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The Federal Democratic Republic of Ethiopia: Request for a 14-Month Arrangement under the Exogenous Shocks Facility—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Federal Democratic Republic of Ethiopia

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on August 26, 2009, with the officials of the Federal Democratic Republic of Ethiopia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 3, 2009. 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.

- Supplements to the staff report.

- A Press Release summarizing the views of the Executive Board as expressed during its August 26, 2009 discussion of the staff report.

- A statement by the Executive Director for the Federal Democratic Republic of Ethiopia.

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

Letter of Intent sent to the IMF by the authorities of the Federal Democratic Republic of Ethiopia *
Memorandum of Economic and Financial Policies by the authorities of the Federal Democratic Republic of Ethiopia *
Technical Memorandum of Understanding*
*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

Request for a 14-Month Arrangement under the Exogenous Shocks Facility

(In consultation with the Finance, Legal, Monetary and Capital Markets, and Strategy, Policy, and Review Departments)

Approved by Mark Plant and Dominique Desruelle

August 3, 2009

Context: Ethiopia is facing a difficult external environment: pressures on export receipts, remittances, and foreign direct investment are occurring at a time when reserves remain quite low (1.8 months of import cover) in the wake of the commodity price shocks of 2007–08. The provision of IMF financing, supporting the sizeable inflows of donor aid in the past two years, would help maintain macroeconomic stability, smoothen the adjustment process, and mitigate risks to the growth and poverty reduction achievements of recent years.

Request for support under the high-access component of the Exogenous Shocks Facility (ESF): The authorities are requesting a 14-month arrangement in the amount of SDR 153.755 million (115 percent of quota), equivalent to about $240 million. SDR 73.535 million (55 percent of quota, equivalent to about $115 million) would become available upon Board approval.

Discussions: Discussions were held in Addis Ababa on June 9–19, 2009. The mission met with Prime Minister Meles Zenawi, Minister of Finance and Economic Development Sufian Ahmed, National Bank Governor Teklewold Atnafu, other senior officials, and representatives of the donor community. The mission team comprised Messrs. Nolan (head), Honda, Zhan (all AFR), and Thomas (SPR); Mr. Singh, resident representative, assisted. Staff collaborate closely with the World Bank, the African Development Bank, and local representatives of the donor community.

IMF relations: The last arrangement under the Poverty Reduction and Growth Facility (in the amount of SDR 100.28 million) expired on September 24, 2004. Ethiopia reached the completion point for the enhanced HIPC Initiative in April 2004 and received further debt relief under the Multilateral Debt Relief Initiative in January 2006. The Board concluded the 2008 Article IV consultation on July 14, 2008. Ethiopia made a drawing under the rapid-access component of the ESF in February 2009. Ethiopia is still under the Article XIV regime and maintains several exchange restrictions that are inconsistent with Article VIII.

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EXECUTIVE SUMMARY

- Ethiopia has faced a turbulent external environment during 2008–09, with commodity price surges, and later the global recession, producing a series of shocks to the balance of payments.

- Facing declining reserves and high inflation, the authorities, from late-2008, have implemented an effective macroeconomic adjustment package supported by the Fund under the rapid-access component (RAC) of the Exogenous Shocks Facility (ESF).

- The global recession is putting renewed pressure on the external position, via weaker export receipts and remittances and slowing inward direct investment. The authorities have fleshed out their economic program for the 2009/10 fiscal year and are seeking support in the form of a Fund arrangement under the high-access component (HAC) of the ESF.

- The authorities' program for 2009/10 includes: a) limits on the domestic borrowing of the public sector, which are eased slightly from 2008/09 levels; b) some easing of the fiscal stance, tightened sharply under the 2008/09 adjustment program; c) further slowing of the pace of monetary expansion; and d) modest real exchange rate adjustment, aided by a step depreciation of the birr on July 10th. Supporting structural measures focus on tax reform, the control of public enterprise borrowing, and the control of liquidity through indirect instruments.

- The policies supported under the proposed arrangement, coupled with the proposed Fund financial support and Ethiopia's increased allocation of SDRs, would contribute to the rebuilding of international reserves to 2½ months of imports by 2010/11, while maintaining a sound macroeconomic environment for growth and poverty reduction. Ethiopia receives substantial support from its development partners, who welcome the reassurance regarding macroeconomic policies provided by a Fund arrangement.

- The staff supports the authorities' request for a 14-month HAC ESF arrangement. The global recession has created an immediate balance of payments need in 2009/10, while the authorities' policy commitments appropriately address the impact of the external shocks. Risks to the program include the uncertain external environment and the always-present potential for adverse supply shocks to Ethiopia's large agricultural sector.

I. Background

1. **Ethiopia has faced a turbulent external economic environment of late, as commodity price movements and, later, global recession produced a series of shocks to the balance of payments**. Rapid import growth, fueled in part by public spending, created pressure on reserve levels even prior to the surge in world food and fuel prices in 2007–08. The price surge then helped push reserves down to some $0.9 billion (1.2 months of imports) by mid-2008, while also contributing to an exceptional jump in consumer price inflation.

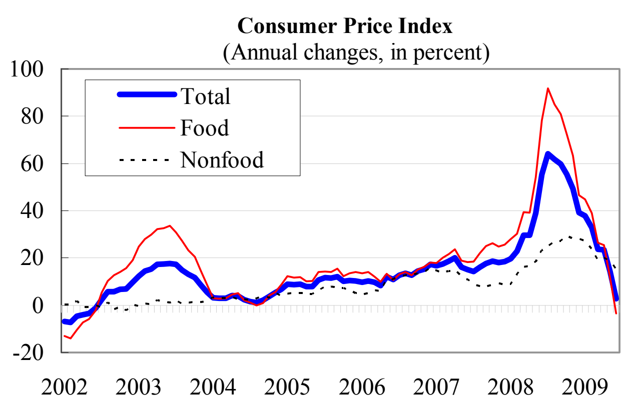
2. **Concerns about declining reserve levels and rising inflation led the authorities to implement a macroeconomic adjustment package from late-2008**, focused on fiscal and monetary tightening and the elimination of fuel subsidies. The package of policy adjustments was supported by a drawing in February 2009 under the rapid access component (RAC) of the Exogenous Shocks Facility (ESF), with ESF access based on the balance of payments impact of the commodity price surge.

3. **The track record of both policy implementation and performance under the adjustment program has been strong**:

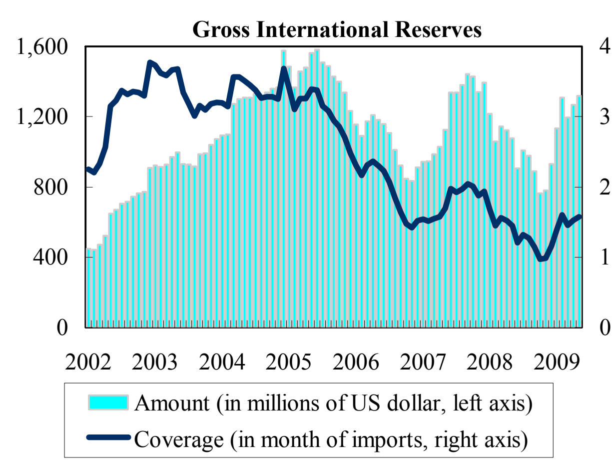
- Key policy targets—zero domestic borrowing by the general government, limits on public enterprise borrowings, elimination of fuel subsidies, exchange rate adjustment—are expected to have been met, although effective monetary control remains a challenge (see Box 1).

- Key policy objectives—bringing inflation down sharply and partially rebuilding reserves—have been achieved, with inflation in the 12 months to June declining to 3 percent, aided by falling food price levels, and foreign reserves, helped by increased donor assistance, ending the year at some $1.5 billion (1.8 months of import cover).

With good harvests and declining world food prices, inflation is subsiding.



International reserves picked up modestly with donor aid.



4. **The authorities anticipate that real GDP increased by some 10 percent in FY 2008/09, down only marginally from the 11.6 percent recorded in 2007/08**: agricultural output is expected to have risen by some 6 percent, industrial output by some 9 percent, and tertiary sector output by 15 percent. Staff believe that underlying growth was on the order of 7–8 percent, with the recorded growth in tertiary output (averaging 15 percent over the past three years) likely overstating the true expansion of such activity.[1]

II. THE NEAR-TERM OUTLOOK

5. **The global recession is constraining export growth and limiting key external resource inflows, but the impact of these pressures on aggregate output is modest given the central role of subsistence agriculture**. The authorities expect GDP to grow by at least 9 percent in 2009/10, with agriculture and industry, aided by weather conditions and progress with key infrastructure projects, growing at 6.2 and 8.7 percent, respectively. Staff believe that the underlying expansion in GDP is more likely to be around 7 percent: the financial program described below has been constructed around this more cautious growth assumption.

6. **Following the dramatic movements in price indices over the past two years, single-digit inflation looks to be achievable over the current (fiscal) year**, although high food price volatility and stubborn non-food price inflation (15 percent as of June 2009) are significant risk factors. The links between CPI movements and macroeconomic aggregates have not been stable (IMF Country Report No. 08/264, July 31, 2008), so further volatility cannot be ruled out—although the buildup of grain reserves should help to limit speculative price surges.

7. **The balance of payments outlook for 2009/10 is troubling**, as global recession takes a toll on remittances, exports, and direct foreign investment, oil prices move upward again, and the exceptional assistance provided by donors during 2008/09 falls away.[2] Staff estimates suggest that, absent policy changes, reserves would decline by some $250 million this year, reversing about one-half of the rebuilding of reserves achieved in 2008/09.

III. THE AUTHORITIES' PROGRAM

8. **The authorities are framing their macroeconomic program for FY 2009/10 around the twin objectives of maintaining price stability and building a stronger reserve position (Table 1)**.[3] They have been encouraged by the results achieved with the

[1] GDP statistics are characterized by some weaknesses; there is also a paucity of high-frequency output indicators, making it difficult to assess current sectoral trends in a timely manner.

[2] Data for the first six months of the year indicate that individual remittances are down 6 percent from the corresponding period of 2008, merchandise exports are down 11 percent. The number of foreign investment projects approved for the first quarter of the year is down by 9 percent.

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

FY 2008/09 adjustment program, but see important trade-offs between the two objectives, intensified by their intention to meet spending needs squeezed in last year's adjustment program and to press ahead with their investment program. They see the appropriate resolution of these trade-offs as involving a combination of some easing of the fiscal stance, continued tight limits on public enterprise borrowing, maintenance of a cautious monetary policy, and gradual real depreciation of the birr.

9. **The authorities' program for FY 2009/10 is outlined in the attached Memorandum of Economic and Financial Policies (Attachment I of the Appendix) and summarized below**. Key quantitative objectives are: a) GDP growth of at least 7 percent; b) 12-month consumer price inflation of not more than 10 percent; and c) raising international reserves, inclusive of the financial support requested here from the IMF, to some $1.85 billion, equivalent to 2.1 months of import coverage by end-2009/10.[4] The authorities are seeking Fund financial support for this program in the form of an arrangement supported under the high-access component (HAC) of the ESF.

A. Policies for the Public Sector

10. **A surge in public sector borrowing levels was an important factor in contributing to widening macroeconomic imbalances during 2005–08**: the authorities' policy framework of 2009/10 therefore envisages continued tight control of domestic borrowing levels, combined with careful scrutiny of external borrowing and its associated implications for debt sustainability (see below). Public sector domestic borrowing will be kept to 3 percent of GDP in 2009/10, up somewhat from the 2008/09 level, but considerably less than the levels of previous years (see Text Table 1).

Text Table 1. Ethiopia: Public Sector Domestic Financing
(In percent of GDP)

	2005/06	2006/07	2007/08	2008/09 Est.	2009/10 Proj.
Federal government	2.1	3.6	2.7	0.0	1.4
Public enterprises	1.5	1.7	4.4	2.1	1.6
EEPCo (Bond Sales)	0.8	1.5	1.8	0.8	…
Oil Stabilization Fund	1.3	0.1	1.7	-0.3	…
Others	-0.6	0.1	0.9	1.6	…
Total	3.6	5.3	7.1	2.1	3.0

Note. ETC and EAL are not planning any domestic financing in coming years.

[4] The projected reserve level is inclusive of the proposed general and special allocations of SDRs (which amount to about $180 million, equivalent to 0.2 months of import cover).

11. **The general government budget for 2009/10 envisages some easing of the tight limits on public spending imposed last year (see Tables 2 and 3)**. Revenues should rise by some 0.5 percent of GDP, aided by the elimination of the temporary VAT exemption for foodstuffs and the delayed impact of the past high inflation on income taxes; domestically-funded capital outlays would rise while recurrent outlays are maintained under tight control. The authorities underscored that the budget was heavily pro-poor in its orientation and that the rise in Treasury-funded capital outlays would be focused on the provinces, benefiting mainly smaller population centers and the rural population. The budget deficit is set to rise from 2.3 percent to 3 percent of GDP, financed by a mix of external and domestic borrowing; if aid inflows, whether in the form of loans or grants, exceed budgetary projections, the authorities intend to reduce domestic borrowing levels.

12. **The gradual erosion of the tax-GDP ratio in recent years is placing significant constraints on the government's ability to finance its spending objectives**. The authorities attach central importance to boosting revenue collections and are set to receive, in the coming months, technical assistance from the Fund's Fiscal Affairs Department in evaluating current tax policies and tax administration. They intend to use the outputs from these missions in developing a new tax strategy, and are committed to preparing a time-bound plan by the time of the first program review. *Development of a tax reform strategy is a structural reform priority for the proposed arrangement.*

13. **Public enterprises play a key role in several sectors of the Ethiopian economy, notably the provision of infrastructure**. Government policy is that enterprise pricing should be based on the principle of full cost-recovery: an exception to this policy, now eliminated, was the subsidy on petroleum products via the Oil Stabilization Fund in place through late-2008.[5] Borrowing levels of public enterprises are now subject to regular scrutiny to evaluate their macroeconomic impact, via an interagency committee that reviews enterprise borrowing on a monthly basis. Large public enterprises submit annual investment and financing plans to the committee, which reviews plans and their implementation and, where warranted, brings proposed remedial policy actions to senior policy makers. The committee is working to extend coverage of its operations to all significant borrowing units and will soon issue a formal notification to that effect to all agencies. *Effective working of this oversight mechanism is a structural reform priority for the proposed arrangement.*

B. Monetary Policy

14. **Monetary policy is to focus on achieving the inflation objective (see Table 4)**. The monetary program is framed around controlling broad money growth, with reserve money as the operational target. For 2009/10, money growth will be limited to 17 percent, equivalent in size to the combined increase in real economic activity and the (end-of-period) price level: given the public sector borrowing program and the foreign reserve targets, this would make room for real growth in credit to the private sector on the order of 6 percent. The policy

[5] Prices of petroleum products are now set at levels that allow gradual repayment of the Oil Stabilization Fund's debt to the banking system.

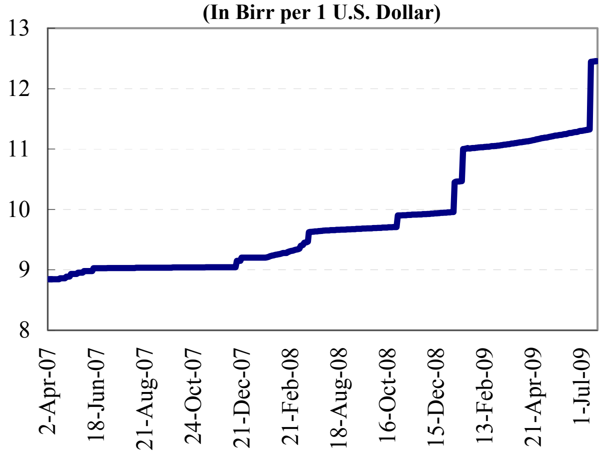
settings for the first semester of FY 2009/10 have been calibrated tightly to help entrench single-digit inflation against a backdrop of exchange rate adjustment; the full-year targets will be reviewed at mid-fiscal year in light of the inflation experience in the coming months.

15. **Limiting the pace of monetary growth to the programmed level will require effective control of reserve money (see Box 2)**. The authorities intend to make systematic use of the regular auctions of Treasury bills to control liquidity, setting sales volumes on the basis of what is needed to meet reserve money targets. Effective liquidity forecasting will entail close cooperation and regular information-sharing between the National Bank of Ethiopia (NBE) and the Ministry of Finance and Economic Development (MoFED). These changes represent a significant break from past practice, and will require that interest rates on Treasury bills adjust to allow the target sales volumes to be realized. The authorities noted that excess liquidity has been a recurrent problem for them, only partially addressed through adjustments in reserve requirements; they therefore expected to face initial challenges in achieving smooth operation of the proposed approach. Assistance in support of this reform agenda is to be obtained from the World Bank's financial sector capacity-building project.

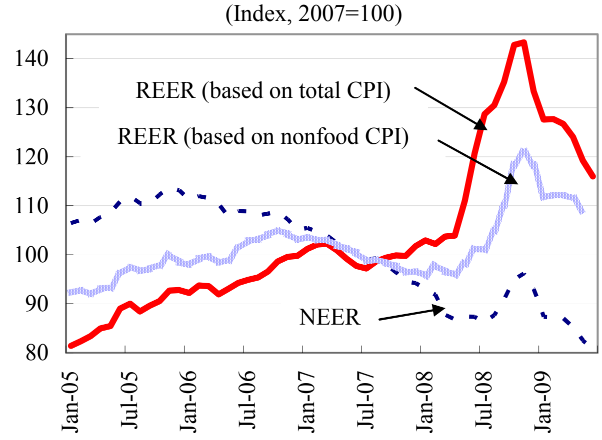
C. Exchange Rate Policy

16. **Ethiopia has a tightly managed exchange rate, classified by staff as a de facto crawl-like arrangement**; the authorities describe their exchange rate regime as a managed float with no pre-determined path for the exchange rate. The pace of depreciation has been modest, partly to anchor price expectations, but there have been occasional discrete jumps in the exchange rate aimed at restoring tradable sector competitiveness. The most recent such move was on July 10th, when the birr was allowed to depreciate by some 9 percent.

Exchange Rates
(In Birr per 1 U.S. Dollar)



Real and Nominal Effective Exchange Rates
(Index, 2007=100)



17. **High inflation in the past two years has been accompanied by significant real exchange rate appreciation, measured either in terms of the full consumer price index or the non-food price index** (which may better track wage and other input costs, and hence competitiveness). Measured against the benchmark of average levels in 2003–07, the real effective exchange rate (all products) had appreciated by some 35 percent as of June 2009,

having fallen from more elevated levels during the first 6 months of 2009; the corresponding net real appreciation based only on non-food prices was some 15 percent.[6]

18. **The authorities agreed with staff that the exchange rate was overvalued at its June 2009 level**; they viewed a real level closer to that observed in 2007 as being broadly appropriate from a medium-term perspective. Price competitiveness needed to be improved, but they argued that this could be achieved only gradually: they ruled out rapid adjustment via a large step devaluation on the grounds that it would revive inflation, only recently brought under control. They saw a step adjustment on the scale of that implemented on July 10th as an important move towards correcting overvaluation. They underscored their commitment to achieving, over the medium-term, an appropriate level for the real exchange rate and would not hesitate to adjust the nominal exchange rate for this purpose, if needed. Staff emphasized the overarching importance of boosting Ethiopia's production of tradable goods and services, arguing that some further real exchange depreciation would likely be needed over time to achieve this objective.

