access CAPITAL

INVESTING IN ETHIOPIA

The Ethiopia Macroeconomic Handbook

2009

This report, part of a series of research publications being launched by Access Capital, provides a broad-based overview of recent economic developments and future prospects. Ten major themes are addressed in an easy to digest question-and-answer format.

1. What has gone well in the Ethiopian economy in recent years?
2. Where are the main shortcomings?
3. What has been the role of macroeconomic and industrial policy?
4. How does the Ethiopian economy compare to its peers?
5. What does the private sector landscape look like and where are the hot spots?
6. How is the banking sector performing?
7. Will double-digit growth continue?
8. When will we see a return of single-digit inflation?
9. Where is the Birr heading?
10. What is needed for deeper private sector development?

The Ethiopia Macroeconomic Handbook

2009

www.accesscapitalsc.com

S U M M A R Y

1. What has gone well in the Ethiopian economy in recent years? 3
Growth, exports, and foreign investment are among the bright spots of the Ethiopian economy in recent years. With government debt cut sharply thanks to external debt forgiveness, spending on debt service has gone down while spending is up substantially on the economy's 'hardware' (roads, power plants) and 'software' (education and health).

2. Where are the main shortcomings? 7
Despite notable progress, many improvements registered in recent years show more modest gains when seen in per capita terms (nearly 30 million Ethiopians have been born since the current government came into power in 1992), relative to GDP, or in comparison to the record of some of Africa's 'star reformers'. Food security remains a challenge. Recently, the inability to control inflation has been a major weakness of monetary policy; the failure to build adequate national buffers—in terms of food stocks or foreign exchange reserves—during the period of high growth was a missed opportunity.

3. What has been the role of macroeconomic and industrial policy? 11
An unprecedented degree of fiscal and monetary policy stimulus as well as 'industrial policies' offering favorable tax and investment treatment for selected sectors have been key drivers of recent growth. Better-than-normal rains helped farm output.

4. How does the Ethiopian economy compare to its peers? 15
Ethiopia's ranking on most measures of development has changed little in relation to other African countries in the past decade or two. But Ethiopia increasingly stands out in terms of aggregate economic size, potentially a big plus for foreign investment.

5. What does the private sector landscape look like and where are the hot spots? 19
The private sector has expanded along multiple dimensions and prospects are particularly strong in agri-business, basic manufacturing, mining, construction, real estate, and banking. There is some concern about whether a level playing field exists in particular sub-sectors, but the most dominant portion of Ethiopia's economy (the 13 million farm households producing nearly 50 percent of GDP) remains—by its very nature—largely characterized by competitive conditions. In some areas, private sector involvement remains restricted.

6. How is the banking sector performing? 23
Ethiopia's banking sector is booming, with strong growth in deposits, loans, and profits. Returns on equity have averaged near 30 percent in recent years, well above the returns of emerging market stocks. The state-owned CBE remains dominant, but private banks are growing fast. The sector faces a somewhat challenging period in the near-term, but medium-term prospects are positive.

7. Will double-digit growth continue? 27
Double-digit growth is unlikely to be registered this year for the economy as a whole, though it remains possible for some key sub-sectors. Due to several near-term drags on the macroeconomy, Access Capital projects somewhat slower but still-strong growth of 8 percent in 2008/09.

8. When will we see a return of single-digit inflation? 29
Not any time soon. Access Capital projects year-average inflation to be just below 40 percent this fiscal year; inflation is unlikely to fall below 10 percent until at least FY 2011.

9. Where is the Birr heading? 31
The steady decline of the Birr seen in recent years will continue, but at an even faster-than-usual pace. Foreign exchange shortages will remain, however, to at least the end of this fiscal year.

10. What is needed for deeper private sector development? 35
In the near-term, private sector activity would be helped most by efforts to control inflation and ease foreign exchange shortages. Over the medium-term, growth will require high levels of investment, which must come either from domestic savings (held down by interest rate policies) or from foreign savings (on which Ethiopia's record so far has been decent but far from exceptional, be it for official inflows of aid or for private inflows such as FDI). Policy reform would boost the investable resources available from all three sources, making the recent growth record more durable. A more inclusive and transparent regulatory and policy environment could also have large payoffs on multiple fronts.

1 What has gone well in the Ethiopian economy in recent years?

KEY POINTS:

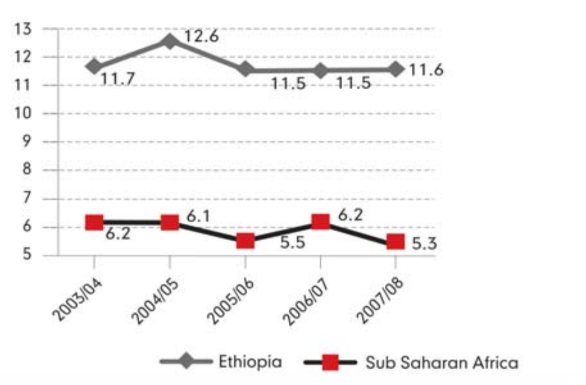
- **Growth, exports, foreign investment, debt reduction, and the expansion of social services and public infrastructure have been the bright spots of the Ethiopian economy in recent years.**
- **Various metrics—beyond just real GDP growth—seem to corroborate the general strength of recent economic activity, even if national accounts statistics may be weak in some areas.**

The Ethiopian economy has been growing rapidly in recent years. According to government statistics, the fiscal year ending in June 2008 marked the fifth consecutive year of double-digit GDP growth (Chart 1.1). A sustained period of such strong growth is rare both in Ethiopia's own economic history and in the experience of other African countries. Indeed, this level of growth is the highest registered among non-oil exporting countries in Africa, and only a handful of other non-oil producing countries worldwide (China among them) have sustained double-digit growth rates during this same time frame.

Ethiopia's growth is not just higher now but also more *broad-based* and *less volatile*. All three main economic sectors—agriculture, services, and industry—grew strongly together, with none falling below 6 percent growth in the past five years (Chart 1.2). Of the 18 sub-categories according to which national income statistics are reported, more than 60 percent registered growth of 8 percent or more in the last five years, compared to just 30 percent in the previous five year period. Expansion in the dominant agricultural sector was driven by rising land use and improved yields (both are up by about 25 percent since 2003/04), which has raised total production of major food crops—as estimated by CSA—to a record 16.1 million tons (Chart 1.3). In the services sector, government spending (which more than doubled in nominal terms between FY 2004 and FY 2008) together with rapid growth in private sector services—retail trade, hotels, transportation, financial services and real estate—were key drivers of growth. Viewed from the demand side, GDP growth has been boosted both by private consumption and investment. Large year-to-year volatility in growth rates, a long-standing problem in Ethiopia due to the dominance of rain-fed agriculture, has also been lowered substantially and is now at its lowest level in many decades (Chart 1.4).

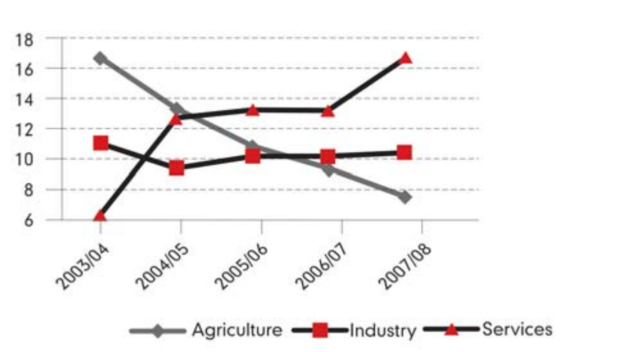
Exports are up sharply in recent years, and are more diversified in terms of *products and destinations.*
Exports now stand at near $1.5 billion (6 percent of GDP) and annual growth rates have averaged 25 percent in the last five years (reflecting roughly 13 percent average volume growth and 12 percent growth in unit prices). This growth has been about 1½ times world export growth, implying a rising market share for Ethiopia in global export markets. The export product mix is now more diversified,

GDP Growth Rates (%) [Chart 1.1]



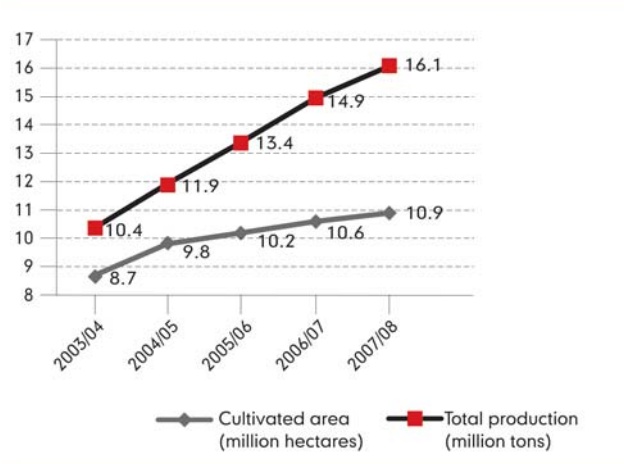
Source: CSA and IMF

Sector Growth Rates (%) [Chart 1.2]



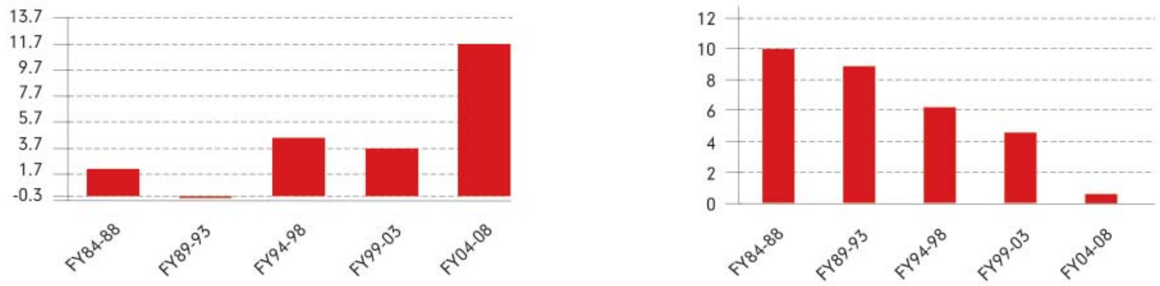
Source: CSA and IMF

Performance of Agriculture [Chart 1.3]



