



THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

October 2016

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

In the context of the 2016 Article IV Consultation, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its, September 26, 2016 consideration of the staff report on issues related to the Article IV Consultation.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 26, 2016, following discussions that ended on June 22, 2016, 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 30, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- A **Statement by the Executive Director** for The Federal Democratic Republic.

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International Monetary Fund
Washington, D.C.



INTERNATIONAL MONETARY FUND



Press Release No. 16/443
FOR IMMEDIATE RELEASE
October 4, 2016

International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2016 Article IV Consultation with the Federal Democratic Republic of Ethiopia

On September 26, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Ethiopia.

Ethiopia's macroeconomic outturn during the past year 2015/16 has been adversely affected by a severe drought and the weak global environment. As a result, output growth is estimated to have slowed down in 2015/16 to 6.5 percent. The slowdown was mitigated by effective and timely policy responses to the drought, and buoyant industrial and services sectors. Stability-oriented macroeconomic policies, including drought-related food imports, curbed inflationary pressures, with overall inflation receding to 6 percent in July 2016. A supplementary budget helped address the social costs of the drought, while keeping the general government deficit at 3 percent of GDP. However, the external current account deficit, estimated at 10.7 percent of GDP, remained wide. Export revenue stagnated due to weak international commodity prices, despite increases in export volumes and diversification to new export markets. Savings on fuel imports were more than offset by increased drought-related food imports and other imports. Remittances and FDI posted strong growth, helping to limit the deterioration of the external position. The foreign reserve buffer is less than 2 months of import coverage. The 2015/16 foreign borrowing requirement of the non-financial public sector is estimated at 5 percent of GDP, a significant reduction compared to the recent past. Public and publicly-guaranteed debt is estimated to have been 54.2 percent of GDP in June 2016, of which 30.2 percent of GDP corresponds to external debt.

Over the medium-term, growth is projected to recover to within the 7.3-7.5 percent range, reflecting the growth-oriented reforms envisaged in the recently adopted second Growth and Transformation Plan (GTP II). Public investment is projected to moderate, while private investment is projected to increase gradually, aided by better access to credit and anticipated improvements in competitiveness. Inflation is projected to remain at around 8 percent, consistent with the authorities' price stability objective, supported by supply expansion and the monetary

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

policy stance. The general government deficit is envisaged to hover at around 3 percent of GDP, with expenditure policies focused on capital and poverty-reducing programs. Export revenue is forecast to expand throughout the medium-term, underpinned by more stable commodity prices, competitiveness gains on account of key ongoing projects in logistic infrastructure, and greenfield FDI. Import growth is projected to remain robust and the current account deficit is projected to remain high, declining gradually over time.

Executive Board Assessment²

Executive Directors noted Ethiopia's track record of sustained rapid growth and poverty reduction. Directors commended the authorities for effective policy responses to the recent severe drought, aimed at mitigating social costs and limiting spillover effects. They concurred that, while the medium-term outlook is generally positive, downside risks remain arising from a large external imbalance and public sector savings-investment gap, and inadequate reserve buffers. Accordingly, they encouraged a macroeconomic policy mix to reduce the existing imbalances and their attendant risks. Directors welcomed the authorities' priorities for structural reforms as outlined in the second Growth and Transformation Plan, with a focus on economic and social development, as well as on private sector development.

Directors noted that, while external debt sustainability risks remain moderate, external vulnerabilities had worsened, as the external deficit and the recent pace of increase in external indebtedness were not sustainable over the medium term. They called for stepped-up efforts to reduce the external imbalance, and considered that the authorities' objective of increasing and diversifying exports is an appropriate response that would yield the highest growth dividend over the medium term. However, while export-oriented policies bear fruit, there is a need to contain imports and prioritize import-intensive investment projects to substantially reduce the current account deficit in the short term. Directors stressed that a tighter fiscal stance, while protecting the vulnerable, and a more flexible exchange rate would facilitate reducing external vulnerabilities and the necessary buildup of foreign reserves. They also welcomed the authorities' intention to refrain from new non-concessional borrowing.

Directors supported the authorities' goal to strengthen mobilization of domestic revenues to finance the development strategy and reduce the savings-investment imbalance. Fiscal revenues could be increased by introducing property taxes, reducing exemptions, and administration reforms to enhance taxpayer coverage and compliance. Directors also welcomed the remit of the new Ministry for Public Enterprises to strengthen the commercial profitability and governance of the key state-owned enterprises, while advancing in the privatization of those with a less strategic role. Fostering public sector oversight and transparency would enhance macroeconomic management and reduce fiscal risks.

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

Directors supported the authorities' efforts toward financial development and inclusion as essential to bolster domestic savings. They stressed the importance of adequate supervisory vigilance and strict provisioning of NPLs given the ongoing significant growth in financial intermediation. Directors welcomed plans to develop a broader range of indirect monetary policy instruments and an active inter-bank market. They encouraged the authorities to replace the current funding mechanism of the national development bank with a less distortive system.

Directors welcomed the authorities' structural reform agenda. They underscored the importance of strengthening competitiveness, creating an enabling environment for private sector development and foreign direct investment, and enhancing public sector governance.

Directors emphasized the importance of accurate, timely, and comprehensive data for the assessment of macroeconomic developments and effective policy responses. They urged the authorities to strengthen efforts to address data weaknesses, gaps, and delays, particularly on national accounts and public sector financial reporting, as well as to increase financial sector information.

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Ethiopia: Selected Economic and Financial Indicators, 2013/14–2015/16

	2013/14	2014/15	2015/16 (Est.)
	(Annual percentage change)		
National income and prices			
GDP at constant prices (at factor cost)	10.3	10.2	6.5
GDP deflator	11.0	6.4	10.6
Consumer prices (period average)	8.1	7.7	9.7
Consumer prices (end period)	8.5	10.4	7.5
External sector			
Exports (U.S. dollars, f.o.b)	8.4	-5.9	-1.7
Imports (U.S. dollars, c.i.f)	17.7	20.9	5.7
Export volume	2.9	-3.4	7.7
Import volume	22.0	27.9	14.9
Nominal effective exchange rate (end of period)	-2.8	2.6	-2.1
Real effective exchange rate (end of period)	2.6	10.0	3.1
	(Percent of beginning period stock of broad money, unless otherwise indicated)		
Money and credit			
Net foreign assets	0.5	-3.2	-3.2
Net domestic assets (including other items net)	26.4	27.5	24.4
Broad money	26.9	24.2	21.2
Base money (annual percentage change)	18.7	15.2	16.1
Velocity (GDP/broad money)	3.56	3.34	3.25
	(Percent of GDP, unless otherwise indicated)		
Financial balances			
Gross domestic savings	20.5	21.8	18.4
Public savings	5.0	3.5	2.3
Private savings	15.6	18.3	16.2
Gross domestic investment	38.0	39.3	39.7
Public investment	17.0	17.6	17.8
Private investment	21.0	21.7	21.9
Resource gap	-17.5	-17.5	-21.3
External current account balance, including official transfers	-7.9	-12.0	-10.7
Government finances			
Revenue	13.8	15.1	16.3
Tax revenue	12.5	13.4	13.5
Nontax revenue	1.2	1.7	2.8
External grants	1.1	1.1	1.0
Expenditure and net lending	17.5	18.6	20.2
Fiscal balance, excluding grants (cash basis)	-3.7	-3.6	-4.0
Fiscal balance, including grants (cash basis)	-2.6	-2.5	-3.0
Total financing (including residuals)	2.6	2.5	3.0
External financing	1.9	1.5	1.5
Domestic financing (not including privatization)	1.3	1.5	1.5
Public debt ¹	45.7	55.3	54.2
Domestic debt	20.5	24.3	24.0
External debt (including to the IMF)	25.2	31.0	30.2
Overall balance (millions of U.S. dollars)	-36	148	153
Gross official reserves (millions of U.S. dollars)	2496	3249	3402
(months of imports of goods and nonfactor services of following year) ²	1.5	1.9	1.9
GDP at current market prices (billions of birr)	1061	1237	1458

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

¹ Non-financial public sector debt.

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



THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

August 30, 2016

KEY ISSUES

Context. The newly issued five-year second Growth and Transformation Plan (GTP II) envisages continued high growth and public infrastructure investment, while placing a greater emphasis on private sector development and foreign direct investment (FDI), competitiveness, and export-oriented industrialization. A major drought and deterioration of the external environment resulted in a 2015/16 growth slowdown to an estimated 6.5 percent. Stability-oriented macroeconomic policies and effective policy responses, including food imports, to mitigate the drought's social costs kept inflation low and the budget deficit on target. The current account, however, posted for a second year a deficit above 10 percent of GDP.

Outlook and Risks. The medium-term baseline envisages growth rebounding to potential and exports recovering momentum as commodity prices stabilize, logistics infrastructure comes online, and GTP II structural reforms take hold. The main risks stem from external imbalances. The risk of external debt distress, currently assessed as moderate, is vulnerable to a worse-than-expected export performance.

Key Policy Issues. Macroeconomic policies should be geared towards reducing the current account deficit and mobilizing internal resources. Raising exports—the authorities' preference—is the first best option. But also, imports and public projects with substantial borrowing requirements will have to be paced according to export performance. After appropriately supporting activity during the drought, the fiscal stance will need to turn restrictive—aiming at over-performance in the 2016/17 budget execution. Achieving the ambitious GTP II objectives will require fostering market competition in key economic areas, including financial, and credit markets; expanding the share of credit and foreign exchange available to the private sector; and improving domestic revenue mobilization, public sector efficiency, and transparency.

Policy Recommendations. Staff broadly supported the authorities reform plans to promote private sector development and competitiveness, and to improve governance, savings, and efficiency within the public sector. Particularly, staff emphasized (i) revenue-enhancing tax policy and administration reforms, and public investment prioritization; (ii) market-based indirect monetary policy instruments and continued supervisory attention to credit quality; (iii) a more flexible exchange rate system to foster competitiveness; (iv) improvements in the business climate; and (v) reform of public enterprises' governance and financial transparency.

Approved By
Michael Atingi-Ego (AFR)
and **Bob M. Traa (SPR)**

Discussions were held in Addis Ababa during June 7– 21, 2016. The mission met with Prime Minister Hailemariam Desalegn, National Bank Governor Teklewold Atnafu, Minister of Finance and Economic Cooperation Abdulaziz Mohammed, Minister of Industry Ahmed Abteu, Minister of Trade Yackob Yalla, Advisor to the Prime Minister Arkebe Oqubay, and other senior officials and members of the donor and business communities. The staff team comprised Mr. Escolano (head), Ms. Radzewicz-Bak, Mr. Ramirez (all AFR), Mr. Hellwig (SPR) and Mr. Choi (STA). Ms. Gasasira-Manzi (OED) joined the mission’s meetings.

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RECENT ECONOMIC DEVELOPMENTS

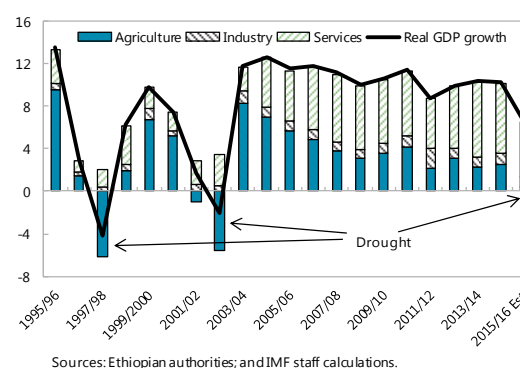
1. In October 2015, Ethiopia's authorities launched the second five-year Growth and Transformation Plan (GTP II), setting medium-term economic and social policy priorities (Annex IV).

Ethiopia has had an impressive track record of growth and poverty reduction in recent years, with GDP growth averaging 10.1 percent³ in 2010/11–2014/15,⁴ about 8 percent GDP per capita growth. Poverty has declined markedly and inequality, with a Gini index of 30 percent, is low by international and Sub-Saharan Africa (SSA) standards. However, income per capita is still low at US\$590, only slightly over one-third of the SSA average. The key GTP II goal is for Ethiopia to become a lower middle-income country by 2025, through average annual real growth of 11 percent in 2015/16–2019/20 (Table 1). While the public sector will continue playing an important role, the GTP II places a key emphasis on private sector development and FDI, particularly in building an export-oriented manufacturing sector. As in past national plans, growth targets are underpinned by envisaged rapid structural transformation and investments in energy generation, transportation, and infrastructure to boost productivity and competitiveness.

	Actual performance in 2014/15	GTP II Targets for 2019/20
<i>Annual growth rate (in percent)</i>		
Real GDP	10.2	11.0
Agriculture	6.4	8.0
Industry	9.7	19.8
Manufacturing	20.3	24.0
<i>As a share of GDP</i>		
Investment	39.3	41.3
Savings	21.8	29.6
Exports	9.8	20.6
Imports	27.3	32.3

2. **The Ethiopian economy coped well with a difficult 2015/16 year, when the country faced two adverse exogenous shocks.** Overall economic growth is estimated at 6.5 percent, placing Ethiopia once again among the world's fast-growing economies. This strong growth performance represents, however, a slowdown relative to last year due to the impact of the "El Niño"-related drought and a drastically weaker global environment, epitomized by the near 12 percent fall in the U.S. dollar value of world merchandise trade in 2015.

Figure 1. Ethiopia: Real GDP Growth and Contribution by Sector (Percent)

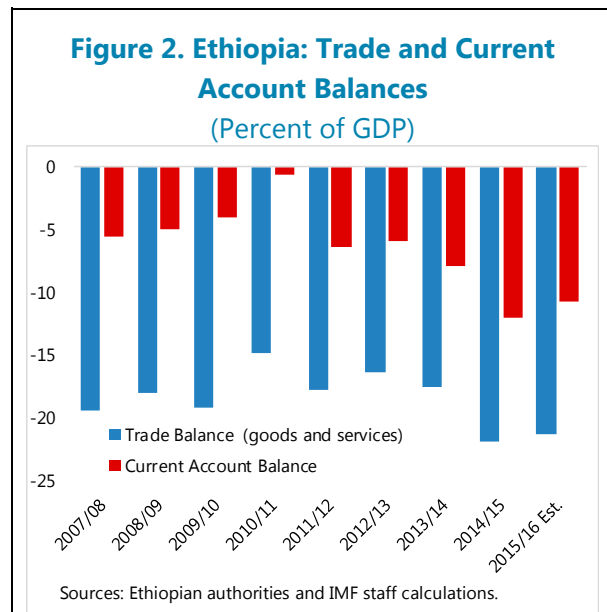


³ Historical GDP data published by the IMF are those issued by Ethiopia's Central Statistical Agency. Staff notes that GDP measurement continues to be affected by source data issues as identified by STA TA that are still not resolved (see paragraph 30).

⁴ The fiscal year runs from July to June.

3. **Targeted policies, buoyant industrial and service sectors, and increased agriculture resilience, helped to maintain growth momentum (Figure 1).** Official data including the Central Statistical Agency (CSA) crop production survey estimate an increase in grain production by 2.9 percent in 2015/16 (versus 7.5 percent in 2014/15), while other sources had pointed to a less favorable outcome.⁵ While the drought spared most export crops and mainly affected low-productivity regions, the social costs were large. Timely government interventions and food aid, coupled with improved agricultural practices, technology, and rural infrastructure, appear to have limited the economic impact of the drought relative to earlier drought episodes, including by helping to increase production in less-affected areas. Indirect indicators point to strong growth in industry (particularly construction and manufacturing) and services (notably trade, freight and passenger transportation, telecoms, tourism and hospitality, and financial intermediation).

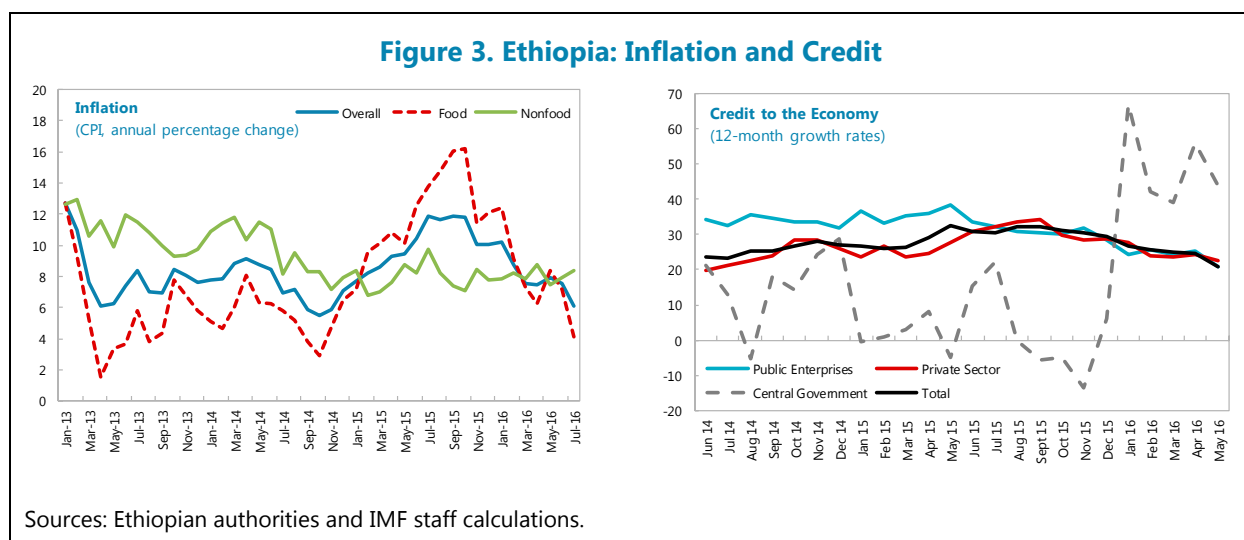
4. **The current account gap remained wide, owing to a weak external environment and imports of drought-related food, inputs, and capital goods – despite lower fuel import costs.** The current account deficit is estimated (as of July 2016) at about US\$7.4 billion (10.7 percent of GDP, Figure 2), broadly unchanged in U.S. dollars from last year. Export revenue stagnated as significant merchandise export volume growth (7.7 percent) was offset by sharp declines in Ethiopia’s export prices (16 percent for coffee, 33 percent for oil seeds, and 6 percent for gold). Import savings from lower fuel prices were more than offset by drought-related food, inputs and capital goods imports. Remittances posted strong growth (28 percent), as did FDI (44½ percent). The foreign reserve cushion, at 1.9 months of imports at end-June 2016 (unchanged from previous year), remains thin.



5. **Inflationary pressure was contained by imports and cross-regional redistribution of domestic market purchases of foodstuffs—supported by a restrictive monetary policy stance (Figure 3).** From an 11.9 percent peak in September 2015, headline inflation receded to 7.5 percent by June 2016, and 6 percent in July—in line with the National Bank of Ethiopia (NBE) inflation objective, driven by food price moderation. Base money grew broadly in line with the NBE target of 16 percent, despite a recent increase in net credit to the government, and the growth of credit to the non-government sectors moderated since December 2015. The NBE acquired a US\$1 billion external liability by end-2015, which eased foreign exchange availability, financed increasing food and other imports, and temporarily boosted reserves. Financial intermediation has continued to

⁵ A FAO report in February 2016 estimated crop losses at 14 percent. The US Department of Agriculture publication “Ethiopia: Grain and Feed Annual” of March 2016 estimated overall losses in major grain crops at 20 percent. As indicated in footnote 1, later in this report, and in the Informational Annex, deficiencies in source data persist which affect the overall estimation of national accounts.

advance at a fast clip with a 25 percent annual growth of bank deposits, supported by a 19 percent increase in bank branches (in the 12 months to December 2015).

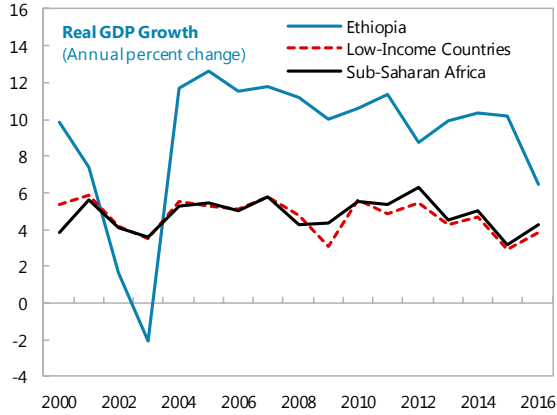


6. **The fiscal stance was appropriately supportive, aiming at minimizing the economic and social impact of the drought.** Tax revenue collection of the federal government is expected to be broadly in line with the annual budget plan, benefiting from good execution of direct and import taxes, while falling short in domestic VAT collection. On the spending side, the supplementary budget approved in December 2015 contained appropriations for food security, agriculture, and investments—funded by Oil Stabilization Fund surpluses (reflecting a limited pass-through of lower fuel import costs into domestic prices). The general government deficit is estimated at 3 percent of GDP. The total borrowing requirement of the non-financial public sector represented about 5 percent of GDP, a significant decline relative to recent years (Figure 4).

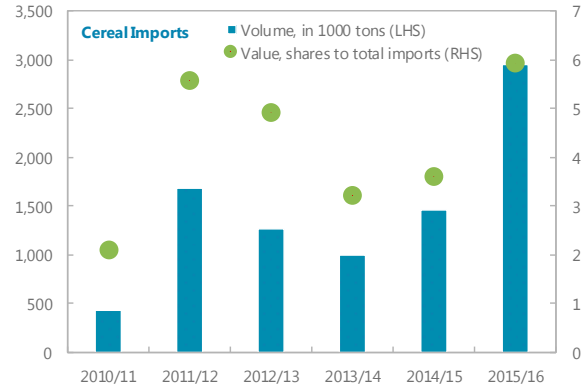
7. **Policy implementation was consistent with outstanding Fund advice in some areas, but less so in others.** Notably, the GTP II incorporates a focus on competitiveness, private sector development and FDI. The new Public-Private Partnerships (PPPs) legal and regulatory framework reform and Small and Medium Enterprises (SMEs) financing schemes will support private sector participation. The newly established Ministry of Public Enterprises' mandate for improved governance, and tax system reforms will strengthen public sector efficiency. Fiscal and monetary policies remained consistent with macroeconomic stability. However, Fund recommendations on interest rates, exchange rate, and financial sector policies are yet to gain momentum, including: (i) allowing for flexible determination of the interest rates, (ii) improving market functioning and price setting mechanism for the exchange rate and increase exchange rate flexibility, and (iii) phasing out the requirement that private banks invest in NBE bonds a 27 percent of their credit (to finance the Development Bank, DBE). Follow up on technical assistance (TA) recommendations to improve data quality and coverage has been mixed.

Figure 4. Ethiopia: Recent Economic Developments

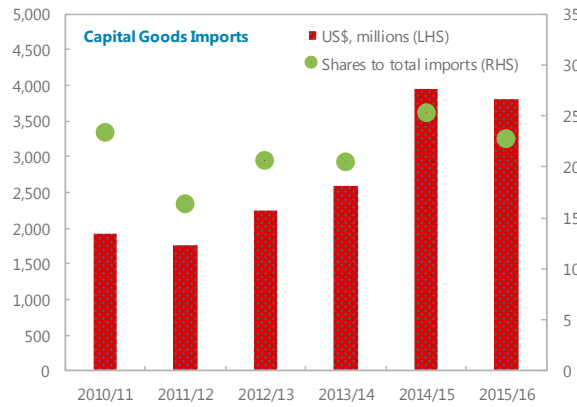
The growth performance slowed down in 2015/16, as Ethiopia faced severe drought conditions...