D. External Debt Issues

19. **Ethiopia's external debt levels are rising significantly as major public enterprises borrow externally to finance infrastructure investment**. The stock of debt (in NPV terms) is set to rise from $1.3 billion at end-June 2008 to $6.0 billion by end-June 2011, with almost 70 percent of the increase accounted for by the state-owned electric power (EEPCo) and telecom (ETC) companies. Given infrastructure weaknesses, the case for large-scale investment in these sectors is compelling but the sizeable and rapid build-up of debt underscores the need to ensure that borrowed funds are being put to effective use, that a supportive business environment is being put in place to ensure full take-up of infrastructure outputs, and that public enterprise pricing policy will ensure the full recovery of costs needed to facilitate debt service in the future.

Text Table 2. Ethiopia: NPV of External Public Debt
(In billions of U.S. Dollars)

	June 2008 1/	June 2009	June 2010	June 2011
Total	1.3	2.7	4.9	6.0
(in percent of exports)	42.8	84.8	136.8	139.0
Government	0.7	1.2	1.7	2.2
Public Enterprises	0.6	1.5	3.2	3.7

1/ based on 2008 DSA

6 Staff analysis as part of the 2008 Article IV Consultation concluded that the real exchange rate was at a broadly appropriate level in late-2007—a level not significantly different from the average level for 2003–07.

20. **An updated external debt sustainability analysis (DSA) yields similar conclusions to the DSA conducted as part of the 2008 Article IV Consultation process**: Ethiopia is at moderate risk of debt distress: debt burden indicators are projected to remain below the policy-dependent thresholds but one threshold (the NPV of debt-to-exports ratio) is breached under four stress tests. While the conclusions are similar to those of the 2008 DSA, the debt profile shows significantly higher levels for debt indicators in the 2009/12 period, reflecting a combination of a) faster-than-projected disbursements on existing loans to ETC; b) additional new borrowings by EEPCo; and c) weaker export performance over the near term in light of weak global demand. Debt sustainability hinges on reaping strong returns, in the form of expanded output of tradables, from the large infrastructure investments.

21. **The authorities currently envisage contracting, either directly or by providing a government guarantee, a number of new loans in 2009/10**. Some of the loans under discussion may be extended on non-concessional terms—including a possible loan to Ethiopian Shipping Lines for the purchase of new ships and some further borrowing by EEPCo for investment projects. The authorities have indicated that the amount of nonconcessional loans contracted will not exceed $500 million during the program period; they have agreed to discuss in advance with staff the contracting of any sizeable new loans within this ceiling.

22. **The authorities emphasized their commitment to carefully overseeing the evolution of public external debt, including that incurred by public enterprises**. They indicated that they will keep debt levels under close review and will make every effort to ensure that new borrowings are contracted at concessional terms and that large foreign-financed projects are subject to rigorous economic appraisal before being approved. *The mechanisms utilized to scrutinize the investment and external borrowing program of the public enterprises will be a topic covered, in coordination with the World Bank, as part of the first program review.*

IV. Program Issues

A. Access and Capacity to Repay the Fund

23. **Ethiopia is facing a difficult external environment**. With low reserves and pressure on the balance of payments, there is a strong case for provision of Fund financial support under the Exogenous Shocks Facility (ESF). But Ethiopia also faces deep-rooted economic challenges as it pursues its development strategy and, while supporting the ESF request, staff advises the authorities to develop a medium-term reform program focusing on more entrenched balance of payments difficulties.

24. **Staff calculations of the effects of the changing global environment on the balance of payments in 2009/10 yield an estimated adverse impact in the range of $260–300 million (125–140 percent of quota) (see Box 3)**. The estimates are based on comparisons of projected outturns in 2009/10 (on unchanged policies and a constant real exchange rate) with the 2008/09 outcome. The authorities argued that these estimates

underestimate the net impact of the global crisis on Ethiopia, suggesting that a more appropriate measure would be to compare projected levels in 2009/10 with the levels that would have prevailed in the counterfactual where the global recession had not taken place.[7]

25. **Staff is proposing access under the arrangement in the amount of 115 percent of quota (SDR 133.7 million)**, to be disbursed in three disbursements. Given the difficult external environment and the low levels of international reserves, it is proposed that 55 percent of quota be made available on approval of the arrangement, with two ensuing disbursements of 30 percent of quota. Front-loaded drawings under the ESF would support a more comfortable international reserve position for 2009/10 and enhance the credibility, and hence feasibility, of the authorities' macroeconomic program.[8] In conjunction with the proposed SDR allocation (totaling SDR 117 million, inclusive of both the general and special allocations), the provision of Fund support along these lines would raise import cover to some 2.1 months by June 2010 and to near 2.5 months of imports by June 2011.

26. **The proposed financing from the Fund would complement substantial inflows from donors to Ethiopia**. Donor aid flows jumped to $2.4 billion (7.2 percent of GDP) in 2008/09, as donors provided exceptional assistance to Ethiopia in responding to commodity price shocks. Aid flows are set to rise slightly in 2009/10, and would be up some 46 percent on 2007/08 levels. Proposed Fund assistance under the ESF, inclusive of the initial RAC-ESF drawing, would amount to some $290 million, equivalent to some 6 percent of donor aid flows during 2008/09 and 2009/10.

27. **Ethiopia has adequate capacity to repay the Fund (see Table 6)**. Notwithstanding the high growth in public enterprise borrowings cited above, the DSA indicates that the various debt thresholds are observed in the baseline scenario and Ethiopia's debt to the Fund would remain at modest levels throughout the projection period. The proposed access of 115 percent of quota would amount to about ½ percent of GDP; with full disbursement under the arrangement, debt to the IMF would amount to 2 percent of total public debt in 2010/11. Access under the proposed arrangement would raise the ratio of the NPV of debt to exports by 4 percentage points at its peak (from 135 percent to 139 percent), and does not affect the rating of moderate debt distress recorded in the DSA. Future repayments to the Fund would be modest in relation to exports of goods and services, peaking at some 0.6 percent of exports in 2016.

[7] Staff noted that the methodology employed in the case of Ethiopia was similar to that employed for other countries seeking assistance under the ESF.

[8] The authorities expect a significant drop in the NBE's NFA position during the first half of the fiscal year (see MEFP Table 1); frontloading of Fund support, combined with the SDR allocation, would ensure a gradual increase in the gross reserve position over the course of the year.

B. Risks to the Program

28. **The immediate risks to the program stem from the uncertain external environment and from Ethiopia's dependence on rain-fed agriculture**; the election cycle, with national elections slated for mid-2010, could also affect developments. Weaker exports, remittances, and inward investment would put pressure on reserves or the exchange rate, the latter threatening the inflation objective. Any significant erosion of donor support would undermine both the external payments and budgetary positions. Ethiopia's narrow export base and dependence on agriculture leave it vulnerable to weather shocks; the authorities are confident that near-term output goals will be achieved but a significant agricultural supply shock cannot be ruled out. Over the medium-term, output diversification and technical progress in agriculture will be key to limiting vulnerabilities: in the near-term, the authorities will need to move flexibly, supported by donors, to handle further adverse shocks.

C. Program Monitoring and Conditionality

29. **Program implementation and its economic results will be subject to two reviews** based on end-December 2009 and end-2009/10 performance criteria (Table 7). The program will be monitored on the basis of (a) quantitative performance criteria and benchmarks, set out in Table I.1 of the attached MEFP and defined in the technical memorandum of understanding; and (b) structural benchmarks, as specified in Table I.2 of the MEFP. The first review would be scheduled for completion by March 2010.

30. **A safeguards assessment update is currently underway**, and a safeguards mission visited Addis Ababa during July 6–14.

V. Staff Appraisal

31. **The Ethiopian authorities face a challenging immediate macroeconomic situation**, notwithstanding the strong growth performance over several years and the important progress made in raising living standards and reducing poverty. The low level of foreign reserves constrains the room for maneuver in handling adverse shocks, underscoring the importance of building reserves towards their target level of 3 months import cover as soon as is feasible.

32. **The adjustment package adopted in late-2008 has been implemented vigorously**, providing key support for controlling inflation and rebuilding still-low reserves. The fiscal squeeze needed to halt domestic borrowing by general government and the elimination of fuel subsidies were important measures, helping to contain domestic monetary growth.

33. **The authorities' program for 2009/10 seeks a balance among conflicting objectives**—maintaining low inflation, rebuilding reserves, allowing some easing of tight expenditure constraints, and unwinding some of the real exchange rate appreciation recorded during the past two years. The package chosen reflects national priorities and is adequate to achieve program targets, although implementation will need to be appropriately cautious with

a bias towards tight control of discretionary fiscal outlays and of reserve money until the desired trajectories for inflation and the balance of payments are assured.

34. **The authorities recognize the need to limit domestic borrowing by the public sector if inflation is to be contained and private sector growth to be fostered**. The strong performance in containing borrowing levels in 2008/09 provides confidence that the limit set for 2009/10—some 3 percent of GDP—can be observed, but this will require careful monitoring and control of budget implementation and effective operation of the inter-agency committee established to monitor borrowing by the public enterprises. This oversight process has received high-level support from policy-makers to date, and it will be important that this support is maintained throughout the current fiscal year.

35. **Budget revenue targets are achievable but ambitious**, viewed against the backdrop of the poor trajectory of revenue collection over the past several years. The authorities are fully cognizant of the need both to achieve revenue targets in the near-term and to put in place the reforms needed to boost the revenue-GDP ratio over the medium-term. For this fiscal year, vigilance will be needed to monitor monthly revenue collections and to initiate a mix of remedial measures and/or expenditure tightening where needed. Looking ahead, it will be important that the authorities make effective use of the upcoming technical assistance from the Fiscal Affairs department to flesh out a medium-term reform strategy.

36. **Controlling the monetary aggregates has been a challenge for the NBE**, given the rudimentary state of the money markets and the lack of instruments to fine-tune control of liquidity. Building money markets and developing central bank open market operations are medium-term development objectives; in the near-term, liquidity control can be enhanced by focusing the regular fortnightly auctions of Treasury bills on achieving liquidity targets. This will require that interest rates be allowed to adjust to achieve the target auction volumes, implying likely upward movement in T-bill interest rates over time. Making effective use of technical assistance will be of importance in developing liquidity forecasting capabilities.

37. **The authorities' policy thinking envisages gradual real depreciation of the birr over an extended period to promote domestic production of tradables and ease external payments constraints**. The step adjustments of the birr in January and again in July represent important steps in implementing this approach and in correcting currency overvaluation. The case for further adjustment over the fiscal year will depend on inflation performance and the extent of any erosion of depreciation-induced gains in competitiveness. Looking ahead, staff urge the authorities to rely more on domestic demand management tools and give less weight to the exchange rate in pursuing their inflation objectives.

38. **The sharp growth in external debt levels underway during 2008–12 reflects heavy investment in public sector-provided infrastructure**, notably electricity and telecommunications. Existing infrastructure is inadequate to sustain current levels of growth, with availability of power already a binding constraint on producers, but it is important that

expansion of infrastructure be appropriately aligned to projected demand growth if public enterprise profitability is not to be undermined by excess capacity. Full cost recovery by public enterprises is an imperative if the debt build-up is not to be converted into public sector deficits; there is likely also a solid case for setting current prices at levels that allow greater contributions from enterprise resources to meet their investment financing needs.

39. **Looking beyond the program period, Ethiopia's macroeconomic policy context remains challenging**, given the competing pressures on domestic credit availability from the public and private sectors, the need to build budgetary revenues to meet spending pressures, the large trade imbalance and the associated heavy dependence on aid flows and remittances, the modest level of foreign reserves, and the fast build-up of external debt levels. Staff will work closely with the authorities on fleshing out the issues and policy options available, using for this purpose the Article IV consultation, the regular visits to Addis between consultations, and, potentially, further program engagement with Ethiopia.

40. **Staff support the authorities' request for an arrangement under the HAC ESF**. The authorities' policy package represents a measured response to the adverse impact of global recession for the period ahead and the policies, if implemented vigorously, are appropriately calibrated to meet the program objectives. Addressing Ethiopia's sizeable medium-term challenges will require the fleshing out of a comprehensive reform agenda, which could possibly be supported by a Fund program, and staff stand ready to work with the authorities on such an endeavor.

Box 1. Ethiopia: The Status of the Policy Package Supported under the RAC ESF

Policy commitments under the RAC ESF have, in the main, been effectively implemented.

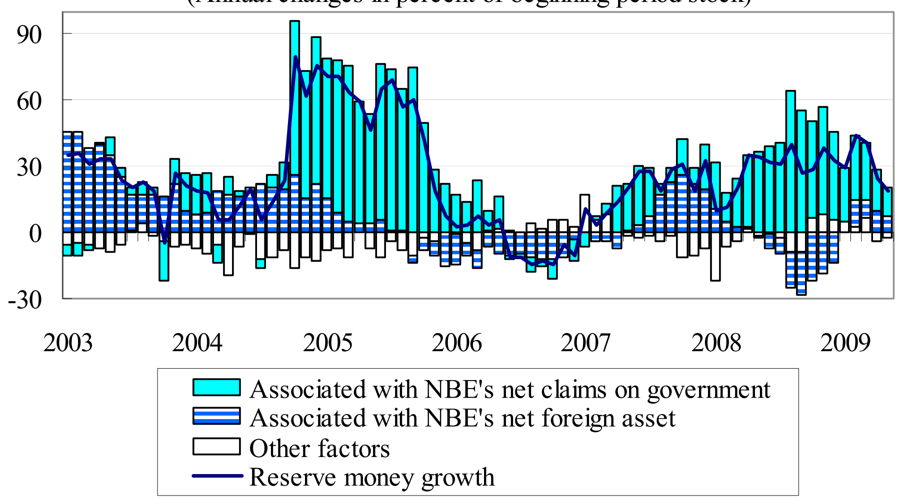
Status of Key Policy Commitments under the RAC ESF Policy Package

Policy commitments	Status
Eliminate the entire fuel subsidy	The fuel subsidy was eliminated in October 2008, and prices have been reset since then on a monthly basis.
Contain the broad money growth below 20 percent in 2008/09	Broad money growth through end-May, at 21 percent (annualized), was above the FY (end-June) target, but the target remained achievable.
Maintain net claims of the domestic banking system on the general government at zero over the course of 2008/09.	Net general government borrowing from the banking system declined over the first 11 months of the fiscal year to -2.8 billion birr, but end-year movements will need to be kept under control.
Reduce public enterprise domestic borrowing to between 4–8 billion birr (no more than 2½ percent of GDP) in 2008/09.	Borrowing through end-May stood at 7.5 billion birr, within the end-year limit.
Establish a committee comprising officials from the Ministry of Finance and Economic Development and the NBE to monitor public enterprise borrowing.	Done.
Introduce greater flexibility in the foreign exchange market	For 2008/09, the exchange rate depreciated by 10 percent in January, and by end-June had depreciated by some 16 percent since September 2008.
Request an update of the safeguards assessment for the NBE.	Done. Following the NBE's response to the data request by FIN, the safeguard assessments mission took place in July 2009.

Box 2. Ethiopia: Liquidity Control

The National Bank of Ethiopia (NBE) has faced significant challenges in maintaining effective control over the stock of reserve money, which has fluctuated significantly as a result of surges in NBE financing of the government (through an advances account) and the foreign exchange operations of the NBE. The NBE does not itself have instruments to conduct offsetting sterilization operations, and has instead relied on changes in reserve requirements and moral suasion to influence growth of the monetary aggregates.

Contributions to Reserve Money Growth
(Annual changes in percent of beginning period stock)



For the period ahead, **the NBE, with support from the Treasury, will make use of the existing auctions of Treasury bills (held every two weeks) as the tool to control liquidity**, setting sales volumes on the basis of the amounts needed to meet reserve money targets. The setting of auction volumes will require the development of a basic liquidity forecasting capability, in turn requiring close collaboration and information-sharing between the NBE and MoFED. Effective use of the mechanism will also require a willingness to allow interest rates adjust to the levels needed to achieve target sales volumes—rather than limiting sales volumes to achieve a specific "cost of funds" target of the government. Technical assistance in support of this reform agenda is being obtained under the World Bank's financial sector capacity building project.

The medium-term challenge will be to develop NBE open market operations using government paper, but this will first require significant developments in both the instruments used for government finance and in money and financial markets.

Box 3. Ethiopia: Balance of Payments Impact of the Global Slowdown

Ethiopia is facing a difficult external environment in 2009/10: the balance of payments position is being adversely affected by pressures on remittances, inward direct investment, and key export items, with resurgent oil prices an additional burden. As a corollary, the trajectory for foreign reserves is now substantially weaker than envisaged at the time of Board approval of the RAC-ESF drawing in January 2009 (IMF Country Report No. 09/34).

Staff have sought to quantify the effects of the changing global environment on the balance of payments in 2009/10, measured against the outturn in 2008/09, excluding the impact of the drop-off in donor flows (as exceptional financing ends), and under the assumption of a constant real exchange rate. The aggregate size of the shock is projected in the range of $260–297 million—equivalent to 125–143 percent of quota—with key components being declining remittances and direct foreign investment and higher oil prices.

Ethiopia: Estimated Impact of Exogenous Shocks on the BoP
(In millions of US$)

	2007/08 (Act.)	2008/09 (Est.) A	2009/10 [1] (Proj.) C	Estimated shock (changes) C-A [2]	C-A [3]
Commodity Exports					
Coffee	525	371	419	48	-21
Oil seeds	219	325	317	-8	-8
Flowers	112	126	150	24	-4
Commodity Imports (selected)					
Fuel	1,621	1,282	1,468	-186	-52
Private Transfers	2,393	2,350	2,225	-125	-125
Foreign Direct Investment [4]	815	805	705	-50	-50
Total shock impact	…	…	…	-297	-260
Other, residual	…	…	…	-433	
Overall balance of payments	-263	476	-254	-730	
MEMO ITEM					
Change in stock of gross reserves (with no real exchange rate adjustment) [5]	-420	616	-254		
Foreign Reserves (with no real exchange rate adjustment) [5]	906	1,523	1,269		
Change in stock of gross reserves (with real exchange rate adjustment and IMF disbursements) [6]	-420	616	327		
Foreign Reserves (with real exchange rate adjustment and IMF disbursements) [6]	906	1,523	1,850		
(months of GNFS imports)	1.2	1.8	2.1		

1/ Based on projections without real exchange rate change in 09/10
2/ Changes in values for all items.
3/ For commodity exports and imports, shock estimates represent impact from price changes only (using 2008/09 volumes).
4/ Shock estimates assume 50 percent import content.
5/ Based on projections without real exchange rate change in 09/10. Assuming no disbursements of IMF financial resources.
6/ Based on projections with real exchange rate change in 09/10. Assuming disbursements of the ESF and new SDR allocations.