Source: CSA

5-Year Growth Rates (%) **5-Year volatility measure (%)** [Chart 1.4]



Source: CSA

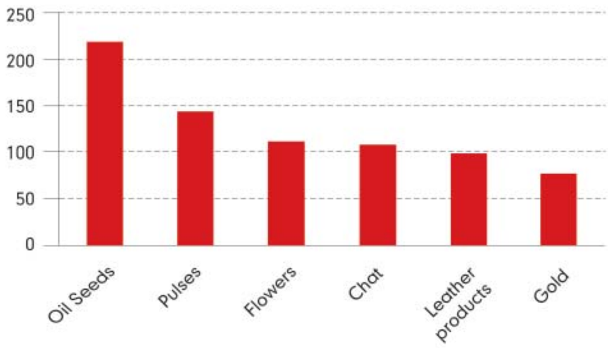
Source: CSA

with coffee exports down to just 36 percent of total exports, from 70 percent a decade ago; export shipments of oil seeds, pulses, flowers, chat, leather products and gold have become increasingly important, with each of these categories now contributing at least $50 million in export income (Chart 1.5). The markets for Ethiopia's goods are changing too: China, for example, was one of the top markets for Ethiopia's exports in FY2006-07, indicative of a broader shift in trade and other economic links to faster-growing world regions such as Asia and the Middle East (Chart 1.6). There is also a markedly lower concentration in Ethiopia's export markets, with the top five export markets now comprising less than 40 percent of Ethiopia's exports, compared to 60 percent a decade ago. Also notable, virtually all of Ethiopia's exports are now undertaken by the private sector, implying Birr 15 billion in gross earnings to an increasingly broadening base of private entrepreneurs and businesses.

Foreign exchange income from services such as tourism has also risen dramatically, as have private transfers in the form of remittances sent by Ethiopians abroad. Gross services income earned from tourism and transportation have more than doubled in the past five years, reflecting a jump in the number of annual tourist visitors to Ethiopia (now around 400,000 persons per year compared to less than half that amount five years ago) as well as several years of strong revenue growth at Ethiopian Airlines (which collected close to Birr 1 billion in net revenue last year, up from just Birr 390 million in FY 2004). Private transfers from abroad reached $2.4 billion in FY2008, more than half from private individuals and the remainder from NGOs (though part of this increase in transfers represents a methodological change to account for estimated remittance inflows). Additional grants of $1.3 billion have been received last year (up from $0.5 billion in FY2004) through official transfers, namely grants provided by governments and international organizations.

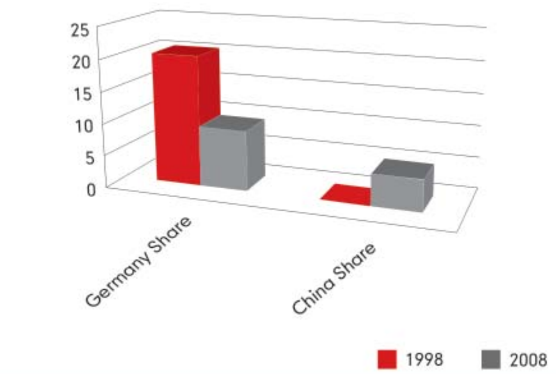
Foreign investment is up more than five-fold in the past five years. FDI data in the balance of payments suggest actual inflows rose from $150 million in FY04 to $816 million in FY08 (Chart 1.7). By a different metric, namely the registrations of foreign investments with the Ethiopian Investment Agency, which record only investor intentions, there is also a five-fold increase in foreign investment approvals between 2004 and 2008, from the equivalent of around $3.5 billion to $18.5 billion. In the past year alone, wide-ranging foreign investments, often mega projects involving hundreds of millions of U.S. dollars, have been reported and/or launched in the cement, mining, manufacturing and agricultural sectors (See page 24 for further details).

Non-coffe exports of $50 mn or more (2008) [Chart 1.5]



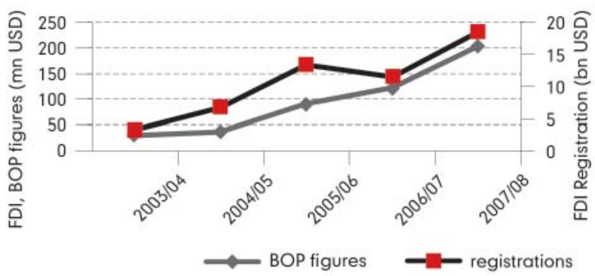
Source: MOTI

Export Market Destination Share (%) [Chart 1.6]



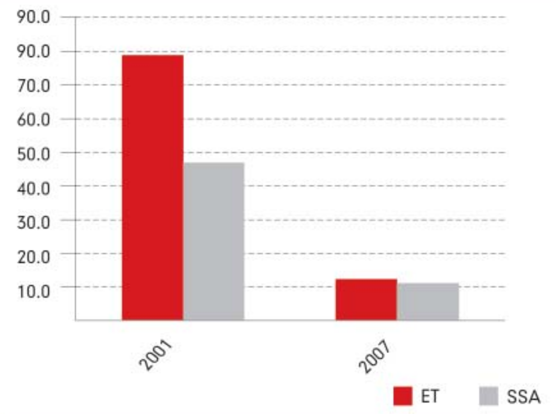
Source: MOTI

Foreign Direct Investment: BOP basis and Registrations [Chart 1.7]



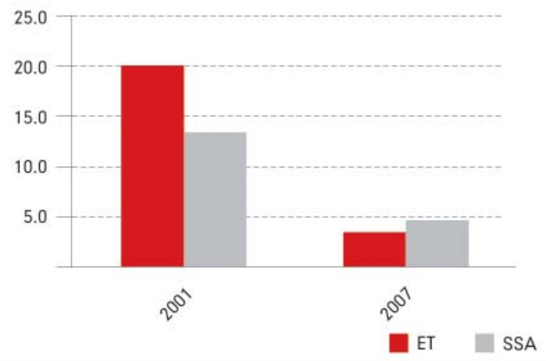
Source: NBE and Ethiopian Investment Agency

External Debt (%GDP)



Source: IMF

External Debt (%Export) [Chart 1.8]



Source: IMF

External debt has been cut drastically. Government debt (domestic and external) has been reduced to moderate levels in recent years (36 percent of GDP in FY08), thanks to large-scale debt relief that international lenders such as the IMF and World Bank provided in the context of the HIPC and MDRI Initiatives. Ethiopia's external debt of 12 percent of GDP is now near the average for SSA countries, and is down from a peak of near 100 percent of GDP in 2001. The external debt service burden is now less than a fifth of what it was at the start of the decade ago, having fallen from 20 to 4 percent of exports (Chart 1.8).

The reduction in debt and debt service has made possible a very large expansion in government spending on public goods, most notably in social services and infrastructure. Annual government expenditure has more than doubled in nominal terms during the past five years, from Birr 21 billion to Birr 47 billion. The increase of Birr 26 billion during this period has been possible thanks to a combination of rising revenue receipts (up Br 16 billion in nominal terms over the same period), higher grant receipts (up by Br 6 billion) and reliance on a much larger deficit (up by Birr 4 billion). Stepped-up government spending has allowed for expanded public goods provision in a wide range of areas, most notably in health, education, roads, electricity and telecommunications (Chart 1.9).

As in most low-income countries, the compilation of GDP statistics is fraught with difficulties and the exact magnitude of growth could very well be mismeasured; however, various other metrics—beyond just GDP growth—seem to provide support for the general strength of economic activity: Estimates of GDP in Ethiopia, compiled by the Central Statistical Agency (CSA), are certainly not without problems, reflecting technical, capacity, and other factors. For example, estimates of agricultural output compiled by the CSA and the Ministry of Agriculture and Rural Development show varying estimates in part due to differences in coverage and methodology; even figures for coffee production—the country's dominant cash crop—are not well established reflecting uncertainties over the amount of domestic consumption.. In terms of overall GDP statistics, one sees a large statistical discrepancy—of as high as 4 percent of GDP in recent years—between GDP compiled from the supply side (sector basis) versus that compiled from the demand side (expenditure basis). The challenge of compiling aggregate GDP statistics is also seen from the sizeable (upward) revision to GDP that was conducted in FY2004/05, when weaknesses in several sectors were addressed and as a result of which the estimate of nominal GDP was raised by around 20 percent (this only affects the level of GDP, not the growth rates).

Infrastructure and Social Sector Trends [Chart 1.9]

Road network
Road network of 44,359 kilometers in FY08, up from 19,000 kilometers in FY93.

Power supply
Generated electrical power is 3531GWH in 2008, up from around 1100GWH in the early 1990s.
Connected towns of 2,358 in FY08, up from 300 at 1991.
Population with electricity access is 1,677,000, up from 401,000 at 1991.

Telecomm services
Fixed telephone subscribers of 890,741 in FY07, up from 404,800 in FY03.
Mobile telephone subscribers of 1,900,000 in FY08, up from 98,000 in FY03.

Water access
Population with access is 52.5 percent in FY07, up from 25 percent in 1990.