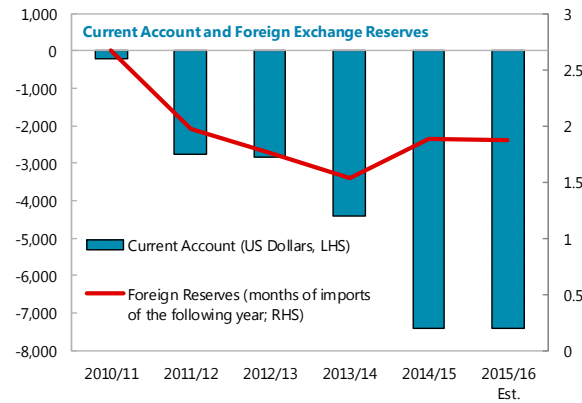
...which resulted in larger imports of cereal.



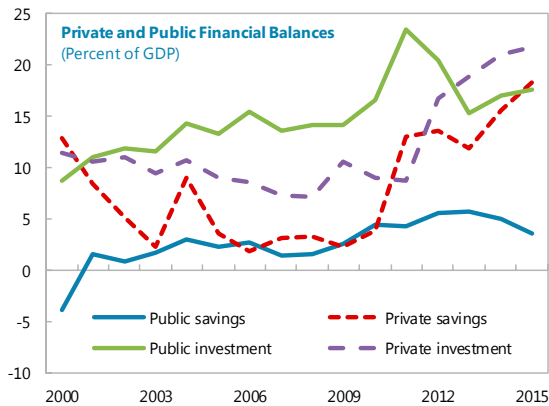
Imports of capital goods remained high...



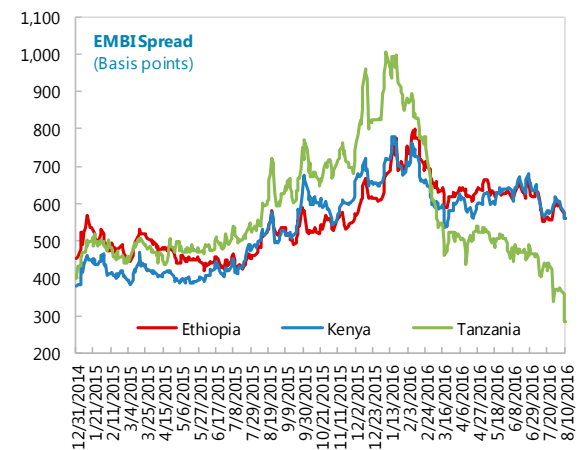
...maintain a wide current account deficit...



...reflecting a large savings-investment gap.



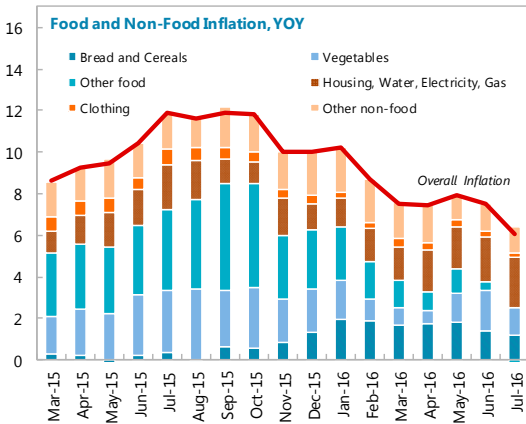
EMBI spreads have moved along with peers.



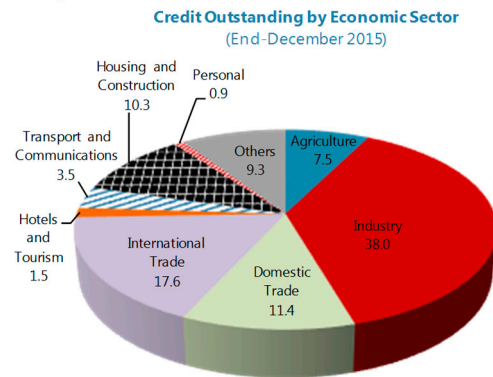
Sources: Ethiopian authorities; IMF staff estimate; World Economic Outlook; and Bloomberg.

Figure 4. Ethiopia: Recent Economic Developments (concluded)

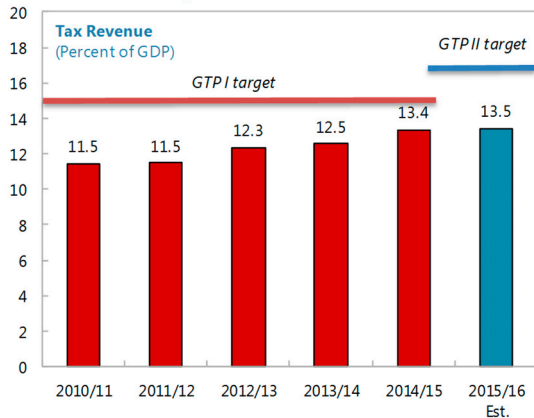
Inflation has receded to a single digit, in line with NBE inflation objective....



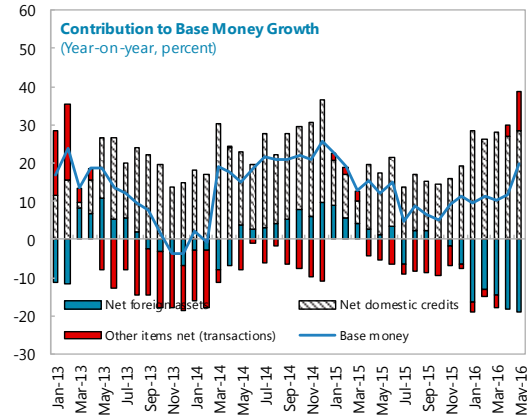
Most of the credit is channeled to the authorities' priority sectors (industry, foreign trade, agriculture, as well as housing and construction).....



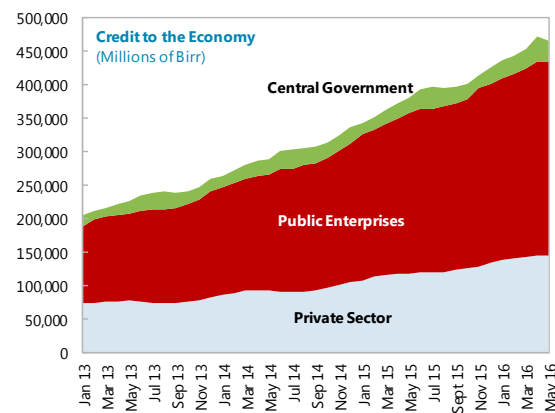
Tax revenue collection continues to remain below the ambitious GTP's targets.



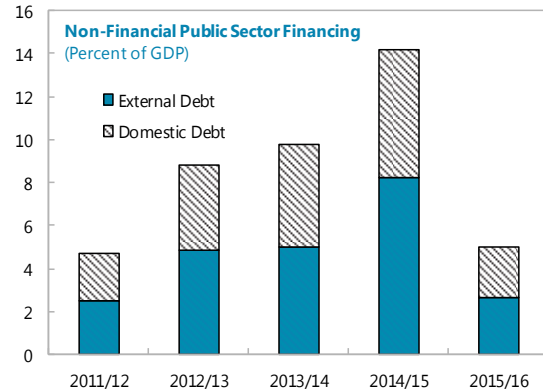
...partly on account of appropriate monetary policy....



... with public enterprises receiving the largest portion of credit.



Non-Financial Public Sector financing requirements have slowed down compared with the last year.



Sources: Ethiopian authorities; IMF staff estimate; World Economic Outlook; and Bloomberg.

MEDIUM-TERM OUTLOOK AND RISKS

8. **Growth is expected to rebound to 7.5 percent in 2016/17, as the weather-dependent agriculture normalizes, and remain at this level over the medium term, supported by strong GTP II growth-oriented reforms.** Inflation is projected to hover around 8 percent through the medium term, buttressed by more stable commodity prices and an appropriate monetary policy stance. Exports of goods and services should pick up substantially in the medium term from the current low base, reflecting the coming online of key infrastructure projects close to completion (in electricity generation and export logistics) and pay-offs from domestic investment and greenfield FDI. Import growth will remain moderate in 2016/17 as emergency food imports are phased out, but is likely to be strong thereafter, as waning public import-intensive investment is replaced by private sector imports. Thus, the current account deficit is projected to remain high and decline only gradually in the medium term.

9. **Against a generally positive outlook, the high current account deficit and a potential export underperformance (should adverse global conditions prove protracted) are the key downside risks (Box 1).** Additional external demand weakness and upturns in global risk aversion could hinder the current account improvement and financing, and hence output and debt sustainability. However, the risk of disorderly external stress episodes is mitigated by the high proportion of official bilateral and multilateral external debt (much of it concessional), a closed financial account, and the use of the borrowed funds for export-enhancing investment projects with expected high returns—increasing repayment capacity. On this basis, and assuming no further borrowing beyond existing plans, the Debt Sustainability Analysis (DSA) currently assesses the risk of debt distress at moderate, but the extended large breach of the debt to export ratio is of increasing concern. Over the medium-term, financing constraints on private sector development, weak export growth, slow implementation of revenue mobilization reforms, potential deterioration of bank assets quality in the wake of rapid credit growth and higher pace in acquisition of external liabilities are the main risks. Ethiopia remains vulnerable to climate change and droughts.

Authorities' views

10. **The authorities estimated growth in 2015/16 and medium-term output and export growth potential higher than staff.** The authorities emphasized rising export volumes, completion of key infrastructure projects, notably in energy generation and transportation, and measures to elicit export-oriented FDI, including commitments by international businesses to locate in the new industrial zones. In their view, these factors argued for two-digit medium-term growth potential, supported by export revenue growth of 32 percent in 2016/17 and about 17 percent subsequently, and continued strong remittances and FDI. Nonetheless, while seeing less downside risks than staff, the authorities concurred on the need to reduce the external deficit; take measures to ensure debt sustainability, consistent with the DSA moderate rating; and, should external revenue disappoint, adopt import-dampening policies.

POLICIES FOR RESILIENT GROWTH

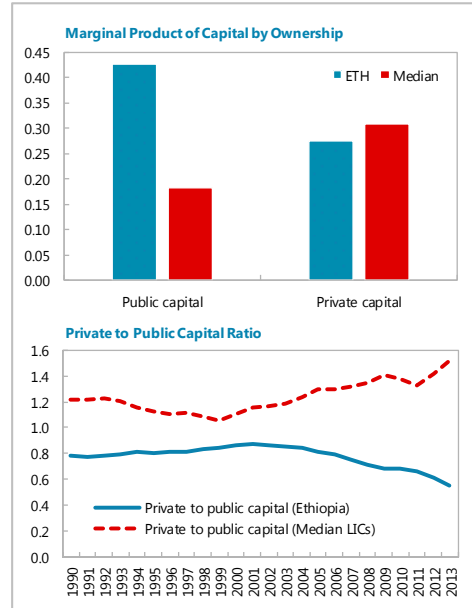
11. **Despite sustained growth, the bottleneck of the Ethiopian economy remains its large savings-investment gap and associated external borrowing requirement.** The current account deficit of the last two years, at about 7½ billion dollars and over 10 percent of GDP, is not sustainable. In the short term, macroeconomic policies should be geared towards reducing the external current account deficit and its attendant risks. To this end, the authorities' objective of rapidly rising exports is the first best option. However, at the same time, imports and large-scale public investment projects with substantial external borrowing requirements need to be paced according to the actual export performance. Specifically, public sector imports need to be curbed in the short term aiming at reducing demand for external credit. This would allow building up the foreign reserve buffer and avoid volatility in foreign exchange availability. Reaching the authorities' ambitious five-year GTP II growth objectives and sustained investment rates of almost 40 percent of GDP without aggravating external imbalances will require mobilizing domestic resources and raising domestic savings, particularly in the public sector—the main user of external borrowing.

12. **In the medium- and long-term horizon, mobilizing and attracting domestic and foreign private sector resources, as envisaged in the GTP II, will require challenging reforms.** After strong public sector-led growth under the GTP I, the authorities' objectives for the current phase of Ethiopia's economic development call for manufacturing expansion accompanied by rapid improvements in competitiveness, economic diversification, and the investment and business climate. This, in turn, requires fostering market competition within an increasing number of economic areas, including financial, credit, and investment markets; and expanding the allocation of resources to the private sector, such as credit and foreign exchange. It also requires increasing the efficiency and transparency of the public sector, including the tax system, public financial management processes, and public enterprise governance and financial management. Important steps in this direction, guided by the GTP II, are already in train—but will need to be scaled up and sustained.

Box 1. Ethiopia: Investing for Development

The marginal product of public capital in Ethiopia is above most peers, but the increasing relative scarcity of private capital calls for private sector development.

Based on staff panel estimations of Cobb-Douglas production functions using data from IMF and WEO databases, and the Penn World Table, the marginal product of public capital (0.42) in Ethiopia is significantly larger than the median of LICs (0.18)—consistent with a relatively good Public Investment Management Index (Dabla-Norris et al., 2012). Large public investments during more than a decade, however, have made private capital comparatively scarce, raising its marginal product and supporting the GTP II new focus on eliciting private investment and FDI.



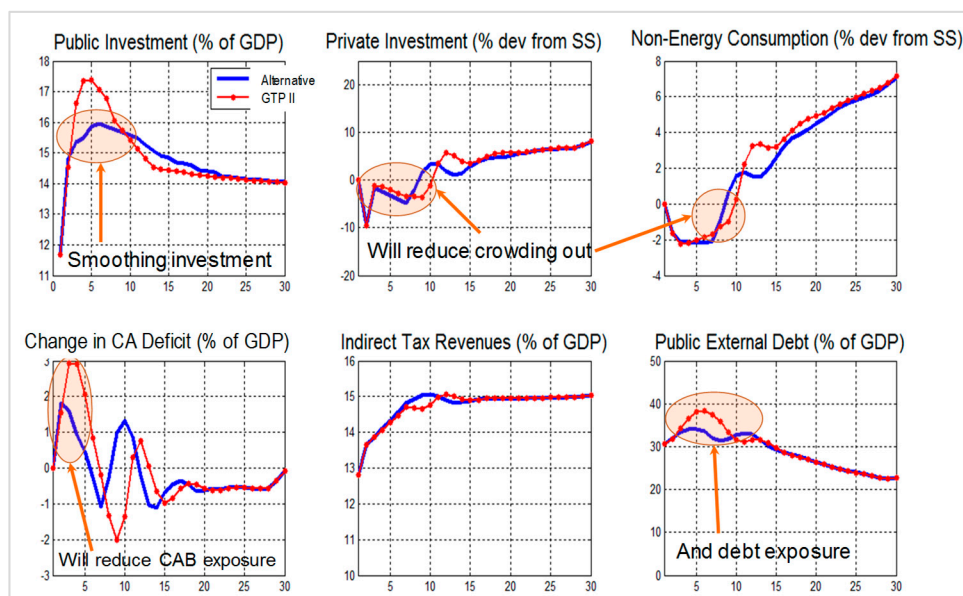
Model-based estimates point to large growth effects of infrastructure investment.

A version of the open-economy Debt, Investment, and Growth (DIG) model developed by Buffie et al. (2012), has been calibrated to the Ethiopian economy. The model simulates the public investment under the GTP II and ascertain the approximate size and time profile of their effects on growth, current account, private investment and debt. An alternative and more cautious investment path could result in more sustainable outcomes—less crowding out of private investment and consumption and lower current account deficit and public debt—with long-term gains in growth and consumption preserved. Decelerating public investment could help Ethiopia to cope with the short-term challenges associated to external imbalances and GTP II financing requirements. The model also highlights the importance of efficiency in public investment implementation and the risks of surges in the cost of external financing.

References

Dabla-Norris, Era, et al., "Investing in public investment: an index of public investment efficiency." *Journal of Economic Growth*.

Buffie, Edward, et al., "Public Investment, Growth, and Debt Sustainability: Putting Together the Pieces." IMF WP 12/144.

Box 1. Ethiopia: Investing for Development (concluded)**A. Fiscal Policy**

13. **The budgetary policy stance has been broadly appropriate, in response to the drought-related needs; however, curbing the external deficit will require tighter policies going forward.**

The relatively expansionary fiscal policy stance in recent months was appropriate to mitigate the transitory agricultural supply shock, associated adverse hysteresis effects, and spillovers to the rest of the economy; and to minimize social costs. However, fiscal expenditure restraint in the implementation of the 2016/17 budget, including under-execution of nonessential lines, and subsequent years should take priority as supply improves, aiming at curbing the public borrowing requirement. The de facto fiscal anchor is the budget deficit, which the authorities target at about 3 percent of GDP over the medium term. However, reducing external imbalances and shifting savings and financing resources to private sector development would be aided by a gradual reduction of the fiscal deficit from its current level by about ½ percentage point of GDP per year over the medium term, underpinned by revenue expansion.

14. **Decisive tax reforms are needed to support the ambitious GTP II targets for revenue mobilization.** The recently passed income tax law simplifies procedures, updates tax brackets, and improves the tax appeals process. Also, the newly introduced invoice-based taxation of imports is an important step in modernizing customs procedures and trade facilitation. However, achieving the GTP II objective of over 17 percent tax-to-GDP ratio by 2019/20 necessitates additional tax policy reforms, including the introduction of a property tax and review of existing tax expenditures and incentives. Property taxes have low distortive effects and, if allocated to sub-national levels of government, would reduce intergovernmental transfers. Annual review of tax expenditures would allow phasing out those

that are no longer cost-effective, while reducing tax complexity and the accumulation of tax loopholes. Regarding tax administration, measures need to focus on improving taxpayer coverage and enforcement, including by updating and maintaining the taxpayer register; using risk-based compliance monitoring; and improving IT systems, data quality, and their use.

15. **Prioritizing public investment, while protecting pro-poor outlays, would enhance fiscal sustainability and efficiency.** Given limited resources, public expenditure policy should focus on critical infrastructure and priority areas. Ongoing reforms of the PPPs legal framework provide an opportunity to improve public sector efficiency and private sector development, while attracting foreign resources. The envisaged new PPP framework, however, should be based on cost-benefit analysis and minimize fiscal risk.

16. **Comprehensive and upgraded fiscal reporting would support macroeconomic management and accountability.** Upgrading government accounting to 2001 Government Finance Statistics Manual (GFSM) standards is an urgent task. Policymaking as well as public understanding of policies would benefit from more comprehensive fiscal reporting covering budgetary institutions jointly with extra-budgetary accounts (such as the Oil Stabilization Fund, Privatization Fund, Industrial Development Fund, Road Fund, and use of Eurobond proceeds).

Authorities' views

17. **The authorities agreed with staff on the need to accelerate revenue mobilization.** They stressed that the adopted tax and administration reforms were an important step in this direction. Introduction of property taxes in the immediate future is not envisaged. They also agreed on reforms to enhance the PPP legal framework, which are under preparation including the creation of a unit to monitor potential fiscal risks. On expenditure policy, the authorities view it as correctly focusing on priority areas, with 2/3 of spending continuing to have a strong pro-poor focus.

B. Monetary and Financial Sector Policies

18. **A more flexible monetary policy framework would facilitate policy implementation.** The NBE uses reserve money, foreign exchange sales, and other direct monetary policy instruments with a view to keeping inflation near 8 percent. The NBE is considering revamping the primary market and introducing a secondary market for government securities—and eventually, possibly for other instruments—to develop interbank market operations. These initiatives and an increased role of indirect monetary policy instruments could substantially benefit policy implementation and liquidity management. They could encourage commercial banks to manage more actively their liquidity positions (through market transactions, rather than via direct access to the NBE's liquidity facilities), and enhance price discovery mechanisms and risk allocation.

19. **The authorities are making commendable progress in mobilizing domestic savings through rapid expansion of financial access and inclusion (Table 2).** Deposit mobilization and bank branch expansion are deepening financial intermediation and funding growth-promoting credit. The authorities' private sector development objectives would be aided by rebalancing the public sector credit demand towards the private sector to avoid its crowding out. Also, development of market-based

incentives for mobilization and allocation of savings will require positive real interest rates—facilitated by the NBE's progress in achieving lower inflation. Efficiency and growth gains will eventually exceed the increased public sector borrowing costs. In the short term, however, higher interest rates will need to be accompanied by fiscal and public sector measures to accommodate the associated higher financing costs. The current means of financing the Development Bank (DBE)—now through banks mandatory purchases of NBE bonds—should be replaced by less distortive mechanisms, including through the budget.

Table 2. Ethiopia: Financial Inclusion and Deepening¹

	Ethiopia	LICs ²
	<i>(annual growth rates)</i>	
Commercial bank branches	18.7	7.8
Deposits at commercial banks	24.8	...
Credit from commercial banks to non-government	29.8	...
	<i>(as percent of total)</i>	
Share of firms using banks to finance working capital	16.4	20.9
Share of firms using banks to finance investment	12.9	17.1
Share of population with an account at a financial institution (age 15+)	21.8	22.3

Sources: World Bank; Ethiopian authorities; and IMF staff calculations.

¹ Data for 2015 or the latest available.

² Averages for low income countries.

20. **A sound financial sector is critical for the mobilization and efficient allocation of savings.** Aggregate capital and profitability ratios of commercial banks do not indicate emerging vulnerabilities; and the system-wide NPL ratio remains low, below the statutory benchmark of 5 percent—although the lack of underlying detailed bank data preclude the assessment of individual bank vulnerabilities. There have occurred sporadic liquidity shortages, and the aggregate liquidity ratio is now close to the statutory minimum of 15 percent. While the rapid pace of financial deepening is welcome, strengthening the supervisory and regulatory environment is necessary to ensure that lending standards do not deteriorate. Risks related to credit exposures and their concentration should be assessed through regular stress-testing of commercial banks' balance sheets. Although not a deposit-taking institution, the ongoing supervisory attention to high NPL ratios in the DBE is warranted—since it could affect confidence or become a fiscal liability. Strengthening the AML/CFT framework, in line with the Financial Action Task Force standard, will also contribute to the soundness of the financial sector.

Authorities' views

21. **The authorities concurred in many areas, explaining that they plan to start secondary market operations in the near future.** Selected NBE and government bonds are to become tradeable during FY2016–17 in a secondary market—which will facilitate liquidity management—while real interest rates are likely to increase moderately. The authorities are considering alternative modalities for financing the DBE while strengthening its private sector financing role. While the NBE is carefully monitoring DBE's NPL ratios, the authorities pointed out that NBE's regulation requires the DBE to maintain provisions of 100 percent for NPLs.

C. Fostering Competitiveness through Structural Transformation

22. **Export diversification and upward shifts in the value-added chain are key items in the authorities' reform agenda.** Nascent export lines (leather, apparel, textile, flowers, electricity) and expansion to new markets point to good prospects,

supported by substantial cost differentials. However, export revenue still depends heavily on commodities, hindering income growth and amplifying volatility.

