

[8] The standard stress tests performed under the framework for low-income countries have been calibrated to represent a 20 percent of occurrence 10 years after the period where the shocks are assumed.

Box 1. Ethiopia: Macroeconomic Assumptions Underlying the DSA

Real GDP growth is projected to average about 5.4 percent during 2005/06-2024/25. This is higher than the historical average of 4.1 percent during 1991/92-2004/05.

- The baseline projection assumes that implementation of the authorities' PRSP (policies to raise agriculture productivity; improve the environment for private sector participation, and build physical infrastructure) succeeds in raising real output growth. Consequently, real output growth in agriculture production is projected to rise from 2.9 percent (1991/92-2004/05) to 3.9 percent during 2005/06-2024/25, while growth in non-agriculture GDP is projected to rise from 5.1 percent to 6.4 percent.
- From a growth accounting framework perspective, the emphasis on improving Ethiopia's physical infrastructure, particularly electricity generation, roads and telecommunications, raises the ratio of public investment to GDP by more than 6 percentage points. The contribution by investment to growth is thus projected to rise to 2.2 percentage points from 1.5 percentage points during 1991/92-2004/05. Total factor productivity growth is projected to contribute 1.0 percentage point, compared with 0.5 percent historically. Given already significant achievements in the past, the contribution by labor to growth is projected to remain around 2.2 percentage points.

Inflation is projected to rise to 10.8 percent in 2005/06, driven by both higher increases in food and nonfood inflation, the latter partly on account of higher petroleum prices. Consistent with the authorities' PRSP, inflation is then projected to decline to an average of 6 percent in 2006/07, and remain at that level thereafter. The real exchange rate, relative to the U.S. dollar is projected to remain broadly unchanged, consistent with the authorities' stated policy of allowing the nominal exchange rate to depreciate in line with the expected inflation differential between Ethiopia and the U.S.

Export (goods and services) growth in 2005-10, is projected to increase by 12 percent which is 2 points higher than the average growth registered during the past 10 years. This marks a decline from an average growth of 27 percent growth per year in 2003/04-2004/05.However, caution is needed in comparing averages due to the very large volatility experienced in the past due in part to the impact of droughts and the war with Eritrea. Thereafter, exports is expected to increase on average at 10 percent annually, which is slightly higher than the increase in nominal GDP growth reflecting the impact of government policies in particular the effort to diversify export bases and improving infrastructures.

The external current account deficit is expected to continue its decrease from its peak level of 2004/05 (9 percent of GDP) to an average of 4 ½ percent of GDP in 2005/06 - 2009/10 and 2 percent in 2005/06 - 2025/26. The reduction in the deficit is due to the increase in services balance surplus and in transfers (private and public) despite the growing trade deficit.

External financing. After a decline in aid flows in 2005-06, the baseline assumes that sufficient progress is made in addressing donors' concerns to allow a resumption in aid flows in 2006/07 and a return to the levels originally budgeted for in 2005-06. Despite the increasing share of grants in total external financing, disbursements are projected to account for 4.0 percent to GDP over 2006/07 – 2015-26 compared to 3.9 in the past 10 years.

Fiscal policy. The primary deficit (including debt relief from the IMF under the MDRI) is projected to decline from 4.9 to 1.5 percent of GDP between 2005/06 and 2025/26. The lower primary deficit is driven by higher revenue and grants totaling 1.1 percent of GDP and lower primary spending by about 1½ percent of GDP. The increase in revenue and grants reflects a projected increase in grants by 1.7 percent of GDP (including MDRI from the IMF) as higher tax revenue is more than offset by a decline in nontax revenue. Lower primary spending is achieved by a continued adjustment in defense and non-priority outlays as a share of GDP to safeguard pro-poor recurrent expenditures, and adjusting public investment in line with available resources. The interest bill also remains well contained given the gradual increase in projected real borrowing rates.

II. Public Debt Sustainability Analysis

7. **The baseline fiscal framework is consistent with lower total public debt and comfortable debt-service ratios.** The NPV of the public debt falls from 51.1 to 39.2 percent of GDP over the twenty-year projection horizon. A decline in the domestic debt by 15.4 percent of GDP is partly offset by an increase in the NPV of external liabilities by about 3.5 percent of GDP. Debt-service ratios absorb an increasing share of revenue in line with the gradual increase in projected real borrowing rates, and the high initial level of domestic debt at 33 percent of GDP. However, debt service remains at manageable levels.

8. **The public debt DSA demonstrates that the principal risks to the scenario include lower average growth and elevated primary deficits** as described below:

- **The main risk to public debt sustainability is permanently lower GDP growth** by one standard deviation relative to the baseline path. This alternative scenario would result in a higher NPV of public debt by about 25 percent of GDP compared to 2005/06. Moreover, debt service would also reach 13 percent of revenue in 2025/26 compared to just 8 percent in the baseline.
- **Debt sustainability prospects would also be adversely affected if average growth and the primary deficit remain at historical levels.** In this scenario, the NPV of the public debt increases by 7 percent of GDP compared to 2005/06, and debt service reaches 11 percent of revenue.
- **The bound tests confirm the sensitivity of public debt sustainability to lower growth.** The NPV of public debt as a share of GDP decreases by 2025/26 in each bound test except the case of a transitory shock in real GDP growth during 2006/07 and 2007/08 .[9] In this case, the NPV of public debt as a share of GDP peaks at 75 percent in 2015/16 after increasing 24 percent of GDP, and debt service reaches 13 percent of revenue compared to 8 percent in the baseline. This example highlights the challenge of maintaining a sustainable public debt given Ethiopia's vulnerability to severe climatic shocks that result in volatile growth swings.

9. **The results of the public DSA reiterate the importance of developing an comprehensive public debt strategy.** The strategy should develop separate targets and adjustment paths for the domestic and external debt based on a range of fiscal indicators. In this manner, medium-term budget planning should be anchored by the public debt strategy. Contingency plans should play an integral role in the strategy to ensure that the public debt remains sustainable following severe shocks. In this context, lowering the domestic debt should be a priority to provide scope for higher borrowing to absorb the fiscal impact of macroeconomic shocks.

[9] The bound test for lower real GDP growth is calculated by reducing projected growth by one standard deviation in 2006/07 and 2007/08. This corresponds to a contraction in real GDP by 0.9 percent compared to the baseline growth projection of 5.7 percent.

III. Impact of the full delivery of debt relief under the MDRI

10. **Delivery of MDRI debt relief from IDA and the AfDB would improve Ethiopia's debt sustainability outlook by leading to a sharp reduction of Ethiopia's debt burden indicators** (text table).[10] The NPV of debt-to export ratio would decrease by about 50 percentage points in the initial year compared to the baseline, and would remain comfortably below the indicative threshold throughout the projection period. Similarly, the NPV of debt-to-GDP would decrease by 6 percentage points on average compared to the baseline. Under the full MDRI scenario, the debt service would average 5.3 percent, increasing from 3.9 percent in 2006/07 to 7.7 percent in 2012/13 to then decline to about 4.0 percent by the end of the projection period. Albeit the sharp initial impact of MDRI debt relief, all debt burden indicators converge over time to the pre-MDRI situation, with the NPV of debt-to-GDP ratio at the end of the projection period above its initial levels.

Table 2. Ethiopia: Impact of the full provision of MDRI on the baseline scenario

	2005/06	2009/10	2012/13	2015/16	2025/26
			NPV of debt-to-GDP ratio		
Before MDRI 1/	17.6	25.7	29.2	27.7	21.5
After MDRI	9.0	18.1	22.5	21.7	19.2
			NPV of exports-to-GDP ratio		
Before MDRI 1/	102.2	132.3	144.0	130.1	78.6
After MDRI	51.9	93.0	110.9	102.2	70.5
			Debt service ratio		
Before MDRI 1/	5.2	5.2	8.2	6.9	5.0
After MDRI	5.2	4.7	7.7	6.5	3.9

1/ Includes the IMF debt relief under the MDRI.

11. **Under the current CPIA classification, and contingent on a strong economic performance, a reassessment of Ethiopia's risk of debt distress could be needed once MDRI from IDA and the AfDB is approved.**

[10] This alternative baseline assumes that MDRI debt relief from IDA is implemented starting in July 2006 through the forgiveness of the debt service payments on the debt outstanding and disbursed (DOD) as of end-December 2003. As for the African Development Fund, it is assumed that debt service payments on the DOD as of end-December 2004 with retroactive application to January-2006. Under those assumptions, IDA and the AfDB would deliver MDRI debt relief in the amount of approximately SDR1.6 billion (equivalent to US$2.3 billion at the exchange rate prevailing at end-December 2005) and US$0.9 billion, respectively.