Agriculture
Extension agriculture workers now 58817 in 2008, up from 9368 in 2003
Fertilizer use up to 404, 756 tonnes in FY 08, from 322,939 tonnes in FY 03
A total of 697, 855 hectare land is irrigated in 2007/08

Education
Primary enrollment up to 15 million in FY 07, from about 5 million in FY 2000 and 1.5 million in the early 1990s.
Secondary enrollment up to 1.4 million in FY00, from 0.4 million in 1991/92
Technical and vocational education and training (TVET) enrollment grew from less than 2506 in 1991/92 to 73969 in 2006/07
University enrollment up to 180,000 in FY 07, from less than 18,000 in 1990/91; 13 new universities now open

Health
Full child immunization up to 53% in FY07, from 30% in FY02.
Total Health Posts up to 11,000 in FY08, from 119 in FY02.
Health Extension Workers up to 25,000 in FY08, up from 2,737 in 2004

Source: PASDEP Annual Reports and other government publications

These and other factors thus suggest caution in an over-reliance on GDP estimates alone. Still, a review of other metrics compiled by Access Capital tends to corroborate the strength of economic activity in recent years, including for example: partner country data for exports and imports (instead of national customs statistics); oil import volumes; FAO data on cereal crop production/acreage; electricity consumption; airline passenger and cargo traffic; Djibouti port activity; cement usage data; vehicle registrations; bank deposits; tax receipts; tourism arrivals; and land leases extended. (See Chart 1.10 for full listing of close to a dozen such proxies for economic activity). ■

Alternative Measures of Economic Activity Besides GDP [Chart 1.10]

Indicator	Annual Average growth	Period
Real import growth-- ET statistics	17.4	FY04-08
Import growth-ET statistics	28.5	FY04-08
Partners' exports to Ethiopia	19.6	FY04-08
Oil import volumes	15.1	FY06-07
Real export growth-- ET statistics	13.9	FY04-08
Export growth-ET statistics	25.0	FY04-08
Partners' imports from Ethiopia	18.8	FY04-08
Food production growth	17.9	FY04-08
Electricity usage growth	14.1	FY05-07
EAL passenger growth	16.4	FY03-06
EAL cargo growth	19.3	FY03-06
Ports traffic growth	12.0	FY03-08
Cement usage growth	19.0	FY05-08
Vehicle registration growth	10.0	FY04-08
Bank deposits nominal growth	18.0	FY04-08
Bank deposits real growth	3.9	FY04-08
Tax receipts nominal growth	22.3	FY04-08
Tax receipts real growth	8.2	FY04-08
Tourism arrivals growth	17.0	FY03-07
A.A. Land leases granted	19.5	FY05-06
GDP growth	11.8	FY04-08

Source: IMF DTS, FAO, EEPCO, EAL, ESL, MOTI, Ethiopian Transport Authority, NBE; Ministry of Revenue, Ministry of Tourism, A.A Municipality

2 Where are the shortcomings?

KEY POINTS:

- **Recent economic improvements—though significant—remain modest when seen in per capita terms, relative to GDP, or in comparison to the progress of Africa's "star performers".**
- **Food security remains a persistent problem in some areas of the country, and progress in the still dominant small-scale agricultural sector has been evolutionary not revolutionary.**
- **The recent inability to control inflation has been a serious failing of monetary policy; in addition, the failure to build adequate national buffers during the high-growth phase—in terms of food stocks or foreign exchange reserves—has also been a major missed opportunity.**

Gains registered in various economic indicators are limited in many areas when seen against rising population levels, relative to the overall size of the economy, and in comparison to the record of some of Africa's star reformers.

- **Per capita measures:** With high population growth—2.6 percent per year according to government statistics—roughly 2 million Ethiopians are born every year. In fact, around 30 million Ethiopians have been born since 1992, the period when the current government came into power, representing a 50 percent cumulative population increase during this period (and thus indicative of the minimum growth needed in key economic and social indicators just to maintain initial starting conditions). By this metric, trends in several social and economic domains—such as USD GDP per capita, exports per capita, or FDI per capita—do show some gains but also a very low base on which there remains much scope for improvement (Chart 2.1).

- **Ratios to GDP versus nominal increases:** Similarly, while the nominal increase in the value of various economic indicators are substantial (e.g., for exports and revenue collections), progress in these areas needs to be seen in relation to the size of the overall economy (i.e. GDP). With nominal GDP rising by 28 percent per year on average in the past five years, any rise in nominal economic aggregates needs to exceed this threshold to show 'real' gains. On this measure, the gains in areas such as industrial activity, investment, private sector credit, revenue, and exports have in recent years typically lagged behind (or only slightly exceeded) the increase in overall economic activity (Chart 2.2)

- **Finally, in a cross-country context, and especially in relation to Africa's star performers, Ethiopia's *cumulative* growth since the early 1990s places it at the lower end of the group.** As noted by others, the growth spurt seen since 2003 follows an extended period of low or modest growth (See, for example, the World Bank's Country Economic Memorandum). Growth in the prior decade or so averaged 4 percent, so that the cumulative growth since 1992 (a breaking point that marks the coming to power of a new government) is in the mid single-digits. And if one focuses on the growth record of certain highly performing African countries often seen as success stories in the international community—Uganda since 1986, Mozambique since 1993, Tanzania since 1996—then Ethiopia's record since 1992 is seen to be just below what was achieved by these three 'star reformers' (Chart 2.3)

Food security remains a challenge in certain parts of the country—despite an extended period of rapid growth. As of January 2009, for example, the government reported some 4.9 million people were reported to be at risk of food insecurity, an increase from the 1.4 million labeled as being at risk of food insecurity two years earlier. An ambitious Food Safety Net program is in place to address the needs of food-vulnerable populations (most often located in pastoral, low land areas of the country far removed from roads and other services), but

Per Capita Trends [Chart 2.1]

Per Capita Metrics	Mid 1990's	FY05	FY08 or 2007
US dollar per capita income(World Bank Atlas method)	180	146	220
Exports per capita	8.3	8.6	18.7
FDI per capita	...	2.1	10.4

Source: World Bank, IMF, NBE

Percent of GDP Trends [Chart 2.2]

Data in percent of GDP	Mid 1990s	FY04/05	FY08
Industrial Production(%GDP)	14	13.6	13.1
Investment(% GDP)	22	23	21
Private sector credit(%GDP)	17	11.77	10.66
Revenue (%GDP)	13	14.6	12.5
Export(%GDP)	5	6.88	5.77

Source: World Bank, IMF, NBE

Growth performance [Chart 2.3]

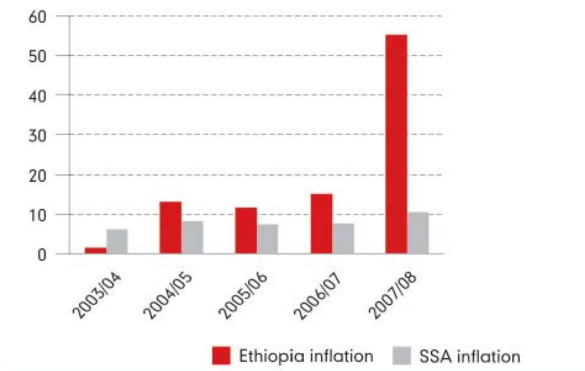
Country	Average Growth	Time frame
Mozambique	8.3	1993-2007
Uganda	6.4	1986-2007
Tanzania	5.8	1996-2007
Ethiopia	5.6	1992-2007

Source: IMF WEO, Data to 2007 only for comparability its scope appears to still need considerable expansion. More fundamentally, Ethiopia has not yet embarked on a full-scale agricultural revolution of the type seen in countries such as China, India, or Vietnam (involving large changes in yields, farming technologies, and institutions). What progress there has been in the use of fertilizers and irrigation is still limited compared to these agricultural success stories, and farm output has been driven more heavily by rain levels and expanded acreage. More dynamic forms of boosting agricultural activity, including through a major expansion of commercial/mechanized agriculture, are thus yet to be fully exploited in this sector, especially given the authorities economic strategy of utilizing "Agricultural Development Led Industrialization" (ADLI) as a tool to reach eventual middle-income status.

In the last couple years, the emergence of several macroeconomic imbalances has been a serious shortcoming of economic policy. In particular, given the priority accorded to accelerating growth, some key elements of macroeconomic stability traditionally associated with Ethiopia (low inflation and a strong revenue base) have been abandoned in recent years.

- **High inflation:** Ethiopia has recently had the worst inflation record in Africa, excluding the very special case of Zimbabwe (Chart 2.4). In July 2008, overall inflation peaked at 64 percent (year-on-year), driven mainly by food prices, which comprise more than half the CPI basket and which rose an astonishing 92 percent year-on-year. However, non-food prices have been very high as well, driven by fuel and construction material prices (which were up 25 percent). The latest inflation reading, for end-January 2009, has moderated somewhat to 38 percent, but still remains among the highest in the world. The exact sources of Ethiopia's record high inflation has generated much debate and controversy domestically, with the blame assigned variously to external factors (namely high global food and fuel prices), domestic structural factors (weak food marketing systems and the increased bargaining power of farmers vis a vis consumers), and domestic policy factors (a loose fiscal and monetary stance generating excess demand relative to the economy's available supply). In our view, the latter is the most significant culprit: neighboring countries have not had anywhere near the inflation levels of Ethiopia despite facing the same global environment, while an explanation based on weak domestic marketing institutions does not seem to provide a fully convincing reason as to why this became binding at this specific juncture. On the other hand, the strong association between inflation and public sector borrowing is striking, as highlighted by recent IMF analysis in this area (see the IMF's July 2008 report on Ethiopia), suggesting a heavy role of domestic policy factors. Also, in the final analysis, the debate about the exact role of policy versus other factors somewhat misses the point: if desired, monetary policy can always be tightened to such an extent that it works to offset other (exogenous) drivers of inflation as long as there is a willingness to sacrifice some growth in the process. In Ethiopia, macroeconomic policy has favored growth even in the face of very high inflationary costs.