Table 1. Ethiopia: Selected Economic and Financial Indicators, 2005/06–2010/11 1/

	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
				Est.	Proj.	Proj.
	(Annual percentage change)					
National income and prices						
GDP at constant prices (at factor cost)	11.5	11.5	11.6	7.5	7.0	8.0
GDP deflator	11.6	17.4	28.4	35.8	6.3	8.2
Consumer prices (period average)	12.3	15.8	25.3	36.4	5.1	8.6
Consumer prices (end period)	11.6	15.1	55.3	3.1	9.8	9.5
External sector						
Exports, (In U.S. dollars, f.o.b.)	18.1	18.7	23.1	-1.1	11.8	11.0
Imports, (In U.S. dollars, c.i.f.) 2/	25.9	13.4	22.6	17.3	19.3	6.2
Export volume	5.1	11.4	0.8	0.7	12.3	12.4
Import volume 2/	21.8	6.9	9.6	16.9	26.3	4.6
Terms of trade (deterioration –)	3.5	-1.3	2.1	6.7	4.1	-4.2
Nominal effective exchange rate (end of period)	-1.8	-7.5	-13.0	...	...	...
Real effective exchange rate (end of period)	6.0	3.8	24.2	...	...	...
	(Percent of beginning-period stock of broad money, unless otherwise indicated)					
Money and credit						
Net foreign assets	-1.6	1.4	-3.1	10.8	2.9	8.6
Net domestic assets (including other items)	19.0	18.3	26.0	9.1	14.2	8.9
Net claims on the government (net)	7.1	9.0	6.8	0.0	7.0	5.1
Claims on public enterprises	4.9	6.1	19.0	8.3	7.5	4.9
Claims on private sector	8.8	9.2	7.9	4.5	5.3	4.4
Broad money	17.4	19.7	22.9	19.9	17.1	17.5
Velocity (GDP/broad money)	2.77	3.02	3.52	4.22	4.11	4.09
Lending rates (maximum rate)	14.0	15.0	15.0	…	…	…
Treasury bill (91-day maturity)	0.04	0.79	0.58	…	…	…
	(In percent of GDP, unless otherwise indicated)					
Financial balances						
Gross domestic saving	3.7	6.1	3.2	2.5	2.6	4.8
Government saving	2.7	1.4	1.5	2.1	2.5	2.7
Private saving	0.9	4.7	1.7	0.4	0.1	2.1
Gross domestic investment	24.2	24.8	21.2	20.8	22.6	22.9
Government investment	16.7	18.1	15.3	14.8	16.3	16.4
Private investment	7.6	6.7	5.9	6.0	6.3	6.5
Resource gap	-20.6	-18.7	-18.0	-18.3	-20.0	-18.1
External current account balance, including official transfers	-9.1	-4.5	-5.7	-5.6	-9.3	-6.5
Government finances						
Revenue	14.8	12.7	12.1	11.7	12.2	12.5
Tax revenue	10.8	10.1	9.7	8.1	8.7	9.1
Nontax revenue	4.1	2.6	2.4	3.6	3.4	3.4
External grants	3.6	4.4	4.0	3.7	3.2	3.5
Expenditure and net lending	22.3	20.7	19.1	17.7	18.4	18.7
Fiscal balance, excluding grants (cash basis)	-7.4	-8.0	-7.0	-6.0	-6.3	-6.2
Fiscal balance, including grants (cash basis)	-3.9	-3.6	-2.9	-2.3	-3.0	-2.7
Total financing	3.9	3.6	2.9	2.3	3.0	2.7
External financing	1.1	1.1	1.0	2.2	1.6	1.7
Domestic financing (not including privatization)	2.1	3.6	2.7	0.0	1.4	1.1
Public debt	68.1	40.7	36.5	32.8	37.5	39.3
Domestic debt	30.9	28.9	24.6	18.0	18.0	16.6
External debt (including to Fund)	37.3	11.7	11.9	14.8	19.5	22.7
Net present value (NPV) of external debt-to-exports ratio (including to Fund) 3/	n.a.	48.5	57.3	84.8	136.7	138.9
External debt-service ratio 4/	3.7	3.7	1.2	3.0	6.1	9.4
Overall balance of payments (in millions of U.S. dollars)	-316	-3	-263	476	-30	354
Gross official reserves (in millions of U.S. dollars)	1,158	1,326	906	1,523	1,493	1,847
(in months of imports of goods and nonfactor services of following year)	2.2	1.9	1.2	1.8	1.7	2.0
GDP at current market prices (in billions of birr)	131.7	171.8	245.6	353.4	403.2	472.0

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

1/ Except for data on external sector which is based on July 1-June 30, data pertain to the period July 8-July 7.
2/ Excluding aircraft and telecom purchases.
3/ Including debt of major public enterprises.
4/ After enhanced HIPC and MDRI relief.

Table 2. Ethiopia: General Government Operations, 2005/06–2010/11
(Millions of birr)

	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
	Act.	Act.	Act.	Est.	Proj.	Proj.
Total revenue and grants	24,251	29,381	39,705	54,147	61,984	75,434
Revenue	19,530	21,797	29,794	41,227	49,044	58,972
Tax revenue	14,159	17,354	23,801	28,580	35,184	42,745
Direct taxes	4,461	5,168	6,628	9,075	11,751	14,227
Indirect taxes	9,698	12,186	17,173	19,505	23,433	28,518
Domestic indirect taxes	3,111	3,997	5,480	7,119	8,426	10,201
Import duties and taxes	6,587	8,189	11,693	12,385	15,008	18,317
Nontax revenue	5,371	4,444	5,993	12,647	13,860	16,226
Grants	4,721	7,583	9,911	12,921	12,940	16,462
Emergency assistance (food and nonfood aid)	586	411	401	640	724	878
Program grants 1/	950	4,091	5,477	7,871	7,599	9,229
Multilateral Debt Relief Initiative 2/	989	...	...	...	...	...
Project grants	2,196	3,081	4,034	4,409	4,617	6,355
Total expenditure and net lending (cash basis) 3/	29,325	35,607	46,915	62,387	74,257	88,379
Recurrent expenditure 3/	15,234	17,165	22,794	29,124	33,637	39,714
Defense spending	3,009	3,005	3,453	4,000	4,000	4,000
Poverty-reducing expenditure 4/	6,493	7,795	10,627	13,656	16,197	19,513
Interest payments	1,054	1,207	1,133	1,570	1,880	2,637
Domestic interest and charges	621	727	908	1,140	1,542	2,175
External interest payments 5/	433	480	225	430	338	462
Emergency assistance (food and other emergency aid)	586	411	401	640	724	878
Other recurrent expenditure	4,091	4,748	7,181	9,257	10,836	12,686
Capital expenditure 3/	14,041	18,398	24,121	33,263	40,620	48,665
Central treasury	10,785	13,832	18,277	22,058	29,218	33,961
External project grants	2,196	3,081	4,034	4,409	4,617	6,355
External project loans	1,061	1,484	1,810	6,795	6,785	8,349
Special programs 6/	50	44	0	0	0	0
Overall balance						
Including grants	-5,074	-6,227	-7,210	-8,240	-12,273	-12,945
Excluding grants	-9,795	-13,810	-17,121	-21,160	-25,213	-29,408
Excluding MDRI	-6,063	...	...	...	...	...
Financing	3,259	8,159	9,984	8,240	12,273	12,945
Net external financing	1,512	1,913	2,396	7,780	6,450	7,945
Gross borrowing	1,520	1,774	1,810	8,072	6,785	8,349
Capital budget	1,061	1,484	1,810	6,795	6,785	8,349
Special program (World Bank's fertilizer project)	459	290	0	1,276	0	0
HIPC debt relief 5/	926	1,057	988	165	119	0
Amortization 5/	-934	-919	-402	-457	-454	-404
Total net domestic financing	1,747	6,246	6,580	0	5,823	5,000
Domestic (net)	2,736	6,246	6,580	0	5,823	5,000
Banking system	2,876	4,259	3,879	0	5,823	5,000
Nonbank sources	-141	1,988	2,701	0	0	0
MDRI, account held at NBE 2/	-989	...	...	...	...	...
Privatization	0	0	1,008	460	0	0
Float/unidentified financing	1,816	-1,932	-2,775	0	0	0
Memorandum items:						
Poverty-reducing expenditure	18,290	22,366	30,051	45,661	52,699	62,247
External grants and loans (US dollars per capita)	10	14	16	25	19	21
Primary fiscal balance, including grants	-4,020	-5,020	-6,077	-6,670	-10,393	-10,308
Domestic fiscal balance, including grants	-5,520	-8,354	-10,651	-8,885	-12,749	-13,363
Gross domestic government debt	38,841	45,088	51,668	51,668	57,491	62,491

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

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

2/ Debt relief from the IMF under the MDRI is recorded in 2005/06. Withdrawal from the special account at the NBE is assumed to take place from FY2006/07 and FY2007/08.

3/ Excluding special programs (demobilization and reconstruction).

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

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

6/ Demobilization and reconstruction.

Table 3. Ethiopia: General Government Operations, 2005/06–2010/11
(In percent of GDP)

	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
	Act.	Act.	Act.	Est.	Proj.	Proj.
Total revenue and grants	18.4	17.1	16.2	15.3	15.4	16.0
Revenue	14.8	12.7	12.1	11.7	12.2	12.5
Tax revenue	10.8	10.1	9.7	8.1	8.7	9.1
Direct taxes	3.4	3.0	2.7	2.6	2.9	3.0
Indirect taxes	7.4	7.1	7.0	5.5	5.8	6.0
Domestic indirect taxes	2.4	2.3	2.2	2.0	2.1	2.2
Import duties and taxes	5.0	4.8	4.8	3.5	3.7	3.9
Nontax revenue	4.1	2.6	2.4	3.6	3.4	3.4
Grants	3.6	4.4	4.0	3.7	3.2	3.5
Emergency assistance (food and nonfood aid)	0.4	0.2	0.2	0.2	0.2	0.2
Program grants 1/	0.7	2.4	2.2	2.2	1.9	2.0
Multilateral Debt Relief Initiative 2/	0.8	0.0	0.0	...	...	...
Project grants	1.7	1.8	1.6	1.2	1.1	1.3
Total expenditure and net lending (cash basis) 3/	22.3	20.7	19.1	17.7	18.4	18.7
Recurrent expenditure 3/	11.6	10.0	9.3	8.2	8.3	8.4
Defense spending	2.3	1.7	1.4	1.1	1.0	0.8
Poverty-reducing expenditure 4/	4.9	4.5	4.3	3.9	4.0	4.1
Interest payments	0.8	0.7	0.5	0.4	0.5	0.6
Domestic interest and charges	0.5	0.4	0.4	0.3	0.4	0.5
External interest payments 5/	0.3	0.3	0.1	0.1	0.1	0.1
Emergency assistance (food and other emergency aid)	0.4	0.2	0.2	0.2	0.2	0.2
Other recurrent expenditure	3.1	2.8	2.9	2.6	2.7	2.7
Capital expenditure 3/	10.7	10.7	9.8	9.4	10.1	10.3
Central treasury	8.2	8.0	7.4	6.2	7.2	7.2
External project grants	1.7	1.8	1.6	1.2	1.1	1.3
External project loans	0.8	0.9	0.7	1.9	1.7	1.8
Special programs 6/	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance						
Including grants	-3.9	-3.6	-2.9	-2.3	-3.0	-2.7
Excluding grants	-7.4	-8.0	-7.0	-6.0	-6.3	-6.2
Excluding MDRI	-4.6	... ..	...	...	...	...
Financing	2.5	4.7	4.1	2.3	3.0	2.7
Net external financing	1.1	1.1	1.0	2.2	1.6	1.7
Gross borrowing	1.2	1.0	0.7	2.3	1.7	1.8
Capital budget	0.8	0.9	0.7	1.9	1.7	1.8
Special programs	0.3	0.2	0.0	0.4	0.0	0.0
HIPC debt relief 5/	0.7	0.6	0.4	0.0	0.0	0.0
Amortization 5/	-0.7	-0.5	-0.2	-0.1	-0.1	-0.1
Total net domestic financing	1.3	3.6	2.7	0.0	1.4	1.1
Domestic (net)	2.1	3.6	2.7	0.0	1.4	1.1
Banking system	2.2	2.5	1.6	0.0	1.4	1.1
Nonbank sources	-0.1	1.2	1.1	0.0	0.0	0.0
MDRI, account held at NBE 2/	-0.8	0.0	0.0	0.0	0.0	...
Privatization	0.0	0.0	0.4	0.1	0.0	0.0
Float/unidentified financing	1.4	-1.1	-1.1	0.0	0.0	0.0
Memorandum items:						
Poverty-reducing expenditure	13.9	13.0	12.2	12.9	13.1	13.2
Primary fiscal balance, including grants	-3.1	-2.9	-2.5	-1.9	-2.6	-2.2
Domestic fiscal balance, including grants	-4.2	-4.9	-4.3	-2.5	-3.2	-2.8
Gross domestic government debt	29.5	26.2	21.0	14.6	14.3	13.2

Sources: Ethiopian authorities; and IMF staff estimates and projections. The Ethiopian fiscal year ends July 7.
1/ Including the disbursements under the PBS operations starting from 2005/06.
2/ Debt relief from the IMF under the MDRI is recorded in 2005/06. Withdrawal from the special account at the NBE is assumed to take place from FY2006/07 and FY2007/08.
3/ Excluding special programs (demobilization and reconstruction).
4/ Poverty-reducing spending is defined to include total spending on health, education, agriculture, roads, and food security.
5/ External interest and amortization are presented after HIPC debt relief from the World Bank and African Development Bank.
6/ Demobilization and reconstruction.

Table 4. Ethiopia: Monetary Survey, 2005/06–2010/11 1/

	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
				Est.	Proj.	Proj.
			(Millions of birr)			
Net foreign assets	13,251	13,927	12,141	19,668	22,135	30,603
National Bank of Ethiopia (NBE)	7,312	8,179	6,472	14,141	15,806	23,357
Assets	9,389	11,807	9,233	17,839	20,040	28,204
Liabilities	2,077	3,628	2,761	3,697	4,234	4,847
Commercial banks	5,939	5,748	5,670	5,527	6,329	7,246
Assets	7,684	7,719	8,075	10,621	12,161	13,924
Liabilities	1,745	1,971	2,405	5,094	5,832	6,678
Net domestic assets	34,235	42,915	57,711	64,097	75,964	84,664
Domestic credit	50,044	61,595	80,773	89,719	106,214	120,336
Claims on government (net) 2/	26,040	30,297	34,169	34,169	39,992	44,992
NBE	18,804	24,065	34,716	34,716	41,680	45,311
Commercial banks	7,236	6,232	-547	-547	-1,688	-319
Claims on nongovernment	24,003	31,297	46,604	55,550	66,222	75,344
NBE	0	0	0	0	0	0
Commercial banks	24,003	31,297	46,604	55,550	66,222	75,344
Public enterprises	7,936	10,845	21,654	27,468	33,738	38,568
Private sector	16,069	20,452	24,950	28,082	32,484	36,776
Other items (net)	-15,810	-18,680	-23,061	-25,622	-30,250	-35,672
Broad money	47,486	56,842	69,853	83,765	98,099	115,267
Money	24,701	29,755	36,810	44,367	51,756	60,813
Currency outside banks	11,360	13,704	17,613	21,477	24,831	29,176
Demand deposits	13,341	16,051	19,197	22,890	26,925	31,637
Quasimoney	22,784	27,087	33,042	39,398	46,343	54,454
Savings deposits	20,688	23,759	29,847	35,588	41,862	49,188
Time deposits	2,097	3,328	3,195	3,810	4,482	5,266
			(Annual percent change, unless otherwise indicated)			
Net foreign assets	-4.6	5.1	-12.8	62.0	12.5	38.3
Net domestic assets	28.9	25.4	34.5	11.1	18.5	11.5
Domestic credit	20.1	23.1	31.1	11.1	18.4	13.3
Claims on government (net)	12.5	16.3	12.8	0.0	17.0	12.5
Claims on nongovernment	29.8	30.4	48.9	19.2	19.2	13.8
Public enterprises	33.0	36.7	99.7	26.8	22.8	14.3
Private sector	28.3	27.3	22.0	12.6	15.7	13.2
Broad money	17.4	19.7	22.9	19.9	17.1	17.5
Money	15.3	20.5	23.7	20.5	16.7	17.5
Quasimoney	19.8	18.9	22.0	19.2	17.6	17.5
Memorandum items:						
Reserve money growth	-10.2	27.4	32.3	21.9	15.6	17.5
Money multiplier	2.3	2.2	2.0	2.0	2.0	2.0
Velocity (GDP/broad money)	2.77	3.02	3.52	4.22	4.11	4.09
Excess reserves (percent of deposits)	16.2	19.4	10.4	9.7	8.3	8.0

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

1/ Year ending July 7. Including commercial bank claims and liabilities to 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.

Table 5 (a). Ethiopia: Balance of Payments, 2006/07–2010/11 1/
(Millions of U.S. dollars, unless otherwise indicated)

	2006/07	2007/08	2008/09	2009/10	2010/11
Trade balance	**-3,940**	**-5,348**	**-6,105**	**-7,015**	**-6,954**
Exports of goods	1,188	1,462	1,446	1,616	1,795
Imports of goods	5,128	6,811	7,552	8,631	8,749
Oil	895	1,621	1,282	1,444	1,665
Capital goods	1,869	1,908	2,270	3,284	3,103
PE investment imports		357	603	1,518	1,063
Cereals	161	208	595	495	250
Other	2,204	3,074	3,406	3,408	3,731
Nonfactor services (net)	**161**	**126**	**249**	**373**	**654**
Exports of nonfactor services	1,301	1,597	1,756	1,982	2,498
Imports of nonfactor services	1,140	1,472	1,506	1,608	1,845
Factor income (net)	**14**	**33**	**-32**	**-212**	**-190**
Private transfers (net)	**1,696**	**2,393**	**2,350**	**2,225**	**2,558**
Official transfers (net) 2/	**1,199**	**1,306**	**1,653**	**1,529**	**1,659**
Current account balance	**-871**	**-1,491**	**-1,885**	**-3,099**	**-2,274**
Capital account balance	**867**	**1,228**	**2,362**	**3,069**	**2,627**
Foreign direct investment (net)	**482**	**815**	**805**	**705**	**910**
Official long-term loans	**239**	**704**	**1,483**	**2,364**	**1,717**
Disbursements	345	759	1,533	2,441	1,899
Public Enterprises (non-concessional)		357	748	1,477	832
Amortization	106	55	50	77	182
Other Capital Flows (net)	**-24**	**-89**	**0**	**0**	**0**
Errors and omissions	**195**	**-112**	**74**	**0**	**0**
Overall balance	**-3**	**-263**	**476**	**-30**	**354**
Financing	**3**	**263**	**-476**	**30**	**-354**
Change in Cent. Bank Foreign Reserves	-39	244	-577	30	-354
Change in Comm Bank Foreign Reserves	-45	19	100	0	0
Exceptional financing and others	88	0	0	0	0
MEMO ITEMS:					
Foreign Reserves (A)	1,326	906	1,523	1,493	1,847
Import Cover (in months of next year's imports)	1.9	1.2	1.8	1.7	2.0
IMF lending (B)				177	63
SDR allocation (C)				180	
Foreign Reserves (with IMF disbursements, A+B+C)				1,850	2,267
Import Cover (in months of next year's imports)				2.1	2.4
Import Volume Growth Rate (excluding Oil, Capital goods Investments and Cereals)	-1.1	19.5	9.0	7.6	7.9
Donor Aid Flows	1,544	1,708	2,437	2,493	2,726

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

1/ Data pertain to the period July 1-June 30.