Table 1a. Ethiopia: External Debt Sustainability Framework, Baseline Scenario, 2002-2025 1/
(In percent of GDP, unless otherwise indicated)

	Actual		Estimate	Historical Average 6/	Standard Deviation 6/	Projections											
	2002/03	2003/04	2004/05			2005/06	2006/07	2007/08	2008/09	2009/10	2012/13	2013/14	2014/15	2015/16	2016/17	2024/25	2025/26
External debt (nominal) 1/	**85.4**	**75.7**	**53.9**			**47.4**	**48.1**	**47.5**	**46.0**	**45.3**	**42.6**	**41.6**	**40.7**	**39.9**	**39.1**	**31.1**	**30.0**
o/w public and publicly guaranteed (PPG)	85.4	75.7	53.9			47.4	48.1	47.5	46.0	45.3	42.6	41.6	40.7	39.9	39.1	31.1	30.0
Change in external debt	1.9	-9.7	-21.8			-6.5	0.7	-0.6	-1.5	-0.7	-1.1	-1.0	-0.9	-0.8	-0.8	-1.0	-1.0
Identified net debt-creating flows	-5.6	-11.6	-2.0			3.7	0.5	-0.9	-0.1	0.3	-0.8	-2.2	-2.8	-2.8	-2.7	-1.2	-1.6
Non-interest current account deficit	**1.3**	**4.5**	**8.6**	**2.9**	**3.4**	**7.0**	**3.8**	**2.5**	**3.1**	**3.4**	**1.7**	**0.2**	**-0.4**	**-0.5**	**-0.5**	**0.5**	**0.1**
Deficit in balance of goods and services	15.2	17.2	22.7			20.4	19.1	18.7	19.3	19.1	17.0	15.4	14.6	14.4	14.3	15.8	15.9
Exports	14.4	15.4	16.4			17.3	18.4	19.0	19.2	19.4	20.3	20.6	20.9	21.3	21.7	26.5	27.3
Imports	29.5	32.6	39.1			37.7	37.5	37.7	38.5	38.5	37.3	36.0	35.5	35.6	36.0	42.3	43.2
Net current transfers (negative = inflow)	-13.8	-12.7	-14.0	-9.8	2.8	-13.1	-14.9	-15.8	-15.8	-15.3	-14.7	-14.4	-14.1	-13.9	-13.7	-14.2	-14.8
Other current account flows (negative = net inflow)	-0.1	0.0	-0.1			-0.3	-0.3	-0.4	-0.3	-0.4	-0.6	-0.8	-0.9	-1.0	-1.0	-1.1	-1.1
Net FDI (negative = inflow)	**-1.4**	**-1.0**	**-1.3**	**-1.0**	**0.7**	**-1.3**	**-1.3**	**-1.3**	**-1.3**	**-1.2**	**-1.0**	**-1.0**	**-1.0**	**-0.9**	**-0.8**	**-0.5**	**-0.5**
Endogenous debt dynamics 2/	**-5.5**	**-15.1**	**-9.3**			**-2.0**	**-2.0**	**-2.0**	**-2.0**	**-1.8**	**-1.5**	**-1.4**	**-1.4**	**-1.4**	**-1.4**	**-1.2**	**-1.2**
Contribution from nominal interest rate	0.9	0.6	0.5			0.5	0.4	0.4	0.4	0.5	0.7	0.7	0.7	0.6	0.6	0.4	0.4
Contribution from real GDP growth	2.5	-7.7	-5.8			-2.4	-2.4	-2.5	-2.4	-2.3	-2.2	-2.1	-2.1	-2.0	-2.0	-1.6	-1.6
Contribution from price and exchange rate changes	-8.9	-8.0	-4.0			…	…	…	…	…	…	…	…	…	…	…	…
Residual (3-4) 3/	**7.5**	**2.0**	**-19.8**			**-10.2**	**0.2**	**0.3**	**-1.4**	**-1.0**	**-0.3**	**1.2**	**1.9**	**2.0**	**1.9**	**0.2**	**0.6**
o/w exceptional financing	-0.9	-0.8	-0.8			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPV of external debt 4/	...	...	17.6			17.6	19.3	20.7	23.5	25.7	29.2	28.6	28.1	27.7	27.2	22.2	21.5
In percent of exports	...	...	107.8			102.2	105.1	108.8	122.4	132.3	144.0	139.0	134.4	130.1	125.6	83.8	78.6
NPV of PPG external debt	**...**	**...**	**17.6**			**17.6**	**19.3**	**20.7**	**23.5**	**25.7**	**29.2**	**28.6**	**28.1**	**27.7**	**27.2**	**22.2**	**21.5**
In percent of exports	...	...	107.8			102.2	105.1	108.8	122.4	132.3	144.0	139.0	134.4	130.1	125.6	83.8	78.6
Debt service-to-exports ratio (in percent)	15.2	12.3	7.1			5.2	4.4	4.2	4.0	5.2	8.2	8.1	7.3	6.9	6.7	5.2	5.0
PPG debt service-to-exports ratio (in percent)	15.2	12.3	7.1			5.2	4.4	4.2	4.0	5.2	8.2	8.1	7.3	6.9	6.7	5.2	5.0
Total gross financing need (billions of U.S. dollars)	0.2	0.5	0.9			0.8	0.4	0.3	0.4	0.5	0.5	0.2	0.0	0.0	0.0	0.7	0.5
Non-interest current account deficit that stabilizes debt ratio	-0.6	14.2	30.5			13.5	3.1	3.1	4.7	4.1	2.8	1.2	0.5	0.3	0.4	1.5	1.1
Key macroeconomic assumptions																	
Real GDP growth (in percent)	-3.3	11.1	8.8	4.7	5.9	5.2	5.4	5.5	5.5	5.5	5.4	5.4	5.4	5.3	5.4	5.4	5.4
GDP deflator in US dollar terms (change in percent)	12.0	10.3	5.5	-1.0	14.1	8.8	-0.1	1.7	2.4	2.2	2.4	2.4	2.3	2.0	1.9	1.7	1.7
Effective interest rate (percent) 5/	1.2	0.9	0.7	1.2	0.3	1.0	0.9	1.0	1.0	1.3	1.8	1.9	1.7	1.6	1.5	1.2	1.2
Growth of exports of G&S (US dollar terms, in percent)	16.0	31.5	22.1	9.7	14.3	20.7	12.3	10.8	9.1	9.0	9.4	9.5	9.5	9.2	9.3	10.4	10.5
Growth of imports of G&S (US dollar terms, in percent)	13.2	35.1	37.7	13.8	13.0	10.3	4.7	7.9	10.3	8.0	8.6	4.3	6.2	7.8	8.4	9.7	9.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	41.8	47.6	49.6	37.4	35.4	35.8	49.7	49.9	50.0	50.2	51.6	51.8
Memorandym item:																	
Nominal GDP (billions of US dollars)	7.9	9.7	11.2			12.8	13.5	14.5	15.6	16.8	21.2	22.8	24.6	26.4	28.4	49.1	52.6

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments devided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

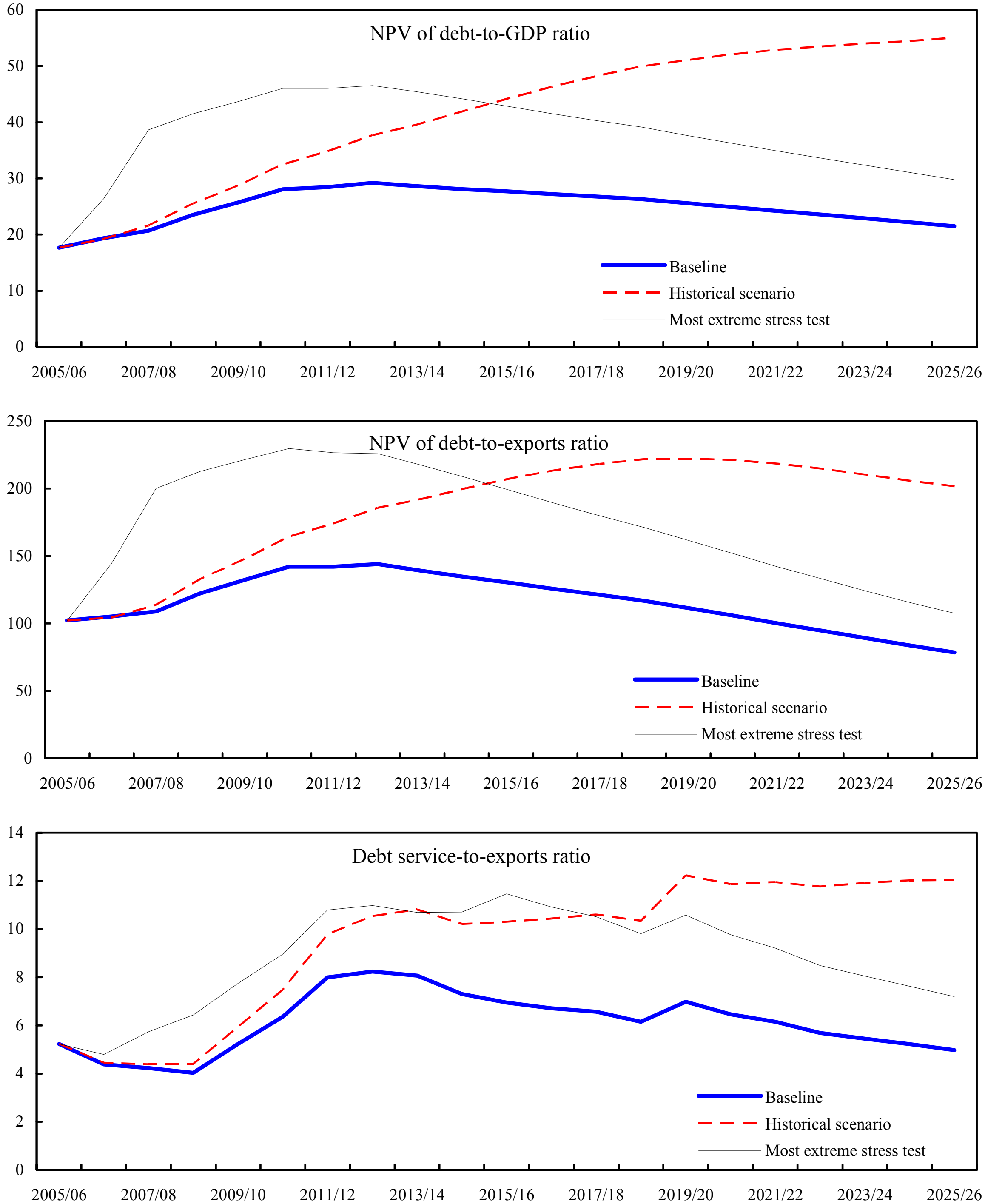
Table 1b. Ethiopia: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2005-25
(In percent)