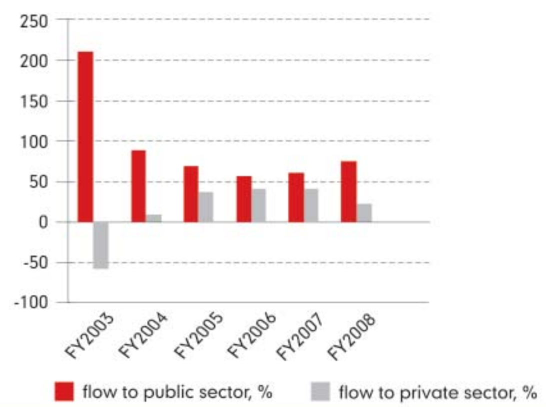
Inflation (%) [Chart 2.4]



Source: CSA and IMF

- **Large-scale public sector borrowing and crowding out of the private sector:** Borrowing by the government and public enterprises has spiked in recent years, reaching 7 percent of GDP in the just completed fiscal year, from a level of just 3½ percent two years earlier. Credit to the public sector (government plus public enterprises) grew by 36 percent in FY2008; by contrast, growth in credit to the private sector was only 22 percent, turning negative in real terms for the first time in many years. Viewed differently, of the 19.2 billion Birr new credit extended in the economy by the banking system in 2007-08, more than three-quarters was directed to the government and state enterprises, leaving less than a quarter for the private sector (Chart 2.5). Government borrowing is facilitated by the operations of the dominant state-owned bank (CBE) which buys government T-bills at near zero interest rates and offers loans to state-owned companies at very low interest rates; more recently, the government has also made use of direct access from the central bank, a policy that has long been discontinued in countries with good monetary management, while large-scale bond issues (by the Addis Ababa municipality, the state-owned electricity company (EEPCO), and the state-owned telecommunications company (ETC)) have been used to finance capital projects. Reflecting in part such crowding out of credit to the private sector, private investment as measured in national account statistics has declined relative to GDP for some time (Chart 2.6).[2]

Flow of Bank Credit [Chart 2.5]

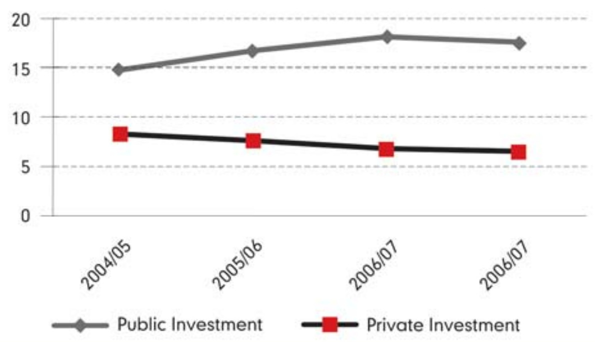


Source: IMF

[1]Macroeconomic data based on the IMF staff reports of February 2009 and July 2008 (www.imf.org).

[2]Private investment data, as reported in IMF staff reports show a decline from 8.3 percent in FY 2005 to just 5.9 percent of GDP in FY 2008. However, for various technical reasons (private investment is measured as a residual in GDP statistics), these estimates may be particularly weak.

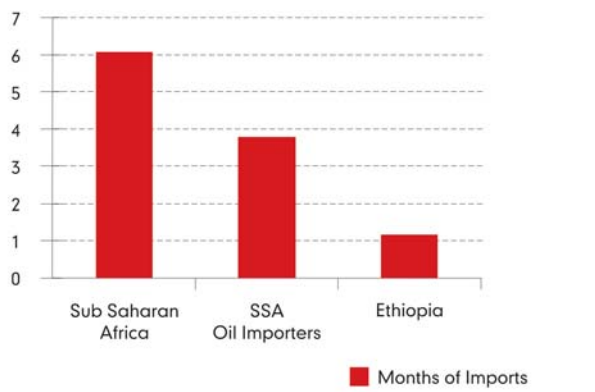
Investment (percent of GDP) [Chart 2.6]



Source: IMF Staff report January 2009

- **Foreign exchange shortages and low international reserves:** Ethiopia's reserves, which were sufficient to cover 3½ months imports as recently as FY 2005, have fallen to levels that are sufficient to cover only around one month of imports, among the lowest coverage ratios in the continent (Chart 2.7). The decline in reserves shows that, despite the strong jump in foreign exchange earnings from exports, remittances, grants and the like, Ethiopia's foreign exchange outflows (on imports, debt service, etc) have risen even higher, requiring a drawndown of the country's foreign reserve savings to pay for the difference. With dwindling reserves, an important source of foreign exchange supply to commercial banks has fallen sharply in recent months (banks acquire foreign exchange either directly from their exporter clients or through buying dollars from the central bank; the latter source of supply has been cut recently as the central bank limited its sales on account of falling reserves). The clearest manifestation of these pressures is the severe difficulty now faced by private business in securing foreign exchange from banks.

International Reserve (2008) [Chart 2.7]



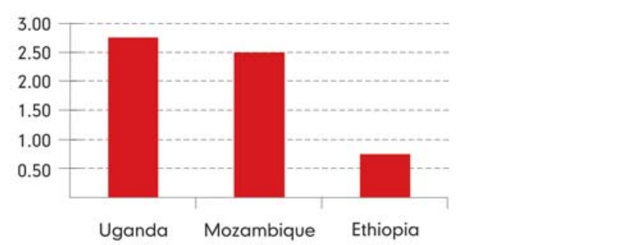
Source: IMF

- **Large real appreciation of the Birr, which has reduced exporters' incomes:** Despite a trend depreciation in the nominal exchange rate of the Birr in recent years (from a year average rate of 8.6 Birr/USD in FY 2004 to 9.2 in FY 2008), Ethiopia's real effective exchange rate (REER) has risen by about 25-30 percent in the past few years, depending on slightly different methodologies for computing the REER (see the IMF's July 2008 Staff Report). This indicates that the Birr has become stronger in 'real terms,' if one accounts for the fact that inflation in Ethiopia is much higher than that in its trading partners. Such a strengthening of the Birr in real terms encourages growth in imports (which are not as expensive as they might have been) and reduces incomes of exporters (whose birr earnings are lower than they could otherwise be). An appreciation of this magnitude also has the very negative effect of biasing economic activity to overuse imports and capital goods, precisely the opposite of what would be desirable for a labor and domestic-resource intensive development strategy. One measure of the extent to which the Birr has deviated from its true 'market value' is offered by the parallel market rate, which is reportedly near 12.8 Birr per USD and thus around 15 percent more depreciated than the bank exchange rate.

Despite a record run of good growth, policies have not been used to build national buffers for key resources such as food stocks or foreign exchange reserves. In many countries, years of high growth are used as opportunities to build savings, but this has not been the case in Ethiopia: the import coverage of international reserves was not improved (it fell instead from 3.7 to 1 month of imports) and stockpiles of basic needs such as food reserves do not appear to have been stockpiled in sufficient quantities (reported food reserve stocks fell from near 300,000 tons - to just 103,00 tons between FY 2004 and FY 2008). Ethiopia's experience stands out when compared to countries that had similar episodes of five consecutive years of strong growth: international reserves, for example, still exceeded three months cover in virtually all those cases.

Finally, Ethiopia's record on poverty reduction—although positive—appears limited and may have stalled recently following the spike in inflation. For a country like Ethiopia, one of the most significant barometers of progress remains the scope of broad-based poverty reduction. Very recent data in this area is not available, but perhaps the most authoritative source in this area—the Household Income, Consumption, and Expenditure Survey—suggests that the poverty ratio fell from 46 percent in FY 1996 to 39 percent in FY 2005. Though cross-country comparisons are not strictly appropriate, Ethiopia's annual percentage point decline in the poverty rate is much lower than the declines registered in some other reforming African countries, such as Uganda and Mozambique (Chart 2.8). In addition, there is widespread concern that improvements in various non-income measures of well-being—such as the expansion in school enrollment, health facilities, teachers and health workers—have focused predominantly on quantity at the expense of quality. Finally, the recent surge in inflation considerably complicates the assessment of poverty reduction, as urban poverty rates for instance have most likely risen substantially, while urban unemployment remains high. Just as likely, a sizeable share of the rural population may also have been hurt by the recent surge of food prices, as large segments of rural Ethiopians are actuallynet buyers of cereals and given that cereal production is quite concentrated among the farm population.[3] In sum, while poverty may have fallen modestly in the early 2000s, the recent spike in inflation has possibly reversed these gains for very large segments of the population. ■

Poverty Reduction on a Comparative Context (Percentage point per year) [Chart 2.8]



Source: World Bank

[3]See, for example, the FAO's "State of Food and Agriculture 2008" (page 76) and the World Bank's World Development Report 2008 (page 109).

3 What has been the role of macroeconomic and industrial policies?

KEY POINTS:

- **An extraordinarily stimulative set of monetary, fiscal and industrial policies propelled recent growth.**
- **Policy stimulus of this type can boost near-term growth easily, but this will be sustained over the longer-term only if government spending on public goods generates sufficiently high returns, if favored export sectors succeed in global markets, and if private sector credit is being direct towards profitable business ventures.**

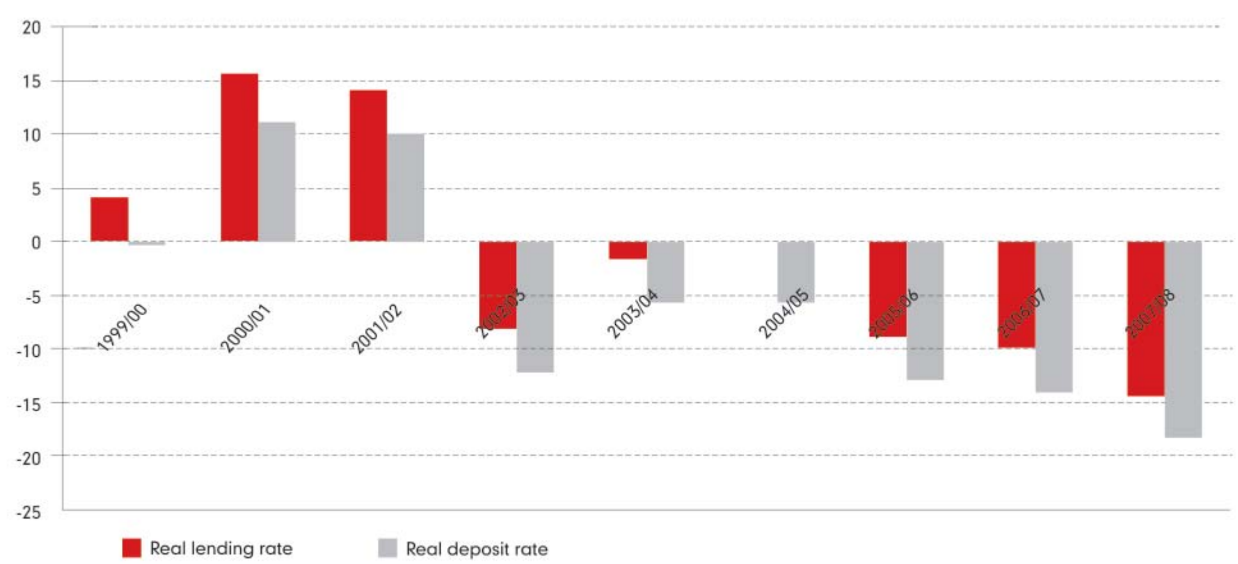
In an effort to maximize growth, a highly stimulative set of economic policies have been put in place in three broad areas:

- **Monetary policy—low interest rates:** Interest rates have been negative in real terms since FY2003, by as much as 30 percent in recent months, as bank nominal bank lending rates have remained near 9-10 percent in the midst of 40-percent plus year-average inflation (Chart 3.1). Not surprisingly, such an interest rate policy—which effectively subsidizes those able to access credit—has led to a spike in demand for loans, be it in construction, services, manufacturing or trade, all of which has worked to stimulate growth. Deposit rates are even more negative in real terms (given nominal deposit rates of just 4 percent). This has been such a deterrent to holding deposits that growth in broad money has fallen short of growth in nominal GDP in Ethiopia since FY 2004, just the opposite of the usual process of increased monetization that takes place in fast growing developing countries.