2/ The 2009/10 PBS II disbursed by the World Bank in June 2009 is reflected in the 2008/09 balances.

Table 5 (b). Ethiopia: Balance of Payments, 2006/07–2013/14 1/
(Millions of U.S. dollars, unless otherwise indicated)

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Trade balance	**-3,940**	**-5,348**	**-6,105**	**-7,015**	**-6,954**	**-7,183**	**-7,819**	**-8,444**
Exports of goods	1,188	1,462	1,446	1,616	1,795	1,987	2,211	2,467
Imports of goods	5,128	6,811	7,552	8,631	8,749	9,170	10,029	10,910
Oil	895	1,621	1,282	1,444	1,665	1,915	2,161	2,434
Capital goods	1,869	1,908	2,270	3,284	3,103	2,984	3,099	3,109
PE investment imports		357	603	1,518	1,063	747	652	475
Cereals	161	208	595	495	250	150	150	150
Other	2,204	3,074	3,406	3,408	3,731	4,120	4,619	5,217
Nonfactor services (net)	**161**	**126**	**249**	**373**	**654**	**963**	**1,434**	**1,954**
Exports of nonfactor services	1,301	1,597	1,756	1,982	2,498	3,001	3,656	4,380
Imports of nonfactor services	1,140	1,472	1,506	1,608	1,845	2,038	2,222	2,426
Factor income (net)	**14**	**33**	**-32**	**-212**	**-190**	**-196**	**-169**	**-200**
Private transfers (net)	**1,696**	**2,393**	**2,350**	**2,225**	**2,558**	**2,651**	**2,759**	**2,875**
Official transfers (net) 2/	**1,199**	**1,306**	**1,653**	**1,529**	**1,659**	**1,759**	**1,906**	**2,136**
Current account balance	**-871**	**-1,491**	**-1,885**	**-3,099**	**-2,274**	**-2,006**	**-1,889**	**-1,679**
Capital account balance	**867**	**1,228**	**2,362**	**3,069**	**2,627**	**2,213**	**2,091**	**1,950**
Foreign direct investment (net)	**482**	**815**	**805**	**705**	**910**	**972**	**1,061**	**1,158**
Official long-term loans	**239**	**704**	**1,483**	**2,364**	**1,717**	**1,241**	**1,030**	**792**
Disbursements	345	759	1,533	2,441	1,899	1,538	1,429	1,263
Public Enterprises (non-concessional)		357	748	1,477	832	466	432	432
Amortization	106	55	50	77	182	297	399	471
Other Capital Flows (net)	**-24**	**-89**	**0**	**0**	**0**	**0**	**0**	**0**
Errors and omissions	**195**	**-112**	**74**	**0**	**0**	**0**	**0**	**0**
Overall balance	**-3**	**-263**	**476**	**-30**	**354**	**206**	**202**	**271**
Financing	**3**	**263**	**-476**	**30**	**-354**	**-206**	**-202**	**-271**
Change in Cent. Bank Foreign Reserves	-39	244	-577	30	-354	-678	-202	-271
Change in Comm Bank Foreign Reserves	-45	19	100	0	0	0	0	0
Exceptional financing and others	88	0	0	0	0	0	0	0
MEMO ITEMS:								
Foreign Reserves 3/	1,326	906	1,523	1,850	2,266	2,525	2,726	2,997
Import Cover (in months of next year's imports)	1.9	1.2	1.8	2.1	2.4	2.5	2.5	2.5
Donor Aid Flows	1,544	1,708	2,437	2,493	2,726	2,831	2,902	2,967

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

1/ Data pertain to the period July 1-June 30.
2/ The 2009/10 PBS II disbursed by the World Bank in June 2009 is reflected in the 2008/09 balances.
3/ Foreign reserves from 09/10 onward include IMF disbursements from the HAC ESF and SDR allocation.

Table 6. Ethiopia: Indicators of Capacity to Repay the Fund, 2009–20

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Fund obligations based on existing credit												
(in millions of SDRs)												
Principal	0.0	0.0	0.0	0.0	0.0	3.3	6.7	6.7	6.7	6.7	3.3	0.0
Charges and interest	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.0	0.0
Fund obligations based on prospective credit 1/												
(in millions of SDRs)												
Principal	0.0	0.0	0.0	0.0	0.0	0.0	18.7	30.8	30.8	30.8	30.8	12.0
Charges and interest	0.1	0.6	0.8	0.8	0.8	0.8	0.7	0.6	0.4	0.3	0.1	0.0
Total obligations based on existing and prospective credit												
In millions of SDRs	0.2	0.8	1.0	1.0	1.0	4.3	26.3	38.2	38.0	37.8	34.3	12.1
In millions of U.S. dollars	0.3	1.2	1.5	1.5	1.5	6.7	41.0	59.5	59.2	58.9	53.4	18.8
In percent of exports of goods and services	0.0	0.0	0.0	0.0	0.0	0.1	0.5	0.6	0.6	0.5	0.4	0.1
In percent of quota	0.2	0.6	0.7	0.7	0.7	3.2	19.7	28.5	28.4	28.3	25.6	9.0
In percent of gross international reserves	0.0	0.1	0.1	0.1	0.1	0.2	1.2	1.4	1.2	1.1	0.9	0.3
In percent of total external debt service	0.3	0.4	0.4	0.3	0.2	0.8	4.4	6.4	6.3	6.2	5.5	2.0
Outstanding Fund credit 1/												
In millions of SDRs	107.0	187.2	187.2	187.2	187.2	183.8	158.4	121.0	83.6	46.1	12.0	0.0
In millions of U.S. dollars	166.7	291.7	291.7	291.7	291.7	286.5	246.9	188.6	130.2	71.9	18.7	0.0
In percent of exports of goods and services	5.2	8.1	6.8	5.8	5.0	4.2	3.1	2.1	1.2	0.6	0.1	0.0
In percent of quota	80.0	140.0	140.0	140.0	140.0	137.5	118.5	90.5	62.5	34.5	9.0	0.0
In percent of gross international reserves	10.9	17.5	14.0	12.4	11.5	10.2	7.5	4.3	2.6	1.3	0.3	0.0
In percent of total external debt stock	4.2	4.6	3.6	3.1	2.8	2.6	2.1	1.6	1.1	0.6	0.1	0.0
Memorandum items												
Exports of goods and services (millions of U.S. dollar) 2/	3,202	3,598	4,293	4,988	5,867	6,847	7,918	9,167	10,419	11,568	12,869	14,299
Quota (millions of SDRs)	133.7	133.7	133.7	133.7	133.7	133.7	133.7	133.7	133.7	133.7	133.7	133.7
Gross international reserves (millions of U.S. dollar) 1/ 2/	1,523	1,670	2,086	2,345	2,546	2,817	3,305	4,336	4,969	5,486	5,904	6,388

Source: IMF staff projections.

1/ Assuming three semi-annual disbursements starting in September 2009, with access of 55, 30, and 30 percent of quota, respectively.
2/ Data pertain to the period July 1 to June 30.

Table 7. Ethiopia: Reviews and Disbursements Under the 14-Month ESF Arrangement
(In millions of SDR)

Date	Action	Associated disbursements
On or after August 26, 2009	On approval of arrangement	73.535
On or after March 15, 2010	Completion of the first ESF review	40.110
On or after September 15, 2010	Completion of the second ESF review	40.110
		153.755

Source: IMF staff projections.

APPENDIX I

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA
LETTER OF INTENT

Addis Ababa, August 7, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn:

The government of Ethiopia requests support from the International Monetary Fund (IMF) for its 2009/10 economic program through a 14-month arrangement under the High-Access Component of the Exogenous Shocks Facility (ESF). We request access of 115 percent of quota, the equivalent of SDR 153.755 million (about USD 240 million).

Macroeconomic performance has improved substantially under the policy package supported by the IMF with a drawing under the Rapid Access Component of the ESF, approved by the IMF Executive Board in January 2009. Given the still-low level of foreign exchange reserves, the requested arrangement will greatly assist with our efforts to steer the Ethiopian economy through the global economic crisis, sending a positive signal to domestic stakeholders and our development partners about our resolve to maintain a stable macroeconomic environment.

In the attached Memorandum of Economic and Financial Policies (MEFP), we describe policy implementation in 2008/09 and set out our macroeconomic objectives and policies for 2009/10. Our program focuses on entrenching low inflation and building international reserves through appropriately tight fiscal and monetary policies supported by the necessary exchange rate flexibility. We also intend to enhance monitoring and control of borrowings by the public enterprise sector, develop the central bank's liquidity forecasting and control capacity, and flesh out, with IMF technical assistance, a comprehensive time-bound tax reform strategy to improve domestic revenue mobilization.

The MEFP and Technical Memorandum of Understanding (TMU) present quantitative performance criteria and indicative targets as well as structural benchmarks through the period of the arrangement. We believe that the policies set forth in the MEFP are adequate to achieve the objectives of the program, but we will take additional measures as needed to reach these goals. We will consult with IMF staff on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the agreed IMF policies on such consultation.

The government of Ethiopia authorizes the IMF to publish the contents of this letter, and the attached MEFP and TMU, on its website after consideration of our request by the Executive Board.

Sincerely yours,

/s/
Sufian Ahmed
Minister
The Ministry of Finance and Economic Development

/s/
Teklewold Atnafu
Governor
The National Bank of Ethiopia

Attachments:

I. Memorandum of Economic and Financial Policies
II. Technical Memorandum of Understanding

Appendix I
Attachment I

The Federal Democratic Republic of Ethiopia
Memorandum of Economic and Financial Policies
for the Period July 8, 2009 – October 25, 2010

Addis Ababa, August 7, 2009

1. Ethiopia has achieved strong economic growth in recent years. Supported by improved agricultural production and large-scale public investment in infrastructure, real GDP growth has averaged 11.5 percent in the past five years, among the highest levels recorded in the continent. Good growth performance has also contributed to significant poverty reduction and to favorable prospects for achieving the MDGs.

2. Strong economic growth coupled with the surge in world commodity prices put serious pressures on both domestic prices and international reserves during 2008, with CPI inflation peaking at 64 percent in July 2008 and international reserves dropping below one month of imports by the second half of that year.

3. Facing the twin challenges of high inflation and low reserves, we introduced significant adjustments to economic policies in late-2008, aimed at restoring macroeconomic stability: these included sizable fiscal tightening, the elimination of fuel subsidies, monetary policy tightening, and adjustments of the exchange rate. The IMF provided support to this policy package through a disbursement of some US$50 million under the rapid-access component of the Exogenous Shocks Facility (ESF) in February 2009. Our development partners also increased substantially their financial support to us during 2008/09.

4. The policy adjustments made last year have worked well, but our improved macroeconomic performance is now being threatened by the fallout from the difficult global economic environment. While the commodity price pressures have eased, receipts from merchandise exports, remittances, and direct foreign investment are coming under pressure, and there is some pullback in aid inflows from the elevated levels recorded in the 2008/09 fiscal year, just ended. We have adjusted our economic program for the year ahead, described below, to respond to the weak global economic environment and expect to achieve solid and sustainable macroeconomic outcomes over the period ahead.

5. We are seeking financial support for this program from the IMF under the high-access component of the ESF; the basis for this requested support is discussed below.

Policies and Economic Performance during 2008/09

6. We have achieved solid results under our economic program for 2008/09, aided by consistent implementation of policies. We anticipate that growth will approach 10 percent for the year. Inflation fell to single digits in June 2009, helped by the partial reversal of last year's food and commodity price surges. International reserves have been rebuilt, helped by increased donor support, and exceeded $1.5 billion by the end of the fiscal year, equivalent to 1.8 months of the coming year's imports of goods and services.

7. We have implemented the key policy measures identified in our December 15, 2008 letter to the Managing Director of the IMF (IMF Country Report No. 09/34) and believe that all quantitative targets for end-2008/09 will be met. The measures include:

- Eliminating fuel subsidies: Domestic fuel prices have been adjusted monthly since October 2008, with prices now set somewhat higher than import costs to enable the Oil Stabilization Fund (OSF) to repay its accumulated debt to the banking system.

- Tightening fiscal policy: Net domestic financing of the general government from the banking system during the first eleven months of the fiscal year stood at -2.8 billion birr and all indications are that the full year target of zero domestic financing will be achieved—a sharp improvement from the borrowing level of 2.7 percent of GDP recorded in 2007/08.

- Reducing public enterprise domestic borrowing: An inter-agency monitoring committee was established (in January) and has been meeting regularly to review developments and identify control measures where warranted. Domestic borrowing during the first eleven months of 2008/09 was 7.5 billion birr, and the full year limit of 8.0 billion birr should be observed.

- Containing money growth: Control of the money supply has proven to be a challenge, despite the support received from the drop in government financing needs. We expect the end-year target of 20 percent growth for broad money to be achieved, but will need to strengthen our framework for liquidity control in the year ahead.

- Greater exchange rate flexibility: The birr fell by some 10 percent vis-à-vis the US dollar in January 2009, and by end-June had depreciated by some 16 percent since September 2008. This nominal depreciation, coupled with the easing of inflation, has reversed some of the accumulated real appreciation of recent years.

Economic Objectives and Policies for 2009/10

8. The global economic crisis has created sizeable challenges for Ethiopia, threatening the sustainability of the solid performance achieved in 2008/09. Favorable weather conditions should provide support for agricultural production in the coming year and key infrastructure projects are expected to move ahead, but drop-offs in selected exports, remittances, direct foreign investment, and donor inflows will place pressure on the balance of payments.

9. The over-arching objective of our economic program for 2009/10 is to maintain macroeconomic stability in the face of the difficult external environment. Program objectives include: a) maintenance of a high, if somewhat lower, level of economic growth than in 2008/09; b) locking in the sharp slowdown in inflation, keeping annual inflation below 10 percent; and c) increasing foreign reserves, inclusive of the financial support requested from the IMF, to some US$1.67 billion, equivalent to 1.9 months of import coverage. We anticipate that GDP growth will reach about 9 percent in 2009/10, but have adopted the conservative assumption of 7 percent in fleshing out the financial and economic program described here.

Fiscal Policies and Public Sector Management

10. We will maintain a tight fiscal stance in 2009/10, containing the overall public sector domestic borrowing level to 3.0 percent of GDP, up somewhat from the 2008/09 level, but down sharply from the 7 percent of GDP recorded in 2007/08. Specific targets are that domestic borrowing of the general government will not exceed 5.8 billion birr (1.4 percent of GDP) while domestic borrowing by public enterprises and public agencies will not exceed 6.3 billion birr (1.6 percent of GDP). Domestic borrowing of the federal government will involve a mix of credit extended by the NBE and sales of government paper to banks and non-banks: we are committed to active use of Treasury bill auctions to allow effective control of reserve money by the NBE (see below).

11. Our budgetary program for 2009/10 is predicated on the need to maintain close control on the government's domestic borrowing requirement while partly easing some of the tight expenditure constraints imposed as part of our ambitious adjustment program during 2008/09. Balancing these conflicting objectives, we envisage a fiscal framework in which general government domestic revenues are at least 49.0 billion birr (12.2 percent of GDP); domestic borrowing levels do not exceed 5.8 billion birr (1.4 percent of GDP); and total domestically-funded outlays are not more than 54.9 billion birr (13.6 percent of GDP). To expand the resource envelope, we will be asking our development partners for additional financial assistance, over and above that assumed in the budget, ideally providing levels of support close to that extended to us in 2008/09. We are committed to cutting expenditure levels if domestic revenues fall below target.

12. The government is maintaining a careful prioritization of public expenditures, protecting poverty-reducing spending and strategic capital projects. Total expenditure and net lending of general government is expected to be 18.4 percent of GDP, up somewhat from the levels of 2008/09. Recurrent spending is projected to remain substantially unchanged at 8.3 percent of GDP, with little room for cuts in light of the tight controls, including salary freezes, maintained over the last two years; poverty-reducing spending is expected to increase slightly to 13.1 percent of GDP; while government-funded capital spending will rise somewhat to 7.2 percent of GDP. Non-priority investments will be postponed until public sector resource constraints are eased.

13. Gradual erosion of the tax-GDP ratio has been a troubling development in recent years, and we are committed to reversing this decline and boosting the fiscal resources available to finance our development needs. For 2009/10, we have opted, against the backdrop of falling food prices, to eliminate the temporary exemption from VAT for food and food-related items introduced last year, and we are intensifying our efforts to improve revenue collections. We expect tax revenues for the year to be around 8.7 percent of GDP, up somewhat from 2008/09 levels. Looking towards the medium term, we have sought technical assistance from the IMF's Fiscal Affairs department to review both tax administration processes and tax policies, and expect to use the recommendations from this assistance (timed for the September-November period) in fleshing out a comprehensive tax reform strategy, to be finalized in January 2010. As initial input to this process, we intend to complete, by mid-August, a status review of the recommendations made by a 2006 IMF technical assistance mission. *Development of a tax reform strategy with a time-bound action plan will be a structural benchmark for the first program review*.

14. We have strengthened our control over financial operations of the public enterprises and agencies, with the aim of limiting their borrowing needs and ensuring a balanced distribution of credit between public and private enterprises. An inter-agency committee is now monitoring enterprise borrowing levels on a monthly basis. Large public enterprises are being called on to submit annual investment and financing plans to the committee, which is to review the potential macroeconomic impact of these plans and, where needed, bring proposed remedial policy actions to high-level policy makers in a timely manner. The committee is working to enhance coverage of its operations to include all significant borrowing enterprises and agencies, and a formal notification to all agencies in this regard will be issued shortly to improve information provision from these institutions. The aggregate domestic borrowing need of public enterprises and agencies fell from 4.4 percent of GDP in 2007/08 to 2.1 percent of GDP in 2008/09 and we expect to see some further decline in domestic borrowing needs in 2009/10. *Effective working of this oversight process, including compliance with the indicative targets for public enterprise borrowing, will be a structural benchmark for the first program review.*

15. Appropriate pricing of outputs is essential if public enterprises and agencies are to remain in solid financial health and not become a drain on scarce fiscal resources. Elimination of fuel subsidies was a key measure to cut public sector borrowing needs; we will continue the current practice of setting price levels above costs to allow repayment of the accumulated debts of the Oil Stabilization Fund. We shall maintain our policy of ensuring that electricity tariffs are set at levels that yield full recovery of costs by the state-owned electricity company. The large state-owned telecommunications and airline corporations are in solid financial health.

Monetary policy and operations

16. Monetary policy will be geared to constrain inflation and support the gradual rebuilding of reserves. Our monetary program is anchored around controlling broad money growth, with reserve money as the main operational target. For 2009/10, we are programming broad money growth at 17.1 percent; with real GDP set to rise by at least 7 percent and end-of-period inflation targeted below 10 percent, this would imply a broadly unchanged real stock of money (adjusted for economic growth) over the twelve months of the fiscal year. Given the public sector borrowing program and our foreign reserve targets, there would be room for some real growth in credit to the private sector (on the order of 6 percent), representing some easing in real credit availability from 2008/09. The monetary targets will be reviewed at mid-(fiscal) year to evaluate whether they are appropriately calibrated to achieve program objectives.