	Estimate	Projections												
	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2024/25	2025/26
NPV of debt-to-GDP ratio														
Baseline	17.6	19.3	20.7	23.5	25.7	28.1	28.4	29.2	28.6	28.1	27.7	27.2	22.2	21.5
A. Alternative Scenarios														
A1. Key variables at their historical averages in 2006-25 1/	17.6	19.2	21.6	25.5	28.7	32.5	34.8	37.7	39.6	41.9	44.2	46.3	54.4	55.0
A2. New public sector loans on less favorable terms in 2006-25 2/	17.6	20.6	23.2	28.1	32.0	36.2	37.7	39.8	39.8	39.9	39.9	39.9	36.5	35.8
B. Bound Tests														
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	17.6	20.6	23.5	26.7	29.3	31.9	32.4	33.2	32.6	32.0	31.5	31.0	25.2	24.4
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	17.6	20.9	25.1	27.7	29.8	32.0	32.2	32.8	32.1	31.4	30.7	30.0	23.6	22.7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	17.6	21.1	25.1	28.5	31.2	34.1	34.5	35.5	34.7	34.1	33.6	33.0	26.9	26.0
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	17.6	24.4	31.2	33.6	35.4	37.4	37.4	37.9	37.0	36.0	34.9	33.9	25.5	24.5
B5. Combination of B1-B4 using one-half standard deviation shocks	17.6	26.4	38.7	41.5	43.7	46.0	46.0	46.5	45.4	44.2	42.9	41.6	31.1	29.8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	17.6	27.7	29.6	33.6	36.7	40.1	40.6	41.7	40.9	40.1	39.5	38.9	31.7	30.7
NPV of debt-to-exports ratio														
Baseline	102.2	105.1	108.8	122.4	132.3	142.3	142.2	144.0	139.0	134.4	130.1	125.6	83.8	78.6
A. Alternative Scenarios														
A1. Key variables at their historical averages in 2006-25 1/	102.2	104.6	113.8	132.9	147.8	164.6	174.2	185.8	192.4	200.5	207.7	213.7	205.8	201.7
A2. New public sector loans on less favorable terms in 2006-25 2/	102.2	111.9	122.2	146.2	164.8	183.4	188.6	196.1	193.7	190.9	187.8	184.1	138.0	131.4
B. Bound Tests														
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	102.2	105.1	108.8	122.4	132.3	142.3	142.2	144.0	139.0	134.4	130.1	125.6	83.8	78.6
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	102.2	133.8	180.4	197.4	209.6	221.7	220.3	221.5	213.4	205.6	197.7	189.6	121.9	114.0
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	102.2	105.1	108.8	122.4	132.3	142.3	142.2	144.0	139.0	134.4	130.1	125.6	83.8	78.6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	102.2	132.6	163.9	174.8	182.3	189.6	187.2	186.8	179.7	172.2	164.4	156.6	96.4	89.7
B5. Combination of B1-B4 using one-half standard deviation shocks	102.2	144.7	200.3	212.9	221.5	229.8	226.7	225.9	217.3	208.2	198.5	188.9	115.6	107.5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	102.2	105.1	108.8	122.4	132.3	142.3	142.2	144.0	139.0	134.4	130.1	125.6	83.8	78.6
Debt service ratio														
Baseline	5.2	4.4	4.2	4.0	5.2	6.4	8.0	8.2	8.1	7.3	6.9	6.7	5.2	5.0
A. Alternative Scenarios														
A1. Key variables at their historical averages in 2006-25 1/	5.2	4.4	4.4	4.4	5.9	7.5	9.8	10.5	10.8	10.2	10.3	10.4	12.0	12.0
A2. New public sector loans on less favorable terms in 2006-25 2/	5.2	4.4	4.4	4.7	5.7	6.3	7.4	7.8	8.0	8.3	10.2	9.7	9.2	8.8
B. Bound Tests														
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	5.2	4.4	4.2	4.0	5.2	6.4	8.0	8.2	8.1	7.3	6.9	6.7	5.2	5.0
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	5.2	5.2	6.0	6.2	7.8	9.3	11.5	11.8	11.5	10.8	10.9	10.5	7.8	7.4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	5.2	4.4	4.2	4.0	5.2	6.4	8.0	8.2	8.1	7.3	6.9	6.7	5.2	5.0
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	5.2	4.4	4.9	5.3	6.4	7.5	9.0	9.2	8.9	9.0	9.4	9.0	6.3	6.0
B5. Combination of B1-B4 using one-half standard deviation shocks	5.2	4.8	5.7	6.4	7.7	9.0	10.8	11.0	10.7	10.7	11.5	10.9	7.6	7.2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	5.2	4.4	4.2	4.0	5.2	6.4	8.0	8.2	8.1	7.3	6.9	6.7	5.2	5.0
Memorandum item:														
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.7

Source: Staff projections and simulations.

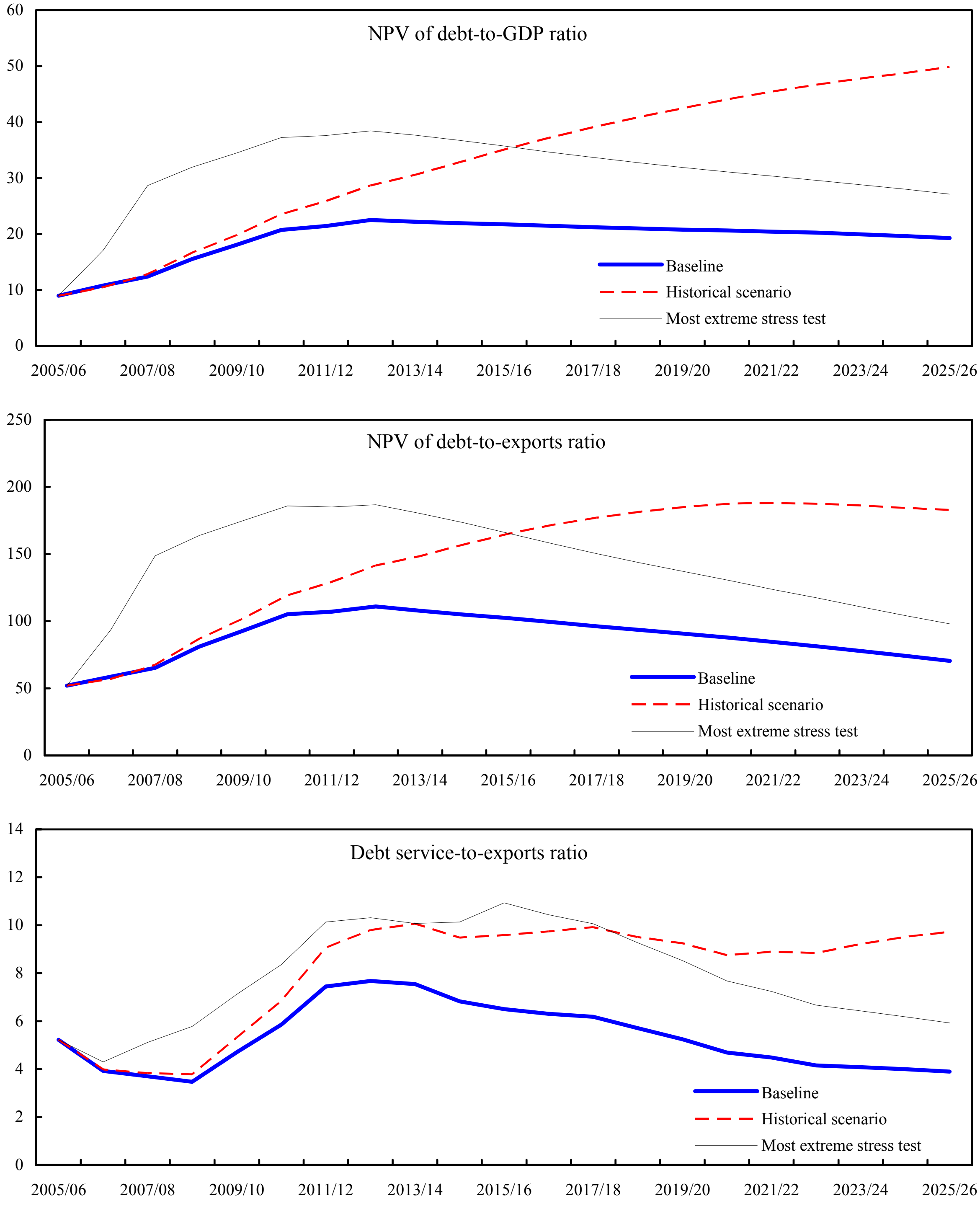
1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 2a. Ethiopia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2005/06-2025/26
(In percent)



Source: Staff projections and simulations.

Figure 2b. Ethiopia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios After full MDRI, 2005/06-2025/26
(In percent)



Source: Staff projections and simulations.

Table 2a.Ethiopia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2002/3-2025/26