- **Fiscal policy—ramped up spending by government and state enterprises:** As noted earlier, government spending has risen from Birr 21 to 47 billion during the past five years, equivalent to average increases of more than Birr 5 billion per year. Such a massive expansion in spending works to boost growth, through the billions of Birr pumped into wages for newly employed teachers, health care providers, social safety net recipients and government workers, and into even larger billions spent on road-building, electrification, telecom expansion, and other capital projects (Chart 3.2). In fact, the level of government *capital spending*, at more than 10 percent of GDP, has been found to be the highest among African countries in a recent Goldman Sachs study reviewing infrastructure spending in 12 large African markets (Chart 3.3).[4] In addition to the jump in government spending, the public enterprise sector has engaged in large capital spending programs of its own, for which aggregate statistics are not fully available; however, judging by their reported use of bank borrowing (near 4½ percent of GDP according to latest IMF staff report), the extra spending of state-owned companies could be at least another Birr 17 billion per year.

- **Industrial policy—favorable tax and investment incentives:** A policy of providing special treatment to favored sectors—along the lines of policies adopted earlier in East Asian countries, China, and many other emerging markets—has provided the third impetus to recent growth. The favorable treatment involves, among others: extended tax holidays to exporters; duty-free importation of capital inputs; preferential access to land to large-scale investors; and special credit terms and facilities to favored sectors. Such policies have clearly generated some widely publicized successes—notably the flower sector whose exports are now $112 million from near zero ten years ago—as well as some less well-known cases of growth in both agriculture and manufacturing.

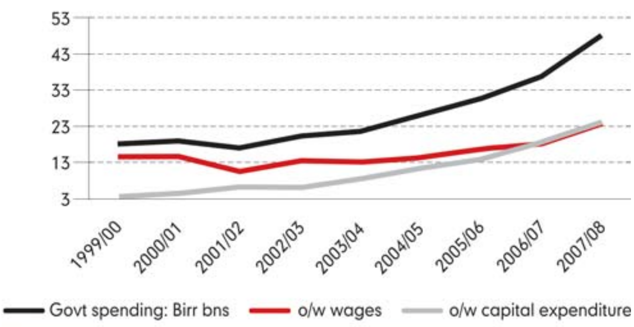
Real Lending Deposit Rates (percent) [Chart 3.1]



Source: NBE

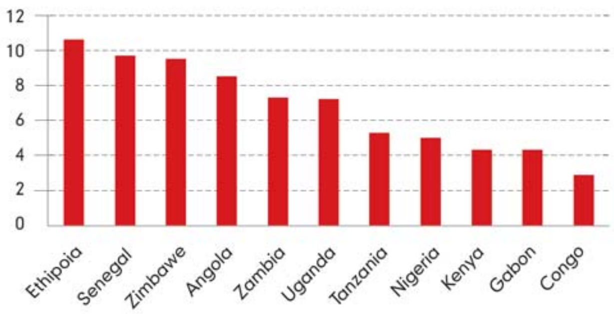
[4]Goldman Sachs Economics Paper 174, "Financing Africa's Infrastructure Bill," October 2008.

Government Spending [Chart 3.2]



Source: NBE and MOFED

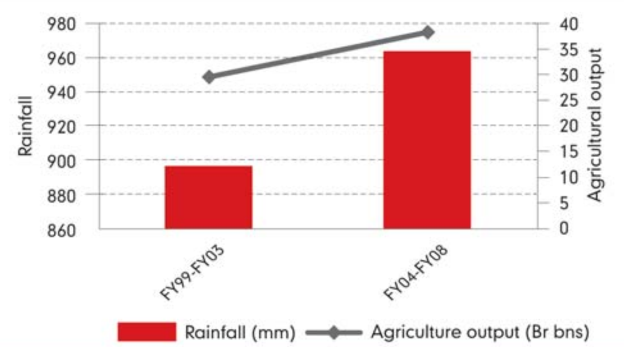
Public Capital Expenditure, Average percent of GDP,2003-07 [Chart 3.3]



Source: Goldman Sachs

Within the agricultural sector, weather played a role in boosting production as has the greater use of yield-improving inputs such as fertilizers. We estimate that around 15 percent of the extra agricultural output can be attributed to better rainfall during FY2004-2008, which was nearly 10 percent higher than the average levels seen in the previous five year period (Charts 3.4).[5] Besides better rains and expanded farm acreage, the improvement in yields has been possible with higher fertilizer use (up from 231,000 to 396,000 tons in the five years to FY 2008 according to the FAO, but a usage rate that is still just about a third of the developing country average of near 100 kilograms/hectare).

Rainfall and Agricultural Output [Chart 3.4]

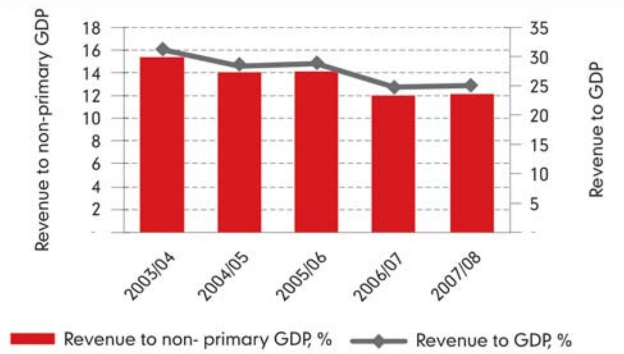


Source: CSA

Activist government economic policies of the type seen in Ethiopia beg the question of whether they contribute just to a short-term growth spurt or lay the foundations for durable long-term growth. While some elements of the policy stimulus provided in recent years boost near-term growth relatively easily, the longer-term consequences are more uncertain: the subsidized or even 'free' (in real terms) private credit being provided to businesses needs to be directed to profitable ventures; favored export sectors must ultimately succeed in global markets; and large government mega-projects eventually need to generate sufficiently high returns. Needless to say, it is too early to judge the long-term success of such policies, but the following points are notable.

Ethiopia's recent experience has already deviated from the record of other "developmental states" in certain respects, for example, in key macroeconomic areas such as the maintenance of low inflation, a strong revenue base, and adequate reserve cover (Chart 3.5). The recent high inflation record, as noted above, already places Ethiopia as an outlier within Africa—but it also makes it an outlier based on the record of other developmental states. Also notable is the rapid erosion of Ethiopia's tax base, which has fallen from above 16 percent of GDP in FY2004 (which was roughly the average for African countries at that time) to just 12.1 percent of GDP last year (the bottom third of African countries) (Chart 3.6). If not reversed, such a sharp fall in internally-generated resources will clearly thwart the effectiveness of any state, whether it aims to be "developmental" or not.

Tax Revenue to GDP [Chart 3.6]



Source: MOFED

Beyond macroeconomic slippages, there are also potential concerns about the form of economic activism taking place in Ethiopia. An activist or developmental state is, in principle, a potentially positive force for economic growth. The record of "development states"—a model held up by many policy makers in Ethiopia—has been impressive in many cases, most notably in East Asia. An extensive economics literature—focused on imperfect markets and second-best policies—can also provide support for an activist, industrial policy. And in certain areas, Ethiopia's policies have indeed followed the positive aspects of a 'developmental state', namely in working to increase the provision of classic public goods such as roads, schools, health centers, etc. However, in other areas, large-scale government spending is taking place on investments that could readily be done by (domestic and foreign) private investors in sectors as varied as telecoms, financial services, railways, and residential construction. Large new foreign investment

[5]The estimates are based on an econometric model which can explain agricultural output almost fully as a function of rain, fertilizer use, area cultivated, and the active rural labor force.

Economic indicators in Ethiopia and High-Growth Countries [Chart 3.5]

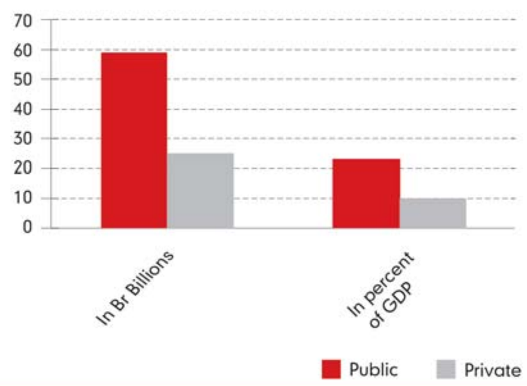
Country	Growth	Inflation	CAD	Reserves	Export growth
Ethiopia FY 2004-2008	11.6	19.3	-5.8	2.5	25.0
High-Growth Countries Average*	**7.8**	**5.4**	**-0.4**	**6.1**	**16.8**
Botswana, 1960-2005	9.6	10	-2.4	18.7	18.7
Brazil, 1950-1980	8.3		-4.6	5.1	21.9
China, 1961-2005	8.8	6.8	1.2	7	16
China, HK, 1960-1997	7.2	8.6	4.8	1.5	17.5
Indonesia, 1966-1997	6.6	11.7	-2.3	2.7	16.6
Japan, 1950-1983	6.4	3.8	0.7	3.4	19.7
Korea, 1960-2001	7.9	6.4	-1.9	2.6	24.3
Malaysia, 1967-1997	7.3	3.9	-2.3	4.5	15.6
Malta, 1963-1994	6.6	3.6	5.2	12.5	18.4
Oman, 1960-1999	7.6	0.3	-2.4	3.9	0
Singapore, 1967-2002	8.3	1.9	-1.1	5	16.2
Taiwan POC, 1965-2002	9.3	3.1	4	7.7	17.2
Thailand, 1960-1997	7.4	5.3	-4.4	5.5	15.9
AVERAGE	**7.8**	**5.4**	**-0.4**	**6.1**	**16.8**
Other High-Growth Countries**	**Growth**	**Inflation**	**CAD**	**Reserves**	**Export growth**
India, 1992-2007	6.6	6.6	-0.6	7.4	14.5
Mauritius, 1980-2007	5.2	7.3	-2.3	3.5	7.3
Mozambique, 1993-2007	8.3	19.7	-15.7	4.8	22.8
Tanzania, 1996-2007	5.8	7.6	-5.8	5.9	9.7
Uganda, 1986-2007	6.4	39.3	-4.6	4.7	10.9
Vietnam, 1986-2007	7	24	-3.5	1.5	22.1
AVERAGE	**6.5**	**17.4**	**-5.4**	**4.7**	**14.6**