Ongoing policy initiatives aim at developing additional export lines with a focus on manufacturing and export-processing activities, notably with the creation of new industrial parks. These provide investors with simplified procedures, tax advantages, and preferential access to credit and foreign exchange. Eventually, however, the industrial park environment will need to be integrated more fully into the local value chain to generate all its potential of positive spillovers into the wider economy. Also,

progress in reducing trade barriers and enhancing the customs' trade facilitation role beyond industrial parks would increase competitiveness. The authorities are also launching other regulatory and administrative reforms aiming at improving the investment environment (Figure 5).



23. **An overvalued real effective exchange rate poses headwinds for exporters and understates the true economic cost of imports.** Staff assess the birr to be overvalued by 20 to 40 percent (Annex III). Allowing for a more flexible exchange rate determination, aiming to gradually eliminate misalignments, would bring the real effective exchange rate in consonance with fundamentals and reduce foreign exchange market shortages.

24. **Also, a more flexible exchange rate policy could be instrumental in developing new export lines and entering new markets (Box 2, Figure 6).** Staff research on Ethiopia's export dynamics, based on product-by-product disaggregated data, indicates that the (country-by-country) real exchange rate plays a crucial role in entering new markets—although significantly less so in increasing revenue from already established markets, which are mainly traditional commodities. As a consequence, the real appreciation of the Birr can pose an impediment to the emergence of a competitive manufacturing

exporting sector—and more generally to the export of non-commodity products with high domestic value-added facing price competition. Thus, exchange rate policies aiming to eliminate currency misalignments could play an instrumental role in achieving the authorities' export diversification objectives. Higher import costs for the public (and private) sector would partly have a desirable dampening effect on imports' demand—in line with a policy to reduce external imbalances—and partly would need to be absorbed through savings in other items; and in the longer term would be compensated by growth effects.

25. **Higher foreign reserves would enhance the resilience of the economy (Annex II).** Ethiopia remains vulnerable to commodity price and weather shocks. Reducing the current account deficit and expanding foreign reserve cover – aiming to eventually reach the standard of 5–7 months of imports - would forestall potentially disorderly import compression in the event of future shocks.

26. **The new policy agenda for public enterprises aims at streamlining the sector, improving its governance and efficiency, and raising its profitability.** The centralization of public enterprise management under a newly created ministry with this mandate is a valuable first step in this direction. The authorities are encouraged to implement expeditiously their plans to focus on 10–15 key public enterprises while privatizing the rest, strengthen their financial disclosure and transparency, and manage them on a commercial basis.

Authorities' views

27. **The authorities agreed with staff's emphasis on competitiveness-enhancing reforms.** They had launched initiatives to improve the business climate and facilitate exports—including logistics infrastructure provision. The authorities expressed concerns regarding the potential adverse impact on inflation and public sector costs from a more flexible exchange rate system. The authorities view the potential overvaluation of the birr substantially lower than staff's estimates. Over the next few years, the NBE plans to increase its reserve import cover target to three months (national definition, about 2½ months in standard definition).

Box 2. Ethiopia: Export Dynamics and Diversification

Over the past 15 years Ethiopia’s merchandise export revenue grew at 13.3 percent on average.

This strong performance stems from volume expansion (15.1 percent annually), as prices decreased by 2.3 percent annually. However, export growth—both price and volume—remains highly volatile, due to concentration on agricultural commodities exposed to price and weather shocks.

To reduce export volatility and increase revenue, policies aim at diversification across products and destination countries. Also, diversification has development spillovers, as less innovative firms follow in the wake of pioneer entrants. As a result, one third of 2015 export revenue comes from markets where Ethiopia was not present 15 years ago. FDI has flowed to horticulture and light manufacturing, and non-traditional exports account for more than 10 percent of total exports. For example, flower exports expanded from US\$440,000 and 5 destinations in 2004 to US\$225 million and 59 destinations now.

Staff analyses, based on disaggregated trade data (UN Comtrade), throw some light on the relative impact on export sales of two competitiveness factors: *structural* competitiveness, as measured by five indices from the Doing Business indicator, and the *real exchange rate* (RER). These factors are measured by market-specific trade-weighted indices of Ethiopia’s strength versus competitors.¹

Regression Results: Export Performance and Competitor Strength

	intensive margin	extensive margin	
	$\log(x_t) - \log(x_{t-1})$	probability of exit	probability of entry
$\log(x_{t-1})$	-0.94 **	-0.018 **	
dl_{RER}	-0.56	0.152	0.0004 **
$dl_{Time\ to\ export}$	0.25 **	0.016	0.0000
$dl_{Time\ to\ import}$	-0.10	-0.012	0.0002 **
$dl_{legal\ rights}$	0.30	0.005	-0.0002
$dl_{Time\ to\ start\ a\ business}$	-0.03	0.001	0.0000
Fixed effects	destination-year, destination-product, product-year	destination-year, destination-product, product-year	destination-year, product
N	8333	17204	1856834

Annual observations: 2006-2013; Sources: COMTRADE, World Bank, IMF.

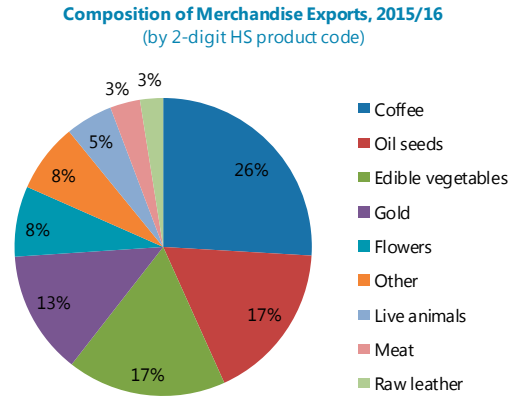
Notes: ** = significant at 1 pct level; dl_y denotes the change of index I_y .

The results (see table) indicate that the relative quality of logistics is key in improving export performance; and that the RER significantly facilitates entry in new markets—such as the above-mentioned case of flower exports. In markets where the “time it takes to export” index moved against Ethiopia (relative to competitors), exports fell significantly (first column). Similarly, the quality of Ethiopia vs. competitors’ trade logistics influences the probability of Ethiopia’s entry into new markets (third column). The RER seemingly matters little when it comes to expanding exports in existing markets (mostly commodities), but it is significant for entry into new markets (third column). Therefore, ongoing improvements in infrastructure, such as the new railway link to Djibouti harbor, are likely to boost exports. But also, Ethiopia could gain a foothold in new products and markets by reducing the substantial real exchange rate misalignment.

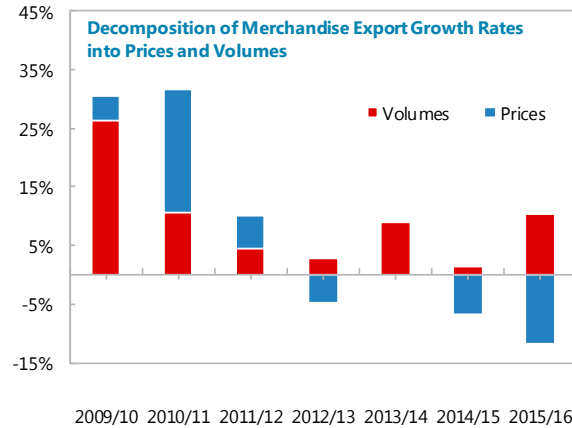
¹ Markets are identified by destination country and (4-digit Harmonized System) product.

Figure 6. Ethiopia: Export Diversification

Ethiopia's exports remain concentrated in basic commodities...



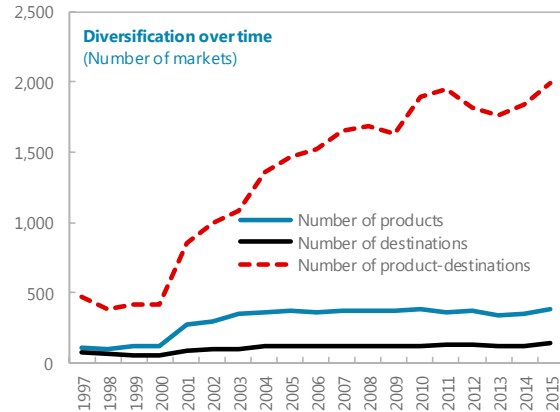
...which leaves the country vulnerable to global commodity price movements.



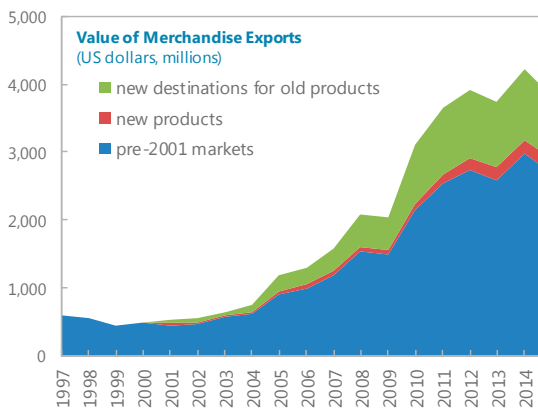
In recent years, higher value-added exports in non-traditional markets have increased substantially...



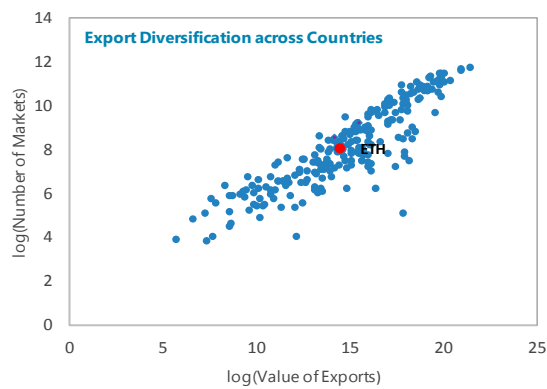
...and Ethiopian exporters have expanded into many new markets,



which are an important engine of export growth.



Cross-country comparisons show potential for further diversification.



Sources: Ethiopian authorities, IMF staff estimates, and UN International Trade Statistics.

D. Alternative Scenario

28. **Implementation of staff’s recommended policies could reduce Ethiopia’s external vulnerabilities and ease financing constraints, while at the same time support achievement of sustainable long-term growth (Table 7).** The implications of these policies would be: (i) a lower current account deficit and a stronger exports performance, owing to timely implemented structural reforms and measures aimed at fostering external competitiveness, including exchange rate flexibility; (ii) a more sustainable debt trajectory, as a result of spreading out low-return large-scale investments over time and reducing State Owned Enterprises’ (SOEs) borrowing requirements; (iii) higher foreign exchange reserves, thus reducing volatility in foreign exchange availability; (iv) higher tax revenue, with a view to closing the fiscal gap in the medium term; and (v) stronger domestic savings with a view to narrowing the savings-investment gap, and larger accumulation of financing for investment in the long term—facilitated by higher real interest rates. The growth trajectory will be lower initially (reflecting slower imports of capital goods), but higher in the medium run, as macroeconomic stability will be enhanced, and mobilization of domestic resources improved. It would also minimize the risk of externally-induced economic stress episodes. This is consistent with staff research (Box 1) indicating the need to elicit private investment and the positive role that a moderation in the pace of public investment could play in this regard.

The authorities envisage a substantially faster export and output expansion. Correspondingly, their assessment of future imbalances and associated risks to the baseline is more subdued than staff’s. They agreed on the need to reduce the current account deficit in the short term—mainly through the expected export expansion—as well as on policies to mobilize domestic resources and foster competitiveness and private investment. They also concurred, however, that in a hypothetical scenario of protracted progress in export gains, policies to re-profile import demand would be considered.

OTHER ISSUES

29. **While data provision is broadly adequate for surveillance, there continue to be issues with the quality and timeliness of some key data.** Publication of an extensive set of macroeconomic statistics by the NBE on a timelier basis has been an important positive development. However, national accounts statistics (especially from the expenditure side) remain work in progress, and economic growth, saving, and investment estimates are subject to considerable uncertainty—partly due to unreliable input data and survey methodologies. The authorities are receiving TA from AFRITAC East to build economic monitoring capacity and compile quarterly national accounts. On the financial sector, staff encouraged the authorities to provide more detailed information including commercial banks’ income, non-performing loans sectoral distribution, and loan-loss provisions. The government is working with the largest SOEs to produce audited financial reports.

30. **The NBE was subject to an update safeguards assessment in 2009.**⁶ The updated assessment found improved financial reporting and internal audit practices. Notwithstanding these developments, the assessment noted significant weakness. Recommendations focused on strengthening oversight of risks and controls, improving accounting records and the external audit process, and legal amendments to address safeguards weakness in the Central Bank Law. Since then, some progress has been reported on the outstanding safeguards recommendations, particularly the establishment of an audit committee, and capacity building for the internal audit function. Staff has recently received audited financial statements for the previous years together with the management letters issued by the NBE's external auditor. A full set of audited financial statements should also be published on the NBE's website (Informational Annex).

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

STAFF APPRAISAL

32. **The GTP II development priorities provide an appropriate agenda for medium-term macroeconomic policies with a focus on increased private sector participation.** Ethiopia has achieved rapid and inclusive growth over the last decade, led by agricultural transformation and public investments in infrastructure. Further progress requires structural reforms to foster market-based incentives for private investment and human capital accumulation. Thus decisive implementation of planned reforms to improve competitiveness and attract FDI, increase the availability of credit and foreign exchange to the private sector, and enhance the efficiency and transparency of the public sector are key.

33. **In the short term, policies should focus on reducing the external imbalance and its attendant risks.** Export growth is the first best policy to that end. However, in the immediate future, public projects that require considerable imports and external financing will need to be aligned with the actual export performance. A restrictive fiscal stance, aiming at under-execution of expenditure in the 2015/16 budget, would buttress efforts to reduce the current account deficit. A more flexible exchange rate regime aiming to narrow the substantial real effective exchange rate misalignment could promote export expansion and diversification, while helping to contain import demand. These measures would also help to build up the foreign reserve buffer and minimize the risk of potential disruptive episodes of sharp import compression.

⁶ The assessment, completed on December 2009, followed up on an initial safeguards assessment from September 2001.

34. **Mobilization of domestic resources will help narrow the savings-investment gap and fund growth-enhancing policies.** Fiscal revenues could be increased by introducing a property tax and by reviewing regularly tax incentives and repealing those that are no longer cost-effective. Ambitious collection targets call for tax administration reforms focusing on expanding taxpayer coverage and registration, improving the use of data and IT systems, and intensifying risk-based compliance monitoring. On the broader public sector, ongoing governance reforms of public companies could increase their profitability and growth contribution. Inclusive financial development remains essential to mobilize untapped domestic resources and fund investment and growth. Plans to accelerate development of inter-bank markets, indirect monetary policy instruments, and price-based allocation of liquidity are welcome—but they will require higher real interest rates. However, supervisory vigilance and strict provisioning of NPLs will be needed so that that rapid credit growth does not undermine financial soundness.
35. **Data are broadly adequate for surveillance, but efforts should be strengthened to address gaps and delays.** Ongoing data weaknesses should be addressed, including by implementing recent Fund technical assistance recommendations on national accounts and balance of payments. Greater transparency on granular financial stability indicators and on fiscal and public companies reporting would enhance policymaking as well as surveillance.
36. **The authorities are encouraged to consider accepting the obligations under Article VIII, Sections 2(a), 3 and 4, of the IMF’s Articles of Agreement in due course.** The authorities did not request and staff does not recommend approval of the exchange restrictions maintained inconsistent with Article VIII obligations.
37. **Staff recommends that the next Article IV consultation with Ethiopia be held on the standard 12-month consultation cycle.**

Table 3. Ethiopia: Selected Economic and Financial Indicators, 2013/14–2020/21

Social Indicators								
GDP			Poverty					
Nominal GDP (2015, billions of U.S. dollars)	61.6		Headcount ratio at \$1.90 a day (2010, percent of population)		33.5			
GNI per capita, Atlas method (2015, current US\$)	590		Undernourished (2015, percent of population)		32.0			
Population characteristics			Income distribution, 2010					
Total (2015, million)	89.8		Income shared by highest 10 percent of population		27.4			
Urban population (2015)	19.5		Income shared by lowest 20 percent of population		8.0			
Life expectancy at birth (2014, years)	64.0		GINI index		30.0			
Economic Indicators								
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
(Annual percentage change)								
National income and prices								
GDP at constant prices (at factor cost)	10.3	10.2	6.5	7.5	7.5	7.5	7.4	7.3
GDP deflator	11.0	6.4	10.6	9.5	8.6	8.1	8.5	8.4
Consumer prices (period average)	8.1	7.7	9.7	8.2	8.0	8.0	8.0	8.0
Consumer prices (end period)	8.5	10.4	7.5	8.0	8.0	8.0	8.0	8.0
External sector								
Exports of goods and services (U.S. dollars, f.o.b.)	8.4	-5.9	-1.7	15.5	12.0	12.0	12.0	12.0
Imports of goods and services (U.S. dollars, c.i.f.)	17.7	20.9	5.7	5.1	8.3	8.0	9.5	9.5
Export volume	2.9	-3.4	7.7	14.1	11.8	13.5	9.1	12.8
Import volume	22.0	27.9	14.9	4.4	6.6	7.2	9.1	8.8
Nominal effective exchange rate (end of period)	-2.8	2.6	-2.1	...	...	...	...	...
Real effective exchange rate (end of period)	2.6	10.0	3.1	...	...	...	...	...
(Percent of beginning-period stock of broad money, unless otherwise indicated)								
Money and credit								
Net foreign assets	0.5	-3.2	-3.2	1.6	2.1	3.2	3.0	1.2
Net domestic assets (including other items net)	26.4	27.5	24.4	23.7	19.6	15.5	14.2	16.4
Broad money	26.9	24.2	21.2	25.3	21.7	18.6	17.2	17.6
Base money (annual percentage change)	18.7	15.2	16.1	17.8	16.9	16.4	16.6	16.4
Velocity (GDP/broad money)	3.56	3.34	3.25	3.06	2.94	2.88	2.87	2.84
(Percent of GDP, unless otherwise indicated)								
Financial balances								
Gross domestic savings	20.5	21.8	18.4	19.6	19.7	20.2	20.0	20.2
Public savings	5.0	3.5	2.3	2.5	2.3	2.2	2.4	2.3
Private savings	15.6	18.3	16.2	17.1	17.4	17.9	17.6	17.9
Gross domestic investment	38.0	39.3	39.7	39.0	38.5	38.6	38.3	38.4
Public investment	17.0	17.6	17.8	16.8	16.0	15.7	15.1	14.1
Private investment	21.0	21.7	21.9	22.1	22.5	22.8	23.2	24.2
Resource gap	-17.5	-17.5	-21.3	-19.4	-18.9	-18.4	-18.3	-18.2
External current account balance, including official transfers	-7.9	-12.0	-10.7	-9.3	-8.9	-8.2	-8.1	-7.8
Government finances								
Revenue	13.8	15.1	16.3	16.1	16.2	16.8	17.5	17.9
Tax revenue	12.5	13.4	13.5	13.9	14.5	15.1	15.7	16.2
Nontax revenue	1.2	1.7	2.8	2.2	1.7	1.7	1.7	1.7
External grants	1.1	1.1	1.0	0.9	0.9	0.8	0.7	0.6
Expenditure and net lending	17.5	18.6	20.2	20.3	20.1	20.7	21.2	21.5
Fiscal balance, excluding grants (cash basis)	-3.7	-3.6	-4.0	-4.1	-3.9	-3.9	-3.8	-3.6
Fiscal balance, including grants (cash basis)	-2.6	-2.5	-3.0	-3.2	-3.0	-3.1	-3.1	-3.0
Total financing (including residuals)	2.6	2.5	3.0	3.2	3.0	3.1	3.1	3.0
External financing	1.9	1.5	1.5	1.3	1.1	1.0	0.9	0.8
Domestic financing	1.3	1.5	1.5	1.9	1.8	2.1	2.2	2.2
Public debt ¹	45.7	55.3	54.2	60.3	60.8	60.7	59.5	58.3
Domestic debt	20.5	24.3	24.0	25.1	25.4	25.8	25.6	25.4
External debt (including to the IMF)	25.2	31.0	30.2	35.1	35.4	34.9	34.0	32.8
Overall balance of payments (in millions of U.S. dollars)	-36	148	153	265	440	782	817	332
Gross official reserves (in millions of U.S. dollars)	2,496	3,249	3,402	3,666	4,107	4,889	5,706	6,038
(months of imports of goods and nonfactor services of following year) ²	1.5	1.9	1.9	1.9	1.9	2.1	2.2	2.2
GDP at current market prices (billions of birr)	1,061	1,237	1,458	1,718	2,008	2,337	2,724	3,170

Sources: Ethiopian authorities and IMF staff estimates and projections.

¹ Non-financial public sector debt.² The NBE definition for import coverage excludes food-aid and franco-valuta imports.

Table 4a. Ethiopia: General Government Operations, 2013/14–2020/21¹
(millions of birr)

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	158,078	199,639	251,636	293,288	343,981	410,924	494,064	586,562
Revenue	146,174	186,619	237,400	277,221	325,704	392,001	475,517	568,342
Tax revenue	133,119	165,312	196,202	238,944	291,006	352,027	428,915	514,106
Direct taxes	47,021	60,154	74,609	91,524	111,142	135,807	167,092	199,758
Indirect taxes	86,098	105,158	121,594	147,422	179,865	216,221	261,825	314,349
Domestic indirect taxes	40,499	52,368	61,757	77,601	95,987	118,718	144,571	177,698
Import duties and taxes	45,599	52,790	59,836	69,819	83,877	97,502	117,253	136,649
Nontax revenue	13,055	21,306	41,198	38,276	34,698	39,974	46,602	54,236
Grants	11,904	13,020	14,236	16,067	18,277	18,923	18,547	18,220
Program grants	2,510	2,866	1,074	2,121	2,140	1,528	1,782	2,074
Project grants	9,394	10,154	13,162	13,946	16,137	17,395	16,765	16,147
Total expenditure and net lending (cash basis)	185,472	230,521	295,114	348,224	404,139	483,293	578,445	681,608
Recurrent expenditure ²	78,087	113,376	157,223	165,748	171,722	195,628	225,541	263,140
Defense spending	7,489	8,814	9,500	11,000	12,500	14,000	16,321	18,995
Poverty-reducing expenditure ³	38,141	59,737	74,142	83,405	90,006	104,742	119,297	138,838
Interest payments	3,794	5,338	7,944	9,485	11,379	13,159	15,585	18,791
Domestic interest and charges	2,290	2,835	3,891	4,980	6,387	7,768	9,429	11,812
External interest payments ⁴	1,504	2,502	4,053	4,506	4,992	5,391	6,156	6,979
Other recurrent expenditure	28,663	39,487	65,638	61,858	57,837	63,727	74,338	86,516
Capital expenditure	107,385	117,146	137,890	182,476	232,418	287,664	352,904	418,468
Central treasury	82,175	91,887	106,472	151,314	197,413	250,234	315,974	381,901
External project grants	9,394	10,154	13,162	13,946	16,137	17,395	16,765	16,147
External project loans	15,816	15,105	18,257	17,216	18,868	20,036	20,165	20,421
Overall balance								
Including grants	-27,394	-30,882	-43,478	-54,937	-60,158	-72,369	-84,381	-95,046
Excluding grants	-39,298	-43,902	-57,714	-71,004	-78,435	-91,292	-102,928	-113,266
Financing	33,384	37,685	43,478	54,937	60,158	72,369	84,381	95,046
Net external financing	19,874	18,734	22,285	21,711	23,027	24,235	24,665	25,271
Gross borrowing	21,258	20,683	23,859	23,799	25,857	27,716	29,118	30,841
Project loans	15,816	15,105	18,257	17,216	18,868	20,036	20,165	20,421
Protection of Basic Services (PBS)	5,442	5,579	5,602	6,583	6,989	7,680	8,953	10,420
Amortization	-1,424	-1,950	-1,574	-2,089	-2,830	-3,481	-4,453	-5,570
<i>Memorandum items:</i>								
Total poverty-reducing expenditure	126,782	152,945	183,207	211,546	239,152	277,746	320,189	371,853
Primary fiscal balance, including grants	-23,600	-25,544	-35,534	-45,452	-48,779	-59,209	-68,796	-76,255

Sources: Ethiopian authorities and IMF staff estimates and projections.