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 5/	Standard Deviation 5/	Estimate	Projections								
	2002/3	2003/4	2004/5			2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2005/6-2010/11 Average	2015/16	2025/26	2011/12-2025/26 Average
Public sector debt 1/	124.5	110.9	88.8			82.0	81.9	81.1	79.0	77.8	76.1		67.3	47.9	
o/w foreign-currency denominated	85.6	75.9	54.0			49.2	49.1	48.4	46.9	46.2	45.4		40.7	30.6	
Change in public sector debt	1.3	-13.6	-22.1			-6.8	-0.1	-0.8	-2.1	-1.1	-1.7		-1.6	-1.9	
Identified debt-creating flows	-4.2	-20.6	-10.8			-5.9	-1.9	-2.4	-1.9	-1.5	-2.1		-1.6	-1.1	
Primary deficit	5.2	1.8	3.9	4.0	2.4	4.0	4.5	3.7	3.6	3.5	3.0	3.7	2.2	1.5	1.9
Revenue and grants	23.0	21.4	20.7			23.5	22.1	21.9	22.8	23.2	23.8		24.4	24.6	
of which : grants	6.7	4.8	4.7			5.4	5.3	5.4	6.3	6.7	7.2		7.4	7.2	
Primary (noninterest) expenditure	28.3	23.2	24.6			27.5	26.5	25.5	26.3	26.6	26.8		26.6	26.1	
Automatic debt dynamics	-8.6	-21.6	-13.6			-9.0	-5.5	-5.2	-5.4	-5.0	-5.1		-3.8	-2.6	
Contribution from interest rate/growth differential	-0.4	-16.8	-11.5			-7.7	-5.6	-5.5	-5.6	-5.1	-5.0		-3.8	-2.7	
of which : contribution from average real interest rate	-4.3	-3.2	-2.6			-3.2	-1.3	-1.0	-1.2	-0.9	-1.0		-0.4	-0.1	
of which : contribution from real GDP growth	3.9	-13.6	-8.9			-4.5	-4.4	-4.4	-4.4	-4.2	-4.1		-3.5	-2.6	
Contribution from real exchange rate depreciation	-8.3	-4.8	-2.1			-1.4	0.1	0.3	0.1	0.2	-0.1		...	...	
Other identified debt-creating flows	-0.8	-0.8	-1.0			-0.9	-0.9	-0.9	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	-0.2			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other) 6/	-0.8	-0.8	-0.8			-0.9	-0.9	-0.9	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	5.5	6.9	-11.3			-0.9	1.9	1.6	-0.3	0.4	0.4		-0.1	-0.8	
NPV of public sector debt	39.0	35.0	52.5			51.1	52.6	53.8	56.1	57.9	59.3		54.8	39.2	
o/w foreign-currency denominated	13.0	12.6	17.7			18.3	19.7	21.1	23.9	26.2	28.6		28.2	21.9	
Gross financing need 2/	22.1	22.6	23.6			24.5	26.1	26.6	26.3	26.8	26.7		25.4	18.5	
NPV of public sector debt-to-revenue ratio (in percent) 3/	169.1	163.9	253.3			217.0	238.1	246.0	246.3	249.7	249.7		224.9	159.2	
o/w external	...	...	85.3			77.9	89.4	96.4	105.2	113.0	120.4		115.6	88.9	
Debt service-to-revenue ratio (in percent) 3/ 4/	11.3	10.7	9.3			8.8	9.8	10.5	6.6	7.1	7.3		8.5	7.9	
Primary deficit that stabilizes the debt-to-GDP ratio	3.9	15.4	26.0			10.8	4.5	4.5	5.7	4.6	4.8		3.9	3.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	-3.1	12.3	8.7	5.0	5.9	5.3	5.7	5.7	5.7	5.7	5.5	5.6	5.3	5.4	5.4
Average nominal interest rate on forex debt (in percent)	1.1	0.9	0.8	0.9	0.2	1.0	1.0	0.9	0.5	0.5	0.5	0.7	0.5	0.6	0.6
Average real interest rate on domestic currency debt (in percent)	-9.3	-6.6	-4.2	-1.0	7.3	-8.2	-2.6	-1.7	-1.5	-0.9	-1.1	-2.7	0.8	1.6	1.0
Real exchange rate depreciation (in percent, + indicates depreciation)	-9.6	-6.3	-3.1	3.1	8.2	-2.7	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	13.0	9.4	6.2	2.5	5.9	11.6	5.8	5.3	5.7	5.5	6.2	6.7	5.9	5.6	5.9
Growth of real primary spending (deflated by GDP deflator, in percent)	2.5	-7.9	15.1	10.4	13.9	18.0	1.6	1.9	9.5	7.4	6.4	7.5	4.2	5.3	5.2
Grant element of new external borrowing (in percent)	...	...	...	...	...	41.8	47.6	49.6	37.4	35.4	30.1	40.3	50.0	51.8	...

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

1/ Public sector debt corresponds to the general government gross debt, including publicly guaranteed debt to the public enterprises and the external debt of Ethiopia Airlines. The fiscal year ends on July 7.

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

3/ Revenues including grants.

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

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

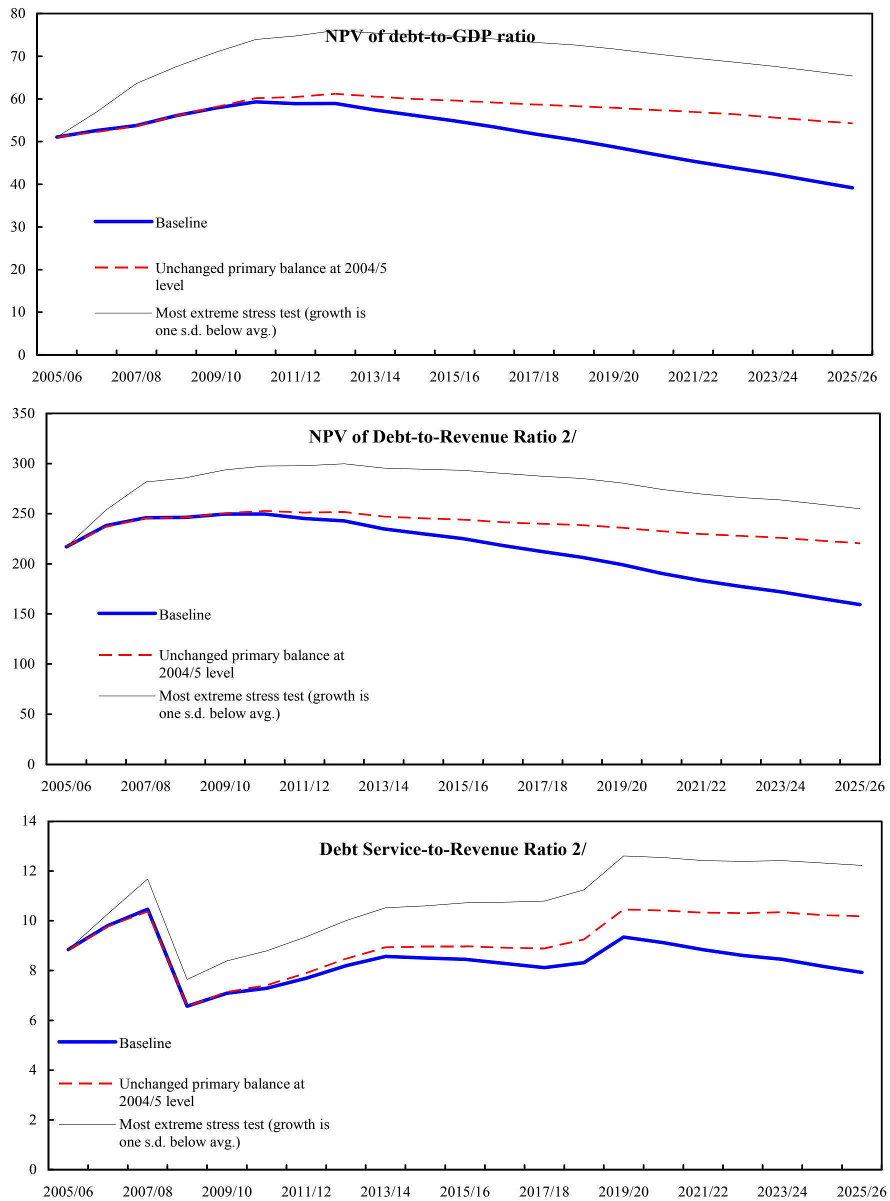
6/ External debt service is presented before debt relief until 2007 for comparability with the authorities' medium-term fiscal framework.

Table 2b.Ethiopia: Sensitivity Analysis for Key Indicators of Public Debt 2005/6-2025/26

	Estimate	Projections						
	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2015/16	2025/26
NPV of Debt-to-GDP Ratio								
Baseline	51	53	54	56	58	59	55	39
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	51	53	54	57	60	62	63	58
A2. Primary balance is unchanged from 2004/5	51	52	54	56	58	60	60	54
A3. Permanently lower GDP growth 1/	51	53	56	59	62	65	70	77
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2006/7-2007/8	51	57	64	68	71	74	75	65
B2. Primary balance is at historical average minus one standard deviations in 2006/7-2007/8	51	54	57	59	60	62	57	41
B3. Combination of B1-B2 using one half standard deviation shocks	51	55	59	61	62	63	57	38
B4. One-time 30 percent real depreciation in 2006/7	51	60	61	64	66	68	62	44
B5. 10 percent of GDP increase in other debt-creating flows in 2006/7	51	60	60	62	63	64	59	42
NPV of Debt-to-Revenue Ratio 2/								
Baseline	217	238	246	246	250	250	225	159
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	218	239	249	251	256	259	253	230
A2. Primary balance is unchanged from 2004/5	217	237	245	246	250	253	244	220
A3. Permanently lower GDP growth 1/	217	241	253	256	264	269	275	290
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2006/7-2007/8	217	254	282	286	294	298	293	255
B2. Primary balance is at historical average minus one standard deviations in 2006/7-2007/8	217	246	262	258	260	259	235	167
B3. Combination of B1-B2 using one half standard deviation shocks	217	247	266	261	262	260	228	151
B4. One-time 30 percent real depreciation in 2006/7	217	274	280	281	285	286	254	181
B5. 10 percent of GDP increase in other debt-creating flows in 2006/7	217	274	275	270	271	269	241	169
Debt Service-to-Revenue Ratio 2/								
Baseline	9	10	10	7	7	7	8	8
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	9	10	10	7	7	8	9	11
A2. Primary balance is unchanged from 2004/5	9	10	10	7	7	7	9	10
A3. Permanently lower GDP growth 1/	9	10	11	7	8	8	10	13
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2006/7-2007/8	9	10	12	8	8	9	11	12
B2. Primary balance is at historical average minus one standard deviations in 2006/7-2007/8	9	10	11	7	8	8	9	8
B3. Combination of B1-B2 using one half standard deviation shocks	9	10	11	7	8	8	9	8
B4. One-time 30 percent real depreciation in 2006	9	10	11	7	8	8	9	9
B5. 10 percent of GDP increase in other debt-creating flows in 2006/7	9	10	12	8	8	8	9	9

Sources: Country authorities; and Fund staff estimates and projections. The fiscal year ends July 7.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).
2/ Revenues are defined inclusive of grants. Debt service ratios are presented before HIPC debt relief until 2007/8 for comparability with the authorities' medium-term fiscal framework. As a result, the ratios drop in 2008/9 once external debt service is expressed net of all debt relief.