17. To improve monetary policy formulation and implementation, it is essential to provide the NBE with the means to manage liquidity through indirect instruments. The medium-term focus of our reform efforts will be on developing central bank open market operations using government paper, but full development of such a capability will require significant developments in the instruments used for government finance and in financial markets. Our immediate priority therefore will be to make use, on a systematic basis, of the existing auctions of Treasury bills (held every two weeks) as the tool to control liquidity, setting sales volumes on the basis of the amounts determined to be needed to meet reserve money targets. This approach will require significant volumes of t-bill sales, with yields being determined by the need to achieve sales volume targets. The setting of auction volumes will require the development of an effective liquidity forecasting capability, in turn entailing close cooperation and weekly information-sharing between the NBE and the MoFED. We are committed to making this arrangement work, deploying the appropriate staff and resources needed to ensure informed and effective decision-making by those tasked with determining auction volumes. Technical assistance in support of this reform agenda will be obtained under the World Bank's financial sector capacity building project. *Achieving substantial progress in implementing these institutional arrangements and capabilities will be a structural benchmark for the first program review.*

Exchange rate and external debt policy

18. Enhanced exchange rate flexibility is an important component of our policy package, aimed at promoting a better allocation of scarce foreign exchange and enhancing the incentives for both exporters and domestic producers competing with imports. Real exchange rate depreciation earlier this year provided an important step in that direction, but there continues to be significant demand pressure in the foreign exchange market. This pressure will likely intensify as global recession impacts on our foreign currency receipts, and takes place in a context where the low level of foreign reserves limits our room for maneuver. Further adjustment of the exchange rate from June 2009 levels will therefore be needed to eliminate these pressures, but will have to be managed in a manner that does not destabilize expectations or consumer price inflation: the 9 percent depreciation of the birr on July 10th represented a judicious move to meet this objective.

19. The government is committed to maintaining effective oversight over the evolution of public sector external debt, including that incurred by public enterprises. While conventional debt sustainability analysis provides a broadly reassuring assessment of Ethiopia's debt burden, we will continue to keep debt levels under close review and will make every effort to ensure that new borrowings are contracted at concessional terms and that large foreign-financed projects are subject to rigorous economic appraisal before being approved. *The mechanisms utilized to scrutinize the investment and external borrowing program of the public enterprises will be a topic covered as part of the first program review.*

Qualification for the ESF and financing needs

20. The difficult external environment has adversely affected the balance of payments outlook and the speed of reserve accumulation that we had envisaged when we requested support under the Rapid-Access Component of the ESF no longer looks achievable. With key exports, remittances, donor assistance, and foreign direct investment inflows all coming under pressure, we anticipate that, notwithstanding the substantive policy measures described above, foreign reserves would fall slightly during the fiscal year in the absence of Fund support, with the import coverage ratio likely to decline to 1.7 months of imports of goods and services by end-2009/10.

21. We are therefore requesting Fund support for our adjustment program in the amount of SDR 153.755 million, equivalent to 115 percent of quota, under the High-Access Component of the ESF. Our eligibility for access to the ESF in this case is based on the sizeable impact of the adverse external environment on our balance of payments position. The requested financial support, in combination with the policy package described here, would allow us to increase reserves to some $1.67 billion (1.9 months of import cover) by the end of 2009/10. Should the proposed allocation of SDRs be approved by the IMF's Board of Governors, we would take advantage of the allocation to increase our gross foreign reserves

by the full amount of the SDR allocation, bringing gross reserves to $1.85 billion (2.1 months of import cover) by the end of 2009/10.

Program Monitoring

22. The program will be monitored on the basis of (a) quantitative performance criteria and benchmarks, which are set out in Table 1, and described fully in the attached technical memorandum of understanding; and (b) structural benchmarks, as specified in Table 2. Government officials will meet regularly with the IMF's resident representative to review the progress made in the implementation of the program. As indicated in the letter of intent addressed to the Managing Director of the IMF, two reviews are envisaged under the program: the first review will be based on economic performance at end-December 2009 and policy reforms inclusive of the tax reform initiatives anticipated for January 2010, and would be completed by March 2010; the second review will take place approximately six months thereafter, and will based on economic performance in the second half of the fiscal year (ending July 7, 2010).

Table I.1. Ethiopia. Quantitative Performance Criteria and Benchmarks 1/

(In millions of birr, unless otherwise indicated)

	2008/09	2009/10			
	July 7 Est.	September QB	December PC	March QB	July 7 PC
A. Quantitative performance criteria (PCs) and quantitative benchmarks (QBs)					
Floor on net foreign assets of the National bank of Ethiopia 2/ (In millions of U.S. dollar)	576	-260	-350	-278	-80
Ceiling on net domestic assets of the National Bank of Ethiopia 3/	4,939	3,420	4,784	6,214	6,945
Ceiling on net domestic financing of the general government 3/	0	2,496	1,983	2,895	5,823
Ceiling on net credit to public enterprises	7,500	1,806	3,338	5,258	6,270
Ceiling on new non-concessional external debt contracted or guaranteed by the public sector 4/ (In millions of U.S. dollar)	n.a.	500	500	500	500
Ceiling on outstanding external payments arrears 5/	n.a.	0	0	0	0
B. Adjusters to quantitative performance criteria					
Disbursed non-project external assistance (In millions of U.S. dollar)	728	0	250	350	670
C. Quantitative benchmarks					
Reserve money	7,608	478	824	3,069	6,604
Floor on federal government revenue collection	32,154	8,774	20,105	29,840	39,711

1/ Cumulative flow from the start of Ethiopia's fiscal year (July 8).
2/ Adjusted upward/downward for 100 percent of any non-project external assistance that exceeds/falls short of programmed amounts, subject to specified caps.
3/ Adjusted upward/downward for 100 percent of any non-project external assistance that falls short of/exceeds programmed amounts, subject to specified caps.
4/ Excluding the Ethiopian Airlines.
5/ This shall be a continuous performance criterion.

Table I.2. Ethiopia: Structural Benchmarks

	Date
Ensuring close monitoring of public enterprises	
• The public enterprise monitoring committee to receive annual financing and investment plans from all key public enterprises (ETC, EEPCo, Housing Agencies, etc.).	September 30, 2009
• Report progress in compliance with borrowing targets to the Minister of Finance and Economic Development on a monthly basis.	Continuous
Establishing a liquidity control framework	
• Establish a high level joint committee, comprised of NBE and MoFED staff, to exchange information on liquidity needs on a weekly basis.	September 15, 2009
• Develop a formal liquidity forecasting framework in manual form and prepare fortnightly forecasts of liquidity needs for use in setting auction volumes.	January 31, 2010
Tax reforms	
• The Minister of Finance and Economic Development to approve a tax reform strategy with a time-bound action plan covering both tax policies and administration.	January 31, 2010

APPENDIX I
ATTACHMENT II

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA
TECHNICAL MEMORANDUM OF UNDERSTANDING

Addis Ababa, August 7, 2009

I. INTRODUCTION

1. This memorandum sets out the understandings between the Ethiopian authorities and staff of the International Monetary Fund (IMF) regarding the definitions of quantitative performance criteria and indicative targets, for the program supported by the high-access component of the Exogenous Shocks Facility (ESF), as well as the mechanisms to monitor the program and related reporting requirements. To monitor the evolution of the economy during the program period, the Ethiopian authorities will provide the data listed in each section below to the African Department of the IMF, in accordance with the indicated timing (summarized in section IV.C.). The financial criteria will be monitored on the basis of the methodological classification of monetary and financial data that exists as of July 7, 2009.

2. For program purposes, the public sector consists of the general government (comprising the federal and regional governments) and public enterprises.

3. For program purposes, public enterprises refer to those entities under the term of "public enterprises" in the monetary survey provided by the National Bank of Ethiopia.

4. The quantitative targets for end-December 2009 and July 7, 2010 constitute performance criteria, and those at end-September, 2009 and end-March 2010 are quantitative benchmarks.

5. The program exchange rate of the Ethiopian birr to the U.S. dollar is set at 11.3145 birr = $1. The corresponding cross exchange rates and program gold price for the duration of the program are provided in table 1, which are the prevailing rates as of July 7, 2009.

Table 1. Program Exchange Rate Assumptions

Currency	US$/currency
Ethiopian Birr	0.0884
SDR	1.5461
Euro	1.3984
British pound	1.6338
Canadian dollar	0.8619
Gold ($/ounce)	925.75

II. Quantitative Performance Criteria and Benchmarks: Definitions and Reporting Standards

A. Floor for Net Foreign Assets (NFA) of the NBE

6. **Definition**. The NFA of the NBE are defined as the difference between gross foreign reserve assets and all foreign reserve liabilities of the NBE, including debts to the IMF and other long- and short-term liabilities of the NBE to nonresidents. For purposes of the program, foreign reserve assets shall be defined as monetary gold, holdings of SDRs, the reserve position in the IMF, and NBE holdings of foreign exchange in convertible currencies. Any such assets shall only be included as foreign reserve assets if they are under the effective control of, and readily available to, the NBE. Excluded from gross foreign reserve assets include capital participation in IFIs, any assets in nonconvertible currencies, holdings of precious metals other than monetary gold, encumbered foreign reserve assets, and foreign reserve assets pledged as collateral for loans and derivative contracts. Foreign reserve liabilities include any foreign currency denominated short-term loans or deposit (with a maturity of up to and including one year); NBE liabilities to residents and nonresidents associated with swaps (including any portion of the NBE gold that is collateralized) and forward contracts; IMF purchases; and loans contracted by the NBE from international capital markets, banks or other financial institutions located abroad, and foreign governments, irrespective of their maturity. Foreign reserve liabilities also include foreign-currency-denominated domestic liabilities of the NBE. For calculating the criteria, foreign reserve assets and liabilities shall be valued at the exchange rates prevailing on July 7, 2009 (see Table 1). It is understood that additional SDR allocation, if any during the program period, will have no impact on the NFA of the NBE.

7. **Reporting**. Data on gross foreign reserve assets and foreign reserve liabilities of the NBE will be transmitted to the African Department of the IMF on a monthly basis within 30 days of the end of each month. The NBE will also report the breakdown between liquid and unencumbered gross foreign reserve assets and those foreign reserve assets that are pledged, swapped, or encumbered.

B. Ceiling on Net Domestic Assets (NDA) of the NBE

8. **Definition**. The NDA of the NBE are defined to include net credit to the government, credit to enterprises and individuals, claims on banks, and other items net (see the monetary survey), but exclude foreign currency valuation adjustments.

9. **Reporting**. The monthly balance sheets of the NBE will be transmitted to the African Department of the IMF within 30 days of the end of each month.

C. Limit on the Net Domestic Financing of the General Government

10. **Definition**. The net domestic financing of the general government is defined as the sum of (i) the change in the net stock of claims of domestic banks and non-banks on the general government and (ii) any pending overdue bills. Net domestic bank claims consist of NBE and domestic commercial bank claims on the general government, including treasury bills and other general government liabilities, net of general government deposits with the NBE and domestic commercial banks. Non-bank claims comprise treasury bills, bonds, and other general government paper placed with non-bank institutions or with the public. For calculating the criteria, the bonds issued by regional housing agencies for condominium projects shall be excluded.

11. **Reporting**. Data on domestic financing (bank and non-bank) of the general government (including treasury bills and government bonds held by the nonbank public) will be transmitted on a monthly basis, within six weeks of the end of each month, except for the data on regional governments, which will be furnished within twelve weeks after the end of each quarter. Reporting on domestic and external arrears (i.e., overdue bills) will be monthly, within six weeks of the end of each month.

D. Ceiling on Net Domestic Credit to public enterprises

12. **Definition**. The net domestic credit to public enterprises is defined as the change in the net stock of domestic bank and non-bank claims on public enterprises. Net bank claims on public enterprises consist of NBE and domestic commercial bank claims on public enterprises, including loans, bonds, and other liabilities, net of public enterprise deposits with domestic commercial banks. Non-bank claims comprise loans, bonds, and other debt papers placed with nonbank institutions or with the public. For calculating the criteria, the bonds issued by regional housing agencies for condominium projects, and the loans extended by the Development Bank of Ethiopia to public enterprises shall be included.

13. **Reporting**. Data on credit (bank and nonbank) to public enterprises will be transmitted on a monthly basis, within six weeks of the end of each month

E. Ceiling on External Payment Arrears

14. **Definition**. External payment arrears are defined as debt service obligations incurred directly or guaranteed by the public sector to non-residents that have not been paid at the time they are falling due, as specified in contractual agreements, except on debt subject to rescheduling or restructuring. The program requires that no new external arrears be accumulated at any time under the arrangement.

15. **Reporting**. The accounting of nonreschedulable external arrears by creditor (if any), with detailed explanations, will be transmitted on a monthly basis within four weeks of the end of each month. This accounting would include, separately, arrears owed by the federal government and other public sector entities; and arrears owed to Paris Club creditors and non-Paris Club creditors. Data on the arrears that creditors have agreed to reschedule shall be provided separately.

F. Ceiling on Nonconcessional External Debt

16. **Definition**. External debt limits apply to the contracting or guaranteeing of nonconcessional external debt by the public sector. External debt includes debt as defined in the Annex (Point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted by the IMF on August 24, 2000) as well as commitments contracted or guaranteed for which value has not been received. Excluded from this limit are short-term import credits and long-term financing operations of Ethiopian Airlines. Concessionality will be based on a currency-specific discount rate based on the ten-year average of the OECD's commercial interest reference rates (CIRR) for loans or leases with maturities greater than 15 years and on the six-month average CIRR for loans or leases maturing in less than 15 years. Under this definition of concessionality, only debt with a grant element equivalent to 35 percent or more will be excluded from the debt limits. Excluded from this performance criterion are credits extended by the IMF and financing from the World Bank and African Development Bank (AfDB), and government counter guarantees on project loans from both the World Bank and AfDB. Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract is entered into, or guarantee issued.

17. **Reporting**. A loan-by-loan accounting of all new concessional and nonconcessional loans contracted or guaranteed by the public sector, including detailed information on the amounts, currencies, and terms and conditions, as well as relevant supporting materials, will be transmitted on a monthly basis within four weeks of the end of each month.

G. Ceiling on reserve money (quantitative benchmark)

18. **Definition**. Reserve money is defined as the sum of currency issued by the NBE (including the vault cash of commercial banks and currency outside banking system) and balances of commercial banks on accounts with the NBE.

19. **Reporting**. The monthly balance sheets of the NBE will be transmitted within six weeks of the end of each month.

H. Floor on federal government revenue collection (quantitative benchmark)

20. **Definition**. Federal government revenue is defined as the sum of all tax revenue and non-tax revenue collected by the federal government.

21. **Reporting**. Data on federal government revenue collection will be transmitted on a quarterly basis, within six weeks of the end of each quarter.

III. ADJUSTERS

I. Excess in Disbursed External Non-Project Financial Assistance

22. In case of an excess external non-project financing beyond the programmed amounts shown in Table 2 for the period July 8, 2009-July 7, 2010,

Table 2. Non-Project External Financing, 2009/10
(Cumulative quarterly flows, in millions of U.S. dollars)

July 8-Sep. 2009	Oct.-Dec. 2009	Jan.-Mar. 2010	Apr.-July 7 2010
0	250	350	670

- The floor on net foreign assets of the NBE will be adjusted upward by 100 percent of the disbursed non-project external financing in excess of the programmed amounts (comprising non project related loans and grants) at the end of each quarter, valued at the average exchange rate of the quarter.
- The ceiling on net domestic assets of the NBE will be adjusted downward by the amount of disbursed external financing in excess of the programmed amounts (comprising non project related loans and grants) at the end of each quarter, converted into birr at the average exchange rate of the quarter.
- The ceiling on domestic financing of the general government will be adjusted downward by the amount of external financing disbursed to the budget in excess of the programmed amounts (comprising non project related loans and grants) at the end of each quarter, converted into birr at the average exchange rate of the quarter.

J. Shortfall in Disbursed External Non-Project Financial Assistance

23. In case of a shortfall in external non-project financing below the programmed amounts, (comprising non-project loans and grants) shown in Table 2 for the period July 8, 2009–July 7, 2010:

- The floor on the NFA of the NBE will be adjusted downward by 100 percent of the amount of the shortfall below the programmed amount, up to a maximum adjustment of $150 million for the end-December test date and up to a maximum adjustment of $250 million for the July 7, 2010 test date The adjustment will be converted at the average exchange rate of the quarter.

- The ceiling on the NDA of the NBE will be adjusted upward by 100 percent of the amount of the shortfall below the programmed amount, up to a maximum adjustment of $150 million for the end-December test date and up to a maximum adjustment of $250 million for the July 7, 2010 test date. The adjustment will be converted into birr at the average exchange rate of the quarter.
- The ceiling on general government net domestic financing will be adjusted upward by 100 percent of the amount of the shortfall below the programmed amount, up to a maximum adjustment of $150 million for the end-December test date and up to a maximum adjustment of $250 million for the July 7, 2010 test date The adjustment will be converted into birr at the average exchange rate of the quarter.

IV. Other Reporting Requirements for Program Monitoring

K. Public Enterprise Monitoring Committee

24. The public enterprise monitoring committee, composed of senior officials from the Ministry of Finance and Economic Development, the NBE, and other relevant agencies, shall meet monthly and be responsible for monitoring public enterprises financing activities and recommending policy responses, if necessary. The committee shall provide the IMF with an update report on a monthly basis within six weeks of the end of each month.

L. Developments on Structural Performance Criteria and Benchmarks

25. The authorities will notify the African Department of the IMF of developments on structural benchmarks as soon as they occur. The authorities will provide the documentation, according to the dates in Table 2 annexed to the MEFP, elaborating on policy implementation.

C. Data Reporting

Information	Provider	Periodicity and due date
Gross international reserves and foreign liabilities of the National Bank of Ethiopia (NBE) Breakdown between liquid and unencumbered reserves and reserves that are pledged, swapped or encumbered	NBE	Monthly within 30 days of the end of each month
Net domestic assets of the NBE	NBE	Monthly within six weeks of the end of each month
Reserve Money	NBE	Monthly within six weeks of the end of each month
Net domestic financing of the general government Regional government's fiscal data	Ministry of Finance and Economic Development (MOFED)	Monthly within six weeks of the end of each month Quarterly within twelve weeks of the end of each month
Domestic Arrears	MOFED	Monthly within six weeks of the end of each month
External Arrears	MOFED	Monthly within four weeks of the end of each month
Domestic credit to public enterprises	NBE/MOFED	Monthly within six weeks of the end of each month
Federal Government Revenue	MOFED	Monthly within six weeks of the end of each month
New Nonconcessional External Debt contracted or guaranteed by the government	MOFED	Quarterly within four weeks
Non-project financial assistance	MOFED/NBE	Quarterly within 30 days
Public enterprise monitoring committee report	NBE	Monthly within six weeks
Consumer Price Index	NBE	Monthly within four weeks
National Accounts	MOFED	Within three weeks of any revision
Consolidated Budget Report of Federal and Regional Government	MOFED	Quarterly within twelve weeks
Monetary Survey	NBE	Monthly within six weeks
T-Bill auction details	NBE	Monthly within two weeks
Interbank exchange rate	NBE	Weekly within five business days
BoP data: Exports, imports, services, private transfers and capital account transactions	NBE	Quarterly within eight weeks
Volume and prices of fuel imports	NBE	Monthly within four weeks
Coffee exports	NBE	Monthly within four weeks

INTERNATIONAL MONETARY FUND

Executive Board Decision No. 6230-(79/140) (Guidelines on Performance Criteria with Respect to Foreign Debt) adopted August 3, 1979, as amended by Executive Board Decision No. 11096-(95/100) adopted October 25, 1995, and as amended on August 24, 2000
Point No. 9

(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. However, arrears arising from the failure to make payment at the time of delivery of assets or services are not debt.