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

² Excluding special programs (demobilization and reconstruction).

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

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

Table 4b. Ethiopia: General Government Operations, 2013/14–2020/21¹
(percent of GDP)

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	14.9	16.1	17.3	17.1	17.1	17.6	18.1	18.5
Revenue	13.8	15.1	16.3	16.1	16.2	16.8	17.5	17.9
Tax revenue	12.5	13.4	13.5	13.9	14.5	15.1	15.7	16.2
Direct taxes	4.4	4.9	5.1	5.3	5.5	5.8	6.1	6.3
Indirect taxes	8.1	8.5	8.3	8.6	9.0	9.3	9.6	9.9
Domestic indirect taxes	3.8	4.2	4.2	4.5	4.8	5.1	5.3	5.6
Import duties and taxes	4.3	4.3	4.1	4.1	4.2	4.2	4.3	4.3
Nontax revenue	1.2	1.7	2.8	2.2	1.7	1.7	1.7	1.7
Grants	1.1	1.1	1.0	0.9	0.9	0.8	0.7	0.6
Program grants	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Project grants	0.9	0.8	0.9	0.8	0.8	0.7	0.6	0.5
Total expenditure and net lending (cash basis)	17.5	18.6	20.2	20.3	20.1	20.7	21.2	21.5
Recurrent expenditure ²	7.4	9.2	10.8	9.6	8.6	8.4	8.3	8.3
Defense spending	0.7	0.7	0.7	0.6	0.6	0.6	0.6	0.6
Poverty-reducing expenditure ³	3.6	4.8	5.1	4.9	4.5	4.5	4.4	4.4
Interest payments	0.4	0.4	0.5	0.6	0.6	0.6	0.6	0.6
Domestic interest and charges	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.4
External interest payments ⁴	0.1	0.2	0.3	0.3	0.2	0.2	0.2	0.2
Other recurrent expenditure	2.7	3.2	4.5	3.6	2.9	2.7	2.7	2.7
Capital expenditure	10.1	9.5	9.5	10.6	11.6	12.3	13.0	13.2
Central treasury	7.7	7.4	7.3	8.8	9.8	10.7	11.6	12.0
External project grants	0.9	0.8	0.9	0.8	0.8	0.7	0.6	0.5
External project loans	1.5	1.2	1.3	1.0	0.9	0.9	0.7	0.6
Overall balance								
Including grants	-2.6	-2.5	-3.0	-3.2	-3.0	-3.1	-3.1	-3.0
Excluding grants	-3.7	-3.6	-4.0	-4.1	-3.9	-3.9	-3.8	-3.6
Financing	3.1	3.0	3.0	3.2	3.0	3.1	3.1	3.0
Net external financing	1.9	1.5	1.5	1.3	1.1	1.0	0.9	0.8
Gross borrowing	2.0	1.7	1.6	1.4	1.3	1.2	1.1	1.0
Project loans	1.5	1.2	1.3	1.0	0.9	0.9	0.7	0.6
Protection of Basic Services (PBS)	0.5	0.5	0.4	0.4	0.3	0.3	0.3	0.3
Amortization	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2
<i>Memorandum items:</i>								
Poverty-reducing expenditure	12.0	12.4	12.6	12.3	11.9	11.9	11.8	11.7
Primary fiscal balance, including grants	-2.2	-2.1	-2.4	-2.6	-2.4	-2.5	-2.5	-2.4

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

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

² Excluding special programs (demobilization and reconstruction).

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

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

Table 5. Ethiopia: Monetary Survey and Central Bank Accounts, 2013/14–2020/21

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	Act	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Monetary survey								
Net foreign assets	46,014	36,410	24,440	31,496	43,390	65,151	89,433	100,715
Central bank	26,821	29,973	10,954	17,066	27,950	48,630	71,756	81,800
Commercial banks	19,193	6,436	13,486	14,430	15,440	16,521	17,677	18,915
Net domestic assets	251,585	333,337	423,623	530,028	640,140	745,854	861,086	1,017,353
Domestic credit	300,473	394,083	500,971	564,848	656,261	766,674	879,266	1,021,437
Claims on government (net) ¹	26,631	30,736	48,315	65,829	86,896	116,336	154,259	198,670
Claims on nongovernment	273,842	363,348	452,656	499,020	569,366	650,338	725,007	822,767
Public enterprises	181,900	242,927	301,400	320,688	360,718	406,429	440,365	491,159
Private sector	91,942	120,421	151,257	178,331	208,648	243,909	284,642	331,608
Broad money	297,599	369,747	448,063	561,524	683,530	811,005	950,519	1,118,068
Money	133,916	153,179	177,931	222,521	269,000	313,393	357,460	420,438
Currency outside banks	53,161	60,496	72,235	90,882	108,032	129,624	156,543	184,095
Demand deposits	80,755	92,683	105,696	131,639	160,968	183,770	200,917	236,343
Quasi money	163,683	216,568	270,132	339,003	414,531	497,612	593,059	697,630
Savings deposits	136,334	174,699	218,763	268,224	327,983	388,327	465,715	547,833
Time deposits	27,349	41,869	51,369	70,779	86,548	109,285	127,343	149,797
Central bank								
Net foreign assets	26,821	29,973	10,954	17,066	27,950	48,630	71,756	81,800
Foreign assets	48,216	66,818	67,580	73,692	84,576	105,256	128,381	138,426
Foreign liabilities	21,395	36,844	56,626	56,626	56,626	56,626	56,626	56,626
Net domestic assets	62,130	72,494	107,977	123,034	135,827	142,007	150,527	176,937
Domestic credit	84,469	100,434	124,507	134,257	139,257	144,257	149,257	154,257
Government (net)	64,212	77,077	95,007	104,757	109,757	114,757	119,757	124,757
Other items (net)	-22,339	-27,939	-16,530	-11,223	-3,430	-2,250	1,270	22,680
Base money	88,951	102,468	118,931	140,101	163,778	190,637	222,283	258,737
Currency outside banks	53,161	60,496	72,235	90,882	108,032	129,624	156,543	184,095
Commercial bank reserves	35,790	41,971	46,696	49,219	55,745	61,013	65,740	74,642
Cash in vault	11,179	14,744	16,405	18,275	20,698	20,214	17,177	19,504
Reserve deposit	24,611	27,227	30,291	30,944	35,047	40,800	48,562	55,139
(Annual percentage change, unless otherwise indicated)								
Monetary survey								
Net foreign assets	2.6	-20.9	-32.9	28.9	37.8	50.2	37.3	12.6
Net domestic assets	32.6	32.5	27.1	25.1	20.8	16.5	15.4	18.1
Domestic credit	28.3	31.2	27.1	12.8	16.2	16.8	14.7	16.2
Claims on government (net)	21.2	15.4	57.2	36.2	32.0	33.9	32.6	28.8
Claims on nongovernment	29.0	32.7	24.6	10.2	14.1	14.2	11.5	13.5
Public enterprises	34.2	33.5	24.1	6.4	12.5	12.7	8.3	11.5
Private sector	19.9	31.0	25.6	17.9	17.0	16.9	16.7	16.5
Broad money	26.9	24.2	21.2	25.3	21.7	18.6	17.2	17.6
Money	17.5	14.4	16.2	25.1	20.9	16.5	14.1	17.6
Quasi money	35.8	32.3	24.7	25.5	22.3	20.0	19.2	17.6
Memorandum items:								
Base money growth	18.7	15.2	16.1	17.8	16.9	16.4	16.6	16.4
Excess reserve deposit (billions of birr)	9,905	8,615	3,858	5,032	3,893	4,351	6,483	6,060
Percent of deposits	3.5	2.4	1.0	1.1	0.7	0.6	0.8	0.6
Money multiplier (broad money/reserve money)	3.35	3.61	3.77	4.01	4.17	4.25	4.28	4.32
Velocity (GDP/broad money)	3.56	3.34	3.25	3.06	2.94	2.88	2.87	2.84
Currency-deposit ratio	0.217	0.196	0.192	0.193	0.188	0.190	0.197	0.197
Gross official foreign reserves (millions of U.S. dollars)	2,496	3,249	3,119	3,384	3,824	4,606	5,424	5,756
Birr per U.S. dollar (end of period)	19.6	20.6	21.6	...	...	...	...	...
Nominal GDP (millions of birr)	1,060,814	1,236,678	1,458,409	1,718,040	2,007,951	2,336,722	2,724,152	3,170,401

Sources: NBE and IMF staff estimates and projections.

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

Table 6. Ethiopia: Balance of Payments, 2013/14–2020/21

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
(Millions of U.S. dollars, unless otherwise indicated)								
Current account balance	-4,407	-7,392	-7,427	-7,164	-7,486	-7,537	-8,015	-8,429
(Percent of GDP)	-7.9	-12.0	-10.7	-9.3	-8.9	-8.2	-8.1	-7.8
Current account balance, excl. official transfers	-5,868	-8,900	-8,769	-8,462	-8,697	-8,810	-9,303	-9,782
(Percent of GDP)	-10.6	-14.4	-12.7	-11.0	-10.4	-9.6	-9.3	-9.0
Trade balance	-10,467	-13,482	-14,275	-14,480	-15,428	-16,427	-18,024	-19,564
Exports of goods	3,255	2,977	2,910	3,490	4,053	4,638	5,145	5,903
Coffee	714	780	790	960	1,159	1,252	1,380	1,521
Oil seeds	652	510	471	546	660	701	737	775
Gold	456	319	259	288	305	352	355	358
Other	1,432	1,367	1,390	1,696	1,929	2,334	2,674	3,250
Imports of goods	-13,722	-16,459	-17,185	-17,970	-19,481	-21,065	-23,169	-25,467
Services (net)	712	-37	-467	-403	-426	-393	-190	-132
Exports	3,174	3,070	3,033	3,377	3,638	3,976	4,503	4,903
Imports	-2,462	-3,107	-3,500	-3,780	-4,064	-4,369	-4,693	-5,035
Income (net)	-153	-262	-278	-518	-545	-539	-579	-619
Private transfers (net)	4,039	4,882	6,251	6,939	7,702	8,549	9,489	10,533
Official transfers (net)	1,461	1,508	1,342	1,298	1,211	1,273	1,288	1,353
Capital account balance	4,135	7,479	6,983	7,429	7,926	8,319	8,832	8,761
Foreign direct investment (net)	1,467	2,202	3,181	4,452	4,872	5,299	5,873	6,496
Other investment (net)	2,668	5,277	3,802	2,977	3,054	3,020	2,959	2,265
Federal government	2,309	1,901	1,306	1,056	1,469	1,483	1,586	1,533
Disbursements	2,443	2,130	1,396	1,199	1,290	1,260	1,265	1,208
Amortization	-134	-229	-90	-143	-178	-223	-320	-324
Other public sector long term (net) ¹	332	2,992	2,108	804	505	75	-141	-345
Private sector borrowing (net)	0	350	500	1,200	1,363	1,832	2,081	1,652
Other (net)	27	34	-112	-83	-283	-371	-567	-574
Errors and omissions	237	60	596	0	0	0	0	0
Overall balance	-36	148	153	265	440	782	817	332
Financing	36	-148	-153	-265	-440	-782	-817	-332
Central bank (net; increase –)	-66	-760	-153	-265	-440	-782	-817	-332
Commercial banks (net; increase –)	102	612	0	0	0	0	0	0
(Annual percentage change, unless otherwise indicated)								
<i>Memorandum items:</i>								
Exports of goods	5.7	-8.6	-2.2	19.9	16.1	14.4	10.9	14.7
Imports of goods	19.7	19.9	4.4	4.6	8.4	8.1	10.0	9.9
Services exports	11.3	-3.3	-1.2	11.3	7.7	9.3	13.2	8.9
Services imports	7.9	26.2	12.6	8.0	7.5	7.5	7.4	7.3
Exports of goods and services (percent of GDP)	11.6	9.8	8.6	8.9	9.2	9.4	9.7	10.0
Imports of goods and services (percent of GDP)	-29.2	-31.7	-29.9	-28.3	-28.0	-27.8	-28.0	-28.2
Trade balance (percent of GDP)	-18.9	-21.9	-20.6	-18.8	-18.4	-18.0	-18.1	-18.1
Private transfers (net, percent of GDP)	7.3	7.9	9.0	9.0	9.2	9.4	9.5	9.7
Gross official reserves (millions U.S. dollars)	2,496	3,249	3,402	3,666	4,107	4,889	5,706	6,038
(Months of following year imports of goods and services) ²	1.5	1.9	1.9	1.9	1.9	2.1	2.2	2.2
(Months of imports -- authorities' definition)	1.9	2.7	2.6	2.6	2.7	2.8	3.0	3.0
GDP (millions of U.S. dollars)	55,511	61,629	69,218	76,907	84,004	91,363	99,543	108,270

Sources: Ethiopian authorities and IMF staff estimates and projections.

¹ Includes net borrowing by state-owned enterprises and NBE time deposits² The NBE definition for import coverage excludes food-aid and franco-valuta imports.

Table 7. Ethiopia: Alternative Scenario: Selected Economic and Financial Indicators, 2013/14–2020/21¹

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Annual percentage change)							
National income and prices								
GDP at constant prices (at factor cost)	10.3	10.2	6.5	6.5	6.5	8.5	9.0	9.5
GDP deflator	11.0	6.4	10.6	8.8	7.5	7.8	8.5	8.3
Consumer prices (period average)	8.1	7.7	9.7	7.6	7.0	7.5	8.0	8.0
Consumer prices (end period)	8.5	10.4	7.5	7.0	7.0	8.0	8.0	8.0
External sector								
Exports of goods and services (U.S. dollars, f.o.b.)	8.4	-5.9	-1.7	18.5	15.0	15.0	15.0	15.0
Imports of goods and services (U.S. dollars, c.i.f.)	17.7	20.9	5.7	4.3	6.9	8.7	10.7	11.1
Export volume	2.9	-3.4	7.8	17.9	16.6	17.4	15.9	15.9
Import volume	22.0	27.9	15.0	3.2	4.8	7.7	10.1	10.3
Nominal effective exchange rate (end of period)	-2.8	2.6	-2.1	...	...	...	...	...
Real effective exchange rate (end of period)	2.6	10.0	3.1	...	...	...	...	...
	(Percent of beginning-period stock of broad money, unless otherwise indicated)							
Money and credit								
Net foreign assets	0.5	-3.2	-3.2	4.4	8.5	10.2	10.4	9.7
Net domestic assets (including other items net)	26.4	27.5	24.4	17.7	10.7	9.1	9.2	10.3
Broad money	26.9	24.2	21.2	22.1	19.2	19.3	19.5	20.0
Base money (annual percentage change)	18.7	15.2	16.1	15.9	14.5	17.0	18.3	18.8
Velocity (GDP/broad money)	3.56	3.34	3.26	3.09	2.97	2.91	2.88	2.85
	(Percent of GDP, unless otherwise indicated)							
Financial balances								
Gross domestic savings	20.5	21.8	18.4	20.3	20.6	21.8	22.6	23.0
Public savings	5.0	3.5	2.3	3.5	4.3	5.0	5.4	6.0
Private savings	15.6	18.3	16.2	16.8	16.3	16.8	17.2	17.0
Gross domestic investment	38.0	39.3	39.7	39.5	39.0	39.6	40.0	40.0
Public investment	17.0	17.6	17.8	17.4	16.5	15.6	15.2	14.4
Private investment	21.0	21.7	21.9	22.1	22.5	24.0	24.8	25.6
Resource gap	-17.5	-17.5	-21.3	-19.2	-18.5	-17.8	-17.4	-17.0
External current account balance, including official transfers	-7.9	-12.0	-10.7	-8.5	-7.1	-6.3	-5.9	-5.3
Government finances								
Revenue	13.8	15.1	16.3	16.6	17.0	17.9	18.9	19.5
Tax revenue	12.5	13.4	13.5	14.3	15.2	16.1	17.2	17.8
Nontax revenue	1.2	1.7	2.8	2.3	1.8	1.7	1.7	1.7
External grants	1.1	1.1	1.0	1.0	0.9	0.8	0.7	0.6
Expenditure and net lending	17.5	18.6	20.2	20.0	19.9	20.2	20.6	20.6
Fiscal balance, excluding grants (cash basis)	-3.7	-3.6	-4.0	-3.5	-2.9	-2.3	-1.7	-1.1
Fiscal balance, including grants (cash basis)	-2.6	-2.5	-3.0	-2.5	-2.0	-1.5	-1.0	-0.5
Total financing (including residuals)	2.6	2.5	3.0	2.5	2.0	1.5	1.0	0.5
External financing	1.9	1.5	1.5	1.3	1.2	1.1	0.6	0.4
Domestic financing	1.3	1.5	1.5	1.2	0.8	0.4	0.4	0.1
Public debt ¹	45.7	55.3	54.2	54.1	52.9	49.1	44.9	40.6
Domestic debt	20.5	24.3	24.0	23.7	21.5	18.8	16.2	13.7
External debt (including to the IMF)	25.2	31.0	30.2	30.5	31.5	30.3	28.7	26.9
Overall balance of payments (in millions of U.S. dollars)	-36	148	-202	804	1,845	2,468	2,813	2,934
Gross official reserves (in millions of U.S. dollars)	2,496	3,249	3,047	3,851	5,695	8,164	10,977	13,911
(months of imports of goods and nonfactor services of following year) ²	1.5	1.9	1.7	2.0	2.7	3.5	4.3	5.0
GDP at current market prices (billions of birr)	1,061	1,237	1,458	1,690	1,935	2,265	2,681	3,185

Sources: Ethiopian authorities and IMF staff estimates and projections.

¹ Non-financial public sector debt.

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

Table 8. Ethiopia: Financial Soundness Indicators of the Commercial Banking Sector, 2010–16

(in percent, unless otherwise indicated)

	Jun-10	Jun-11	Jun-12	Jun-13	Jun-14	Jun-15	Mar-16
Capital adequacy							
Capital to Risk-Weighted Assets	18.7	18.1	13.4	17.9	17.4	16.4	15.0
Regulatory Capital Tier I to Risk-Weighted Assets	18.7	18.1	13.4	17.9	17.4	16.4	15.0
Capital to Assets	9.1	7.8	6.7	7.2	7.0	6.6	6.3
Asset quality							
NPLs to Total Loans	3.5	2.1	1.4	2.5	2.0	2.1	3.5
NPLs Net of Provisions to Capital	0.7	-3.8	-5.6	-0.5	-2.3	-1.1	...
Earning and profitability							
Return on Assets	3.1	3.0	4.1	3.2	3.1	3.1	2.8
Return on Equity ¹	34.4	34.9	55.8	48.0	44.9	47.4	44.2
Gross Interest Income to Total Income ²	60.1	54.4	54.7	64.9	62.8	67.9	75.5
Interest Margin to Gross Income	38.7	40.0	45.0	56.2	53.2	58.9	67.2
Non-interest Expenses to Gross Income ³	28.0	28.7	26.6	33.6	41.0	41.0	38.7
Personnel Expenses to Non-interest Expenses	46.0	51.1	42.3	43.3	43.7	47.4	56.3
Liquidity							
Liquid Assets to Total Assets	32.7	32.7	20.6	23.2	16.2	10.9	9.8
Liquid Assets to Short-term liabilities	42.7	43.4	26.7	30.1	21.5	17.6	16.1
Total Loans and Bonds to Total Deposits ⁴	...	...	94.0	93.9	100.6	103.9	108.8

Source: Ethiopian authorities.

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

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

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

⁴Customer deposit includes time, current and saving deposits.