Figure 3.Ethiopia: Indicators of Public Debt Under Alternative Scenarios, 2005/6-2025/26 1/



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2015/16.
2/ Revenues are defined inclusive of grants. Debt service ratios are presented gross of HIPC debt relief until 2007/8 for comparability with the authorities' medium-term fiscal framework. As a result, the ratios drop in 2008/9 once external debt service is expressed net of all debt relief.

Ethiopia: Relations with the Fund

(As of December 31, 2005)

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	0.13	1.12

IV. Outstanding Purchases and Loans	**SDR Million**	**Percent of quota**
Poverty Reduction and Growth Facility (PRGF)	112.07	83.82

V. Latest Financial Arrangements

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

VI. Projected Obligations to Fund (without HIPC Assistance)

	Forthcoming; in SDR million				
	2006	2007	2008	2009	2010
Principal	7.64	12.28	16.75	16.93	20.06
Charges/interest	0.88	0.83	0.75	0.67	0.57
Total	8.51	13.11	17.5	17.59	20.63

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

	Forthcoming; in SDR million				
	2006	2007	2008	2009	2010
Principal	1.93	4.02	7.96	10.97	17.24
Charges/Interest	0.88	0.83	0.75	0.67	0.57
Total	2.81	4.85	8.72	11.64	17.82

VII. Implementation of HIPC Initiative

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	Nov. 2001
Assistance committed (NPV terms)[1]	
Total assistance by all creditors (US$ Million)	1,982.20
Of which: IMF Assistance (SDR Million)[2]	60.85
Completion point date	Apr 2004
Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	45.12
Interim assistance	10.28
Completion point balance	34.84
Additional disbursement of interest income[3]	1.54

VIII. Safeguards Assessment

Under the Fund's safeguards assessment policy, an assessment of the National Bank of Ethiopia (NBE) was completed on September 12, 2001 with respect to the Poverty Reduction and Growth Facility arrangement approved on March 22, 2001. The NBE made progress in implementing the recommendations of 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, 2005 was Br 8.681 = US$1.

In March 2004, the authorities eliminated the previous limit of US$1,200 on foreign exchange purchases for holiday travelers, and in May 2004, allowed nonresident Ethiopians and nonresident foreign nationals of Ethiopian origin to open current and fixed deposit

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

[2] Excludes commitment of additional enhanced HIPC assistance of SDR 18.19 million subject to receipt of satisfactory financial assurances from other creditors.

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

accounts in foreign currency. Since March 2001, exporters are 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. Effective March 2004, the NBE transferred to commercial banks the responsibility for determining compliance with import and export licensing requirements and foreign exchange regulations. The multiple currency practice that might have arisen from the NBE's weekly foreign exchange auction was lifted with the replacement of the auction by the interbank foreign exchange market. Remaining current account exchange restrictions relate to (a) the tax certification requirement for repatriation of investment income; (b) restrictions on repayment of legally entered into external loans and supplies and foreign partner's credits; (c) rules for issuance of import permits; and (d) the requirement to provide a clearance certificate from NBE to obtain import permits. These restrictions are inconsistent with Article VIII, Section 2(a) of the IMF's Articles of Agreement.

X. Article IV Consultation

Ethiopia is on the standard 12-month consultation cycle The Executive Board concluded the last Article IV consultation on September 13, 2004, concurrently with the completion of the sixth review under the third annual PRGF-supported program.

XI. Technical Assistance (2001—present)

Department	Purpose	Time of Delivery
FAD/LEG	Tax administration and VAT legislation	January-February 2001
MAE	Monetary and banking reforms	February-March 2001
FAD	Tax administration	April 2001
MAE	Bank supervision	April-May 2001
MAE	Monetary and banking reforms	May 2001
MAE	Interbank foreign exchange market	June-July 2001
LEG	Income tax legislation	September 2001
FAD	Tax administration	September-November 2001
MAE	Bank supervision	September-October 2001
LEG	Review of compliance with Article VIII	November 2001
STA	Consumer price index	November-December 2001
STA	Multisector	January 2002
MAE	Bank supervision	February 2002
FAD	Tax administration	February 2002
STA	Fiscal and monetary accounts	May 2002
LEG	VAT law	May 2002
MAE	Payment system	May-June 2002
FAD	Public expenditure management	July 2002

FAD	Tax administration	July 2002
MAE	Accounting and internal audit of central bank	August 2002
FAD	Tax administration	November 2002
MAE	Accounting and internal audit of central bank	November-December 2002
FAD	Tax and Customs Administration Reforms	June-July 2003
STA	Reconciliation of fiscal and monetary accounts	August 2003
MFD	Bank Supervision	August 2003
MFD	Restructuring plan of the CBE	November 2003
STA	Monetary and Financial Statistics Mission	January-February 2004
MFD	Bank Supervision	March 2004
MFD	Monetary Policy and Operations	April-May 2004
STA	Balance of Payments Statistics	April 2004
STA	Monetary and Financial Statistics	September 2004
MFD	Monetary Operations – Liquidity Forecasting and Instruments Design	September 2004
STA	Producer Price Index	October 2004
FAD	Modernization of tax administration	November 2004
FAD	Program/performance budgeting	January-February 2005
STA	Balance of Payments Statistics	January-February 2005
STA	Balance of Payments Statistics	July 2005
STA	Government Finance Statistics	August 2005

XII. Resident Representative

Arnim Schwidrowski

Ethiopia: Relations with the World Bank

(As of January 2006)[1]

A. Partnership in Ethiopia's Development Strategy

1. In July 2002, the Government of Ethiopia finalized its full Poverty Reduction Strategy Paper (PRSP), known as the Sustainable Development and Poverty Reduction Program (SDPRP). This was discussed in September 2002 by the Boards of the World Bank and the Fund, along with a Joint Staff Assessment (JSA). The first Annual Progress Report (APR) was sent to the Board in February 2004, followed in July 2005 by the second APR. In December 2005, the Government presented a draft of the second PRSP, an ambitious strategy called the Plan for Accelerated and Sustained Development to End Poverty (PASDEP), to cover FY06-FY10. The World Bank, together with the donor community, is providing feedback for the finalization of the document.

B. Key Areas of Common Interest to Bank and Fund

2. **Preparation and Implementation of the PRSP.** Staff of the Bank and the Fund shared information and collaborated in providing advice related to the SDPRP, and in supporting the implementation of SDPRP's policy reforms. The Bank and the Fund have also collaborated in providing support in the formulation of the policy and reform agenda needed to support the Government's strategy over the next 5 years, the PASDEP. Currently, the Bank and the IMF are separately reviewing the draft PASDEP, but will start collaborating in the preparation of the Joint Staff Advisory Note as soon as the final version is received.

3. The Bank and Fund share joint responsibility in supporting financial sector, taxation, decentralization, and public expenditure reforms. 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. Such dialogue is supported by an extensive agenda for analytical work.

4. **Macroeconomic policy, private sector development, and the financial sector.** There is close cooperation between the World Bank and the IMF in discussing macroeconomic policy with the Government, particularly in relation to the impact of the current macroeconomic situation and its implications for an eventual scaling up to achieve the MDGs. Initial work was undertaken in the joint Pilot Case Study on Public Investment and Fiscal Policy (presented to the IMF board). A close dialogue has characterized the period of intensive consultations with the Government following the suspension of direct budget support. In the context of Ethiopia's banking sector reforms (including restructuring the

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[1] For any question, please contact Caterina Ruggeri Laderchi at the World Bank

Commercial Bank of Ethiopia), staff are working together to encourage the Government to allow the entry of foreign banks into the sector over time, initially by encouraging international management contracts for domestic banks.

5. **Public sector reforms.** The Bank and Fund have been supporting the Government's decentralization program 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, the Bank is 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 (US$100 million), approved by the Board in May 2004, and currently under implementation.

6. **Public expenditure management.** Traditionally, the Fund has been an active participant in Bank-coordinated annual public expenditure reviews (PERs). In FY05, the Government, together with the Bank, Fund, and Joint Budget Support (JBS) donors, introduced the first annual Joint Budget and Aid Review (JBAR) as part of a new dialogue framework around the Government's own planning and budgeting cycle. This instrument, together with the Fiduciary Assessment replaces the previous series of PERs. The JBAR's primary objective is to review budget allocations – at the sectoral, sub-sectoral, regional and local levels – in terms of the links to national growth, poverty and human development outcomes as laid out in the SDPRP. Additionally, in the context of HIPC, the Government, IDA and the IMF have been tracking the use of savings arising from debt relief. Furthermore, in the present context in which Ethiopia does not have a PRGF agreement, JBAR discussions have acquired additional value as an important channel for macroeconomic discussion.

7. **Fiduciary assessments.** The Ministry of Finance and Economic Development (MOFED) conducted a joint fiduciary assessment in FY05 with JBS donors and the Bank. This represented the first of a series of annual Fiduciary Assessments (FAs). Like the Public Expenditure and Financial Accountability (PEFA) initiative, FAs are intended to consolidate and replace the various reviews of expenditure management systems in Ethiopia. Aspects of the PER related to institutional and inter-governmental fiscal design issues, as well as the Country Financial Accountability Assessment (CFAA) and Country Procurement Assessment Report (CPAR) will now be reflected in the FAs. The Bank is expected to work closely with the IMF's AFRITAC on the FAs.

8. **Millennium Development Goals.** The Bank and Fund have been closely coordinating on issues related to scaling up to meet the MDGs, particularly the assessment of the Government's macroeconomic analysis and development of a financing strategy. The Bank, together with UN agencies in Ethiopia and the U.N. Millennium Project, has supported the Government in undertaking sectoral needs assessments to estimate the cost of the investments required to put Ethiopia on a path to meet the MDGs. A Synthesis report was issued in December 2005. The Government has grounded its macro-scenarios for the PASDEP in the planning done for the whole of the MDG period in the Synthesis report with support from the World Bank. Further support to the Government is expected to take place

before the PASDEP is finalized to adapt the PASDEP to the current macroeconomic environment.