INTERNATIONAL MONETARY FUND

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

Joint Fund/World Bank Debt Sustainability Analysis 2009

Prepared by the staffs of the International Monetary Fund
and the International Development Association

Approved by Mark Plant and Dominique Desruelle (IMF)
and Sudhir Shetty and Carlos Primo Braga (IDA)

August 11, 2009

Based on the joint World Bank-IMF debt sustainability framework for low-income countries, Ethiopia remains at moderate risk of debt distress.[9] *Compared to the previous DSA, however, external debt ratios are much closer to the indicative thresholds following a rapid rise in the external borrowing of public enterprises and weaker exports in 2008/09. This underscores the need to closely monitor borrowing of the largest public enterprises, to develop an integrated debt strategy for the entire public sector, and to undertake much needed structural reforms to attract large FDI and stimulate growth of exports.*

I. Background

1. **The last DSA undertaken in June 2008 concluded that Ethiopia was at moderate risk of debt distress**. Ethiopia reached its HIPC Initiative completion point in 2004 and benefited from debt relief under the MDRI in 2006. The debt relief provided under both initiatives helped to lower the external debt ratio to 7 percent of GDP in NPV terms at end 2007/08.[10,11] While the debt burden indicators were projected to remain below the policy dependent-thresholds for the whole projection period, it was shown that the indicative threshold for the NPV of debt-to-exports ratio would be breached under three stress tests (public sector loans on less favorable terms, lower export growth by 1 standard deviation below the historical

[9] "Operational Framework for Debt Sustainability Assessments in Low-Income Countries – Further Considerations," IDA/R2005-0056 and IMF Country No. 05/27.

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

[11] While Ethiopia has received debt relief from most of its creditors, it has not been able to reach agreement with Algeria, Bulgaria, India, Italy, Czechoslovakia and FR Yugoslavia, which account for over 4.4 percent of the debt stock in 2008/09. Agreements regarding Libyan arrears and Russian debts are at an advanced stage of negotiation and, thus, excluded from this DSA.

average, and applying one half standard deviation shocks to growth, exports and grants in the baseline scenario).[12]

2. **The new DSA differs from the previous one in that it excludes Ethiopian Airlines (EAL) from the calculation of debt burden indicators**. Although owned by the government, EAL is run on commercial terms and has continued to make strong profits even in the face of the global slowdown. EAL's debt was excluded from the performance criterion specifying a ceiling for new non-concessional debt in the last Fund-supported PRGF program because of its strong financial performance and its arms-length relationship with the government. Moreover, current debt contracts do not require a government guarantee.

3. **Ethiopia's current level of external public debt is low and largely concessional, though it is likely to change in the next 2–3 years**. The stock of debt (in PV terms) is set to rise from US$2.7 billion at the end of 2008/09 to US$6.0 billion by the end of 2010/11. The majority of the current debt is from multilateral creditors- around 51 percent of total outstanding debt. In recent years, however, the share of Paris Club creditors in total external debt has declined, while the share of non-Paris Club creditors has increased. Between 2006/07 and 2008/09, the share of Paris Club creditors has fallen from 16 to 8 percent and the share of non-Paris Club creditors (mostly from China and India) has increased from 19 to 35 percent—the bulk of the latter has been borrowed by major public enterprises to finance infrastructure investment. The share of commercial creditors has also fallen from 14 percent to 6 percent during the last two years.

4. **The updated DSA concludes that Ethiopia's risk of debt distress remains moderate, though the level of risk has increased since the last review**. The rapid rise in the financing of the public enterprises and weak export growth in 2008/09 have put the debt levels in terms of exports close to the ceiling. While the baseline projections remain below the indicative thresholds in all categories, the threshold for the NPV of debt-to-exports ratio is breached under four stress tests, one more than in last year's DSA.

II. Macroeconomic Assumptions

5. **The macroeconomic framework over the medium term is comparable to the one presented in the last DSA**. Export growth in goods is weaker, while growth in service exports is stronger with the net effect having minimal impact on the external current account. FDI is comparable with the projection made a year ago, while official transfers are projected to be down by about 1 percent of GDP per annum over the next five years.

[12] Based on the three-year moving average of the Country Policy and Institutional Assessment (CPIA) score, Ethiopia is classified as a medium performer. The thresholds for the debt burden for medium performers are 150, 40 and 250 for the NPV of debt to exports, GDP and revenue respectively. Under the same classification, thresholds for debt service are 20 and 30 percent of exports and revenue, respectively.

Box 1. Ethiopia: Macroeconomic Assumptions for the Baseline Scenario

Real GDP growth is projected to fall slightly to 7 percent in 2009/10, rising to 7½ percent over the medium term. This assessment assumes continued good harvests supporting agriculture and increased activity in services and industry. **The inflation rate** is projected to remain in single digits in response to tight monetary policies combined with the assumption of moderate commodity price increases.

The fiscal deficit (including grants) is projected to rise from 2.3 percent in 2008/09 to 3.0 percent of GDP in 2009/10 and beyond to facilitate priority spending.

The current account deficit (before official transfers) is projected to deteriorate to 12½ percent of GDP in 2009/10 before improving to average out at 7 percent of GDP over the long term.

Exports of goods are projected to rebound in volume terms by about 12 percent in 2009/10 and maintain healthy levels over the medium term, led by coffee, oil seeds, pulses, flowers, garments and leather products. However, export prices are projected to remain weak, growing at an annual rate of 1 percent. **Exports of services** are projected to grow at a faster rate (over 20 percent per annum) as the investments in the telecom and electricity sectors begin to pay financial dividends in terms of export receipts.

The pace of growth of **imports of goods and services** has slowed from 32 percent in 2007/08 to 9 percent in 2008/09 and is expected to decline further in the short-run before leveling off at an annual average rate of 11 percent.

Private transfers are projected to decline from 9.7 percent of GDP in 2007/08 to 6.8 percent of GDP in 2009/10 on account of global slowdown and to remain fairly constant in relation to GDP thereafter.

Foreign direct investment is envisaged to dip in 2009/10 but then to rise gradually over time to 2 ¾ percent of GDP because of expected improvements in the investment climate.

Official transfers are projected to decline by half a point of GDP to 4½ percent of GDP in 2009/10 and to stay at this level over the long run. **Loan financing** on concessional terms is projected to fall slightly to about 2¼ percent of GDP in 2009/10 and continue to decline to about 1 percent of GDP by 2028/29, associated with the diminished need for external financing over the longer term. Loan financing for public enterprises at non-concessional rates is projected to average over 2½ percent of GDP per annum over the next few years.

III. External Debt Sustainability Analysis

A. Baseline

6. **Under the baseline scenario, public and publicly guaranteed external debt will rise sharply in 2009/10, but will remain below the various thresholds**. In particular, the PV of debt to exports is projected to rise by about 52 percentage points to 137 percent and to rise further in 2010/11 to peak at 139 percent. Relative to last year's projections, the peak in the profile of the PV of debt has been brought forward for two reasons (see Text Table below). First, the pace of borrowing by public enterprises, especially in the telecom and electricity sectors, has accelerated considerably since the last DSA, raising the profile of the PV of debt in the immediate term relative to outer years. Second, exports of goods declined in value terms in 2008/09 and, given its low base, the export level over the next few years is projected to be considerably weaker than in the last DSA. The debt-to-GDP ratio has a similar hump-shaped profile to the debt-to-export ratio, but peaks in 2011/12 at about 18½ percent of GDP. The debt

service ratio remains below the threshold of 20 percent of exports, but is projected to rise rapidly over the next few years as a large fraction of new borrowing is for public enterprises on non-concessional terms.[13]

7. **Under the historical scenario, the debt burden indicators are comparable to those under the baseline scenario over the short term, but the debt ratios also remain elevated over the medium term**. The PV of debt to exports peaks at 137 percent in 2009/10 before dipping and settling at about 47 percent by the end of the forecast period. The profile of the PV of debt to GDP ratio also shows a hump-shaped profile and levels out at 12 percent of GDP.

Comparison of Indicators of PPG External Debt: Baseline Scenario

	2008/09	2009/10	2010/11	2011/12	2012/13	2020/21	2025/26
			PV of debt to exports ratio				
2008 DSA 1/	65.2	83.0	95.4	98.2	100.1	58.9	44.8
2009 DSA	84.8	136.8	139.0	131.6	118.8	51.1	37.9
			PV of debt to GDP ratio				
2008 DSA 1/	7.9	10.4	12.7	14.5	15.9	12.3	10.2
2009 DSA	8.0	14.8	17.6	18.5	18.4	11.1	9.0
			PV of debt to revenue ratio				
2008 DSA 1/	43.9	57.5	69.9	77.9	86.3	72.4	62.3
2009 DSA	60.0	105.1	122.3	123.5	121.4	73.8	59.7
			Debt service to exports ratio				
2008 DSA 1/	1.9	3.8	5.5	6.8	7.6	5.1	2.9
2009 DSA	2.0	7.4	8.5	10.3	10.7	4.9	2.6

1/ excluding Ethiopian Airlines debt

B. Sensitivity Tests

8. **Four stress tests yield a breach of the indicative threshold for the PV of debt to exports over the forecast horizon**. If the new public sector loans are negotiated on less favorable terms (200 basis point higher interest rate during the forecast horizon), the debt ratio peaks at 153 percent in 2010/11, slightly above the debt sustainability threshold (Table 1b). Similarly, if export growth is slower than the historical average by 1 standard deviation[14], the debt ratio peaks at 170 percent in 2011/12. Also, if the net non-debt creating flows (FDI and current transfers) are lower than the historical average by one standard deviation, the PV of debt

[13] Detailed information is not yet available to Bank staff to establish whether all the loans/credits undertaken or guaranteed by the Government meet the non-concessional borrowing limit of the Bank. The Finance Minister has recently assured the Bank team that the Government of Ethiopia has not to date incurred any loans on non-concessional terms.

[14] The historical average for growth of exports is based on last five years performance rather than 10 years, as stated in the DSF. This is because the structure of exports has significantly changed in recent years, with growing share of non-traditional exports like flower, garment and leather products.

to export ratio peaks at 159 percent in 2011/12. Finally, a combination of one half standard deviation shock to growth, exports, non-debt creating flows and foreign inflation, also shows a breaching of the threshold.

9. **The debt profile is sensitive to assumptions about export growth, the availability of FDI, and grant financing**. The baseline assumes that growth of exports of goods and services levels out at about 11 percent per annum at the end of forecast period, with slightly higher growth for service exports on account of the expected foreign exchange proceeds from large infrastructure investments in the electricity, telecommunication, and transportation sectors. In a scenario with slower export growth (8 percent per annum over the forecast horizon), possibly related to weaker than expected foreign earnings from the large public sector investments, the profile of the PV of debt to exports would show a peak above the indicative threshold in 2011/12, reaching 156 percent. Given the lingering uncertainties about the world economy and its impact on Ethiopia and the uncertainties surrounding the 2010 elections, it is possible that FDI and donor flows may decelerate to levels below the ones assumed in the baseline scenario (see uncertainty profile in Figure 1). Assuming smaller FDI financing and official transfers of two standard deviations in 2009/10 and 2010/11, which are substituted by commercial borrowing, the PV of debt to export ratio would reach a maximum of 142 percent.

10. **The inclusion of EAL in total external debt would raise the various debt indicators, but would not lead to a breach in the debt threshold in terms of the PV of debt to exports**. The PV of debt-to-exports would peak at 150 percent in 2010/11 and then gradually decline and approach the baseline by 2020/21.

IV. Fiscal Sustainability Analysis

11. **Under the baseline, public domestic debt in terms of GDP will continue to decline**. Despite significant borrowing by some public enterprises in 2008/09, domestic financing of the general government was reduced to zero. Moreover, negative real interest rates on public debt resulting from rising inflation have also helped reduce the real debt burden. Consequently, domestic debt is projected to decline to 18 percent of GDP by end 2008/09, down by about 7 percentage points from a year ago.

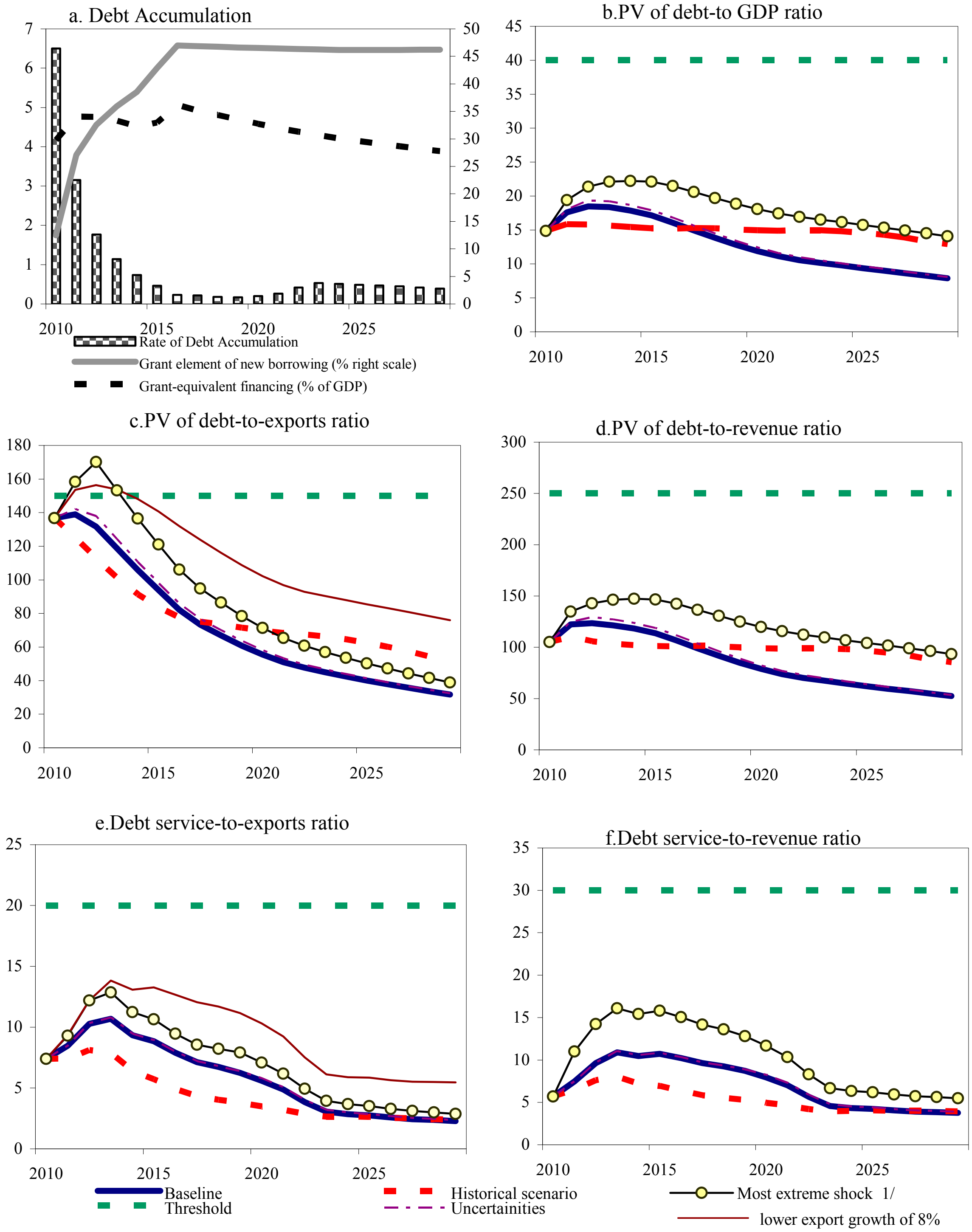
12. **With the increase in external debt, Ethiopia's public debt burden (including domestic debt) is expected to increase slightly, before trending down over the projection period**. The domestic debt profile is based on two assumptions: (i) domestic financing will gradually increase to 2 percent of GDP per annum, and (ii) real domestic interest rates will gradually become positive. While rising in the short-run, the PV of debt to GDP ratio is projected to peak at about 35 percent in 2010/11 and then gradually decline to 23 percent over the long term (Figure 2). The PV of debt to revenue ratio is projected to reach 198 percent by 2010/11 and then fall below 125 percent over the long term.

13. **Some stress tests show that the PV of debt to GDP will exceed 40 percent of GDP over a period of roughly three years**. If the real GDP growth slows down by 1 standard deviation from the historical average for two years, the PV of debt-to-GDP ratio would slightly exceed 40 percent between 2011/12 to 2014/15. A temporary shock to primary balances (historical average minus one standard deviation in 2011/12) would raise the debt ratio to 39 percent in 2011/12. Furthermore, with real GDP growth and primary deficits at historical levels, the debt-to-GDP ratio would increase gradually over the projected period. The PV of debt-to-revenue ratio would follow a similar path. These results highlight the importance of maintaining the growth momentum while continuing with adjustment efforts to correct the macroeconomic imbalances.

V. Conclusion

14. **Ethiopia remains at moderate risk of debt distress, though the level of risk is higher now than a year ago**. This assessment highlights the importance for Ethiopia of keeping a close tab on debt vulnerabilities and of making every effort to secure grant and concessional financing for its ambitious public enterprise investment plans. At the same time, there is considerable scope to attract large FDI and increase export growth by means of structural reforms. In addition, emphasis should be placed on strengthening debt management capacity as well as sharing detailed information on future borrowings—both external and domestic—with relevant stakeholders, such as the IMF and the Bank. Finally, given the size of borrowing by public enterprises, it is imperative to expand the current debt strategy and monitoring exercise to include the largest public enterprises and assess potential contingent liabilities.

Figure 1. Ethiopia: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2010-2030 1/



Source: Staff projections and simulations.