*These represent 13 countries found to have sustained high growth rates in the World Bank's "The Growth Report(2008)

** For averages, data to 2007 used since 2008 GDP data still not available for most countries

Source: World Bank's "The Growth Report (2008)" and IMF WEO in these sectors would provide the benefit of bringing in new (non-debt) financing, including foreign exchange, in contrast to public sector mega-projects which draw down on existing foreign exchange within the domestic banking system, leaving less (all else equal) for the existing private sector (Chart 3.7). It is the case that some of Ethiopia's public enterprises can, in principle, draw in new foreign exchange themselves through external borrowing, implying that they should have no net negative impact on the balance of payments (for example if telecom equipment imports are covered by the investment or loans of the Chinese partners involved). However, other major public sector activities do not bring in counterpart foreign exchange reserves to pay for the associated imports of items such as cement, steel, and machinery—for instance, the government's massive condominium construction projects (some 24 billion over many years), the domestic borrowings of the Oil Stabilization Fund (1½ percent of GDP to October 2008 according to the IMF), municipal bond borrowings (of Birr 2 billion by Addis Ababa alone), or even simply the growth in overall government spending that is not matched by additional loans or grants. Moreover, in many of these areas, it is not clear why the public sector should in the first place be seen as better equipped in the managerial, financing, and technical aspects of these activities compared to, say, established private or foreign operators in the relevant sectors.

Stock of bank credit to public and private sectors (FY2007-08) [Chart 3.7]



Source: NBE

A major credit push by government directive or influence—as is the case in CBE and DBE—also raises the risk for potentially major losses over time. The record of state-directed and state-influenced lending is dismal in African countries, resulting on average in fiscal costs of 5-15 percent of GDP.[6] Ethiopia may, of course, turn out to defy the historical record and the record profits reported by at least some public sector banks (i.e. CBE) might seem to suggest that this is the case.[7] However, it is notable that prior to its recent turnaround the state-owned CBE went through an extended period during which its non-performing loans (NPLs) rose to unprecedented levels (exceeding 50 percent of loans) and this may occur again as problems with new loans only accumulate with a lag. Second, guarantees offered by the government's development banks (e.g. for exporters and other favored sectors) potentially represent a huge burden that has to be covered by public funds in the coming years. Recent press reports (neither denied or confirmed by the relevant authorities) already seem to suggest that the main development bank, DBE, may have NPL ratios of as high as 80 percent—at least for certain categories of its loan portfolio. Given the lack of up-to-date annual public reports for major state-owned banks such as DBE—in contrast to the timely publication cycle seen at private banks— there is only limited scope for assessing the scale of potential public sector losses linked to "developmental lending".

[6]See the World Bank's "Making Finance Work in Africa" (Chapter 3) and IMF Working Paper 04/55.

[7]The CBE has recently reported record gross profits of Birr 1.3 billion for the first half of this fiscal year alone, an 80 percent jump from the same period last year.

4 How does the Ethiopian economy compare to its peers?

KEY POINTS:

- **Ethiopia's relative ranking in many areas of economic and social development is yet to change substantially and the scope of overall economic transformation is still in its early stages.**
- **Ethiopia nonetheless increasingly stands out relative to other African countries on account of the sheer size of its population (now second only to Nigeria) and the large absolute value of key economic aggregates such as its US dollar GDP, total imports, overall food production, available crop land, etc. The 'scale effects' associated with these economic aggregates could potentially be a big plus for foreign investment and also for making growth (once kick-started) more durable over time.**

Ethiopia has made some advances in key economic spheres but still shows a need for considerable progress on many measures of development. This, in part, simply reflects the fact that Ethiopia's relative standing is partly determined by the progress registered by other countries.

- **Development Indicator Rankings:** On simple rankings of per capita GDP (USD PPP basis), while Ethiopia's per capita income has risen (in PPP terms) from $450 in 1990 to $574 in 2000 and $1055 in 2007, it remains at roughly the 10 percent income level of average world per capita income. However, moving beyond a purely income based measure, a somewhat better record is seen in terms of its level on the UNDP's Human Development Index, which shows Ethiopia rising from ranking at just 28 percent of the highest rated nation to ranking at 40 percent of the highest rated nation (Chart 4.1).

[Chart 4.1]

Per Capita Income	1990	2000	2007 Or latest
Ethiopia (USD PPP basis)	450	574	1055
World average(USD PPP basis)	4110	6526	9543
Ethiopia Vs World Average	11%	9%	11%
Human Development Index			
Ethiopia Level(Index)	0.282	0.309	0.406
Global Level Average (Index)	0.714	0.712	0.743
Ethiopia Vs Global Average Level	39%	43%	55%
Ethiopia Vs. Highest Ranking Nation	28%	31%	41%

Source: WB and UNDP Human Development Report

Business Environment Ranking [Chart 4.2]

Business Environment Global Ranking	2007	2008
Doing Business rank	109/181	116/181
Doing Business rank (%)	Top 60%	Top 64%

Business Environment Africa Ranking	2008
Doing Business rank	11/46
Doing Business rank (%)	Top 24%

Source: World Bank Doing Business

- **Business Environment Rankings:** With respect to the business environment, Ethiopia has a ranking of 116 out of 181 nations worldwide. But Ethiopia compares relatively favorably against its regional peers, placing within the top quarter among 46 Sub-Saharan African countries (Chart 4.2).
- **Infrastructure rankings:** In terms of infrastructure, Ethiopia relative position in various cross-country comparisons—as in the infrastructure rankings of Global Competitiveness Report or the World Bank's Logistics Performance index—generally also show a low base relative to countries worldwide but an average or better standing within Sub-Saharan Africa (Chart 4.3 and 4.4).

Global Competitiveness Report [Chart 4.3]

Infrastructure measures	Overall score	Rank in World
Quality of overall infrastructure	2.2	114/128
Quality of railroad infrastructure	1.3	113/128
Quality of port infrastructure	1.4	124/128
Quality of air transport infrastructure	4.5	65/128
Quality of electricity supply	3.6	87/128

Source: World Economic Forum

World Bank Logistics Performance Index [Chart 4.4]

World Bank Logistics Performance Index	Rank in World	Ratio to Africa Average
Overall Logistics	104/150	99%
Customs	109/150	97%
Infrastructure	135/150	85%
International shipments	97/150	103%
Logistics competence	129/150	86%
Tracking and tracing	141/150	79%
Domestic logistics cost	34/150	106%
Timeliness	37/150	75%

Source: World Bank

Additional metrics show the still limited scope of overall economic transformation, even when compared with other African countries. The agriculture share of GDP, the urbanization rate, the role of industrial activity and FDI, levels of private investment and exports, as well as private sector credit show some level improvement from the past but generally stand at lower levels than in other African countries (Chart 4.5).

But Ethiopia increasingly stands out in terms of aggregate economic size, and the 'scale effects' associated with these economic aggregates could potentially be a big plus for foreign investment and also for making growth (once kick-started) more durable over time (Chart 4.6, 4.7, 4.8).

- **Population:** Ethiopia's population is now the second largest in Africa and 16th largest in the world.

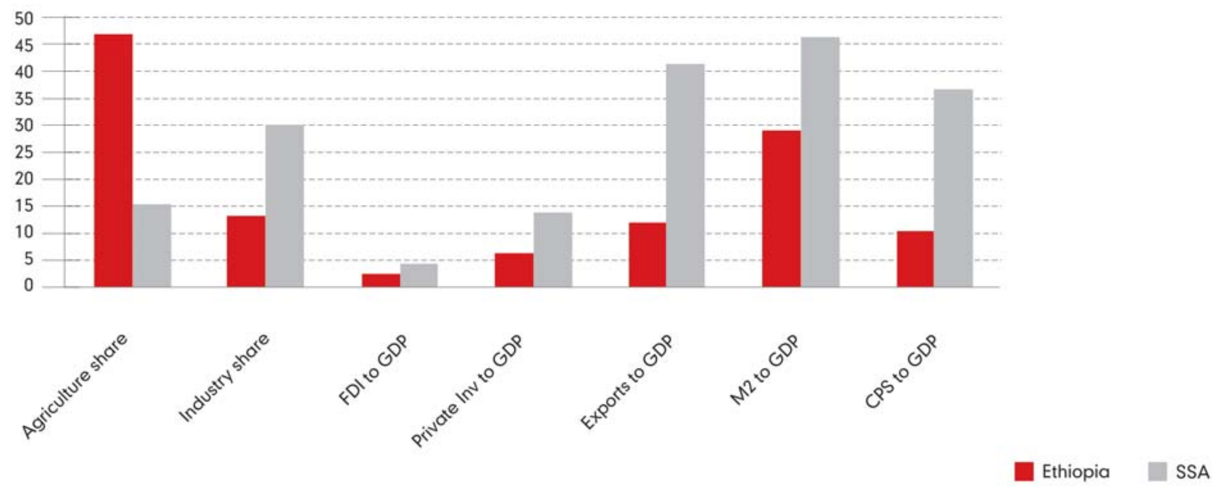
- **US dollar GDP:** Aggregate dollar GDP (at $25 billion in 2008) is fifth largest in all of Sub-Saharan Africa and third largest outside of South Africa and Nigeria (behind Angola and Kenya).