Annex I. Ethiopia: Risk Assessment Matrix (RAM)¹

Source of Risk	Relative Likelihood	Impact if Realized	Policy Response
Domestic Risks			
Slow progress in reforms enhancing export competitiveness	H	H. Underperformance of exports, decreased foreign currency availability and lower capital goods imports. Slow-down in investment and growth. Weaker debt sustainability.	Implement structural reforms to enhance competitiveness and support export diversification. Postpone some investment to reduce public sector borrowing and avoid deterioration in the debt sustainability.
Slow implementation of tax administration and tax law reforms, hindering achieving targets in GTP II	H	H. Less resources for investment, slower growth and poverty reduction.	Prioritize investment adequately to growing country's capacity to generate taxes. Accelerate tax administration and tax policy reforms to strengthen fiscal revenues.
Deterioration in asset quality of SOE loans	M	H. Higher fiscal costs related to an increase in contingent liabilities, which could divert resources from investment. Public banks would write off loans, and curb credit. Slow-down in economic activity and growth.	Strengthen oversight of SOEs' performance. Prioritize large-scale investment to ensure efficient use of scarce domestic resources. Strengthen bank supervision and enforce prudential limits. Increase competition and recapitalize public banks.
Climate change	M	H. Food price shock leading to a higher food inflation. Adverse social impact, and stalled progress in poverty reduction. Lower agricultural exports, higher medical and social spending.	Increase food assistance. Tighten monetary policy if second-round effects are significant. Slow SOE imports and increase fiscal expenditure for social and medical protection.
External Risks			
Surge in the US dollar	H	H. Further real exchange rate appreciation. Weaker exports and widening trade deficit.	Accelerate reforms enhancing exports competitiveness. Adopt a more flexible exchange rate policy.
Structurally weak growth in key advanced and emerging economies.	H/M	H. Lower demand for Ethiopia's main exports leading to widening trade deficit and weaker debt sustainability.	Accelerate reforms enhancing exports competitiveness. Adopt a more flexible exchange rate policy.
Significant China slowdown.	L/M	M. China's demand for Ethiopia's agricultural exports plummeted in 2015. Continuing decline will reduce export revenues further via lower demand and lower commodity prices, and will exert pressure on foreign exchange shortages, and weaken debt sustainability. Given Ethiopia high exposure to Chinese financing, investment could slow, although longer-term projects are likely to remain financed.	Promote export diversification, seek alternative sources of foreign financing (with focus on concessional) and FDI.
<p>¹The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of Fund staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities.</p>			

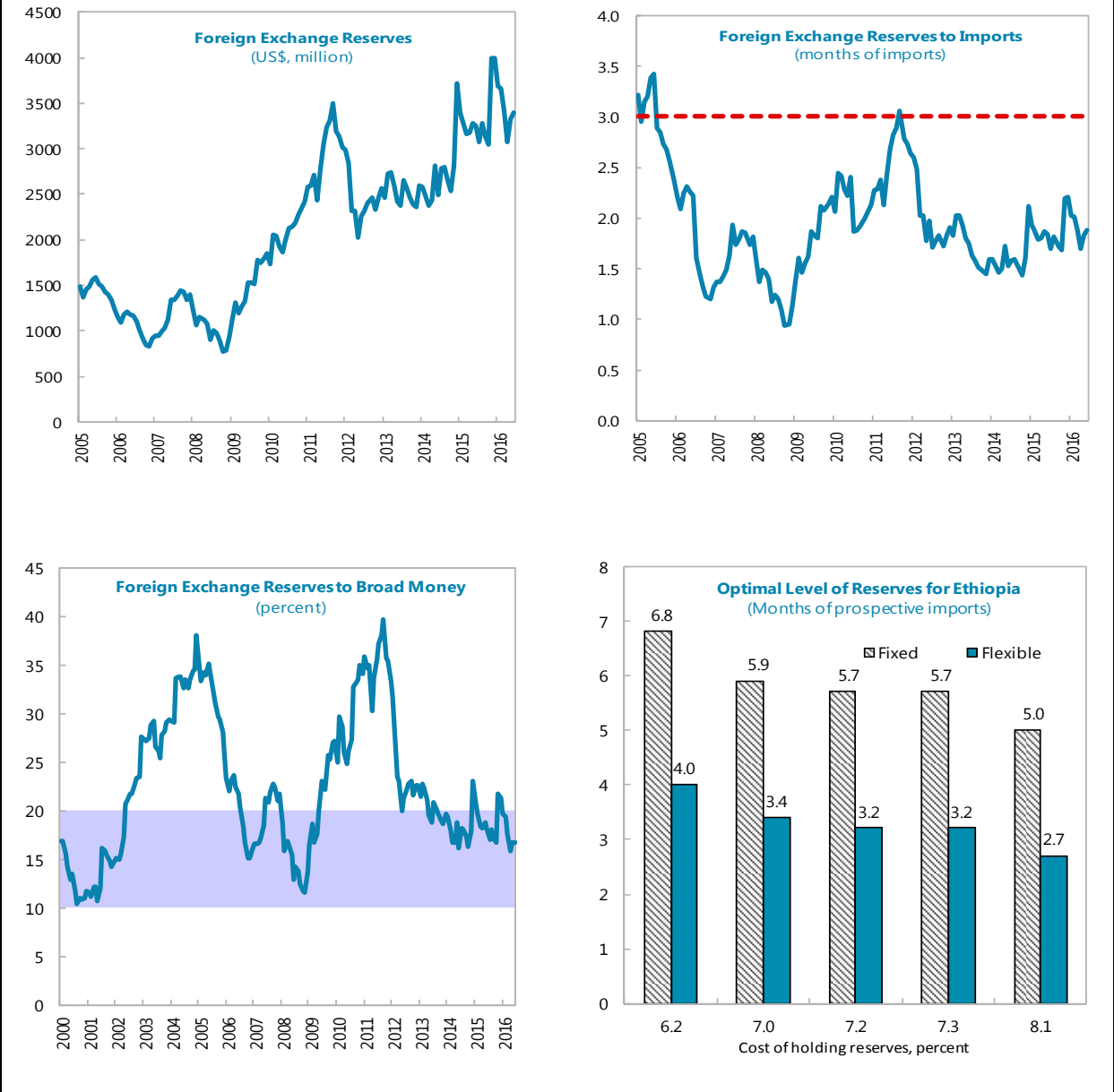
Annex II. Reserve Adequacy Assessment

1. **Ethiopia is a low-income country that is highly dependent on exports of agricultural commodities and transport services, as well as imports of fuel, capital goods, and currently, foodstuffs due to the drought.** As a result, the economy is sensitive to terms-of-trade and weather-related shocks. Although terms-of-trade have recently moved in its favor, Ethiopia's capacity to absorb adverse trade shocks is highly constrained by the low level of its foreign reserves buffer.
2. **Foreign reserves increased slightly in 2015/16.** In November 2015, the NBE acquired a US\$1 billion deposit (from an official bilateral lender), which temporarily boosted reserves and subsequently partly financed drought-related imports of food as well as other imports. By end-June 2016, reserves stood at US\$3.4 billion covering 1.9 months of prospective imports—moderately above the previous year level. This increase reflects a change in the NBE's policy target to reach a coverage of 3 months of imports (as per national definition¹) in the medium term. The ratio of foreign reserves to broad money has been volatile, and is estimated at about 15 percent by end-June, 2016.
3. **Ethiopia's foreign reserves are below model-based optimal benchmarks.** A formal reserve adequacy assessment based on a cost-benefit analysis shows that for a country with a heavily managed floating exchange rate (classified as a de facto crawl-like arrangement), the optimal reserve coverage is between 5 and 6.8 months of imports.² The model evaluates shocks in external demand, terms of trade, FDI, and aid flows for different cost levels of holding reserves (using the cost of borrowing as a proxy), and the methodology uses up-to-date data in the panel regression. Maintaining an insufficient foreign reserve buffer poses concerns that, in case of terms-of-trade, weather-related, or other shocks, this could force severe import compression, with adverse effects on economic growth.
4. **In the current policy setting, staff expects that reserve import coverage will remain below adequate levels (baseline scenario), unless policies are changed to address external vulnerabilities (alternative scenario).** Growth in cargo and passenger transport services as well as electricity exports, together with a gradual increase in merchandise export volumes, offer some potential to bolster foreign reserves. However, as demand for capital imports—partly driven by investment plans—is expected to remain strong, the reserve import coverage is forecasted to remain below three months in the medium term. The associated risks are mitigated by a tightly controlled external financial and current account, low external liabilities to private creditors (mainly trade-related or the outstanding Eurobond), and absence of portfolio investment—which suggest a low risk of sudden capital outflows. Staff recommends policies aimed at reducing the external current account deficit and strengthening the foreign reserves buffer.

¹ Ethiopian authorities calculate the reserve coverage by deducting food aid and franco-valuta imports from the total. This methodology results in a reserve coverage of 2.4 months of adjusted imports (i.e., under national definition) at the end of June 2016. The new reserve target of 3 months of import coverage under the national definition translates into an import coverage of about 2.5 months under the standard definition.

² Based on the 2014 Assessing Reserve Adequacy template and methodology.

Figure 1. Ethiopia: Reserve Adequacy Analysis



Annex III. Exchange Rate Assessment

1. **The pace of real appreciation of the birr has slowed down significantly in 2015/16.** The NBE continues to adhere to its policy of a gradual depreciation of the birr against the US dollar at a constant rate. At the same time, however, the US dollar appreciated on average, so that the nominal effective exchange rate remained stable in 2015–16. Together with a persistent inflation differential with the Euro zone and other trading partners, this led to a slight appreciation in real effective terms (see Figure 2).

2. **The Fund’s EBA-lite methodology points to a significant overvaluation of the birr.** Since the start of the GTP I in 2010/11, the current account deficit has widened sharply, whereas the evolution of fundamentals would have suggested a closing of the gap in recent years (see Figure). Accordingly, the external balance approach yields an estimated exchange rate overvaluation of 33.2 percent—slightly higher than last year’s 32.5 percent.¹

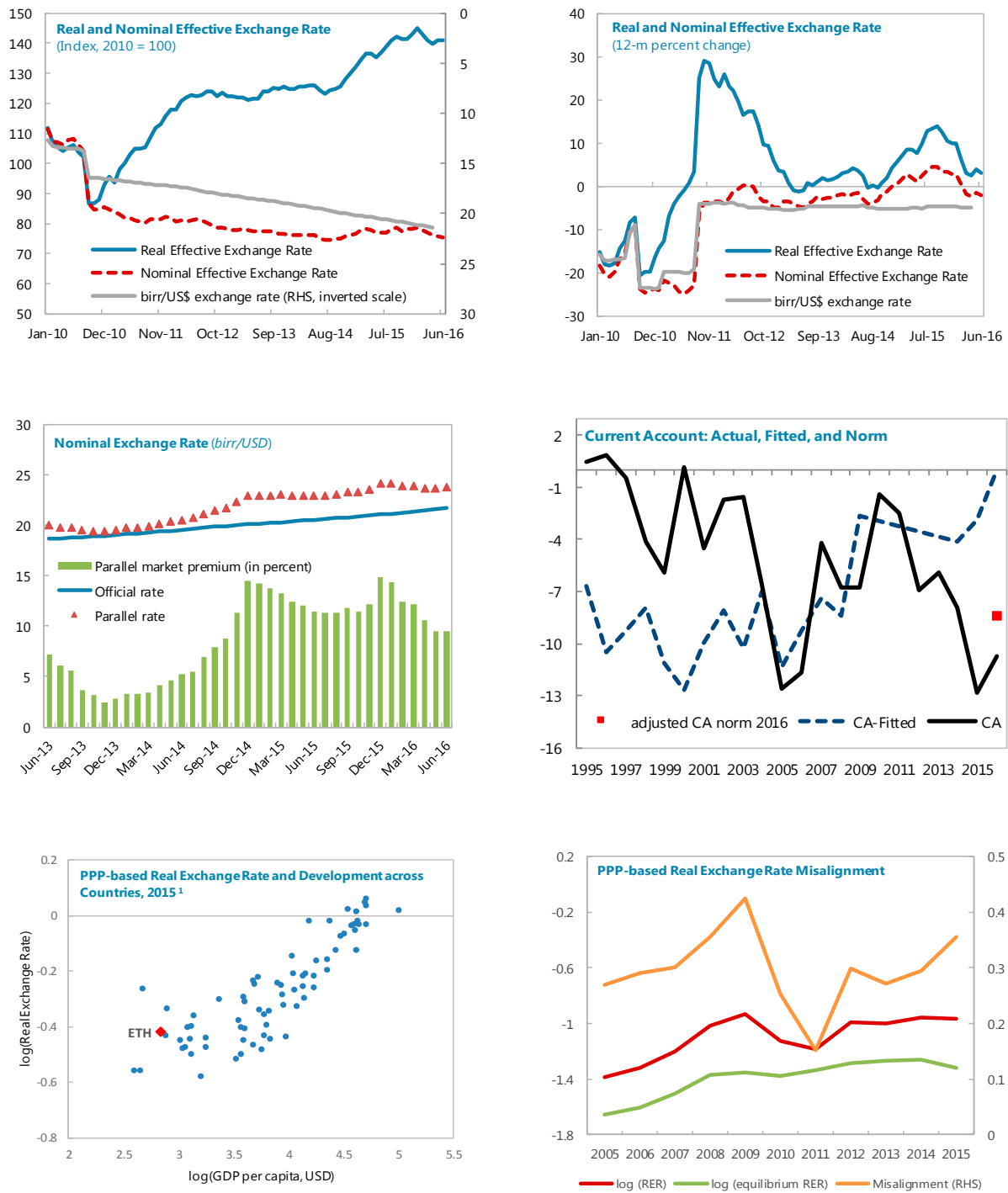
3. **Benchmarking the real effective exchange rate directly against fundamentals supports the assessment of a considerable overvaluation.** Given Ethiopia’s history of overvaluation, the Fund’s Index Real Exchange Rate methodology, which benchmarks the CPI-based real exchange rate against a country’s historical average, is of limited use. PPP-based real exchange rates, by contrast, allow for a cross-country comparison. Figure 2 illustrates the strong log-linear relationship between the PPP-based real exchange rate and the level of development across countries. Following Rodrik (2008)², a linear regression model is used to estimate this equilibrium relationship between GDP per capita (as a share of US GDP per capita) and the real exchange rate (which reflects the Balassa-Samuelson effect): based on an annual (1995–2015) sample of all countries, excluding commodity exporters and small states, a 10 percent increase in GDP per capita typically leads to an appreciation of 2.9 percent. Therefore, a real exchange rate appreciation of 1 percent annually would have been in line with Ethiopia’s growth since 2010, whereas the actual appreciation was about 2.5 percent annually. Based on this methodology, the degree of overvaluation is estimated at 36 percent in 2015. Including non-fuel commodity exporters in the sample would yield an overvaluation of 22 percent.³

¹ The assumed elasticity of the current account with respect to the real exchange rate is 7 percent. To account for the special role of public sector-driven investment, the current account norm is adjusted by 2.9 percent of GDP, the estimated amount of imports from the public sector (excluding humanitarian goods).

² “The real exchange rate and economic growth.” Brookings papers on economic activity, 2008

³ The preferred specification excludes small states and commodity exporters to avoid an upward bias of equilibrium exchange rates driven by cases of Dutch disease.

Figure 1. Ethiopia: Exchange Rate Developments and Assessment



Sources: Ethiopian authorities, IMF staff estimates, and World Economic Outlook.

Annex IV. Key Sustainable Development Goals for Ethiopia

	Base Year 2015	Target by 2020
Goal 1: End poverty in all its forms everywhere		
National headcount poverty rate (measured as people leaving on less than \$1.25 a day) (in %)	23.4	16.7
Share of resources allocated to poverty reduction (as expenditure to GDP) (in %)	12.3	15.4
Goal 2: End hunger, achieve food security and promote sustainable agriculture		
Productivity of major crops (quintal/hectare)	21.5	27.3
Number of smallholder farmers of agricultural extension service beneficiaries ('000)	14,014	16,776
Number of pastoralists of agricultural extension service beneficiaries ('000)	690	858
Quantity of chemical fertilizers supplied (in metric ton)	1,025,231	2,062,106
Quantity of improved seed supplied (in '000 quintals)	1,874	3,560
Land with community based water shade development program (mln hectares)	12.2	41.4
Land with modern small scale irrigation schemes (mln hectares)	2.3	4.1
Goal 3: Ensure healthy lives and promote well-being for all at all ages		
Maternal mortality ratio (%)	420	199
Under-five mortality rate (%)	64	30
Neonatal mortality rate (%)	28	10
Number of HIV infections (per 1,000 uninfected population)	0.03	0.01
Coverage of essential health services (i.e.: reproductive, maternal, newborn, and child health, infectious diseases, and others) (% of population)	98	100
Goal 4: Ensure inclusive and equitable quality education		
Primary school net enrolment rate (%)	96.9	100
Primary school completion rate (%)	52.2	74
Share of primary school certified teachers (%)	71.4	95
Share of secondary school certified teachers (%)	87.3	100
Adult education participation rate (%)	74.4	100
Undergraduate program admission capacity	755,244	1,106,287
Total number of students admitted to post graduate program	28,140	56,000
Goal 5: Achieve gender equality and empower all women and girls		
Proportion of seats held by women in national parliaments (%)	38.8	50
Share of decision-making role of women in the federal executive bodies (%)	9.2	40
Share of mobile phone owners (in million)	38.8	103
Goal 6: Ensure availability and sustainable management of water and sanitation		
Proportion of population using safely managed drinking water (%)	58	83
Goal 7: Ensure access to affordable and sustainable energy		
Proportion of population with access to electricity (%)	60	90
Consumption of green renewable electric power source in MW	4,091	16,699
Goal 8: Promote sustained, inclusive economic growth, full and productive employment		
Unemployment rate (%)	4.1	3.5
Number of jobs in tourism industry (million)	0.7	1.7
Number of commercial bank branches	2,868	5,736
Goal 9: Build resilient infrastructure, promote inclusive industrialization and foster innovation		
Share of rural population, who live within 5 km of an all-season road (%)	36.6	13.5
Micro and small manufacturing industry growth rate (%)	2.9	23.5
Micro and small manufacturing as share of GDP (%)	1.1	1.8
Research and development expenditure as a proportion of GDP (%)	0.61	1.0
Goal 10: Reduce inequality		
Per capita income in USD	691	1,177
Income distribution (GINI coefficient)	0.3	0.3
Goal 11: Take urgent action to combat climate change and its impacts		
Share of population living in slums and inadequate settlements (%)	...	...
Share of population that has access to public transport (%)	34	52
Other		
Number of new and amended legal documents promoting sound public procurement	...	4
Number of improved policies, strategies, rules, directives and guidelines	...	20
Share of children under 5, whose births have been registered with a civil authority (%)	...	50
Number of internet users ('000)	40,000	103,662
Forest coverage (%)	16	20

Source: The Ethiopian National Planning Commission



THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

August 30, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared by

The African Department
(In collaboration with other departments)

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RELATIONS WITH THE FUND

(As of July 31, 2016)

Membership Status: Joined: December 27, 1945

[Article XIV](#)

General Resources Account:	<u>SDR Million</u>	<u>% Quota</u>
Quota	300.70	100.00
IMF's holdings of currency (holdings rate)	293.28	97.53
Reserve Tranche Position	7.51	2.50

SDR Department:	<u>SDR Million</u>	<u>% Allocation</u>
Net cumulative allocation	127.93	100.00
Holdings	49.68	38.83

Outstanding Purchases and Loans:	<u>SDR Million</u>	<u>% Quota</u>
ESF Arrangement	119.66	39.79
ESF RAC Loan	20.06	6.67

Latest Financial Arrangements:

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

¹ Formerly PRGF.

Overdue Obligations and Projected Payments to Fund ²

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

	Forthcoming				
	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
Principal	18.72	37.44	37.44	34.09	12.03
Charges/Interest	0.02	0.30	0.21	0.12	0.06
Total	<u>18.74</u>	<u>37.74</u>	<u>37.64</u>	<u>34.21</u>	<u>12.09</u>

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

Implementation of HIPC Initiative:

Enhanced
Framework

I. Commitment of HIPC assistance

Decision point date November 2001

Assistance committed

by all creditors (US\$ million) ³ 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 ⁴ 1.54

Total disbursements 46.66

³ Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence, these two amounts cannot be added.

⁴ Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

Implementation of Multilateral Debt Relief Initiative (MDRI):

I. MDRI-eligible debt (SDR million) ⁵	112.07
Financed by: MDRI Trust	79.66
Remaining HIPC resources	32.41
II. Debt Relief by Facility (SDR million)	

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

⁵ The MDRI provided 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

As of February 4, 2015, the post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

Exchange Rate Arrangement

The de-facto exchange rate arrangement is classified as a crawl-like arrangement. The authorities describe their exchange rate regime as a managed float with no predetermined path for the exchange rate. The pace of depreciation of the nominal exchange rate, however, has been stable. The NBE continues to supply foreign exchange to the interbank market based on plans prepared at the beginning of each fiscal year, which take into account estimates of supply and demand. The transaction-weighted average interbank market exchange rate as of August 5, 2016, is Br 21.8943 = US\$1.

Ethiopia maintains four restrictions on payments and transfers for current international transactions, which relate to: (i) the tax certification requirement for repatriation of dividend and other investment income; (ii) restrictions on repayment of legal external loans and suppliers of foreign partners credits; (iii) rules for issuance of import permits by commercial banks; and (iv) the requirement to provide a clearance certificate from the NBE to obtain import permits. These restrictions are inconsistent with Article VIII, Section 2(a), of the IMF's Articles of Agreement and remain unapproved. In addition, In February 2016, the authorities introduced a regulation providing for the prioritization of foreign exchange for certain import items and payments. Staff is in the process of assessing this and other measures introduced by the authorities with respect to their implications to Ethiopia's obligations under Article VIII, Section 2(a) and 3.

Safeguards Assessment

The National Bank of Ethiopia (NBE) was subject to an update safeguards assessment in 2009 (previous assessment was completed in 2001). The update assessment found improved financial reporting and internal audit practices. However, weaknesses were noted and recommendations primarily focused on strengthening oversight of risks and controls, improving accounting records and external audit process, and legal amendments to address safeguards shortcomings in the Law. Since 2009, the NBE has further

strengthened its internal audit function through capacity building, and has implemented the outstanding actions of the 2007 external quality assessment. Some progress has been reported on the outstanding safeguards recommendations related to legal amendments needed to strengthen NBE's autonomy. While there have been improvements in financial statement disclosures, they still do not fully comply with International Financial Reporting Standards. The assessment also noted that a full set of the audited financial statements is usually available to the public in hard copy, but the NBE does not publish the financial statements on its website.

Article IV Consultation

Ethiopia is on the standard 12-month consultation cycle, in accordance with the Decision on Article IV Consultation Cycles (Decision No, 14747-(10/96), 9/28/2010). The last consultation was concluded on September 21, 2015.

Technical Assistance (2015–present)

Department	Purpose	Time of Delivery
FAD, AFE	Strengthening and Improving Cash Management	March 2015
AFE	Financial Analysis and Stress Testing of Insurers	April 2015
FAD	Tax Administration Reform	April-May 2015
AFE	Liquidity Forecasting and Management	May 2015
AFE	National Accounts Statistics	May 2015
AFE	Developing High Frequency Indicators	June 2015
AFE	Price Statistics	August 2015
FAD, AFE	Tax Analysis and Revenue	August 2015
FAD, AFE	Budget Preparation and PEM	October 2015
FAD, AFE	National Planning and Budgeting: Strengthening the Linkage	October 2015
AFE	Training on International Reserve Management	November 2015
AFE	Building Capacity on Reinsurance Supervision	November 2015
STA	National Accounts and Price Statistics	December 2015
STA	Balance of Payments Statistics	January 2016
FAD, AFE	Medium Term Budgetary Framework	January 2016
AFE	Strengthening Crisis Management Framework	February 2016
FAD	Overcoming Challenges in Tax Administration	February 2016
AFE	Strengthening Cash Management	February 2016
FAD, AFE	Strengthening Revenue Mobilization and Tax Administration	March 2016
STA	National Accounts and Price Statistics	April 2016

Resident Representative

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

JOINT MANAGEMENT ACTION PLAN, JULY 2016–JUNE 2017

(As of July 31, 2016)

Title	Products	Provisional and actual timing of missions	Expected and actual delivery date
A. Mutual information on relevant work program			
The World Bank work program in the next 12 months	Economic policy analysis and advice <ul style="list-style-type: none"> Ethiopia Economic Update (annual) Policy dialogue on economic reform issues Real exchange rate analysis Tax study Technical Assistance <ul style="list-style-type: none"> Capacity building of the Central Statistical Agency Debt Management 	July 2016–June 2017 July 2016–June 2017 July 2016–June 2017 July 2016–June 2017 July 2016–June 2017 July 2016–June 2017	Q2 2017 Ongoing Q4 2016 Q2 2017 Ongoing (until Q2 2017) Q2 2017
The Fund work program in the next 12 months	Macroeconomic policy analysis and advice <ul style="list-style-type: none"> Article IV consultation Technical Assistance <ul style="list-style-type: none"> Building statistical capacity (in areas of National Accounts, PPI, GFS) Developing secondary market for government securities Program-based budgeting Tax administration 	May/June 2017 Ongoing Ongoing November/December 2016 July 2016–June 2017	June 2017 Ongoing Ongoing Q4 2016 Q1 2017
B. Mutual information on relevant work program			
Fund request to Bank	<ul style="list-style-type: none"> Periodic update on all TA activities Macroeconomic and financial data to be shared regularly Participating in reviews of key analytical work 	Ongoing	Ongoing
Bank request to Fund	<ul style="list-style-type: none"> Periodic update on all TA activities Macroeconomic and financial data to be shared regularly 	Ongoing	Ongoing
C. Agreement on joint products and missions			
Joint products in the next 12 months	<ul style="list-style-type: none"> Debt Sustainability Analysis (DSA) 		May/June 2017

STATISTICAL ISSUES

(As of July 31, 2016)

I. Assessment of Data Adequacy for Surveillance

General: Data provision is broadly adequate for surveillance. However, in 2015/16 some data reported to the Fund were subject to considerable delays and revisions. The existing data weaknesses reflect capacity constraints and the authorities are seeking to address them through technical assistance (TA).