1/ The most extreme stress test is the test that yields the highest ratio in 2020. In figure b. it corresponds to a Terms shock; in c. to a Lower exports of 8% shock; in d. to a Terms shock; in e. to a Lower exports of 8% shock and in picture f. to a One-time depreciation shock

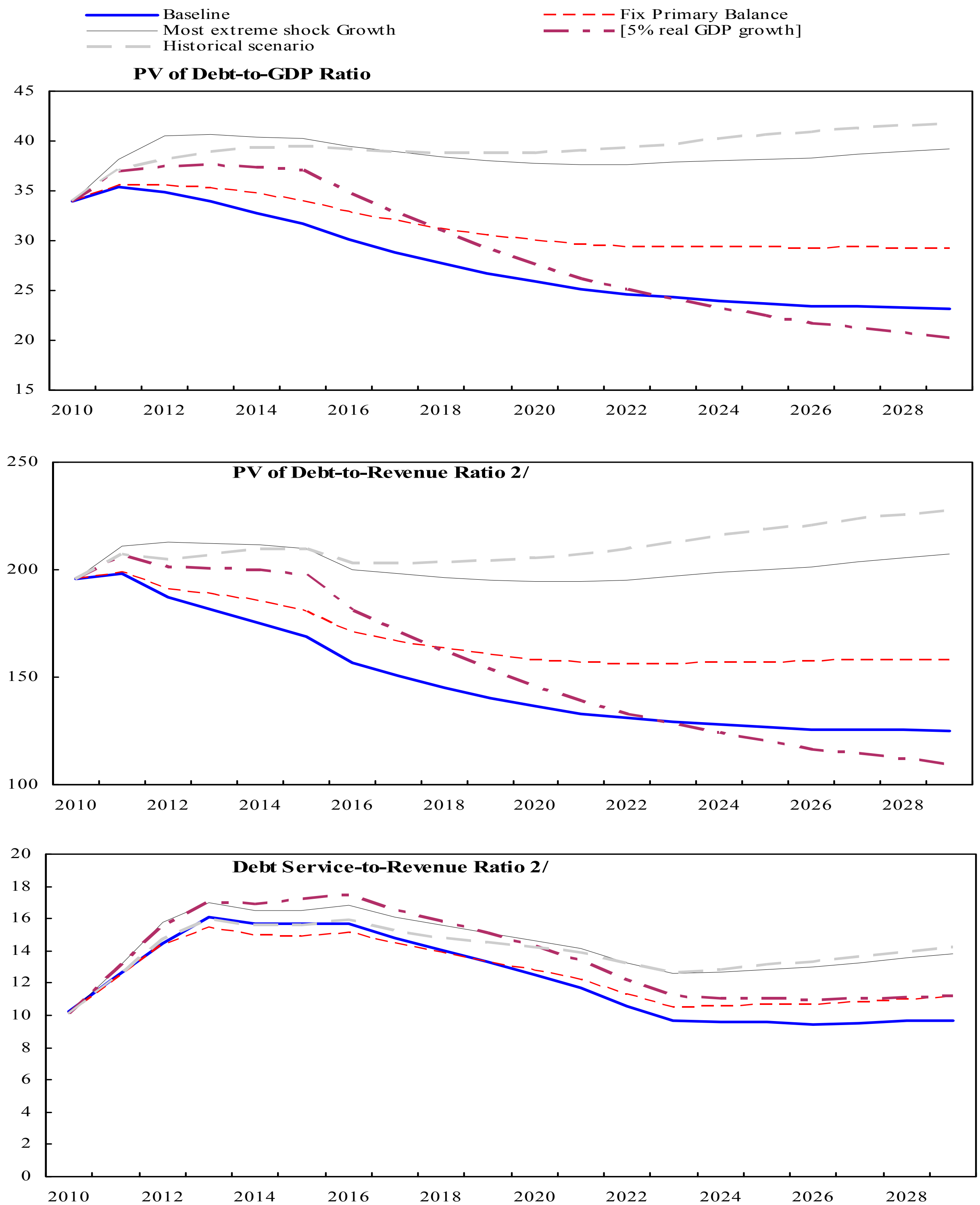
Table 1a.: External Debt Sustainability Framework, Baseline Scenario, 2007-2030 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average	Standard Deviation	Projections										
	2007	2008	2009			2010	2011	2012	2013	2014	2015	2010-2015 Average	2020	2025	2030	2016-2030 Average
External debt (nominal) 1/	**12.3**	**11.8**	**12.5**			**20.5**	**25.5**	**27.3**	**28.3**	**28.5**	**27.6**		**19.7**	**15.2**	**12.8**	
o/w public and publicly guaranteed (PPG)	10.7	10.9	11.9			20.0	24.1	25.1	25.5	25.3	24.9		18.9	15.2	12.8	
Change in external debt	-25.3	-0.5	0.7			8.0	5.0	1.8	1.0	0.2	-0.9		-1.4	-0.7	-0.6	
Identified net debt-creating flows	-6.4	-0.6	1.0			5.0	0.5	-0.5	-0.9	-1.5	-2.2		-2.1	-1.3	-0.7	
Non-interest current account deficit	**4.3**	**5.5**	**5.8**	**3.9**	**3.4**	**7.2**	**4.4**	**3.7**	**3.3**	**2.8**	**2.2**		**2.0**	**2.4**	**2.7**	2.2
Deficit in balance of goods and services	19.3	19.8	17.7			18.8	16.5	16.5	15.9	15.5	15.4		14.5	14.2	13.5	
Exports	12.7	11.6	9.4			10.9	12.7	14.0	15.4	16.9	18.3		21.4	23.3	24.9	
Imports	32.1	31.4	27.1			29.7	29.2	30.5	31.4	32.4	33.7		35.9	37.5	38.4	
Net current transfers (negative = inflow)	-14.8	-14.0	-11.8	-12.5	2.2	-11.4	-11.9	-12.4	-12.3	-12.3	-12.9		-12.1	-11.3	-10.8	-11.6
o/w official	-6.1	-5.0	-4.9			-4.6	-4.9	-4.9	-5.0	-5.3	-5.3		-4.9	-4.6	-4.4	
Other current account flows (negative = net inflow)	-0.3	-0.3	-0.1			-0.2	-0.3	-0.4	-0.4	-0.4	-0.4		-0.3	-0.5	0.0	
Net FDI (negative = inflow)	**-2.5**	**-3.1**	**-2.4**	**-2.0**	**0.6**	**-2.1**	**-2.7**	**-2.9**	**-3.0**	**-3.0**	**-3.0**		**-2.9**	**-2.7**	**-2.6**	-2.8
Endogenous debt dynamics 2/	**-8.2**	**-3.0**	**-2.5**			**-0.1**	**-1.3**	**-1.3**	**-1.2**	**-1.3**	**-1.3**		**-1.2**	**-1.0**	**-0.9**	
Contribution from nominal interest rate	0.2	0.2	0.2			0.7	0.7	0.8	0.8	0.8	0.8		0.3	0.2	0.1	
Contribution from real GDP growth	-3.7	-0.9	-0.2			-0.8	-2.0	-2.1	-2.1	-2.2	-2.1		-1.5	-1.2	-1.0	
Contribution from price and exchange rate changes	-4.7	-2.3	-2.4			…	…	…	…	…	…		…	…	…	
Residual (3-4) 3/	**-18.9**	**0.1**	**-0.3**			**3.0**	**4.5**	**2.3**	**2.0**	**1.7**	**1.2**		**0.7**	**0.6**	**0.2**	
o/w exceptional financing	-0.4	0.0	0.0			0.2	0.2	0.3	0.4	0.4	0.3		0.5	0.0	0.0	
PV of external debt 4/	...	...	8.6			15.4	19.0	20.6	21.1	21.0	19.9		12.7	9.4	7.9	
In percent of exports	...	...	91.6			141.9	150.1	147.0	136.8	124.7	108.7		59.2	40.3	31.8	
PV of PPG external debt	**...**	**...**	**8.0**			**14.8**	**17.6**	**18.5**	**18.4**	**17.9**	**17.1**		**11.9**	**9.4**	**7.9**	
In percent of exports	**...**	**...**	**84.8**			**136.8**	**139.0**	**131.6**	**118.8**	**105.9**	**93.9**		**55.6**	**40.2**	**31.8**	
In percent of government revenues	**...**	**...**	**60.0**			**105.1**	**122.3**	**123.5**	**121.4**	**118.4**	**113.7**		**78.9**	**62.1**	**52.4**	
Debt service-to-exports ratio (in percent)	**5.3**	**4.3**	**3.5**			**8.5**	**9.4**	**11.0**	**13.0**	**12.0**	**11.7**		**6.7**	**2.9**	**2.3**	
PPG debt service-to-exports ratio (in percent)	**3.0**	**2.6**	**2.4**			**7.4**	**8.5**	**10.3**	**10.7**	**9.3**	**8.9**		**5.6**	**2.7**	**2.3**	
PPG debt service-to-revenue ratio (in percent)	**2.7**	**2.2**	**1.7**			**5.7**	**7.5**	**9.6**	**10.9**	**10.5**	**10.7**		**8.0**	**4.2**	**3.8**	
Total gross financing need (Billions of U.S. dollars)	0.5	0.8	1.3			2.0	1.0	0.8	0.9	0.7	0.6		0.4	0.4	1.0	
Non-interest current account deficit that stabilizes debt ratio	29.6	6.0	5.1			-0.8	-0.5	1.9	2.2	2.6	3.1		3.4	3.1	3.3	
Key macroeconomic assumptions																
Real GDP growth (in percent)	12.7	9.7	2.1	8.3	5.0	6.4	9.8	8.5	8.1	8.2	8.0	8.2	7.9	8.0	8.0	8.0
GDP deflator in US dollar terms (change in percent)	14.3	23.0	26.1	7.9	11.7	-8.2	-6.8	-3.4	-1.2	-1.2	-1.1	-3.6	1.2	1.2	1.4	1.2
Effective interest rate (percent) 5/	0.6	1.6	1.8	1.0	0.5	5.6	3.4	3.1	3.3	3.1	3.0	3.6	1.7	1.0	1.0	1.5
Growth of exports of G&S (US dollar terms, in percent)	18.2	22.9	4.7	16.7	8.0	12.4	19.3	16.2	17.6	16.7	15.6	16.3	11.1	11.2	11.2	11.6
Growth of imports of G&S (US dollar terms, in percent)	13.0	32.1	11.1	24.2	11.7	7.0	0.6	9.5	10.0	10.3	11.0	8.1	9.8	10.6	9.5	10.2
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	12.5	27.1	32.6	35.9	38.5	42.9	31.6	46.5	46.2	46.2	46.4

Source: Staff simulations.

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

Figure 2.Ethiopia: Indicators of Public Debt Under Alternative Scenarios, 2010-2030 1/



Sources: Country authorities; and Fund staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2020.
2/ Revenues are defined inclusive of grants.

Table 1b.Ethiopia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2010-2030
(In percent)

	Projections								
	2010	2011	2012	2013	2014	2015	**2020**	2025	2030
PV of debt-to GDP ratio									
Baseline	15	18	18	18	18	17	**12**	9	7
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2010-2030 1/	15	16	16	16	15	15	**15**	15	12
A2. New public sector loans on less favorable terms in 2010-2030 2	15	19	21	22	22	22	**18**	16	13
A3. Customized Scenario- Uncertainity in 2010	15	18	19	19	19	18	**12**	10	7
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	15	19	21	20	20	19	**13**	10	8
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	15	18	20	20	20	19	**13**	10	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	15	17	18	18	17	17	**11**	9	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	15	19	22	22	22	21	**14**	11	8
B5. Combination of B1-B4 using one-half standard deviation shocks	15	17	19	19	18	18	**12**	9	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	15	26	27	27	26	25	**17**	14	10
PV of debt-to-exports ratio									
Baseline	137	139	132	119	106	94	**56**	40	28
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2010-2030 1/	137	125	113	101	91	84	**70**	63	47
A2. New public sector loans on less favorable terms in 2010-2030 2	137	153	152	143	132	121	**84**	67	51
A3. Customized Scenario- Uncertainity in 2010	137	142	138	124	111	98	**58**	41	28
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	137	139	131	118	105	93	**55**	40	28
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	137	158	170	153	136	121	**71**	50	34
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	137	139	131	118	105	93	**55**	40	28
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	137	153	159	143	128	113	**67**	46	31
B5. Combination of B1-B4 using one-half standard deviation shocks	137	154	161	145	129	115	**68**	47	32
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	137	139	131	118	105	93	**55**	40	28
B7. Lower export growth of 8 percent over the projection period	137	154	156	154	148	141	102	85	
PV of debt-to-revenue ratio									
Baseline	105	122	124	121	118	114	**79**	62	49.0
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2010-2030 1/	105	110	106	104	102	101	**99**	97	83
A2. New public sector loans on less favorable terms in 2010-2030 2	105	135	143	146	147	147	**120**	104	90
A3. Customized Scenario- Uncertainity in 2010	105	125	130	127	124	119	**82**	64	50
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	105	130	137	135	131	126	**87**	69	54
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	105	127	136	133	130	125	**86**	66	51
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	105	118	120	118	115	110	**76**	60	47
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	105	134	150	146	143	137	**95**	71	54
B5. Combination of B1-B4 using one-half standard deviation shocks	105	122	127	125	122	117	**81**	62	48
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	105	180	182	178	174	167	**115**	91	72

Table 1b.Ethiopia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2010-2030 (continued)
(In percent)

	Projections								
	2010	2011	2012	2013	2014	2015	2020	2025	2030
	Debt service-to-exports ratio								
Baseline	7	8	10	11	9	9	**6**	3	2
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2010-2030 1/	7	7	8	8	6	6	**3**	3	2
A2. New public sector loans on less favorable terms in 2010-2030 2	7	8	7	7	6	7	**5**	4	3
A3. Customized Scenario- Uncertainity in 2010	7	8	10	11	9	9	**6**	3	2
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	7	8	10	11	9	9	**6**	3	2
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	7	9	12	13	11	11	**7**	4	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	7	8	10	11	9	9	**6**	3	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	7	8	11	11	10	9	**7**	3	2
B5. Combination of B1-B4 using one-half standard deviation shocks	7	9	11	12	11	10	**7**	3	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	7	8	10	11	9	9	**6**	3	2
B7. Lower export growth of 8 percent over the projection period	7	9	12	14	13	13	10	6	0
	Debt service-to-revenue ratio								
Baseline	6	7	10	11	10	11	**8**	4	4
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2010-2030 1/	6	7	8	8	7	7	**5**	4	4
A2. New public sector loans on less favorable terms in 2010-2030 2	6	7	7	7	7	9	**8**	6	5
A3. Customized Scenario- Uncertainity in 2010	6	7	10	11	11	11	**8**	4	4
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	6	8	11	12	12	12	**9**	5	4
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	6	7	10	11	11	11	**9**	5	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	6	7	9	11	10	10	**8**	4	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	6	7	10	11	11	11	**9**	5	4
B5. Combination of B1-B4 using one-half standard deviation shocks	6	7	9	10	10	10	**8**	4	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	6	11	14	16	15	16	**12**	6	5
Memorandum item:									
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	40	40	40	40	40	40	**40**	40	40

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.
3/ Exports values remain permanently at the lower level, but the current account as a share of GDP returns to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 2a.Ethiopia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2007-2031
(In percent of GDP, unless otherwise indicated)

	Actual				Estimate	Projections								
	2008	2009	Average	Standard Deviation	2010	2011	2012	2013	2014	2015	2010-15 Average	2020	2030	2016-31 Average
Public sector debt 1/	35.5	29.9			38.0	40.7	40.8	40.4	39.6	38.7		32.5	27.8	
o/w foreign-currency denominated	10.9	11.9			20.0	24.1	25.1	25.5	25.3	24.9		18.9	12.8	
Change in public sector debt	-4.1	-5.6			8.1	2.7	0.1	-0.4	-0.8	-0.8		-1.0	-0.3	
Identified debt-creating flows	-9.5	-7.4			0.5	-0.6	-2.0	-1.9	-1.7	-1.5		-1.8	-1.2	
Primary deficit	2.1	1.8	3.1	1.4	1.4	1.1	0.6	0.4	0.5	0.8	0.8	0.6	0.8	0.6
Revenue and grants	18.0	17.0			17.3	17.9	18.6	18.7	18.7	18.8		19.0	18.5	
of which: grants	4.0	3.7			3.2	3.5	3.6	3.6	3.6	3.7		3.9	3.4	
Primary (noninterest) expenditure	20.0	18.7			18.7	19.0	19.2	19.1	19.2	19.6		19.5	19.3	
Automatic debt dynamics	-10.8	-8.8			-0.9	-1.7	-2.6	-2.3	-2.3	-2.3		-2.3	-2.0	
Contribution from interest rate/growth differential	-9.1	-7.3			-0.5	-1.6	-1.9	-2.3	-2.3	-2.2		-2.3	-2.0	
of which: contribution from average real interest rate	-5.6	-6.6			1.3	1.8	1.3	0.8	0.8	0.7		0.1	0.1	
of which: contribution from real GDP growth	-3.5	-0.7			-1.8	-3.4	-3.2	-3.1	-3.1	-2.9		-2.5	-2.1	
Contribution from real exchange rate depreciation	-1.7	-1.6			-0.3	-0.1	-0.7	0.0	0.0	0.0		...	...	
Other identified debt-creating flows	-0.8	-0.3			-0.1	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.4	-0.1			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
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	
Debt relief (HIPC and other)	-0.4	-0.2			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	5.4	1.7			7.7	3.3	2.1	1.6	0.9	0.6		0.7	0.9	
Other Sustainability Indicators														
PV of public sector debt	24.6	26.7			33.9	35.4	34.8	33.9	32.8	31.7		25.9	23.1	
o/w foreign-currency denominated	0.0	8.7			15.8	18.8	19.2	19.1	18.5	17.8		12.2	8.1	
o/w external	...	8.7			15.8	18.8	19.2	19.1	18.5	17.8		12.2	8.1	
PV of contingent liabilities (not included in public sector debt)	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	3.2	2.8			3.2	3.3	3.3	3.4	3.5	3.7		2.9	2.6	
PV of public sector debt-to-revenue and grants ratio (in percent)	136.9	157.1			195.5	197.9	187.2	181.0	175.2	168.6		136.4	125.1	
PV of public sector debt-to-revenue ratio (in percent)	176.5	200.1			239.9	245.8	232.8	224.3	217.2	209.8		171.4	153.5	
o/w external 3/	…	65.3			112.2	130.5	128.3	126.1	123.0	118.0		81.1	53.9	
Debt service-to-revenue and grants ratio (in percent) 4/	6.3	6.4			10.3	12.3	14.5	16.1	15.7	15.6		12.5	9.7	
Debt service-to-revenue ratio (in percent) 4/	8.1	8.1			12.6	15.3	18.0	20.0	19.4	19.5		15.8	11.9	
Primary deficit that stabilizes the debt-to-GDP ratio	6.1	7.4			-6.8	-1.6	0.6	0.7	1.4	1.6		1.6	1.1	
Key macroeconomic and fiscal assumptions														
Real GDP growth (in percent)	9.7	2.1	8.3	5.0	6.4	9.8	8.5	8.1	8.2	8.0	8.2	7.9	8.0	8.0
Average nominal interest rate on forex debt (in percent)	1.3	1.6	1.0	0.5	5.6	3.3	3.2	3.0	2.7	2.5	3.4	1.5	1.0	1.3
Average real interest rate on domestic debt (in percent)	-21.2	-27.0	-6.4	11.7	-2.9	-2.1	-1.9	-1.4	-1.3	-1.4	-1.8	0.8	1.0	0.8
Real exchange rate depreciation (in percent, + indicates depreciation)	-17.0	-14.7	-6.2	8.4	-2.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	30.3	40.9	11.7	14.6	7.1	6.7	7.3	6.8	6.7	6.8	6.9	7.0	7.0	7.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	…	…	12.5	27.1	32.6	35.9	38.5	42.9	31.6	46.5	46.2	...