9. **Debt sustainability analysis and the Enhanced HIPC Initiative.** The Boards of the Bank and the Fund agreed on April 20, 2004 that Ethiopia had taken the necessary steps to reach its HIPC completion point, thereby making irrevocable the US$1.3 billion of NPV debt relief envisaged at Decision Point in November 2001. The Boards approved also an exceptional topping-up of debt relief by an additional US$0.7 billion in NPV terms on account of exogenous factors – particularly changes in the discount rate and exchange rate since the decision point – that had fundamentally changed Ethiopia's economic circumstances and thereby adversely affected its debt sustainability. In preparation for the Board discussions, Bank and Fund staff had jointly monitored progress in meeting the HIPC triggers necessary to reach Completion Point. The staff jointly updated the debt sustainability analysis (DSA) prior to Completion Point and for the present paper. Additional debt relief with an NPV of approximately US$1.5 billion, was announced at the G-8 Summit at Gleneagles in July 2005.

10. **Statistical issues.** Both institutions have been providing technical assistance to the Government on data and statistics, with the Fund focusing on the macroeconomic side and the Bank supporting the improvement of data on poverty and social indicators, and on the monitoring of output and outcomes of SDPRP/PASDEP programs. Further work related to increasing accountability and transparency and to foster structured learning through appropriate evaluation is currently being planned.

C. Bank Group Strategy

11. The Bank's last Country Assistance Strategy (CAS) for Ethiopia covered FY03-FY05. A Progress Report presented to the Bank's Board in August 2004 outlined the progress achieved to date, and recommended a continuation of the existing strategy until a new CAS was finalized. Preparation for a three-year CAS based on the new PASDEP was stopped due to recent political developments. An Interim Country Assistance Strategy (ICAS) covering the next 15 months is currently under preparation and is expected to be discussed at the Bank's Board in late March.

12. The Bank's proposed ICAS will aim to support Government in developing, achieving consensus with citizens on, and implementing a strengthened program of institution building and governance reform that will help in its efforts to accelerate pro-poor growth. This strategy will also recognize the importance of continued efforts to promote long-term economic growth, and reflects the need for good governance in supporting economic growth by raising investor confidence, building infrastructure rapidly, improving the provision of critical basic services for poor people, managing vulnerabilities and preserving the potential for an eventual return to a scaling-up by protecting institutional capital.

13. As of January 20, 2006, Ethiopia's portfolio of IDA operations comprised 22 active projects, with total net commitments of US$1,614 million and an undisbursed balance of

US$912.3 million. This compares with 18 projects, commitments of US$1,795 million, and an undisbursed amount of US$835 million in March, 2003 when the current CAS was discussed by the Board. Total disbursements to Ethiopia in FY05 amounted to US$373 million (of which US$195 million of grants), compared to US$422 million (US$179 million in grants) in FY04 andUS$362 million (with no grants) in FY03.

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Ethiopia: Statistical Issues

General

1. The statistical base is broadly adequate to conduct effective surveillance, despite shortcomings in certain areas. Recognizing the importance of accurate and timely data for macroeconomic policy formulation and monitoring progress with implementation of the PRSP, the authorities have developed a comprehensive Medium-Term National Statistical Program. The program, which will be implemented over a period of five years, addresses data deficiencies in each of the major socio-economic sectors and has been identified as an essential element of the authorities' efforts to strengthen the Monitoring and Evaluation System of the PRSP. Ethiopia is a participant in the General Data Dissemination System (GDDS) and its metadata were initially posted on the Fund's Dissemination Standards Bulletin Board (DSBB) in November 2002. These metadata were last updated in September 2004. Ethiopia also participates in the GDDS project for Anglophone Africa and had been receiving technical assistance in the fiscal and external sectors under this project.

Real sector

2. The authorities have improved the timeliness and coverage of national accounts, economic surveys, and price data since 1993. Preliminary national accounts are available through 2003/04 (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 designed to collect data on a range of economic indicators (e.g. employment, capital stock, inputs and outputs) for all business establishments. The first census was conducted during March 2004. Following the successful completion of the program to amend the methodological framework of the consumer price index, the authorities have been working on a production price index with technical assistance from AFRITAC East. In February 2005, the authorities revised the nonfood index of the CPI by imposing a constant value on the charges for money transfers. Fund staff is working with the authorities to review regional reporting of data to the Central Statistical Authority (CSA) to ensure data integrity.

Public finances

3. Monthly federal government accounts are reported with a six- to eight-week lag. Under the PRGF arrangement, progress was made in 2002/03 in improving the quality and coverage of reporting on the consolidated general government and consolidating federal and regional budgets, inclusive of all extra budgetary funds and accounts. However, with the ongoing decentralization of fiscal powers to woredas (districts), ensuring the integrity of the consolidated budget reporting will be an ongoing task. Progress was also made in 2002/03 in eliminating discrepancies between data on the domestic and foreign financing of the budget deficit and the monetary accounts. With the assistance of a STA mission which visited Addis Ababa in 2003, the joint reconciliation committee, composed by the Ministry of Finance and

Economic Development (MOFED) and the National Bank of Ethiopia (NBE), established a short-term work program to achieve the reconciliation of provisional quarterly fiscal and monetary data for 2001/02 and 2002/03. This action was also a performance criterion under the Third Annual Program of the PRGF and a trigger for the completion point under the HIPC Initiative. The second assessment of the public expenditure management systems, which was conducted by FAD in 2004, identified a lack of timely fiscal reporting as a key concern, particularly as it hampers the management of fiscal policy within the year. As a result, a detailed action plan for improving the public expenditure management system has been developed.

Monetary accounts

4. The monetary survey is reported with a six-week lag to AFR and with a three-month lag to STA. Two STA technical assistance missions in 2004 found that the quality of monetary and financial statistics was compromised by various methodological problems. The missions recommended correcting a number of instances of misclassification of accounting data, assisted the central bank in compiling the standardized report forms (SRFs) for reporting monetary statistics to STA, and worked with the authorities and AFR to establish an Integrated Monetary Database (IMD). The follow-up mission in September 2004 finalized the IMD. Thereafter, the authorities started providing SRF-based data for the National Bank of Ethiopia (NBE) and the other depository corporations to STA on a regular basis, until December 2004. At present, there is a need for the NBE to resume data submissions based on the SRF and IMD framework.

Balance of payments

5. Balance of payments data still require improvements in the coverage, valuation, timing, and classification of transactions. Between April 2004 and March 2006, a total of five balance of payments statistics missions will be completed in the context of the GDDS project for Anglophone Africa. With assistance from the expert, the authorities plan to publish data consistent with the fifth edition of the *Balance of Payments Manual* later this year. Under the project, improvements have been developed in questionnaire design and data collection procedures. Also, improved methods were introduced for cif/fob valuation adjustments for imports, external aid, trade credit, and financial account transactions of the banks.

Social indicators

6. Data on poverty exist in the form of several household surveys regularly conducted by the Central Statistical Authority (CSA).[1] In addition, the World Bank has produced

[1] Examples of existing surveys include the Household Income, Consumption, and Expenditure Survey (1995/96, 1999/2000, and 2004/05) and the Welfare Monitoring Survey (1996, 1997, 1998, 1999, and 2004). Additional household and consumption surveys were carried out by the University of Addis Ababa in collaboration with Oxford University.

reports on Education and Health Sector Development Programs, as well as the Poverty and Policies for the New Millennium Report (1999), which contain data on the poverty situation. 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. During 2004/05 the authorities conducted a number of surveys aimed at measuring household welfare, including: (i) a Participatory Poverty Assessment; (ii) the Household Income, Consumption and Expenditure Survey (HICES); and (iii) a Welfare Monitoring Survey. Data from surveys are currently being processed. Adequate data do not exist on prevalence rates of HIV/AIDS, especially among the rural population, and it is not clear whether there is sufficient monitoring of food consumption among people living in drought-prone areas. The Welfare Monitoring Survey, conducted in 2004/05, is expected to include a number of indicators relating to HIV/AIDS.

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ETHIOPIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of February 17, 2006)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	December 30, 2005	January 2006	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	October, 2005	December 2005	M	M	M
Reserve/Base Money	October, 2005	December 2005	M	M	M
Broad Money	October, 2005	December 2005	M	M	M
Central Bank Balance Sheet	October 7, 2005	December 2005	M	M	M
Consolidated Balance Sheet of the Banking System	October 7, 2005	December 2005	M	M	M
Interest Rates[2]	October, 2005	December 2005	M	M	M
Consumer Price Index	December, 2005	February 2006	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	September 2005	December 2005	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	September 2005	December 2005	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2004/05	October 2005	A	On Mission	A
External Current Account Balance	September 2005	December 2005	Q	Q	Q
Exports and Imports of Goods and Services	September 2005	December 2005	Q	Q	Q
GDP/GNP	2004/05	October 2005	A	On Mission	A
Gross External Debt	2004/05	October 2005	A	On Mission	A

1Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
2 Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
3 Foreign, domestic bank, and domestic nonbank financing.
4 The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
5 Including currency and maturity composition.
6 Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

Statement by the IMF Staff Representative
March 15, 2006

This statement provides additional information that has become available since the issuance of the staff report for Ethiopia. This information does not alter the thrust of the staff's assessment.

- The crop forecast for the main 2005/06 Meher harvest issued by the Central Statistical Agency projects a 15 percent increase in grain production, driven mainly by a 10 percent increase in yields. If confirmed this would suggest an annual real GDP growth rate closer to the authorities' projection of 7 percent. Crop estimates to be released in April/May will provide firmer indications of whether grain yields are indeed set to record their highest levels on record.

- January inflation was in line with staff's projections with the general year-on-year CPI rate declining to 11.5 percent, reflecting lower food and non-food inflation rates.

- Preliminary federal revenue and expenditure data for the first half of 2005/06 are also consistent with meeting staff's annual projections. During this period the federal deficit reached 2.6 percent of full-year GDP. This was largely financed by an increase in domestic financing, which offset lower external support.

- Annualized export growth of 21 percent in the first half of 2005/06 was broadly in line with staff projections, while import growth of 26 percent was somewhat faster. Fuel imports of US$300 million were consistent with the end-year projection of US$700 million. As noted in the staff report, through end-December, net international reserves fell by US$323 million to around 3 months of imports. This is in line with the full-year projection, which took into account expected donor disbursements targeted to support regional social service delivery. No additional data on international reserves have been released to Fund staff.