National Accounts: Deficiencies in the source data and compilation practices affect the accuracy and reliability of the GDP statistics. Weaknesses are particularly evident in respect to the estimation of private consumption, saving, investment, and fixed capital formation. The statistical discrepancies between the expenditure categories and output remain significant. Information provided to the Fund is subject to discrepancies. Policymaking and surveillance would benefit from improving national accounts statistics. The authorities have been receiving TA in this area from AFRITAC East.

Government finance statistics: Despite some improvements, the government fiscal statistics continue to be affected by shortcomings in terms of coverage and outdated reporting standards. Data for the general government are based on Government Finance Statistics Manual (GFSM) 1986. Establishing a framework for compiling and disseminating Government Finance Statistics (GFS) and public sector debt statistics that meet GFSM 2001 is an urgent task (in October, the authorities will receive TA in this area from AFRITAC East). Lack of consolidation of extra-budgetary funds into comprehensive fiscal reporting hinder proper assessment of the Government's fiscal stance, savings, and borrowing requirement. Current financial statements of public enterprises and other information on their operations is not available.

Monetary statistics: Monetary survey data for commercial banks are subject to revisions and frequent delays in the reporting to the Fund.

Financial statistics: Aggregate set of Financial Soundness Indicators (FSIs) neglect many core indicators. In addition, information gaps, e.g.: commercial banks' income statements, information on distribution of non-performing loans (NPLs) by sector, NPL provisions, maturity of credit, net open position, have implications for conducting an assessment of financial sector risks.

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

II. Data Standards and Quality

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

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of July 31, 2016)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange rates	August 2016	August 2016	D	D	D
International reserve assets and reserve liabilities of the monetary authorities ^{1/}	May 2016	July 2016	M	M	M
Reserve/base money	May 2016	July 2016	M	M	M
Broad money	May 2016	July 2016	M	M	M
Central bank balance sheet	May 2016	July 2016	M	M	M
Consolidated balance sheet of the banking system ^{2/}	May 2016	July 2016	M	M	Q
Interest rates ^{3/}	April 2016	June 2016	M	M	M
Consumer price index	July 2016	August 2016	M	M	M
Revenue, expenditure, balance, and composition of financing ^{4/} – central government	April 2016	July 2016	M	M	M
Revenue, expenditure, balance, and composition of financing ^{4/} – general government ^{5/}	December 2016	June 2016	Q	Q	A
Stocks of central government and central government-guaranteed debt ^{6/}	March 2016	July 2016	Q	Q	Q
External current account balance	May 2016	July 2016	M/Q	Q	Q
Exports and imports of goods and services	May 2016	July 2016	M	M	M
GDP/GNP	2014/15	December 2015	A	A	A
Gross external debt	March 2016	July 2016	Q	Q	Q
International investment position ^{7/}	...	...	N/A	N/A	N/A

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

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

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

⁴ Foreign, domestic bank, and domestic nonbank financing.

⁵ The general government consists of the central government and local governments.

⁶ Including currency and maturity composition.

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



THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

August 30, 2016

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Ethiopia's risk of external debt distress remains moderate, although external vulnerabilities have increased. Exports underperformed relative to projections, owing to a weak external environment; and the supply shock from the drought required scaled-up food imports. Despite strong remittances and curtailed public sector imports of investment goods, the current account deficit remains high. Reflecting higher indebtedness and low exports, indicators based on debt-to-exports ratios have deteriorated and (as in the 2015 DSA) breach one standard threshold in the baseline. Key considerations in maintaining the moderate rating are: (i) the envisaged investment-based expansion in re-payment capacity financed by the external borrowing; and (ii) special factors that mitigate the risk of debt/currency distress episodes including capital controls, the large share of debt with official creditors with a significant concessional component, virtual absence of tradeable debt instruments, and limited integration in global markets. The main risks are a potential continuation of export underperformance and failure to rein in project-related imports and refrain from associated new non-concessional borrowing. Should these risks materialize, debt sustainability prospects would deteriorate materially. The projected baseline path of total public sector debt-to-GDP (external plus domestic debt) does not result in additional risks beyond those discussed for the external debt above.

BACKGROUND AND RECENT DEVELOPMENTS

1. **Ethiopia's large-scale public investments in infrastructure over recent years have been largely financed by borrowing, raising public debt.** Ethiopia reached the completion point under the Heavily Indebted Poor Countries (HIPC) Initiative in 2004 and benefited from debt relief under the Multilateral Debt Relief Initiative (MDRI) in 2006.¹ Public and publicly guaranteed (PPG) external debt² fell in the years that followed, reaching a low of 18 percent of GDP in mid-2012. By end-2015/16³ it is estimated at 30.2 percent of GDP and total (including domestic) public debt is estimated at 54.2 percent of GDP.

2. **The Debt Sustainability Analysis (DSA) prepared in 2015 raised Ethiopia's risk of external debt distress from "low" to "moderate".** In the baseline scenario, only the present value of debt-to-exports (PVDE) temporarily breached the 150 percent threshold.⁴ Ethiopia was considered a special case of "moderate" risk, for which the use of judgment was warranted. The growth-enhancing nature of the borrowing plans, was deemed crucial in making sustainable the relatively low debt-to-GDP ratio of Ethiopia. The probability approach and the inclusion of remittances confirmed these findings.

3. **In 2015/16, growth slowed down and the current account deficit remained high.** Growth in 2015/16 is estimated at 6.5 percent, a slowdown relative to previous years, owing to a major drought and a sharply weaker external environment. Export revenue stagnated as pronounced falls in merchandise export prices (by 11 percent) were only partially offset by an expansion in volumes, despite significant redirection of exports towards alternative destination markets and development of new export lines. Savings from lower fuel import prices were more than compensated by large drought-related food imports and other imports. On the other hand, remittances surged to US\$6¼ billion (9 percent of GDP), exceeding exports of goods and services. Overall, the current account deficit is estimated to have experienced a small improvement in relation to GDP—from

¹ While Ethiopia has received debt relief from most of its creditors, it has not been able to reach agreement with a few bilateral creditors (Bulgaria, Libya, and FR Yugoslavia) and commercial creditors from Italy, the former Czechoslovakia, India, and FR Yugoslavia. These outstanding loans (US\$382.9 million) accounted for 2 percent of the debt stock in 2014/15. HIPC terms are assumed for these loans. While negotiations with Russia on outstanding loans (US\$161.6 million) have not been completed, the debt service on these loans is assumed to be given HIPC comparable treatment.

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

³ The DSA is based on the Ethiopian fiscal year, which runs from July–June.

⁴ Based on its 2015 Country Policy and Institutional Assessment (CPIA) score (3.4), Ethiopia is classified as a medium performer. The thresholds for the debt burden for medium performers are 150, 40, and 250 percent for the PV of debt to exports, GDP, and revenue, respectively; a 10 percent band is applied to the thresholds to determine if the country is a borderline case; and debt service thresholds are 20 and 30 percent of exports and revenue, respectively. In the scenarios that include workers' remittances, the corresponding threshold for the PV of debt to exports and remittances is 120 percent, and is 16 percent for debt service to exports and remittances; the PV of debt to GDP and remittances is 36 percent.

12 percent in 2014/15 to 10.7 percent in 2015/16—while remaining, essentially, unchanged in U.S. dollars.

4. **External financing was provided mainly by foreign direct investments (FDI), project-related lending, and the central bank.** FDI inflows continued strong gains, reaching over US\$3 billion (4.6 percent of GDP). In addition to previously envisaged project financing disbursements, the NBE received from an official bilateral creditor a US\$1 billion deposit, which had not been anticipated in the 2015 DSA.⁵ Its proceeds were used to finance drought relief and other imports and to reinforce foreign exchange reserves.

5. **Ethiopia's non-concessional commitment ceiling under IDA's non-concessional borrowing policy, set at US\$0.75 billion for 2015/16, was substantively met.** In June 2016, IDA reviewed Ethiopia's non-concessional borrowing performance for 2015/16. The review concluded that the limit of US\$0.75 billion, which was defined in the previous year, had been substantively met with new Non-concessional borrowing (NCB) contracting amounting to US\$0.775 billion in 2015/16.

OUTLOOK AND KEY ASSUMPTIONS

6. **Macroeconomic assumptions reflect the 2015/16 adverse supply shock and the lower starting base in exports (Box 1).** After the 2015/16 slowdown, real GDP growth is projected to recover to 7.5 percent by 2016/17 and the medium term, converging subsequently towards 6 percent in the longer term. Compared to the 2015 DSA, the time profile of the level of exports has shifted downwards, reflecting the lower 2015/16 estimate. The medium-term outlook for export performance will face downside risks if structural reforms lag and competitiveness gains disappoint.

7. **During the 2016 Article IV Consultation discussions, the authorities expressed their commitment to refrain from new NCB for the time being inasmuch as this borrowing might deteriorate debt sustainability—the DSA borrowing assumptions reflect this policy.** The DSA includes NCB disbursements of about US\$1.5 billion in 2016/17 from existing commitments, but no additional NCB commitments. WB staff is seeking to set a NCB ceiling consistent with these projections—unless exports were to perform better than currently envisaged. Also, IDA decided to continue to provide assistance to Ethiopia on credit terms only in 2016/17, a measure implemented in 2013/14 as a response to Ethiopia's breaches of the NCB ceiling at that time. The continuation of this measure is meant to maintain an incentive to restrain non-concessional borrowing commitments during 2016/17.

⁵ The US\$1 billion deposit has an annual interest rate of 3 percent, a two-year grace period and long-term maturity (equal annual installments after the grace period). This central bank liability has been included in the stock of public sector debt considered in this DSA, as required by current guidelines ("Staff Guidance Note on the Application of the Joint Bank-Fund DSF for LICs," SM/13/292, section K). It does not fall, however, under the IDA NCB ceiling since IDA considers that as a central bank-to-central bank transaction it does not carry the risk of IDA cross-subsidizing NCB from other donors, a main rationale behind the NCB ceiling.

8. **Projections on new indebtedness are also based on the following assumptions:**
- Non-concessional loan (NCL) disbursements will average about US\$1.1 billion per year in the next five years, and around US\$830 million per year over the entire projection period (FY2016/17–FY2035/36).
 - The maturity on all new external loans will average 29 years, and 13–16 years for new non-concessional loans.
 - The interest rate on all new external loans will average 1.9 percent, and 3–5 percent on new non-concessional loans.

Box 1. Ethiopia: Macroeconomic Assumptions for the Baseline Scenario

Real GDP growth is projected at 6.5 percent in 2015/16, 7.5 percent in 2016/17, and at 6 percent over the longer term. CPI Inflation is projected at 8 percent in the long run. The government primary deficit is projected to remain at about 2¼ percent of GDP, with gradual progress in tax collection offsetting increased investment and social spending.

The external current account deficit (before official transfers) is estimated at 12.7 percent of GDP in 2015/16. Improved export performance, a slowdown in capital goods imports, and steady remittances (although slowly declining as a ratio to GDP) will lead to a gradual improvement of the deficit over the longer term. Economic transformation is expected to ameliorate external imbalances, with more dynamic and diversified exports and a phase down in the imports of capital goods.

Exports of goods and services are expected to decline by 1.7 percent in 2015/16, with gains in export volumes not enough to compensate lower commodity prices. In future years, a recovery in traditional exports and development of new exports could raise average growth to 13.2 percent over the next three years, and sustain growth in the long run. Investments in hydro-power, industrial parks, export processing zones, and public policies targeting emerging manufactures, food processing, and FDI technology transfers are expected to support export growth and diversification. Imports of goods and services are estimated to have increased by 5.7 percent in 2015/16, and are projected to increase by 5.1 percent in 2016/17 from a high level, due in part to emergency food imports. A slowdown is expected in the longer term but demand for imported capital goods will remain strong during the remaining four years of the GTP II implementation period. In the long run, imports are expected to grow in line with domestic output.

Remittances have recently performed strongly, at an estimated 9 percent of GDP in 2015/16, up 28 percent in dollar terms from the previous year. Projections assume remittances will represent about 3.8 percent of GDP by 2035/36.

FDI is projected to increase from 4.6 percent of GDP in 2015/16 to 6 percent in the medium term, reflecting improved competitiveness and policies to attract foreign investment.

The exchange rate is expected to remain determined by the NBE's crawl-like arrangement, with the real effective exchange rate remaining constant over time.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

A. Baseline scenario

9. **The 2016 DSA projects external debt to peak as a share of GDP in 2016/17 (Figure 1).** The present value (PV) of PPG external debt increases to 21.9 percent of GDP in 2015/16, and will marginally increase in 2016/17, to start declining gradually to single digits in the long-run. These ratios are within the thresholds.

10. **Under the baseline scenario, the ratio of the PVDE breaches the indicative threshold (Table 3 and Figure 1).** The PVDE ratio is estimated at 255.7 percent in 2015/16. The ratio is projected to remain above the threshold until 2023/24, when export growth and the declining borrowing ratio bring the indicator to the 150 percent threshold. No other indicator breaches its threshold under the baseline scenario, as in the 2015 DSA (Table 1).

B. Alternative scenarios

11. **Under the alternative scenarios with extreme shocks the ratios based on exports (PV debt-to exports, and debt service-to-exports) exceed the thresholds under an export shock.** In the presence of this shock, the breach of the indicative threshold for the PV debt-to-exports ratio would last three more years than in the baseline. Under the same shock to exports, the debt service-to-exports ratio would breach the threshold in two different periods: in the short term, as exports are still low and Ethiopia has to repay the term-deposit taken by the NBE, and in 2025, when the outstanding US\$1 billion Eurobond matures.

12. **Results from the probability approach indicate a similar, although milder, risk than the standard approach.**⁶ As in the standard approach, the PV debt-to-exports ratio indicator breaches the threshold in the baseline and in the extreme shock alternative scenario—although for a shorter period (three years). The debt service-to-exports indicator does not breach the threshold under the baseline or the most extreme shock scenarios—unlike under the standard approach, where it is breached under the most extreme shock scenario (Figure 2).

13. **The inclusion of remittances also reduces somewhat the severity of threshold breaches.**⁷ In Ethiopia, rising remittances already play an important role in bolstering external stability. In 2015/16 they are estimated at 9 percent of GDP, representing 105 percent of exports (goods and services). When remittances are included in the DSA, the breach of the augmented indicator (namely the ratio of the PV of debt to exports of goods and services *plus* remittances) breaches the threshold for 6 years in the baseline and for 10 years in the extreme shock scenario (Figure 3). The debt service-to-exports (plus remittances) ratio reaches the threshold in 2025, following a terms-of-trade shock (the most extreme one), again prompted by the Eurobond redemption.

⁶ The probability approach is being reported for additional background information. It is not required from a strictly technical standpoint. The breach of threshold for PV debt-to-exports ratio exceeds the margins established by the guidelines for a borderline case (± 5 percent of threshold).

⁷ The effect of the inclusion of remittances is reported for additional background information. Its reporting is not required from a strictly technical standpoint since the average remittances of the last three years do not exceed 10 percent of GDP as indicated in the guidelines (although in 2015/16, at 9 percent of GDP, they come very close to the threshold). Remittances exceed the threshold indicated in the guidelines of 20 percent of exports.

Table 1. Ethiopia: Comparison of PPG External Debt Baseline Scenario, 2016–36

Fiscal year ending July 7	Threshold	2016	2017	2018	2019	2020	2021	2026	2036
(Percent, unless otherwise indicated)									
PV of Debt to Exports Ratio									
2016DSA	150.0	255.6	250.9	243.9	226.0	207.5	190.4	123.7	51.6
2015DSA	150.0	212.3	220.4	213.9	192.0	174.5	158.2	88.1	...
PV of Debt to GDP Ratio									
2016DSA	40.0	21.9	22.4	22.3	21.3	20.1	19.0	13.4	7.6
2015DSA	40.0	21.7	23.8	24.5	23.2	21.8	20.6	13.4	...
PV of Debt to Revenue Ratio									
2016DSA	250.0	127.0	129.3	126.7	117.6	107.2	99.2	67.0	32.9
2015DSA	250.0	134.8	144.4	146.0	136.9	128.1	123.7	81.4	...
Debt Service to Exports Ratio									
2016DSA	20.0	16.6	17.3	17.3	19.3	18.8	17.7	11.7	4.6
2015DSA	20.0	13.0	13.4	13.0	12.6	12.8	12.1	11.9	...
<i>Memorandum items:</i>									
Grant Element of New External Borrowing									
2016DSA		20.7	31.9	36.9	45.0	41.6	38.1	42.3	52.7
2015DSA		18.4	19.1	28.0	40.1	40.0	39.5	38.6	...
New Commercial Loan Disbursements (billions of U.S. dollars)									
2016DSA		4.825	2.612	1.745	1.303	0.828	0.772	0.856	0.200
2015DSA		3.104	2.916	1.502	0.589	0.654	0.716	0.720	...
Real GDP Growth (annual percent change)									
2016DSA		6.5	7.5	7.5	7.5	7.4	7.3	6.3	6.0
2015DSA		8.1	7.6	7.5	7.5	7.5	7.3	6.5	...
Current Account Balance to GDP Ratio									
2016DSA		-12.0	-10.7	-9.3	-8.9	-8.2	-8.1	-6.0	-3.7
2015DSA		-9.9	-9.1	-8.1	-7.3	-6.6	-5.8	-4.0	...

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

C. Assessment

14. **The external debt sustainability tests confirm that exports are key to ensure external sustainability.** The dollar value of exports (goods and services) has almost tripled in the last decade. But despite this rapid growth, export revenue remains low relative to the indebtedness necessary to finance the level of imports required by the authorities' far-reaching investment plans. Correspondingly, expanding presence in existing export markets and rapid diversification into new products and markets constitutes the linchpin in the authorities' development strategy.

15. **Several factors mitigate external debt sustainability risks, and argue for retaining the current "moderate" rating.** The DSA methodology calls for the use of judgment in interpreting the

mechanical test results. The following considerations mitigate the breach of the export-related thresholds:

- The high level of debt relative to exports is directly associated to sizable initial investments aimed at boosting export competitiveness and domestic supply, which are expected to generate high returns. The main sectors benefiting from the debt-financed investment include energy supply, merchandise transportation, and other priority infrastructure with large expected impact on output. These investments have large up-front costs, but produce sizable and lasting improvements in export competitiveness and hence in Ethiopia's capacity to repay its debt. In the short term (when the PV of debt-to-exports ratio indicator breaches the threshold because of the lagged export response) projected debt service is deemed manageable.

Table 2. Ethiopia: External Public Sector Debt
(Outstanding at end-March, 2016)

	USD, million	Percent of Total
Total	21,647	100.0
Official Creditors	14,912	68.9
Multilaterals	7,088	32.7
IDA	5,002	23.1
IMF	222	1.0
AfDF	1,397	6.5
Other	468	2.2
Bilaterals	7,824	36.1
Paris Club	393	1.8
Non-Paris Club ¹	7,431	34.3
Private Creditors	6,735	31.1
Commercial Banks	2,557	11.8
Suppliers	3,178	14.7
Bond and Notes Holders	1,000	4.6

Sources: Ethiopian authorities and IMF staff calculations.
¹ Includes US\$1 billion deposit in the NBE.

- The probability of debt distress or “sudden stop” episodes is moderated by specific factors: About 70 percent of Ethiopia's external debt is with official creditors, with a significant concessional component (Table 2). The rest is largely trade and other credit linked to external commercial operations of internationally active public corporations (e.g., Ethiopian Airlines, Ethio Telecom). Strict capital controls and administrative controls on current account operations are in place; the Birr is not traded internationally; and there is virtually no portfolio investment or market-tradeable debt—the only exception being the 2015 US\$1 billion Eurobond, which has 9 years remaining maturity and thus does not pose a refinancing risk at this time. While staff advises a phased liberalization of external operations, this would in any case be implemented gradually, posing little immediate risks.

16. **The outlook, however, presents potentially severe risks if exports disappoint relative to projections, and if non-concessional borrowing were to exceed DSA assumptions—which would materially worsen debt sustainability prospects.** While the test breached in this DSA was already breached in the 2015 DSA, the extent of the breached has increased. This is mainly the result of a weakening of the external environment (which is expected to stabilize in 2016/17) and of high imports largely due to drought-related external food purchases. This kept the current account deficit wide and raised debt. The assessment above is posited on significant export growth as identified projects with high export potential come on line (electrical railway link to Djibouti, electricity generation capacity, and Hawassa and other industrial parks, among other); prioritization of investment projects with high import content; and strict adherence to the authorities' borrowing plans described above. Should these projections fail to materialize, debt sustainability prospects and DSA indicators could significantly worsen.

17. **The authorities argued for the maintenance of a moderate rating and expressed their intention to refrain from any additional borrowing that could deteriorate debt sustainability.** From their standpoint, Ethiopia's debt sustainability was firmly supported by the use of the borrowed funds exclusively for investment projects with expected high growth returns—rather than for current spending—and by their careful monitoring of public sector indebtedness, among other things to forestall any other uses. The authorities stated their commitment to refrain from pursuing any additional loans that could deteriorate the sustainability of external debt, including some new commercial (non-concessional) loans that had previously been under consideration. Also, the authorities argued that the US\$1 billion deposit in the NBE should not be considered debt for the purposes of the DSA—as it was unrelated to fiscal operations—and that the debt of Ethio Telecom should likewise be excluded from the DSA. Staff explained that under current joint IMF/WB guidelines, central bank external liabilities must be included in the DSA public debt,⁸ as they represent a claim on the country's external resources not substantially different from government debt for DSA purposes. Regarding the debt of Ethio Telecom, staff stands ready to consider its exclusion if conditions stated in the DSA guidelines are met. However, an essential component for this consideration would be the availability of current financial accounts (only accounts through 2012 are available at this time), audited by commercial financial auditors—since the state audit's focus is mainly on compliance with the law and not on the company's underlying financial situation. The availability of such current audited financial accounts would also be a necessary condition for Ethio Telecom to be able to borrow commercially on the strength of its own balance sheet and profitability, and not on explicit or implicit government guarantees.