- **Imports:** Excluding the two regional giants of South Africa and Nigeria, Ethiopia's imports of near $7 billion last year place it among the top five African importers. Ethiopia thus already represents among the biggest African markets for exporters around the world seeking business opportunities in Africa. At the same time, for foreign investors seeking to establish operations domestically, the large size of imports indicates the sizeable scope for the establishment of import-substituting industries.

- **Agricultural produce:** Besides its dominant role as Africa's top coffee producer, Ethiopia is among the top Sub-Saharan producers of key food products such as wheat (#1), barley (#1); corn (#3), and sorghum (#3); in all these products Ethiopia is also among the top 20 worldwide producers (as per data from the United States Department of Agriculture's 2008 ranking of top global food producers).

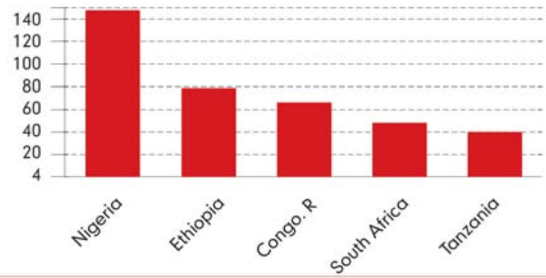
- **Key natural resources:** Ethiopia is either among the top 5 or top 10 African countries with key agriculture related natural resources, especially arable land and water resources.■

Structural Features of Ethiopian Economy [Chart 4.5]



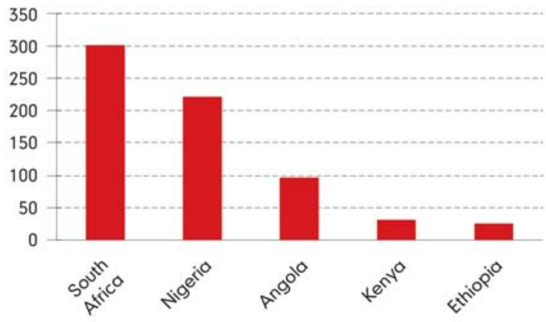
Source: MOFED, NBE, CSA and IMF

Sub-Saharan Africa, Top 5 largest populations (in mns)



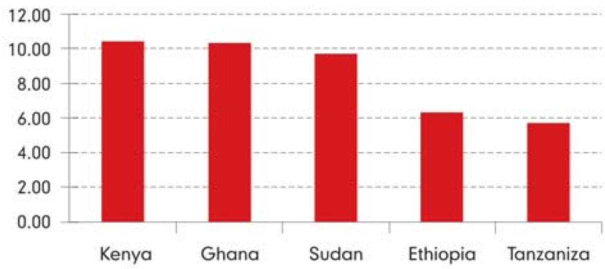
Source: World Factbook

Sub-Saharan Africa, Top 5 largest USD GDP [Chart 4.6]



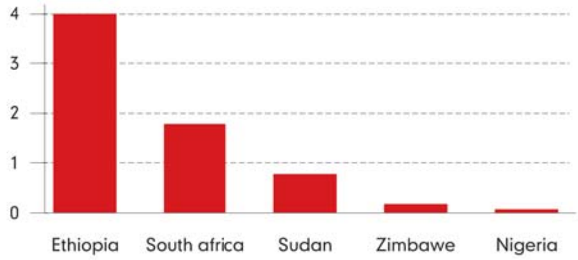
Source: IMF WEO

SSA largest importers (excluding South Africa and Nigeria), USD bns



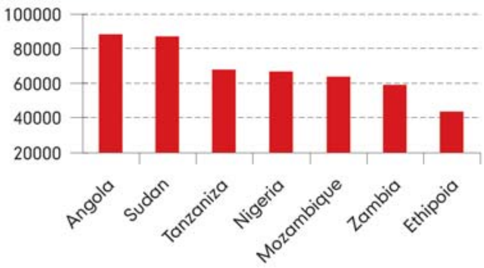
Source: IMF WEO

Top 5 Sub-Saharan Africa Wheat producers (mn tons) [Chart 4.7]



Source: USDA

Arable land (000 ha) [Chart 4.8]



Source: FAO

5 What does the private sector landscape look like and where are the hot spots?

KEY POINTS:

- **The private sector has expanded along multiple dimensions and prospects are particularly strong in agri-business, basic manufacturing, mining, construction, real estate, and banking.**
- **There is some concern about whether a level playing field exists in particular sub-sectors, but the most dominant portion of Ethiopia's economy (the 13 million farm households producing nearly 50 percent of GDP) remains—by its very nature—largely characterized by competitive conditions. And the private sector as a whole, judging by the World Bank's Doing Business and Investment Climate surveys, seems to see other challenges—such as the tax regime, securing land, and access to credit—as its top concerns.**
- **In some areas, most notably telecommunications, private sector involvement remains restricted.**

Private sector activity has expanded substantially in all three main economic areas—agriculture, manufacturing and services (Chart 5.1). Private agricultural output has doubled since FY 2003; coffee exports, once dominated by government, are now almost exclusively in private hands; and private sector manufacturers (now over 2200) make up 90 percent of total manufacturers from 79 percent ten years ago. Overall registrations of private investment across all sectors provide similar evidence of similar growth, with total registered investments reaching a cumulative total of over 37,000 in numbers in 2008 from around 4000 investors a decade ago. In the real estate field, some 400 real estate developers are now registered in Addis Ababa, up from just five in FY 2002, while the number of registered construction companies has jumped to nearly 2,000 from just 145 a decade ago. The financial sector now has ten private banks operating (with four more in the pipeline) from none in the early 1990s, while there are now around a dozen private insurance companies. Foreign investment, as noted earlier, has reached record levels in recent years as evidenced by both foreign investment registration figures (numbers and values) as well as by actual inflows recorded in balance of payments statistics. Economic activity in the informal sector—comprising tens of thousands of small-scale businesses, retailiers and entrepreneurs—has likely multiplied several fold in the past decade on the plausible assumption that this sub-sector has grown in line with the formal (recorded) private sector.

Notwithstanding the impressive growth of the formal private sector, the economy is still heavily based on small-scale farming and large areas of activity remain restricted to private players. The government still plays a dominant role in various industries (airlines, telecommunications, power supply, shipping, banking, and insurance) (Chart 5.2). Also, besides the already dominant position in these areas, there is a somewhat anachronistic foray into activities that in other countries have long been relegated to the private sector, e.g. recent government initiatives to get involved in large-scale residential housing projects or establish a state railways corporation.

Moreover, there is some concern about the degree of competitive conditions in selected sub-sectors given the role of state-owned and party-affiliated companies. These enterprises are involved in sectors as varied as agriculture, construction, domestic trade, exports, and financial services. Fortunately, such entities appear (for the moment) to be only one of many operators in most sectors and the private sector as a whole (judging by World Bank's Investment Climate surveys) seems to see other challenges—such as the tax regime, infrastructure issues, and access to credit—as its top concerns (Chart 5.3).[7] In any case, it is comforting that by far the most dominant portion of Ethiopia's economy (the 13 million farm households producing roughly half of total GDP) must, by its very nature, be largely immune to this legitimate concern about a potentially anti-competitive business environment.

Indicators of Private Sector Activity [Chart 5.1]

Indicators	Prior year	Latest year
Farm households	10,216,322 (2001/02)	13,279,659 (2007/08)
Agricultural output	103,509,050 (2003/04)	164,947,903 (2007/08)
Private manufacturing enterprises	643 (1999/2000)	2273 (2006/07)
Private sector coffee exporters	...	156 (2008)
Private sector share in manufacturing	79% (1996/97)	90% (2006/07)
Real estate developers	5 (2002)	400 (2008)
Leases to RE developers	...	2.7mn
Construction companies	145 (1998)	1,971(2008)
Number of privatized firms	108 (2005)	267 (2008)
Private investment licenses (cumm.)	4,222 (1998)	37,948 (2008)
Private investment approvals(in billions of Birr; cummilative)	35 (1998)	566 (2008)
Private banks	0 (1994)	10 (2007/08)

Source: CSA, AA municipality, Privatization Agency, EIA

[7] See findings of Investment Climate Assessment in WB "Country Economic Memorandum," April 2007.

Looking ahead, private sector business opportunities are expected to be particularly attractive in agri-business, basic manufacturing, mining, banking and selected segments of the real estate sector. An increasing commercialization of agriculture—given vast tracts of land being leased out by regional governments—should propel growth in this sub-sector, especially for products that enjoy high margins, seek export opportunities, and take advantage of Ethiopia's strategic location near African, European and Middle Eastern markets. In manufacturing, Ethiopia's very low starting base as well as the considerable scope for import substitution suggests the potential for continued strong growth in basic consumer goods as well as in products geared towards the local construction and services industries; for example, steel, cement, plastics, pharmaceuticals, textile fabrics, and vegetable oils are among Ethiopia's top non-oil imports, all of which are already being challenged by rising domestic producers that still have much room to expand by displacing imports. Service sector activities—ranging from private health and education to the hotel, tourism, and hospitality industries—can also show strong growth if focused on introducing innovative or much improved standards to an industry that displays highly uneven quality and remains untapped in many areas. The opening of the country's largely unexploited mining resources, as evidenced by a surge of mining applications processed in recent years (over $1 billion since FY 2004 according to EIA data), suggests a potentially major expansion in that sector. And in real estate, we believe that although there are tentative signs of a slowdown in the very upper-end of the market (reflecting the previously dominant role of diaspora buyers), the middle segment of the real estate market retains considerable scope for growth given huge pent-up demand for basic residential facilities among the urban, wage-earning population. (For banking sector prospects, see the discussion in the next section).