- Broad money growth slowed to 17.2 percent (year-on-year) in December 2005 reflecting the decline in net foreign assets. While domestic credit growth remained strong, rising by 34 percent year-on-year, and higher than staff's end-year projection of 20.6 percent. Net bank borrowing by the government reached 1.3 percent of GDP in the first half of the year. This was entirely financed by the National Bank of Ethiopia. However, consistent with the government's commitments in December to shift financing away from the central bank, treasury bill issuance has subsequently risen, and data through March 1, 2006, show a Birr 1.4 billion (1.2 percent of GDP) increase in commercial bank treasury bill holdings.

- As of March 10, 2006, there has been no adjustment in domestic fuel prices, although the authorities have reiterated their commitment to implementing this during the 2005/06 fiscal year.

- Reports have emerged of an outbreak of Avian flu in a poultry farm in the south of the country. These have yet to be officially confirmed and staff will continue to monitor developments.

- To date, 90 of the 109 elected opposition parliamentarians have taken their seats. UN reports indicate that tension on the Eritrean border has decreased. Ethiopia's main donors have reconfirmed that they are continuing to provide project aid, while reiterating that a resumption of direct budget support will require progress in addressing concerns over political governance and human rights.

No further information has been received regarding the remaining current account restrictions inconsistent with Article VIII section 2(a) and staff are not recommending approval of such restrictions at this time.

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IMF Executive Board Concludes 2005 Article IV Consultation with the Federal Democratic Republic of Ethiopia

On March 17, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Federal Democratic Republic of Ethiopia.[1]

Background

Ethiopia continues to pursue its development strategy aimed at achieving the Millennium Development Goals. However, it faces political uncertainties, both from unresolved tensions stemming from the May 2005 national elections, and over the border demarcation with Eritrea, which are impacting donor support. Ethiopia's largely agricultural economy also remains vulnerable to climatic shocks, which have resulted in wide swings in output with severe effects for the poor. Even after two successive years of good harvests, and favorable prospects for 2005/06, the total number of people identified as requiring humanitarian assistance in 2006 is estimated at 11 million.

In 2004/05, the economy grew by 8.8 percent, the second year of rapid expansion after the recent drought. The average annual consumer price inflation rate declined to 6.8 percent in 2004/05, from 8.6 percent in 2003/04, although the year-end rate rose to 13 percent. While the nominal exchange rate against the US dollar remains highly stable, the trend of real

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

depreciation experienced in 2004/05 reversed during early 2005/06, reflecting a relative strengthening of the US dollar, and a pick up in Ethiopia's inflation. The National Bank of Ethiopia's (NBE) gross reserves rose during 2004/05 to the equivalent of 3.9 months import cover, but have declined in the first 5 months of 2005/06.

The government's domestic borrowing rose to 3.5 percent of GDP in 2004/05—2 percent of GDP higher than budgeted—as a result of shortfall in revenues and aid inflows, and the stock of government's domestic debt remained high at 35 percent of GDP. Capital spending rose sharply as the government began to scale-up domestically-financed spending on infrastructure, which was reflected in an increase in overall poverty spending.

Broad money growth in 2004/05 and through November 2005, was entirely due to an expansion of net domestic assets, including sharp increases in credit to the private sector and public enterprises. At the same time, commercial bank's excess reserves rose to over 30 percent of deposits as the NBE met government financing needs, and the dominant Commercial Bank of Ethiopia (CBE) sharply reduced its holdings of treasury bills. The external current account deficit (after official transfers) widened to 9.1 percent of GDP in 2004/05, in spite of export growth of 36 percent. Imports rose by 40 percent, or about US$1 billion. About a third of this increase reflected higher fuel costs.

Ethiopia has continued to implement its financial restructuring program, and met the plan's 2004/05 non performing loan and capital adequacy ratio targets for the CBE. Progress has also been made on strengthening public expenditure management. Ethiopia secured debt relief from the IMF under the Multilateral Debt Relief Initiative in December 2005. It reached the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in April 2004.

Executive Board Assessment

Executive Directors welcomed the recent strong growth performance, led by an improvement in the agricultural sector. However, they emphasized the need to maintain a stable macroeconomic framework, and in that regard, noted the importance of containing inflation and emerging pressures on the balance of payments. Looking ahead, the main challenge will be to sustain strong growth to meet the development objectives and to reduce poverty. Directors recommended that the authorities begin to set the stage for the evolution of a vibrant private sector that will complement the state's own economic development efforts. They stressed the importance of accelerating the structural reform agenda, in particular in order to raise agricultural productivity and boost private sector growth. The resumption of the privatization program and introduction of a competition policy are steps in the right direction in this regard, but they need to be supported by a strengthened legal and regulatory framework.

Directors considered that significantly higher levels of external assistance will be required to sustain growth at levels that would reduce poverty—which remains widespread—and meet the Millennium Development Goals (MDGs). They welcomed the presentation of a scenario laying out the financing requirements as well as the policy challenges for meeting the MDGs.
They stressed that, in line with the Monterey Consensus, donor efforts will need to be complemented by a sound development strategy and strong governance systems.
Directors encouraged the authorities to engage in a constructive dialogue with all concerned

parties to resolve outstanding political issues and generate the conditions for a resumption of donor budget support. They also stressed the need to strengthen public expenditure management and ensure that aid and resources set free by the Multilateral Debt Relief Initiative are used in an efficient and macroeconomically sound manner.

Directors agreed that improving Ethiopia's infrastructure will be essential to enhancing its growth prospects. However, scaling up domestically financed investments by public enterprises risks jeopardizing the balance of payments position and macroeconomic stability. Against this background, Directors welcomed the authorities' decision to postpone some public enterprise infrastructure imports and their commitment to take additional measures, as necessary, to ensure an adequate level of international reserves. At the same time, administrative controls should be avoided as they could have an adverse impact on the private sector.

Directors recommended that fiscal policy should support monetary policy in containing inflation and be focused on limiting domestic bank financing and ensuring debt sustainability. They welcomed the expenditure cuts introduced this year, as well as the proposal to pass through higher oil prices to consumers by reducing the domestic fuel subsidy—stressing the need to implement this promptly. Nevertheless, a tighter fiscal stance might be required to contain demand and to stabilize the balance of payments. Directors also saw a need to better prioritize expenditures, with the objective of strengthening pro-poor spending and establishing an effective social safety net, while improving public expenditure management. Looking further ahead, domestic borrowing should be reduced in order to contain debt levels and provide room to respond to unexpected shocks. Efforts are also needed to improve the buoyancy of the tax regime to ensure that revenue growth keeps up with the growth of recurrent expenditures.

Directors supported the authorities' request for technical assistance from the Fund in the area of tax and customs policy, including on the structure and level of tariff exemptions. They noted the importance of ensuring a non-discriminatory tax and tariff structure to encourage private sector development and foreign direct investment.

Directors called for the close monitoring of large public enterprises, and urged the authorities to move in the direction of incorporating the activities of these enterprises into the consolidated fiscal accounts to help illuminate the fiscal risks stemming from the government's on-lending of external financing to public enterprises and its guarantees on domestic borrowing by public enterprises. Directors stressed that the debt of public enterprises and the government's contingent liabilities should be fully taken into account in a comprehensive debt management strategy.

Directors called for a tightening of monetary policy. They observed that the high level of commercial bank excess reserves—most of which are held by the state-owned Commercial Bank of Ethiopia (CBE)—constrains the use of indirect monetary instruments. In this context, Directors agreed that, at the current stage of development of the monetary system, imposing a direct ceiling on the CBE's credit operations would be the most reliable means of guarding against excessive credit expansion without compromising credit extension to the private sector, which remains at a relatively low level.

Directors agreed that external competitiveness is adequate, and that the current managed floating exchange rate system has served Ethiopia well. At the same time, they saw scope for increased flexibility to allow the exchange rate to reflect balance of payments developments going forward.

Directors welcomed the signs of improvement in the financial sector, with a steady decline in nonperforming loans and a general strengthening of capital adequacy ratios. At the same time, prudential supervision of the banking system needs to be strengthened. Directors called for further financial sector reforms over the medium term, aimed in particular at increasing banking sector competition, in order to support the efficient allocation of financial resources in the economy, encourage the development of the private sector, and boost long-term growth prospects.

Directors commended the authorities for their commitment to maintain a close relationship with the Fund. They looked forward to further discussions of how the Fund could best contribute to the achievement of the authorities' economic objectives in the period ahead.