D. Public Debt Sustainability Analysis

18. **In the baseline, the projected path of total public sector debt-to-GDP does not result in additional risks beyond those discussed in the external debt sustainability section (Table 5, Figure 4).** As in the 2015 DSA, total public debt remains within the standard thresholds, while declining gradually in the medium and long term. This is the result of output growth and the eventual tapering of large public investment projects after the five-year GTP II. In addition to

⁸ "Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries," SM/13/292, section K.

external debt, discussed above, domestic public debt reached 24 percent of GDP in 2015/16 (from 22.4 percent in 2014/15). About 45 percent of it corresponds to the central government, mostly to the NBE reflecting direct advances to finance the budget (60.5 percent of central government debt), and treasury bills (33.6 percent). State-owned enterprises (SOEs) hold 55 percent of total domestic debt which is all issued in the form of bonds and loans provided by the state-owned Commercial Bank of Ethiopia. Financial soundness and stability indicators do not point to domestic debt servicing difficulties by SOEs.

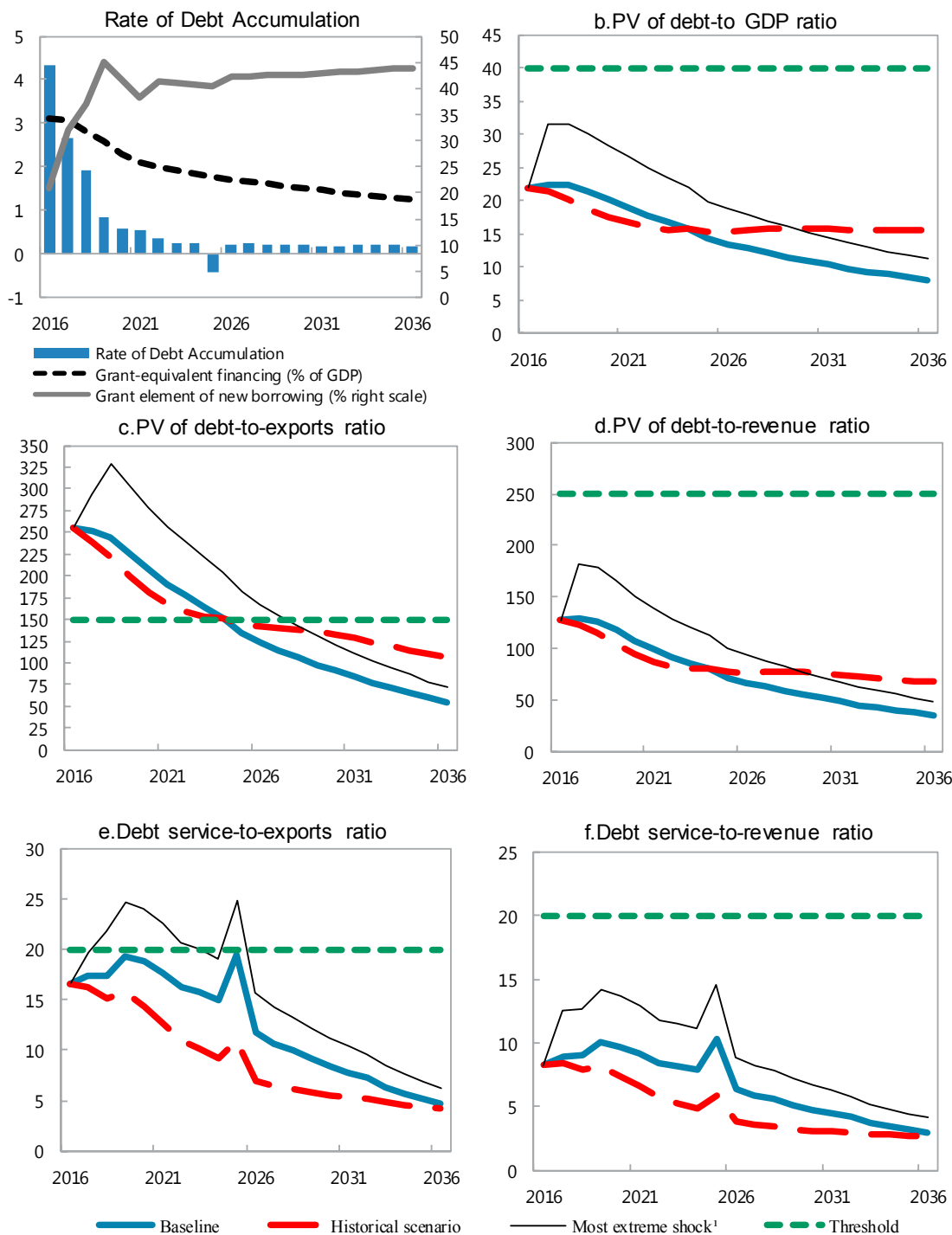
19. **The PV of debt-to-GDP ratio remains below the threshold in the baseline.** However, as in the 2015 DSA, there is a three-year threshold breach under the extreme shock (a one-time depreciation) scenario. This is due to the relatively high initial external debt, as discussed above. Nevertheless, the assumed shock of a large sudden depreciation (a “currency crisis”) is unlikely, as discussed above. Also, the historical scenario shows that an indefinite continuation of the past and present public investment drive—which is not currently envisaged by staff or the authorities—would be unsustainable.

20. **Over the medium and long term, however, gradual reversal of the favorable interest rate-growth differential would require public sector measures to accommodate higher financial costs.** As in most developing countries, the interest rate-growth differential in Ethiopia is negative, reflecting high growth but also distorted interest rates (particularly on domestic liabilities and external concessional borrowing). In Ethiopia, tightly controlled financial markets contribute to these distortions. Financial development and increasing private sector participation will likely result in an upward drift in real interest rates over time. While this process would enhance growth and opportunities to mobilize additional resources, it would also require deliberate public finance policies to create the necessary space for higher financial costs to the budget and broader public sector.

E. Conclusion

21. **Despite some deterioration in external debt sustainability indicators, Ethiopia’s risk of external debt distress remains “moderate.”** The current pace in acquisition of external liabilities and export levels, if maintained over time, would result in an unsustainable external position. This risk, however, is mitigated by its temporary nature and by the envisaged expansion in productive and exporting capacity as a result of ongoing infrastructure investment with high expected returns—partly financed by the increased indebtedness. The structure of external debt (mainly official credit, often concessional), existing administrative controls on imports and capital controls additionally reduce the risk of severe external stress episodes. The main risks are a potential continuation of export underperformance and failure to rein in project-related imports and refrain from associated new non-concessional borrowing. Should these risks materialize, debt sustainability prospects would deteriorate materially. In the event of tighter external financing conditions, the authorities would need to resort to further import compression—which although less disruptive than an episode of external debt distress, could entail severe negative growth effects.

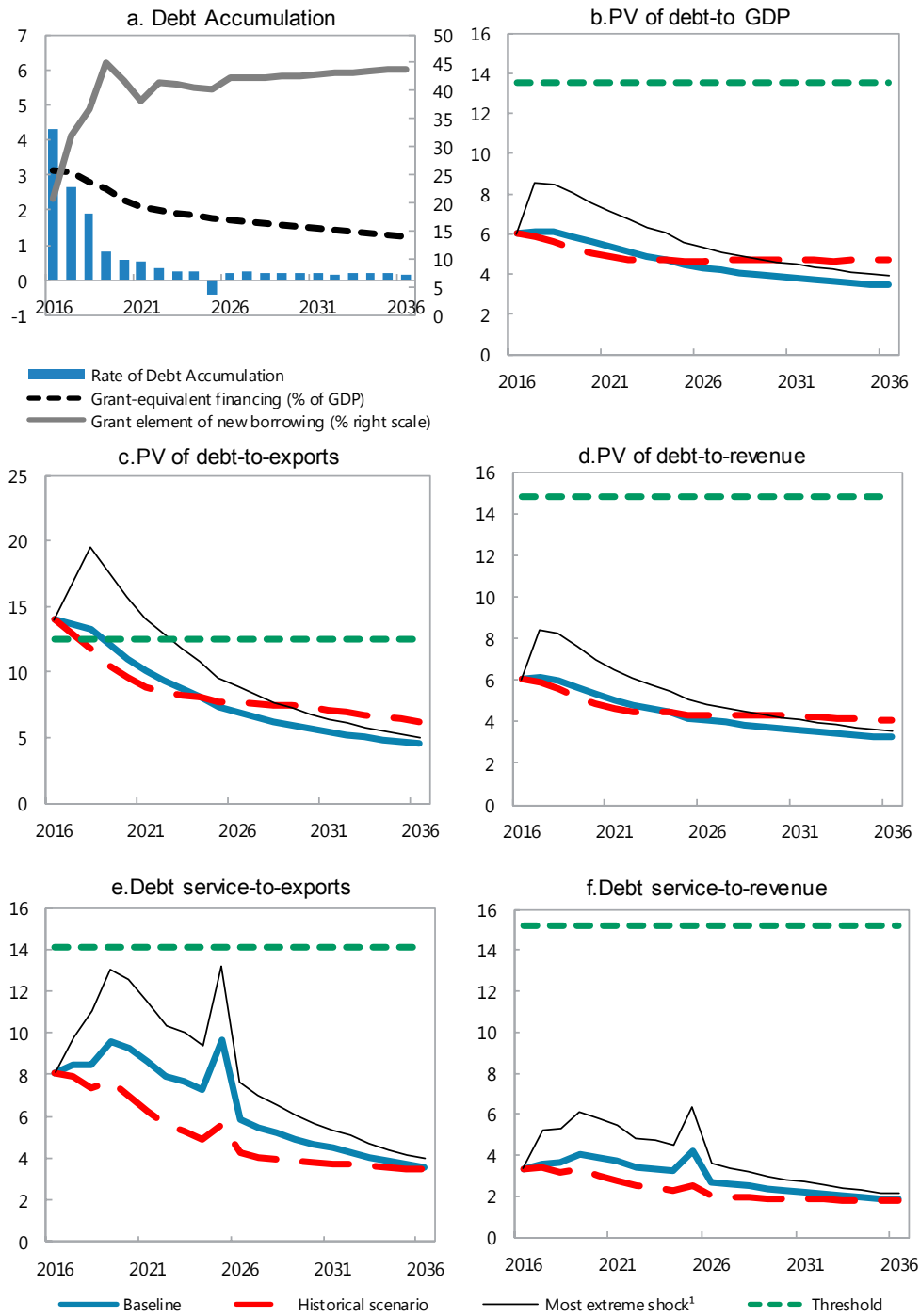
Figure 1. Ethiopia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2016–36¹



Sources: Ethiopian authorities and staff estimates and projections.

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

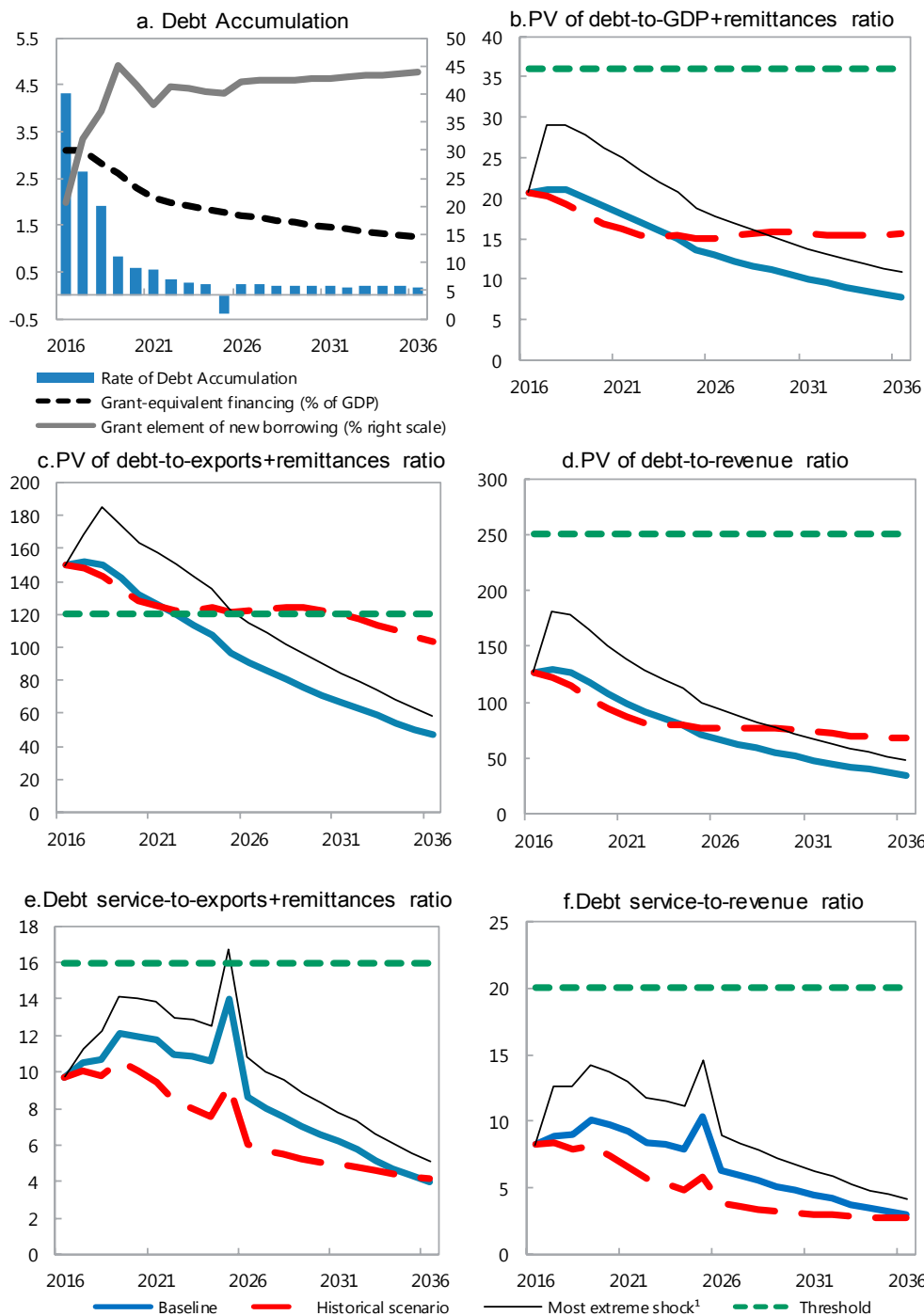
Figure 2. Ethiopia: Probability of Debt Distress of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2016–36¹



Sources: Ethiopian authorities; and staff estimates and projections.

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

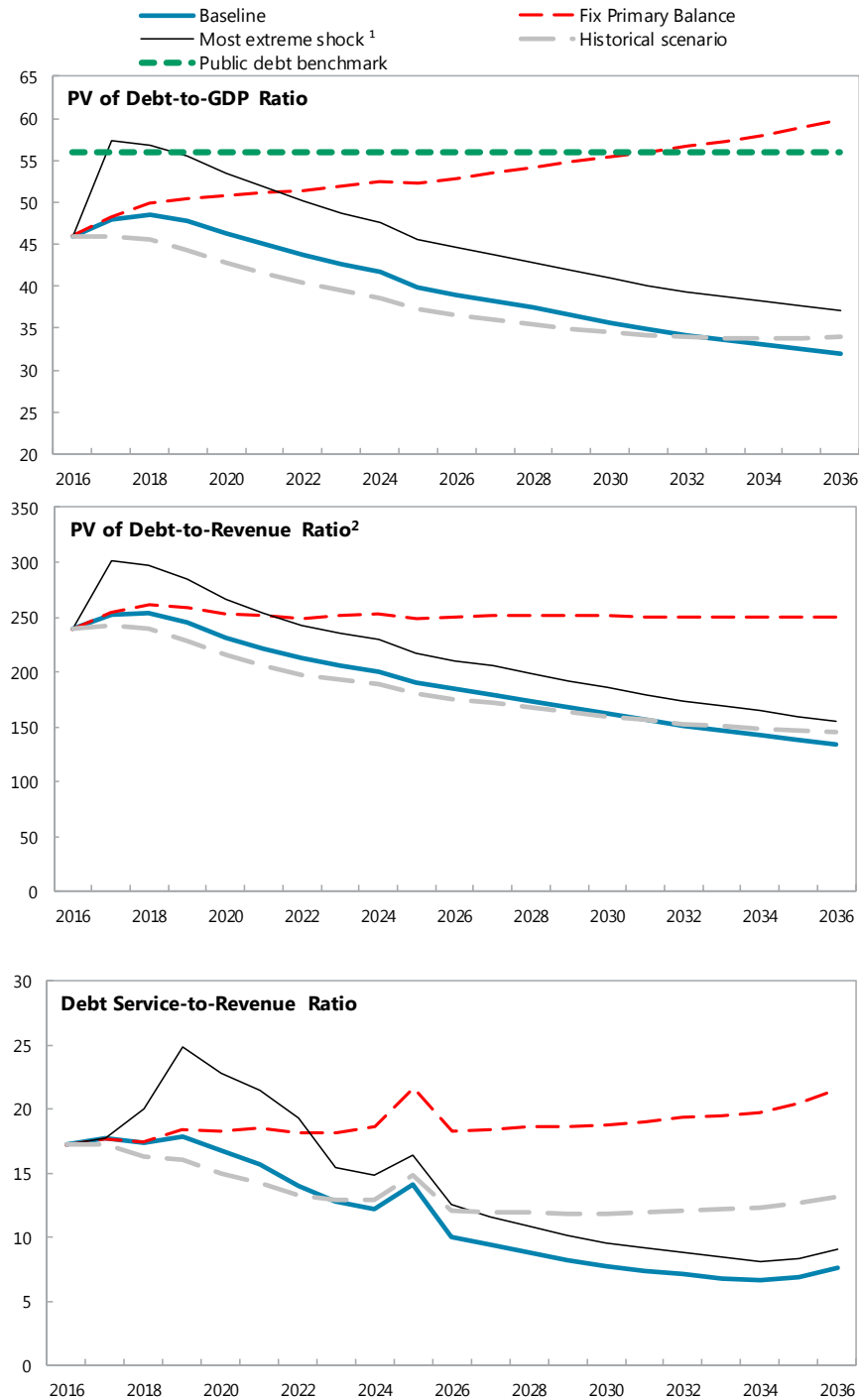
Figure 3. Ethiopia: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios (Including Remittances), 2016–36¹



Sources: Ethiopian authorities and staff estimates and projections.

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

Figure 4. Ethiopia: Indicators of Public and Publicly Guaranteed Debt (Domestic and External) Under Alternative Scenarios, 2015–36¹



Sources: Ethiopian authorities; and staff estimates and projections.

¹ The most extreme stress test is the test that yields the highest ratio on or before 2025. It corresponds to a one-time depreciation shock.

² Revenues are defined inclusive of grants.

Table 3. Ethiopia: External Debt Sustainability Framework, Baseline Scenario, 2013–36¹

	Actual			Historical Average ^{6/}	Standard Deviation ^{6/}	Projections						2016-2021		2022-2036	
	2013	2014	2015			2016	2017	2018	2019	2020	2021	Average	2026	2036	Average
External debt (nominal) 1/	24.1	25.8	31.6			34.5	35.0	35.3	34.7	33.8	32.7		25.5	13.9	
<i>of which: public and publicly guaranteed (PPG)</i>	21.1	22.5	28.3			30.1	30.9	31.1	30.2	28.9	27.6		21.1	13.5	
Change in external debt	3.0	1.7	5.9			2.8	0.5	0.3	-0.6	-0.9	-1.1		-1.3	-0.7	
Identified net debt-creating flows	1.3	1.9	5.9			4.3	1.2	0.7	0.0	-0.2	-0.5		-1.1	-0.8	
Non-interest current account deficit	5.7	7.7	11.6	5.9	3.0	10.1	8.6	8.2	7.5	7.4	7.1		5.2	3.4	4.7
Deficit in balance of goods and services	16.4	17.6	21.9			21.3	19.4	18.9	18.4	18.3	18.2		13.3	7.2	
Exports	12.4	11.6	9.8			8.6	8.9	9.2	9.4	9.7	10.0		10.9	14.7	
Imports	28.8	29.2	31.7			29.9	28.3	28.0	27.8	28.0	28.2		24.2	21.9	
Net current transfers (negative = inflow)	-10.7	-9.9	-10.4	-12.8	2.0	-11.0	-10.7	-10.6	-10.8	-10.8	-11.0		-8.1	-4.7	-7.1
<i>of which: official</i>	-3.2	-2.6	-2.4			-1.9	-1.7	-1.4	-1.4	-1.3	-1.2		-1.1	-0.9	
Other current account flows (negative = net inflow)	0.0	0.0	0.0			-0.2	0.0	-0.1	-0.1	-0.1	-0.1		0.0	0.9	
Net FDI (negative = inflow)	-2.6	-2.6	-3.6	-2.9	0.5	-4.6	-5.8	-5.8	-5.8	-5.9	-6.0		-5.2	-3.7	-4.8
Endogenous debt dynamics 2/	-1.7	-3.1	-2.1			-1.2	-1.6	-1.6	-1.7	-1.6	-1.6		-1.1	-0.5	
Contribution from nominal interest rate	0.2	0.3	0.4			0.6	0.7	0.8	0.8	0.7	0.7		0.5	0.3	
Contribution from real GDP growth	-1.9	-2.1	-2.4			-1.8	-2.3	-2.4	-2.4	-2.4	-2.3		-1.6	-0.8	
Contribution from price and exchange rate changes	-0.1	-1.3	-0.2			...	...	...	...	...	...		...	...
Residual (3-4) 3/	1.7	-0.2	0.0			-1.5	-0.7	-0.4	-0.6	-0.7	-0.7		-0.1	0.1	
<i>of which: exceptional financing</i>	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	23.6			26.3	26.5	26.5	25.8	25.0	24.0		17.9	8.4	
In percent of exports	...	...	240.2			306.5	297.0	289.0	274.1	257.9	240.9		164.2	57.0	
PV of PPG external debt	...	...	20.2			21.9	22.4	22.3	21.3	20.1	19.0		13.4	8.1	
In percent of exports	...	...	206.1			255.6	250.9	243.9	226.0	207.5	190.4		123.7	54.8	
In percent of government revenues	...	...	129.1			127.0	129.3	126.7	117.6	107.2	99.2		67.0	35.0	
Debt service-to-exports ratio (in percent)	8.1	10.5	16.1			22.8	23.5	23.5	25.5	24.9	23.6		14.5	5.4	
PPG debt service-to-exports ratio (in percent)	6.5	7.0	10.2			16.6	17.3	17.3	19.3	18.8	17.7		11.7	4.7	
PPG debt service-to-revenue ratio (in percent)	5.5	5.7	6.4			8.2	8.9	9.0	10.1	9.7	9.2		6.3	3.0	
Total gross financing need (Billions of U.S. dollars)	2.0	3.5	5.9			5.2	3.8	3.8	3.8	3.8	3.8		2.5	1.7	
Non-interest current account deficit that stabilizes debt ratio	2.7	6.0	5.7			7.3	8.1	7.9	8.1	8.2	8.3		6.5	4.0	
Key macroeconomic assumptions															
Real GDP growth (in percent)	9.9	10.3	10.2	10.6	0.9	6.5	7.5	7.5	7.5	7.4	7.3		7.3	6.3	6.0
GDP deflator in US dollar terms (change in percent)	0.5	5.6	0.7	6.8	12.4	5.5	3.4	1.6	1.2	1.4	1.4		2.4	1.1	1.2
Effective interest rate (percent) 5/	1.3	1.4	1.8	1.1	0.3	2.2	2.4	2.4	2.3	2.3	2.2		2.3	1.8	2.2
Growth of exports of G&S (US dollar terms, in percent)	-0.5	8.4	-5.9	13.0	11.0	-1.7	15.5	12.0	12.0	12.0	12.0		10.3	10.1	12.0
Growth of imports of G&S (US dollar terms, in percent)	0.7	17.7	20.9	16.7	12.1	5.7	5.1	8.3	8.0	9.5	9.5		7.7	5.4	6.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	20.7	31.9	36.9	45.0	41.6	38.1		35.7	42.3	43.9
Government revenues (excluding grants, in percent of GDP)	14.8	14.3	15.7			17.3	17.3	17.6	18.1	18.8	19.1		20.1	23.1	20.9
Aid flows (in Billions of US dollars) 7/	2.8	2.6	2.7			2.6	2.9	3.0	2.9	2.9	2.8		3.3	4.8	
<i>of which: Grants</i>	1.5	1.5	1.5			1.3	1.3	1.2	1.3	1.3	1.4		1.7	2.8	
<i>of which: Concessional loans</i>	1.2	1.2	1.2			1.3	1.6	1.8	1.6	1.6	1.4		1.6	1.9	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			3.1	3.1	2.8	2.6	2.3	2.1		1.7	1.2	1.6
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			41.0	50.9	54.5	63.8	62.0	60.5		66.9	72.5	68.2
Memorandum items:															
Nominal GDP (Billions of US dollars)	47.7	55.5	61.6			69.2	76.9	84.0	91.4	99.5	108.3		158.8	319.9	
Nominal dollar GDP growth	10.5	16.5	11.0			12.3	11.1	9.2	8.8	9.0	8.8		9.9	7.5	7.3
PV of PPG external debt (in Billions of US dollars)	...	...	12.2			14.8	16.7	18.1	18.8	19.4	19.9		20.7	24.9	
(Pvt-Pvt-1)/GDPT-1 (in percent)	...	...	...			4.3	2.7	1.9	0.8	0.6	0.5		1.8	0.2	0.2
Gross workers' remittances (Billions of US dollars)	2.5	3.0	3.8			4.2	4.5	4.8	5.1	5.5	5.4		6.2	8.1	
PV of PPG external debt (in percent of GDP + remittances)	...	...	19.1			20.7	21.2	21.1	20.2	19.1	18.1		12.9	7.9	
PV of PPG external debt (in percent of exports + remittances)	...	...	126.6			149.8	151.7	150.1	141.5	132.1	126.6		90.8	46.8	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	6.3			9.7	10.5	10.7	12.1	12.0	11.8		8.6	4.0	