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

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

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

3/ Revenues excluding grants.

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

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

Table 2a.Ethiopia: Sensitivity Analysis for Key Indicators of Public Debt 2010-2030

	Projections							
	2010	2011	2012	2013	2014	2015	2020	2030
PV of Debt-to-GDP Ratio								
Baseline	34	35	35	34	33	32	26	23
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	34	37	38	39	39	39	39	42
A2. Primary balance is unchanged from 2010	34	36	35	35	35	34	30	29
A3. Permanently lower GDP growth 1/	34	36	36	36	35	35	34	44
A4. Alternative Scenario :[Costumize, lower real GDP 5%]	34	37	37	38	37	37	28	20
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-2012	34	38	41	41	40	40	38	39
B2. Primary balance is at historical average minus one standard deviations in 2011-2012	34	38	39	38	37	36	29	25
B3. Combination of B1-B2 using one half standard deviation shocks	34	38	41	40	40	39	34	33
B4. One-time 15 percent real depreciation in 2011	34	39	38	37	35	34	28	24
B5. 10 percent of GDP increase in other debt-creating flows in 2011	34	42	41	40	39	38	30	25
PV of Debt-to-Revenue Ratio 2/								
Baseline	195	198	187	181	175	169	136	125
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	195	207	205	207	210	210	205	227
A2. Primary balance is unchanged from 2010	195	199	191	188	185	181	158	158
A3. Permanently lower GDP growth 1/	195	200	192	189	187	184	175	230
A4. Alternative Scenario :[Costumize, lower real GDP 5%]	195	206	201	201	200	198	146	110
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-2012	195	211	213	212	212	210	195	207
B2. Primary balance is at historical average minus one standard deviations in 2011-2012	195	210	212	205	199	192	154	134
B3. Combination of B1-B2 using one half standard deviation shocks	195	213	216	213	210	206	179	176
B4. One-time 15 percent real depreciation in 2011	195	215	202	195	189	181	145	131
B5. 10 percent of GDP increase in other debt-creating flows in 2011	195	233	220	213	207	200	160	138
Debt Service-to-Revenue Ratio 2/								
Baseline	10.3	12.3	14.5	16.1	15.7	15.6	12.5	9.7
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	10	12	15	16	16	16	14	14
A2. Primary balance is unchanged from 2010	10	12	14	15	15	15	13	11
A3. Permanently lower GDP growth 1/	10	12	15	16	15	15	14	14
A4. Alternative Scenario :[Costumize, lower real GDP 5%]	10	13	16	17	17	17	14	11
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-2012	10	13	16	17	17	16	15	14
B2. Primary balance is at historical average minus one standard deviations in 2011-2012	10	12	15	16	15	15	13	10
B3. Combination of B1-B2 using one half standard deviation shocks	10	13	15	17	16	16	14	12
B4. One-time 15 percent real depreciation in 2011	10	13	16	17	17	16	14	11
B5. 10 percent of GDP increase in other debt-creating flows in 2011	10	12	15	16	16	15	14	11

Sources: Country authorities; and Fund staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

INTERNATIONAL MONETARY FUND

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

Request for a 14-Month Arrangement under the Exogenous Shocks Facility

Informational Annex

Prepared by the African Department
(In consultation with other departments)

August 6, 2009

- **Relations with the Fund**. Describes financial and technical assistance from the Fund and provides information on the safeguards assessment and exchange rate system. Outstanding purchases amounted to SDR 33.43 million (25 percent of quota) at end-June 2009.
- **Joint Managerial Action Plan—July 2009–June 2010**. Describes the IMF's and World Bank Group's work program.
- **Statistical Issues**. Assesses the quality of statistical data. Data provided to the Fund are adequate for surveillance and program monitoring purposes.
- **Table of Common Indicators Required for Surveillance**. Provides information on statistical data for surveillance purpose.

Contents Page

ANNEX I

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA RELATIONS WITH THE FUND

(as of June 30, 2009)

I. **Membership Status:** Joined: December 27, 1945; Article XIV

II. **General Resources Account:**	**SDR Million**	**%Quota**
Quota	133.70	100.00
Fund holdings of currency	126.22	94.41
Reserve Tranche Position	7.51	5.62
Lending to the Fund		
Holdings Exchange Rate		

III. **SDR Department:**	**SDR Million**	**%Allocation**
Net cumulative allocation	11.16	100.00
Holdings	0.04	0.40

IV. **Outstanding Purchases and Loans**	**SDR Million**	**%Quota**
ESF RAC Loan	33.43	25.00

V. **Latest Financial Arrangements:**

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	Mar 22, 2001	Oct 31, 2004	100.28	100.28
PRGF	Oct 11, 1996	Oct 22, 1999	88.47	29.49
SAF	Oct 28, 1992	Nov 08, 1995	49.42	49.42

VI. **Projected Payments to Fund**[1/]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2009	2010	2011	2012	2013
Principal					
Charges/Interest	0.11	0.21	0.21	0.21	0.21
Total	0.11	0.21	0.21	0.21	0.21

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. Implementation of HIPC Initiative:

	Enhanced Framework
I. Commitment of HIPC assistance	
Decision point date	November 2001
Assistance committed by all creditors (US$ Million) [1/]	1,982.20
of which: IMF assistance (US$ million)	60.85
(SDR equivalent in millions)	45.12
Completion point date	April 2004

II. Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	45.12
Interim assistance	10.28
Completion point balance	34.84
Additional disbursement of interest income [2/]	1.54
Total disbursements	46.66

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

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

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI):

I. MDRI-eligible debt (SDR Million)[1/]	112.07
Financed by: MDRI Trust	79.66
Remaining HIPC resources	32.41

II. Debt Relief by Facility (SDR Million)

	Eligible Debt		
Delivery Date	**GRA**	**PRGF**	**Total**
January 2006	N/A	112.07	112.07

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

IX. Safeguards Assessment

According to Fund 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 has made progress in implementing the recommendations of the safeguards assessment. An update assessment is currently underway in the context of Ethiopia's Exogenous Shocks Facility approved in January 2009, and a safeguards mission visited Addis Ababa in July 2009.

X. Exchange Rate Arrangement

The de facto exchange rate regime is classified as a crawl-like arrangement, in light of the recent market developments. The authorities describe their exchange rate regime as a managed float with no predetermined path for the exchange rate, and the birr has steadily depreciated against the U.S. dollar. The pace of the depreciation, however, has been stable. Furthermore, the NBE supplies foreign exchange to the market based on plans established at the beginning of each fiscal year that took into account estimates of likely supply and demand. The transaction-weighted average interbank market exchange rate on July 17, 2009, was Br 12.4553 = US$1.

Ethiopia currently maintains four restrictions on the payments and transfers for current international transactions, which relate to (a) the tax certification requirement for repatriation of dividend and other investment income; (b) restrictions on repayment of legal external loans and supplies and foreign partner credits; (c) rules for issuance of import permits by commercial banks; 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 and remain unapproved.

XI. Article IV Consultation

Ethiopia is on the standard 12-month consultation cycle. The Executive Board concluded the last Article IV consultation on July 14, 2008 (IMF Country Report No. 08/264).

XII. Technical Assistance (2004–present)

Department	Purpose	Time of Delivery
STA	Monetary and financial statistics mission	January–February 2004
STA	Balance of payments statistics	April 2004
MFD	Payments system	May 2004
MFD	Bank supervision	July 2004
STA	Monetary and financial statistics	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
MFD	Bank supervision	June–July 2005
STA	Balance of payments statistics	July 2005
STA	Government finance statistics	August 2005
FAD	Tax administration	September 2005
MCM	Bank supervision	February 2006
MCM	Modernization of payment systems	March 2006
STA	Consumer price data	March 2006
FAD	Tax policy assessment	May 2006
MCM	Bank supervision	July 2007
MCM	Monetary operations	July 2007
MCM	Payment system	July 2007
AFE	Customs Administration	October 2007
FAD	Public expenditure management	December 2007
AFE	Macro-fiscal	January 2008
AFE	Program budgeting	January 2008
AFE	Banking Supervision	February 2008
AFE	Consumer price index	March 2008
MCM	Islamic banking regulation	April 2009
AFE	Banking Supervision	June 2009

XIII. Resident Representative

The IMF has had a resident representative office in Addis Ababa since 1993. The current Resident Representative, Mr. Sukhwinder Singh, took up the post in January 2009.

ANNEX II
THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA
JOINT MANAGERIAL ACTION PLAN
JULY 2009–JUNE 2010

Title	Products	Provisional timing of missions	Expected delivery date
A. Mutual information on relevant work programs			
The World Bank work program in the next 12 months	***Economic policy analysis and advice*:** • Annual Public Finance Review-2010 • Policy dialogue on economic reform issues, including private sector development, financial sector reforms and new industrial policy. • Regional Growth Report (Addis Ababa).	July 2009–June 2010 July 2009–June 2010 April 2009–December 2009	Q1 2010 Q3 2011 Q2 2009
	Technical Assistance: • Financial sector capacity building project • Second phase of programmatic poverty update -- support to poverty mapping activity • Strengthen the capacity of public sector (PSCAP-2) • Support for preparation for PASDEP-2 • Support to CSA for improving agricultural statistics as part of the "Agriculture Growth project."	July 2009–June 2010 TBC July 2009–June 2010 September 2009 July 2009-June 2010	June 2010 Q4 2011 Dec 2009 December 2009
The Fund work program in the next 12 months	**Macroeconomic policy analysis and advice** **IMF Program** • Discussions for a HAC ESF arrangement • The first review of the HAC ESF • Safeguards Assessments	Late 2009 (Article IV) June 2009 February 2010 July 2009	Early 2010 August 2009 March 2010 April 2010
	Technical assistance • Revenue administration and tax reform • Public financial management • Statistical capacity (government finance, national accounts, monetary/financial statistics, CPI)	August–December 2009 September 2009–March 2010 June 2009–April 2010	
B. Requests for work program inputs			
Fund request to Bank	• Periodic update on progress on FSCBP. • Macroeconomic and financial data to be shared on a regular basis.		
Bank request to Fund	• IMF Res Rep to actively participate in the working of the Macro Sub-Group. • Periodic update on all the three TA activities. • Macroeconomic and financial data to be shared on a regular basis.		
C. Agreement on joint products and missions			
Joint products in the next 12 months	Debt Sustainability Analysis		August 2009

ANNEX III

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA
STATISTICAL ISSUES
(as of July 2009)

I. Assessment of Data Adequacy for Surveillance

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

National Accounts: Shortcomings affect the accuracy and reliability of the data. First, the quality of GDP estimates by industry is affected by the poor coverage of construction activities. Second, while some progress has been made in making GDP estimates by final expenditure consistent with output-based measures, there remain substantial shortcomings, particularly in the estimation of private consumption and fixed capital formation. The statistical discrepancy in GDP estimates by expenditure categories has increased in recent years.

Government finance statistics: Despite recent improvements, fiscal balance statistics continue to be affected by shortcomings. Timely data on the consolidated operations of local governments is unavailable. Significant discrepancies between data on the domestic and foreign financing of the budget deficit and the monetary accounts continue to complicate assessment of fiscal developments. Ensuring the integrity of consolidated budget reporting in a timely fashion will be a continuing task.

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

Balance of payments: Balance of payments data still require improvements on coverage, valuation, timing, and classification of transactions. These include long delays in the collection of trade and tourist arrival data and poor data on capital flows.

II. Data Standards and Quality

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

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

ANNEX IV
ETHIOPIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(as of July 21, 2009)

	Date of Latest Observation	Date Received	Frequency of Data[6/]	Frequency of Reporting[6/]	Frequency of Publication[6/]
Exchange rates	July 17, 2009	July 20, 2009	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1/]	May 2009	July 2009	M	M	M
Reserve/base money	May 2009	July 2009	M	M	M
Broad money	May 2009	July 2009	M	M	M
Central bank balance sheet	May 2009	July 2009	M	M	M
Consolidated balance sheet of the banking system	May 2009	July 2009	M	M	M
Interest rates[2/]	April 2009	June 2009	M	M	M
Consumer Price Index	June 2009	July 2009	M	M	M
Revenue, expenditure, balance, and composition of financing[3/] – general government[4/]	December 2009	April 2009	Q	Q	Q
Revenue, expenditure, balance, and composition of financing[3/]– central government	March 2009	June 2009	Q	Q	Q
Stocks of Central government and central government-guaranteed debt[5/]	2007/08	November 2008	A	On mission	A
External current account balance	March 2009	June 2009	Q	Q	Q
Exports and imports of goods and services	March 2009	June 2009	Q	Q	Q
GDP/GNP	2007/08	November 2008	A	On mission	A
Gross external debt	2007/08	November 2008	A	On mission	A
International Investment Position	…	…	NA	NA	NA

1/ Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
2/ Both market-based and officially determined, including discount rates, money market rates, and 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, extrabudgetary funds, and social security funds) and state and local governments.
5/ Including currency and maturity composition.

Statement by Mr. Samuel Itam, Executive Director
for The Federal Democratic Republic of Ethiopia
August 26, 2009

We thank staff and Management for the candid and constructive dialogue with the Ethiopian authorities and their support for Ethiopia's request for an arrangement under the Exogenous Shocks Facility. We also thank staff for their excellent and comprehensive set of papers, which lay out the case for the requested balance of payments support.

Ethiopia's impressive economic performance over the last few years is being buffeted by spillovers from the current global economic crisis following last year's fuel and food prices shocks. The authorities' successful drive to generate rapid socio-economic development under the Program for Accelerated and Sustainable Development (PASDEP) enabled double-digit real GDP growth over the past five years and contributed to a general improvement in the quality of life for the people with significant reduction in poverty. However, the massive development effort also boosted imports, particularly of inputs, creating pressure on external reserves. This pressure was further exacerbated by the surge in fuel and food prices. Consequently, the authorities have been diligently and effectively implementing an adjustment program they designed to address the various shocks and macroeconomic imbalances with Fund support under the ESF/RAC.

Despite the authorities' efforts and adjustment policies, the continued global economic crisis has severely affected the Ethiopian economy. In the last six months, remittances, which play an important role in the economy, have declined significantly. Export growth has been constrained and exports receipts have decreased substantially. Some new export lines have been particularly hit hard. Other external resource inflows, especially foreign investment, have also fallen. Staff estimate that the adverse effects of the changed global environment on Ethiopia's balance of payments at about US $260–300 million or up to 140 percent of quota. However, the authorities believe that this understates the impact and that a more accurate assessment needs to be based on the trend magnitudes of FDI, remittances and aid flows prior to the global economic crisis. The declines from the trends together with the recent upward trend of oil prices and lower aid inflows have negatively affected the balance of payments outlook and underscored the need for greater support to assist the authorities' policies directed at a prudent level of international reserves and macroeconomic stability.

Policy implementation and economic performance during 2008/09

The authorities' strong commitment and diligent implementation of their adjustment policies have enabled them to attain their key objectives for 2008/09 and to sustain a robust economic performance under difficult conditions. They have maintained the zero domestic borrowing target for the general government, limited public enterprises borrowing, eliminated fuel subsidies, tightened monetary policy and adjusted the exchange rate of the birr. The vigorous policy implementation has enabled them to make significant advances in meeting the key challenges of high inflation and low reserves while sustaining the double-digit growth rate and development momentum. Consequently, inflation declined to 3 percent in the 12 months to June while international reserves improved to 1.8 months of import cover by end-June. Although the adjustment policies have been effective in addressing the impact of the fuel and food price shocks and other imbalances, the spillovers from the turbulent external environment pose new additional threats to the hard-won macroeconomic performance. Accordingly, the authorities have adjusted their economic policies and programs for the near term to meet the emerging challenges and maintain macroeconomic stability while sustaining the growth and poverty reduction objectives.

Economic objectives and policies for 2009/10

The authorities have recalibrated their economic objectives for the year ahead to focus on maintaining a slightly lower economic growth rate of 9 percent, an inflation rate in single-digits, while increasing international reserves to 2.1 months of import cover. While they expect to achieve their growth rate target they have used a lower rate (7 percent) in formulating their economic and financial program in light of uncertainties in the global economy. Building on their solid record of accomplishment and strong implementation, they have also adjusted their fiscal, monetary, exchange and external debt policies to achieve these near-term objectives while at the same time maintaining their focus on their long-term development objectives.

Fiscal policy and public sector management

The authorities are committed to maintaining a tight fiscal stance and intend to restrain domestic borrowing by the public sector to 3 percent of GDP in 2009/10. Nevertheless, they see the need to accommodate necessary investment that was curtailed in last year's drastic but necessary adjustment program. They are committed to improving domestic revenue mobilization and have requested Fund TA to this end. They also plan to seek additional financial assistance from their development partners to bring aid flows to at least last years' level. They intend to cut expenditures if domestic revenue falls below target and to reduce domestic borrowing levels if aid inflows exceed budgetary projections.

The authorities intend to continue and expand their regular scrutiny of public enterprises' borrowing. They, however, recognize the important role played by these public enterprises, particularly in the improvement of infrastructure critical to socio-economic development. The recent power shortage, which has hamstrung private and public sector activity, is a case in point that reflects the urgent need for such investment. While staff's concern with the build up of external debt to finance major infrastructure investment is appreciated, the recognition of the compelling need for such financing should also be appreciated. Moreover, the debt sustainability analysis undertaken by the Fund in conjunction with the appraisal of the ESF/HAC request reaffirms that the level of debt distress and the country's ability to repay the Fund will not worsen.

Monetary policy and exchange rate

The authorities intend to continue to focus monetary policy on containing inflation and supporting the gradual replenishment of international reserves. Their monetary program is anchored on controlling broad money growth, with reserve money serving as the operational target. To this end, the authorities intend to improve liquidity forecasting by enhancing the coordination between the National Bank of Ethiopia and the Ministry of Finance and Economic Development. The restrains on public sector borrowing and the international reserve targets will also open greater space for provision of credit to the private sector.

The authorities see the need for enhanced exchange rate flexibility and have undertaken two significant step depreciations of the birr to this effect. However, they also recognize the need to move judiciously and gradually in this respect in order to maintain expectations and not reignite inflation. In this respect, the authorities are convinced that the existence of significant demand pressure in the exchange market and the low level of reserves dictate caution in the tempo of adjustment.

The need for Fund support

A difficult external economic environment is threatening Ethiopia's impressive economic performance. Falling remittances, export receipts, foreign investment inflows are exerting pressure on the international reserves, which had already been weakened by the fuel and food prices surges. The authorities have formulated a focused set of macroeconomic policies and programs to address the emerging challenges. They have demonstrated a track record of speedy response and strong implementation of policies and programs. They believe that their adjustment policies and measures for 2009/10 complemented by the Fund support for SDR 153.755 million, equivalent to 115 percent under the ESF/HAC, will increase reserves to 2.1 months of import cover and ameliorate the adverse impact of the global recession. The authorities expect the Fund support to be an essential and timely input that will help them to sustain their effort to maintain macroeconomic stability and enhance growth.