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

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

	2000/01	2001/02	2002/03	2003/04	2004/05 Est.	2005/06 Proj.
	(Annual percentage change)					
National income and prices						
GDP at constant prices (at factor cost)	7.4	-0.3	-3.3	11.1	8.8	5.2
GDP deflator	-5.1	-4.9	13.0	9.4	6.2	11.6
Consumer prices (period average)	-5.2	-7.2	15.1	8.6	6.8	10.8
External sector						
Exports, f.o.b.	-4.8	-2.2	6.7	24.4	36.2	27.7
Imports, c.i.f.	-3.4	8.9	9.5	39.3	40.4	11.4
Terms of trade (deterioration -)	-3.1	-10.1	-6.5	-14.8	10.8	5.1
Nominal effective exchange rate (end of period)	6.5	-7.8	-12.5	-4.0	-1.5	...
Real effective exchange rate (end of period)	-14.2	-3.3	5.9	-4.6	9.2	...
	(In percent of beginning-period stock of broad money, unless otherwise indicated)					
Money and credit						
Broad money	9.5	8.1	10.9	14.7	19.6	19.5
Velocity (GDP/broad money)	2.7	2.4	2.3	2.5	2.4	2.4
Interest rates (savings deposits, in percent)	6.0	3.0	3.0	3.0	3.0	…
	(In percent of GDP, unless otherwise indicated)					
External sector						
External current account balance, including official transfers	-3.0	-4.7	-2.2	-5.1	-9.1	-7.5
External current account balance, excluding official transfers	-8.0	-10.7	-9.8	-10.9	-15.8	-13.1
Government finances						
Revenue	18.8	16.6	16.4	16.6	16.0	18.1
Tax revenue	13.7	12.6	12.1	13.0	12.7	13.2
Nontax revenue	5.0	4.0	4.3	3.6	3.3	4.9
External grants	4.8	3.9	6.7	4.8	4.7	5.4
Expenditure and net lending 2/	28.4	26.6	29.1	24.1	25.4	28.4
Fiscal balance, excluding grants (cash basis)	-9.6	-12.3	-14.8	-10.2	-10.7	-11.6
Fiscal balance, including grants (cash basis)	-4.8	-8.4	-8.1	-5.5	-6.0	-6.1
Total financing	5.5	8.4	8.1	5.5	6.0	6.1
External financing	3.8	7.8	5.7	2.9	2.5	2.1
Domestic financing (including residual)	0.9	0.5	2.4	2.6	3.5	4.0
Domestic debt 3/	35.1	39.5	39.0	35.0	34.8	32.7
External debt (including to Fund)	71.2	90.7	85.4	75.7	53.9	47.4
External debt-service ratio 6/	29.1	17.0	14.9	15.1	14.2	12.7
External debt-service ratio 7/	…	11.0	7.3	6.3	7.1	5.2
Overall balance of payments (in millions of U.S. dollars)	-454	305	275	227	-101	-357
Gross official reserves (in millions of U.S. dollars)	337	664	931	1,350	1,555	1,264
(in months of imports of goods and nonfactor services of following year)	2.0	3.4	3.5	3.7	3.9	3.0
Exchange rate (birr per U.S. dollar; period average rate)	8.34	8.54	8.58	8.62	8.65	...

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

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

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

Statement by Peter Gakunu, Alternate Executive Dicrector
for The Federal Democratic Republic of Ethiopia and
Gualberto Campos, Senior Advisor to Executive Director
March 17, 2006

1. The Ethiopian authorities thank staff and Fund management for the constructive engagement with Ethiopia. The authorities view the set of papers produced by staff as fair and balanced and as providing helpful policy advice on the way going forward. The authorities also thank the Executive Board for its continued support. They are particularly grateful for the Board's approval of Ethiopia's qualification for debt relief under the MDRI in December 2005 and they take this opportunity to reassure the Board of their commitment to prudent macroeconomic policies and poverty reduction objectives. These additional resources will allow the authorities to substantially increase spending in priority areas to reduce poverty, promote growth, and to make genuine progress towards achieving the MDGs. They are, however, fully aware that many challenges still lie ahead, especially to overcome the deep-rooted poverty prevailing in the country. They will, therefore, continue to count on the Fund and the donor community for assistance.

2. Democratic elections were held in May 2005. The elections were characterized by high voter turnout, open debate and greater political participation. Regrettably tensions emerged in the post election period, leading to violence, detentions and boycott of the new parliament by the main opposition party. Following these developments, donors switched their assistance from general budgetary support to targeted regional social services and the authorities had to scale back their public sector investment program.

3. Meanwhile, the independent Boundary Commission that drew up the frontier in the border dispute between Ethiopia and Eritrea held a meeting recently with representatives from both countries. The meeting was characterized as constructive by the UN Secretary-General. Negotiations continue, aimed at reducing border tensions and finding a peaceful and lasting solution to the dispute by agreeing to a permanent demarcation of the border.

Recent Economic Developments

4. Ethiopia's economy continued to expand solidly for the second consecutive year. Real GDP in 2004/2005 grew by 8.8 percent following the impressive growth rate of 11.6 percent attained in 2003/04. Instrumental to this good performance were the structural reforms implemented in previous years under the PRGF-supported program. Agricultural output was strong, led by export crops. However, drought and starvation continue to plague the country. Indeed, although agro-food production has been steadily increasing, the Ethiopian population keeps growing at a higher rate, which in practice leads to a chronically structural food deficit. The authorities are aware of this dilemma and continue to make all efforts to improve food security and assist the populations in need, particularly through the Productive Safety Net Program (PSNP), which is essentially a multi-sector program that remunerates the poor with cash and food for their contribution in specific public work projects.

5. During the last two years, the authorities started implementing a vast program of infrastructure upgrading with the view to strengthening the business environment and improving economic competitiveness. The program includes rehabilitation and construction of roads, reinforcement of power capacity and rural electrification and improvement of telecommunication systems. As a result, in 2004/05 fiscal capital spending rose significantly, while aid inflows decreased substantially. Due to the persistence of drought, the authorities also increased poverty-alleviating spending. Consequently, the fiscal deficit jumped to 6 percent of GDP, while government's domestic borrowing was 2 percent higher than planned. In addition, annual inflation increased, reflecting in large part aggregate demand pressures associated with the implementation of various infrastructure projects.

6. Broad money in 2004/05 grew in line with the expansion of net domestic assets linked to increases in credit to the private sector and public enterprises. At the same time, imports rose by 40 percent, while exports were also on the rise, particularly coffee and non-traditional exports, including flowers and spices, and non-factor services. The birr continued to depreciate gradually against the US dollar, but has slightly appreciated in recent times in line with the pick up in inflation. Gross official reserves rose to 3.9 months of imports in 2004/05 but dropped to 3 months in the first half of 2005/06 reflecting higher fuel prices and increased imports of capital goods in line with infrastructure upgrading.

Medium-Term Strategy and Economic Program for 2005/06

7. The Ethiopian authorities are determined to maintain macroeconomic stability and continue to monitor closely all macro indicators. They are fully committed to implementing appropriate fiscal, monetary and exchange rate policies and continue to place high priority in the creation of a sustainable macroeconomic environment, which is essential to enhance growth performance and address the widespread prevalence of poverty.

8. The medium-term strategy is embedded in the authorities' Plan for Accelerated and Sustained Development to End Poverty (PASDEP), which was recently updated according to the MDG Needs Assessment Synthesis Report. It aims at bolstering the conditions for sustained high levels of economic growth needed to reduce poverty and achieve the MDGs, including halving poverty by 2015. Key macroeconomic objectives include annual real growth rate of GDP and of GDP per capita of about 7 percent and 4.7 percent respectively. In support of growth projections for achieving the MDGs, the authorities have estimated the total costs at US$101 billion with an upper and a lower bound cost of US$58 billion and US$76 billion respectively. Such scenario will require current aid flows to double as a percentage of GDP. The spending will be largely directed to construction and upgrading of infrastructure, improvement of agriculture performance and institutional capacity building.

9. In accordance with the medium term scenario, the economic policy agenda for 2005/06 estimated a real GDP growth of 7 percent, which would be supported by strong agricultural production and large public infrastructure investments. Inflation was projected at 9.5 percent, tanking into account that the authorities plan to adjust fuel prices substantially. However, as aid flows have drastically decreased since November 2005, the authorities had to opt for radical cuts in the investment programs of the power and telecommunication

sectors in order to ease pressures on the balance of payments, while they look for alternative external sources of financing.

10. The authorities are committed to reducing government domestic borrowing over the medium-term. They are also determined to enhance the effectiveness of public spending, while promoting strong economic growth and meeting poverty reduction goals. In this connection, the authorities intend to go ahead with reforms aimed at strengthening public expenditure management, for which they have requested technical assistance from the Fund. The authorities intend also to take measures to improve tax administration, focused particularly at strengthening revenue, customs and regional tax administrations. They plan to adjust retail prices for petroleum products with a view to removing subsidies, which are currently being financed from domestic bank borrowing by the Ethiopian Petroleum Enterprise. The authorities are aware that these price subsidies on fuels contribute to crowding out financing for the private sector, while they will affect the budget at a later stage.

11. Monetary and exchange rate policies will be geared towards achieving inflation objectives and defending the reserve position of at least 3 months of imports. The authorities will also continue to monitor closely the evolution of the real exchange rate with a view to taking appropriate measures to discourage any strong appreciation that would affect economic competitiveness and threaten the current policy of export diversification. In case additional balance of payments pressures emerge, the authorities are also ready to take measures that will promote greater exchange rate flexibility.

12. The authorities will continue to implement the financial sector strategy initiated some years ago, while the Central Bank of Ethiopia (CBE) will continue to implement its financial restructuring program. Overall, the banking sector continued to show signs of improvement in 2004/05, as all but one commercial bank reported capital ratios above the minimum required. Nevertheless, the authorities are determined to take further financial sector reforms in the medium term if needed to increase competition in the banking system. The Fund is currently assisting the authorities with technical assistance in the areas of bank supervision and payment systems, while the Bank is preparing a Financial Sector Capacity Building Project, which will prepare the ground for broader policy reform.

13. Despite a wide-range of structural reforms implemented over the years, the authorities acknowledge that Ethiopia needs to firmly pursue the reform agenda to underpin increased efficiency in the economy. Hence, they intend to accelerate the pace of reforms to further encourage rural and private sector development to support faster growth and employment creation and achieving the MDGs. In this connection, work is underway with the support of the Bank, to improve government service delivery to the private sector, including credit access.

14. Nevertheless, the authorities are of the view that their growth strategy will also continue to rely on state intervention to support economic diversification and exports, particularly in the sectors of horticulture, floriculture, textiles, garment and leather. The support includes the establishment of training institutes and a variety of incentives to

companies. The authorities' growth strategy is modeled on that followed by many East Asian countries, which proved to be successful. They recognize, nonetheless, the distortions that some policies may entail and acknowledge their willingness to review some aspects of trade policy.

Conclusion

15. The Ethiopian authorities look forward to maintaining the excellent and productive relations and the support they have enjoyed from the Fund and the international community, which they consider pivotal in assisting Ethiopia to meet the many challenges that still lie ahead. Indeed, achieving the MDGs will require high levels of external assistance. Although the authorities are not looking for a financial arrangement with the Fund at this time, they see the Fund's signaling to donors as instrumental for a scaling up of aid and are willing to consider any viable option in their future relations with the Fund, including through a Policy Support Instrument.