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

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

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

Table 4. Ethiopia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2016–36

	Projections							2036
	2016	2017	2018	2019	2020	2021	2026	
PV of debt-to GDP ratio								
Baseline	22	22	22	21	20	19	13	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	22	21	20	19	18	17	15	16
A2. New public sector loans on less favorable terms in 2016-2036 2	22	24	25	25	24	23	20	16
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	22	22	21	20	19	18	13	8
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	22	23	24	23	22	21	15	8
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	22	25	26	25	24	22	16	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	22	25	27	25	24	23	16	9
B5. Combination of B1-B4 using one-half standard deviation shocks	22	24	26	24	23	22	16	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	22	32	31	30	28	27	19	11
PV of debt-to-exports ratio								
Baseline	256	251	244	226	207	190	124	55
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	256	239	221	199	182	168	141	106
A2. New public sector loans on less favorable terms in 2016-2036 2	256	266	272	262	249	235	181	107
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	256	251	244	226	207	190	123	54
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	256	293	328	304	279	256	167	71
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	256	251	244	226	207	190	123	54
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	256	275	290	268	247	227	149	61
B5. Combination of B1-B4 using one-half standard deviation shocks	256	291	317	293	269	248	162	68
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	256	251	244	226	207	190	123	54
PV of debt-to-revenue ratio								
Baseline	127	129	127	118	107	99	67	35
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	127	123	115	104	94	87	76	68
A2. New public sector loans on less favorable terms in 2016-2036 2	127	137	141	136	128	122	98	68
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	127	127	122	113	103	95	64	33
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	127	133	137	127	116	107	73	37
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	127	141	149	138	126	117	78	41
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	127	142	151	140	128	118	81	39
B5. Combination of B1-B4 using one-half standard deviation shocks	127	140	145	135	123	114	78	38
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	127	182	178	165	151	139	94	49

Table 4. Ethiopia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–35 (concluded)
(percent)

Debt service-to-exports ratio								
Baseline	17	17	17	19	19	18	12	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	17	16	15	16	14	13	7	4
A2. New public sector loans on less favorable terms in 2016-2036 2	17	17	16	18	18	16	12	7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	17	17	17	19	19	18	12	5
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	17	20	22	25	24	22	16	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	17	17	17	19	19	18	12	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	17	17	18	20	20	19	14	5
B5. Combination of B1-B4 using one-half standard deviation shocks	17	19	20	23	22	21	15	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	17	17	17	19	19	18	12	5
Debt service-to-revenue ratio								
Baseline	8	9	9	10	10	9	6	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	8	8	8	8	7	7	4	3
A2. New public sector loans on less favorable terms in 2016-2036 2	8	9	9	9	9	8	7	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	8	9	9	10	9	9	6	3
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	8	9	9	10	10	9	7	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	8	10	11	12	11	11	7	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	8	9	9	11	10	10	7	3
B5. Combination of B1-B4 using one-half standard deviation shocks	8	9	9	10	10	10	7	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	8	13	13	14	14	13	9	4
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	36	36	36	36	36	36	36	36
Sources: Country authorities; and staff estimates and projections.								
1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.								
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.								
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly 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 5. Ethiopia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2013–36
(percent of GDP, unless otherwise indicated)

	Actual			Average ^{5/}	Standard Deviation ^{5/}	Estimate					Projections					
	2013	2014	2015			2016	2017	2018	2019	2020	2021	2016-21 Average	2026	2036	2022-36 Average	
Public sector debt 1/	37.7	41.3	50.7			54.1	56.5	57.3	56.6	55.1	53.7				46.7	37.5
<i>of which: foreign-currency denominated</i>	21.1	22.5	28.3			30.1	30.9	31.1	30.2	28.9	27.6				21.1	13.5
Change in public sector debt	4.2	3.7	9.3			3.4	2.4	0.8	-0.6	-1.5	-1.5				-1.1	-0.7
Identified debt-creating flows	3.0	2.3	3.3			0.4	0.2	-0.7	-1.0	-1.8	-1.7				-1.1	-0.7
Primary deficit	5.9	7.3	7.1	4.3	2.3	5.6	5.3	4.2	3.9	3.3	3.2	4.3			2.9	2.1
Revenue and grants	18.0	16.9	18.1			19.2	19.0	19.1	19.5	20.0	20.4				21.2	23.9
<i>of which: grants</i>	3.2	2.6	2.4			1.9	1.7	1.4	1.4	1.3	1.2				1.1	0.9
Primary (noninterest) expenditure	23.9	24.2	25.2			24.9	24.3	23.3	23.4	23.3	23.6				24.0	26.1
Automatic debt dynamics	-2.7	-5.0	-3.8			-5.2	-5.0	-5.0	-4.9	-5.0	-4.9				-4.0	-2.8
Contribution from interest rate/growth differential	-3.2	-4.5	-3.9			-4.3	-4.9	-5.0	-5.1	-5.2	-5.0				-4.1	-2.9
<i>of which: contribution from average real interest rate</i>	-0.2	-0.9	-0.1			-1.2	-1.1	-1.1	-1.1	-1.3	-1.3				-1.3	-0.8
<i>of which: contribution from real GDP growth</i>	-3.0	-3.5	-3.8			-3.1	-3.8	-3.9	-4.0	-3.9	-3.7				-2.8	-2.2
Contribution from real exchange rate depreciation	0.5	-0.5	0.2			-0.9	-0.1	0.1	0.2	0.1	0.1				...	...
Other identified debt-creating flows	-0.1	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0				0.0	0.0
Privatization receipts (negative)	-0.1	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0				0.0	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0				0.0	0.0
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0				0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0				0.0	0.0
Residual, including asset changes	1.2	1.3	6.1			3.0	2.2	1.5	0.4	0.3	0.2				0.0	0.0
Other Sustainability Indicators																
PV of public sector debt	...	...	42.6			45.9	48.0	48.4	47.8	46.3	45.1				39.0	32.0
<i>of which: foreign-currency denominated</i>	...	...	20.2			21.9	22.4	22.3	21.3	20.1	19.0				13.4	8.1
<i>of which: external</i>	...	...	20.2			21.9	22.4	22.3	21.3	20.1	19.0				13.4	8.1
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...				...	...
Gross financing need 2/	8.0	9.3	9.6			8.9	8.6	7.5	7.4	6.6	6.4				5.0	3.9
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	235.0			239.1	252.3	254.1	244.9	231.1	220.9				184.4	133.8
PV of public sector debt-to-revenue ratio (in percent)	...	...	271.7			265.9	276.9	274.8	263.8	247.1	235.3				194.4	138.9
<i>of which: external 3/</i>	...	...	129.1			127.0	129.3	126.7	117.6	107.2	99.2				67.0	35.0
Debt service-to-revenue and grants ratio (in percent) 4/	12.1	11.9	13.7			17.2	17.7	17.4	17.8	16.7	15.7				10.0	7.6
Debt service-to-revenue ratio (in percent) 4/	14.7	14.1	15.8			19.1	19.4	18.8	19.1	17.9	16.7				10.6	7.9
Primary deficit that stabilizes the debt-to-GDP ratio	1.7	3.7	-2.3			2.2	2.9	3.4	4.5	4.8	4.7				4.0	2.8
Key macroeconomic and fiscal assumptions																
Real GDP growth (in percent)	9.9	10.3	10.2	10.6	0.9	6.5	7.5	7.5	7.5	7.4	7.3	7.3	6.3	6.0	6.3	
Average nominal interest rate on forex debt (in percent)	1.4	1.2	1.6	1.0	0.4	2.2	2.3	2.3	2.3	2.2	2.2	2.3	1.8	1.4	1.7	
Average real interest rate on domestic debt (in percent)	0.9	-4.5	-0.7	-9.7	8.4	-6.1	-5.6	-5.2	-5.0	-5.5	-5.5	-5.5	-5.3	-3.0	-5.0	
Real exchange rate depreciation (in percent, + indicates depreciation)	2.7	-2.9	0.8	-2.8	11.0	-3.4	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	5.5	10.9	5.8	15.9	10.4	10.7	9.6	8.7	8.2	8.5	8.5	9.0	8.2	8.3	8.2	
Growth of real primary spending (deflated by GDP deflator, in percent)	22.7	11.9	14.6	5.0	8.3	5.1	5.1	3.1	8.1	6.9	8.6	6.1	6.9	6.5	7.0	
Grant element of new external borrowing (in percent)	...	...	...	...	...	20.7	31.9	36.9	45.0	41.6	38.1	35.7	42.3	43.9	...	

Sources: Ethiopian authorities and staff estimates and projections.

1/ Refers to nonfinancial public sector gross debt.

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 6. Ethiopia: Sensitivity Analysis for Key Indicators of Public Debt, 2016–36
(percent)

	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
PV of Debt-to-GDP Ratio								
Baseline	46	48	48	48	46	45	39	32
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	46	46	45	44	43	42	37	34
A2. Primary balance is unchanged from 2016	46	48	50	51	51	51	53	60
A3. Permanently lower GDP growth 1/	46	48	49	48	47	46	41	38
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	46	47	46	45	43	41	33	23
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	46	49	51	51	49	47	41	33
B3. Combination of B1-B2 using one half standard deviation shocks	46	47	48	46	44	42	33	22
B4. One-time 30 percent real depreciation in 2017	46	57	57	55	53	52	45	37
B5. 10 percent of GDP increase in other debt-creating flows in 2017	46	56	56	55	53	51	43	35
PV of Debt-to-Revenue Ratio 2/								
Baseline	239	252	254	245	231	221	184	134
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	239	243	239	228	215	206	175	144
A2. Primary balance is unchanged from 2016	239	254	262	259	253	251	250	250
A3. Permanently lower GDP growth 1/	239	253	255	247	234	225	194	160
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	239	246	241	229	214	202	157	96
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	239	258	269	259	244	232	192	138
B3. Combination of B1-B2 using one half standard deviation shocks	239	248	250	237	220	207	158	92
B4. One-time 30 percent real depreciation in 2017	239	302	298	284	266	254	211	155
B5. 10 percent of GDP increase in other debt-creating flows in 2017	239	295	294	281	263	250	205	146
Debt Service-to-Revenue Ratio 2/								
Baseline	17	18	17	18	17	16	10	8
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	17	17	16	16	15	14	12	13
A2. Primary balance is unchanged from 2016	17	18	17	18	18	18	18	22
A3. Permanently lower GDP growth 1/	17	18	17	18	17	16	11	10
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	17	17	17	17	15	14	7	3
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	17	18	18	19	19	18	11	8
B3. Combination of B1-B2 using one half standard deviation shocks	17	17	17	18	17	15	7	3
B4. One-time 30 percent real depreciation in 2017	17	20	21	23	22	21	16	12
B5. 10 percent of GDP increase in other debt-creating flows in 2017	17	18	20	25	23	21	13	9

Sources: Country authorities; and staff estimates and projections.

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

2/ Revenues are defined inclusive of grants.

**Statement by Ms. Chileshe Mpundu Kapwepwe, Executive Director for The Federal Democratic Republic of Ethiopia, and Ms. Gloria Gasasira-Manzi, Advisor to the Executive Director
September 26, 2016**

1. The Ethiopian authorities value the engagement with the Fund and thank staff for the constructive dialogue, during the 2016 Article IV mission, which continues to inform implementation of the country's macroeconomic policy and development agenda. The authorities broadly agree with staff's balanced assessment of the economic challenges and priorities for Ethiopia in the short and medium term.
2. The Ethiopian economy which is one of the fastest growing economies in Sub Saharan Africa has achieved tremendous social and economic gains with increasingly inclusive and employment-generating growth realized in recent years. The second Growth and Transformation Plan (GTP II), which was launched in October 2015 builds on this progress to guide the national development policy priorities for the next five years, 2015/16–2019/20. The key objective of the GTP II is to maintain rapid, sustainable and broad-based growth in a stable macroeconomic environment conducive for investment and international competitiveness. The plan envisions transforming the Ethiopian economy into lower middle income status by 2025.

Recent Economic Developments

3. In FY 2015/16, the economy continued to exhibit strong growth supported by prudent macroeconomic management and productivity-enhancing reforms. In this context, economic activity is estimated to have expanded by 6.5 percent mainly underpinned by growth in manufacturing, construction and service sectors. Economic momentum was, however, dampened by the negative impact of a weaker global environment and severe weather conditions which affected agriculture in some parts of the country.
4. This notwithstanding, the investments made to build resilience in agriculture over time, coupled with pragmatic and timely interventions by the authorities, minimized the impact of the El- Niño induced drought. The authorities have over the past two decades invested in improving agricultural practices, including through commercial farming, training, technology, irrigation schemes for smallholder farmers and infrastructure development. This has resulted in more resilient and interconnected communities and complemented government's actions to mitigate the impact of the drought through provision of substantial resources and food aid with the help of the international community and regional states. These interventions were in addition to the ongoing Productive Safety Net Program (PSNP) successfully implemented in close collaboration with development partners.

5. Fiscal policy implementation has remained prudent, with expenditure and tax revenues broadly in line with the annual budget plan. The general government deficit estimated at 3 percent of GDP, is consistent with targeted levels for the fiscal year. Drought related expenditures were largely met by tapping into reserves accumulated in the oil stabilization fund. This ensured that there was no need to shift resources within the budget and pro-poor development activities were protected.

6. The authorities maintained a tight monetary policy stance in order to keep inflation within the National Bank of Ethiopia (NBE)'s target of single digit inflation. After peaking at 11.9 percent in September 2015, headline inflation receded to 5.9 percent in August 2016. Financial intermediation continues to advance, with a 25.2 percent increase in bank branch openings and a 19.3 percent annual growth of bank deposits as at the end of the fiscal year.

7. The current account deficit for 2015/16 was US\$ 7.06 billion representing a decline from 12 percent of GDP in the preceding year to 10 percent. Notwithstanding the decline in commodity export earnings and increased imports of food, capital and intermediate goods, the increase in export volumes and the strong remittances had a moderating effect on the current account. In addition, Foreign Direct Investment (FDI) inflows, in response to the ongoing investment promotion initiatives, provided strong impetus to the financial account of the balance of payments.

Medium-Term Outlook and Policies

Fiscal Policy

8. The authorities remain committed to prudent fiscal policy and maintaining the deficit at less than 3 percent of GDP. The 2016/17 budget, in line with the GTP II priorities, continues to focus on attaining the key objectives under the Sustainable Development Goals (SDGs) which is one of the major ambitions of the authorities' five-year plan. Expenditure to growth-enhancing infrastructure and social developments largely remain a priority, with about two-thirds of spending having a strong pro-poor focus.

9. Efforts in domestic resource mobilization are being enhanced to support development spending and maintain fiscal sustainability. Although tax revenues have steadily grown over time, the authorities are determined to achieve their medium term target of tax-to-GDP of over 17 percent. Efforts to strengthen tax administration and streamline tax policies to simplify procedures, update tax brackets as well as other measures to improve capacity, technology and tax compliance are being stepped up. The authorities are mindful of the financial implication of tax incentives and for this reason, they are mainly used to support export promotion, and are time-bound and performance-based to ensure their effectiveness.

10. Ethiopia's risk of external debt distress remains moderate and my authorities are committed to maintaining debt at sustainable levels. In this regard, the authorities intend to

refrain from any new non-concessional debt for the time being to the extent that it threatens debt sustainability. Moreover, a significant scale up of financing in the near term is not anticipated as most of the investments commenced in previous years and are expected to materialize in the near and medium term. The debt contracted by the Ethiopian authorities is directly associated with significant growth-enhancing public investments aimed at boosting export competitiveness and expected to generate high returns. The authorities are confident that critical infrastructure, like the energy projects, transportation and industrial parks some of which have already started operations will strengthen the country's export and tax revenues. In addition, state owned enterprises are being managed in a manner that ensures they are self-sufficient. In this regard, a new ministry has been created with the mandate to streamline public enterprises and improve their governance and efficiency. Further to their efforts to boost domestic resource mobilization, the authorities are working on a regulatory framework for Public Private Partnerships (PPPs).

11. The authorities maintain a well-coordinated and centralized management of public funds including extra budgetary funds, which are all monitored and audited. In addition, reforms pertaining to the roll out of program budgeting and IFMIS as well as cash management in preparation for the development of a Single Treasury Account are progressing well. Capacity building and civil service reforms envisaged in the GTP II are expected to enhance institutional and human development at all administrative levels.

Monetary, Exchange Rate and Financial Sector Policies

12. Monetary policy is aimed at maintaining price and exchange rate stability so as to create a macroeconomic environment that is conducive for strong and sustained economic growth. Inflation is expected to remain in single digits in the medium term as reserve money stays in line with nominal GDP and government borrowing remains consistent with monetary policy objectives. The NBE is working on establishing a secondary market for government securities to effectively pursue indirect policy instruments in its monetary policy operations. To further strengthen its monetary policy framework, a forecasting team has been set up under the Economic Modeling and Statistical Analysis Directorate to improve liquidity monitoring and forecasting.

13. The exchange rate remained broadly stable in 2015/16 and the NBE assesses that any potential overvaluation of the birr against the US dollar in 2015/16 would be less than 10 percent. Against this background and recognizing the benefits of a flexible exchange rate, the NBE continues to pursue a gradual depreciation of the birr given the weak export responsiveness to real effective exchange rate movements but yet pronounced pass through into inflation. In addition, the authorities are working towards strengthening the foreign reserves buffer, with the NBE targeting 3 months of prospective imports.

14. The financial sector remains healthy characterized by an increase in banking, insurance and microfinance branches; expansion in savings as a result of the creation of new instruments; and an expansion of credit to the private sector. The NBE continues to promote greater access to

finance and financial inclusion initiatives. New products such as electronic, mobile and agent banking services are being introduced and regulated by the NBE. With this rapid pace of expansion, the NBE will continue to strengthen its surveillance and monitoring tools to ensure that the sector remains sound and stable. In addition, the NBE will also closely monitor the Non-Performing Loans (NPLs) of the Development Bank of Ethiopia (DBE), notwithstanding their provisioning requirement in the NBE's *Asset Classification and Provisioning for Development Finance Institutions Directives* to maintain 100 percent provisioning of NPLs.

Structural Reforms

15. Structural reforms continue with a focus on diversification of the economy, agricultural transformation and industrialization. In this regard, an export-led industrial development strategy has been developed to support a shift from reliance on traditional commodity to high value and diversified goods and services. In addition, government has developed a 10-year National Sustainable Tourism Master Plan with the objective of enhancing the contribution of tourism to economic development.

16. The authorities recognize the importance of private sector participation in the development process and are promoting an environment conducive for investment and private sector development. The government has developed industrial parks and clusters to boost FDI and private investment in key sectors. To this end, the Industrial Park Development Corporation (IPDC) has been set up with the responsibility of facilitating and removing bureaucratic bottlenecks that hinder production and capacity of both export and import substitution industries. In addition, efforts to increase access to credit through the DBE and improve the ease of doing business have been intensified. Moreover, increasing investments in various infrastructure development projects in power generation, telecom, transportation especially the Ethio-Djibouti railways and other logistical services are expected to reduce production costs and enhance overall productivity and competitiveness.

Statistics

17. With support from development partners including the Fund, the authorities have made progress in data compilation and dissemination. The quality of the national accounts and overall statistics continues to improve. Going forward, the authorities have a comprehensive plan to further strengthen the national statistics agency to improve its economic monitoring capacity. With respect to agricultural statistics, an assessment of the Agricultural Statistics System in Africa by the African Development Bank in 2014 concluded that Ethiopia emerges as the country best equipped to run an effective and efficient agricultural statistics system to produce timely, reliable and sustainable statistics.

Conclusion

18. The authorities remain committed to sustain efforts aimed at structurally transforming the economy to address emerging vulnerabilities and build resilience to exogenous shocks in pursuit of strong and inclusive growth. As part of the agricultural development strategy and the Climate Resilient Green Economy (CRGE) Strategy, measures to strengthen resilience of the agricultural sector to weather shocks are being scaled up. In addition, the increased focus on exports is in line with efforts to address some of the emerging macroeconomic imbalances and attendant risks as the authorities pursue their ambitious growth strategy. The authorities appreciate the Fund's policy advice and technical assistance which remain vital as they proceed with implementation of their development agenda under the GTPII.