Finally, foreign investment is poised to make a substantially larger contribution to private economic activity in the coming years, judging by the pipeline of announced and/or recently launched projects. Large FDI projects announced and/or recently launched include ventures in the agricultural, mining, and industrial sectors—including, for example, at least two large industrial parks; factories for the production of textiles, leather, cement, steel, and medicines; car assembly operations; explorations for oil, coal, potash, gold, and natural gas; and large scale commercial farming operations for wheat, fruits, and bio-fuel crops. A particularly notable aspect of the pipeline of FDI deals is Ethiopia's deepening links with three fast-growing and increasingly important world regions: China, India, and the Middle East. Indicators of export, import, and investment flows between Ethiopia and these three economic blocs have risen remarkably in recent years (Chart 5.4). One very telling indicator in this area is the jump in passenger and cargo traffic between Ethiopia and these three regions: Ethiopian Airlines alone now has 9 weekly flights to China, 9 weekly flights to India, and 44 weekly flights to the Middle East (including 20 weekly flights to Dubai alone). ■

Ethiopian Public Sector Enterprises [Chart 5.2]

Public Enterprises	Revenue(mn)	Profits(mn)	Employment
Ethiopian Air Lines	980	504	4,700
Ethiopian Telecommunication Corporation	1,037	594	11,489
Ethiopia Electric Power Corporation	983	393	12,687
Ethiopian Shipping Lines	2,550	417	710
Ethiopian Insurance Corporation	541	78	1,285
Commercial Bank of Ethiopia	...	1,870	8,000

Source: Public Enterprises or other publicly available sources

Private Sector Challenges

Top challenges	Percent reporting as top challenge
Access to financing	17.6
Infrastructure	15.0
Bureaucracy	12.6
Policy instability	9.6
Labor	7.4

Source: World Economic Forum (GCI 2007)

Private Sector Challenges [Chart 5.3]

Top Constraints Perceived by Business	Percent reporting constraint
Tax rates	74
Tax administration	60
Access to land	56
Access to finance	56
Electricity	42

Source: WB Investment Climate profile

Deepening links with emerging economic blocs [Chart 5.4]

	China		India		Middle East	
	2000	**2007**	**2000**	**2007**	**2000**	**2007**
Total Trade (USD mns)	88	972	69	434	463	1785
o/w Imports	87	852	61	420	396	1608
o/w Exports	1	120	8	14	67	177
FDI Registrations (Br mns, 2000-08)*	...	1,444	...	940	...	2,501
Weekly flights (2009 data)	...	9	...	9	...	44

* Only FDI registrations recorded as operational and where the listed country is sole the investor.

Source: IMF DTS, Ethiopian Investment Agency, Ethiopian Airlines

6 How is the banking sector performing?

KEY POINTS:

- **Ethiopia's private banks have enjoyed a decade-long boom, with high profits propelled by a combination of lending to fast-growing sectors and remarkably low overhead costs.**
- **Taken collectively, private banks have in recent years collected more new deposits and extended more new loans than the dominant (and state-owned) CBE; this trend is unlikely to be reversed.**
- **Though policy and regulatory risks remain, and the central bank's anti-inflationary measures may begin to bite this year, the medium-term outlook for the banking sector remains positive.**
- **The broader financial sector is also deepening from the growth of a largely rural-oriented micro-finance sector as well as the emergence of non-bank private share companies in urban areas.**

Banking in Ethiopia has been highly profitable in recent years. Deposits have grown at an annual rate of nearly 20 percent in the past five years (FY2004 to FY2008), allowing commercial banks to expand their loan books by an annual average of 24 percent over the same period (Chart 6.1). Over the past decade, profits showed average annual growth of nearly 40 percent per year. In terms of investment returns, Birr 100,000 put into Ethiopian bank shares ten years ago would have risen to Birr 709,000 today, given average returns on equity of 20 percent per year. By comparison, annual average returns for the ten years ending December 2008 were 6.6 percent for emerging market equities (MSCI EM) and 5 percent for the US Dow Jones stock index (both clearly weighed down by last year's large drop). Relative to banks in Africa and other developing countries, Ethiopia's banks stand out for their significantly lower overhead: costs are just 30 percent of operating income, compared to an average of 60 percent in Sub-Saharan African countries.

Private banks have been notable for their relative dynamism, better services, and reliance on private sector clients. The introduction and expansion of private banks in the past decade has coincided with improved banking services, including such features as longer banking hours, ATMs, electronic banking, and improved facilities. Private banks have also been dynamic actors, in that they are not (as is common elsewhere in Africa) reliant primarily on buying government debt and living off its interest; in fact, because lending to government offers such limited rewards in Ethiopia, private banks do virtually none of it, and have focused on fast-growing sectors in the economy. Neither are they just living of 'easy' fee income derived from activities such as LCs and foreign exchange commissions, another common charge against African banks: Ethiopian banks earn on more than half their operating income from net interest earnings (i.e. by offering loans to growing businesses), a much higher share than is seen in many other African countries (where reliance on fee and commission income is often much higher). Profit margins are also not excessive as is sometimes the case

Summary statistics of six private banks and CBE [Chart 6.1]

Deposits	2004	2005	2006	2007	2008
Abyssinia	1,275	1,628	2,177	2,721	3,478
Awash	1,733	2,213	2,721	3,419	...
Dashen	2,178	2,833	3,692	4,861	6,152
NIB	832	1,224	1,452	1,879	2,470
United	533	865	1,293	1,681	2,443
Wegagen	876	1,288	1,778	2,724	2,966
CBE	22,439	25,380	28,143	32,994	38,900

Loans	2004	2005	2006	2007	2008
Abyssinia	889	1,173	1,902	2,197	2,567
Awash	1,069	1,453	2,355	2,500	....
Dashen	1,627	2,161	3,080	3,889	4,292
NIB	757	1,086	1,418	1,756	2,034
United	369	570	975	1,368	1,810
Wegagen	695	951	1,517	2,061	2,208
CBE*	5,883	7,385	7,377	8,144	13,600

Net Profits	2004	2005	2006	2007	2008
Abyssinia	38	61	87	66	17
Awash	35	45	95	127	...
Dashen	56	71	134	188	239
NIB	35	46	57	76	113
United	7	31	44	64	91
Wegagen	32	48	71	111	139
CBE	412	579	793	867	1,365

ROAE	2004	2005	2006	2007	2008
Abyssinia	22%	27%	27%	16%	4%
Awash	12%	20%	20%	33%	...
Dashen	37%	34%	42%	40%	38%
NIB	23%	23%	22%	21%	22%
United	7%	28%	28%	23%	22%
Wegagen	28%	31%	33%	34%	28%
CBE	29%	40%	54%	30%	32%

Source: Banks' Annual Reports (*CBE loan data is for "loans to customers" only). FY08 data for CBE reflect press reports/estimates.
Data are in Birr millions, except for the return on average equity (ROAE) which is in percent.

in other banking systems: net interest margins of 5 percent (reflecting loan rates of near 9 percent and deposit rates of 4 percent) are at the lower end of the norm seen in other African countries.

Within the private banking sector, there is some notable variation across banks in their reliance on different lines of lending and sources of income (Charts 6.2 and 6.3). Focusing solely on the six private banks that have now been established for many years (Abyssinia, Awash, Dashen, NIB, United, and Wegagen), the leader in both the volume of deposits collected and amount of loans provided is Dashen Bank, followed by Bank of Abyssinia and Awash Bank. Dashen Bank also offered the highest returns to its shareholders, with a return on average equity of 31 percent per annum in the past five years. The private banks have somewhat differing income streams, with Bank of Abyssinia and NIB showing the highest reliance on interest income (above 60 percent for both), while Awash, United, and Wegagen banks tend to generate more of their income from fees and commissions. Although all the private banks have seen windfall foreign exchange valuation gains as the Birr depreciated in recent years, some have relied on this 'accounting' gain much more so than others (revaluation gains provided about 30 percent of operating income for Dashen and Wegagen, for example). In terms of market shares within specific categories of loans, Dashen holds the leading market share in most areas, including in lending for domestic services, construction, imports, manufacturing and transport; elsewhere, however, the market leadership position is held by other banks, for example, by Wegagen for exports and by Awash for agriculture. Dashen and NIB are the leaders in productivity measures, with each of their employees generating around Birr 250,000 in operating income per year.

The dominance of the state-owned Commercial Bank of Ethiopia, though still high, is declining steadily. The dominance of the CBE is evident in many areas, including its branch network (205 out of a total of 562 bank branches nationwide), asset holdings (nearly 60 percent of total commercial bank assets), and deposit base (60 percent of total bank deposits for FY 2007). However, in recent years (for example FY 2006) private banks as a whole have been collecting more new deposits and providing more new loans than has the CBE; in fact, excluding loans to the government (roughly half of CBE's assets last year), the stock of loans provided by private banks as a whole has surpassed that of CBE since FY 2005. Also, for the first time last year, the number of private bank branches (298) exceeded that of public sector bank branches (264). With the continued expansion and entry of new private banks, the dominant role of CBE should decline over time, though the outlook here will depend in part on the policy and regulatory environment.

Private Banks' Loan Books [Chart 6.2]

Share of loan by sector	BOA	DB	UB	NIB	AIB(2007)	Wogagen
Agriculture	1%	3%		5%	7%	1%
Manufacturing	15%	21%	14%	28%	10%	11%
Domestic Trade and Services	33%	20%	13%	19%	34%	13%
Export	7%	7%	12%	9%	11%	22%
Import	12%	11%	27%	17%	14%	21%
Construction	15%	17%	20%	17%	12%	11%
Transport	6%	8%	8%	5%	11%	13%
Personal	0%	1%	1%	0%	1%	2%
Loans in legal department	7%	10%	1%			3%
Advance in letter of Credit	3%	2%	2%			3%
Total	100%	100%	100%	100%	100%	100%

Source: Banks Annual reports for six long-established private banks

Market shares of private banks in different loan categories [Chart 6.3]

Private Banks	Agriculture	Manufacturing	Domestic Trade and Services	Export	Import	Construction	Transport	Personal	Loans in Legal Department	Advance in Letters of Credit
AIB	34%	9%	23%	15%	14%	11%	20%	18%	0%	0%
BOA	4%	15%	25%	12%	14%	17%	13%	4%	26%	30%
DB	33%	37%	27%	20%	21%	33%	27%	28%	61%	33%
NIB	24%	21%	11%	11%	14%	14%	8%	5%	0%	0%
UB	0%	9%	6%	13%	19%	14%	10%	17%	3%	15%
Wegagen	5%	9%	8%	29%	19%	10%	22%	28%	10%	22%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Banks annual reports, categories used by banks not always identical so some assumptions on classification used in a few cases.

Beyond banks, financial services in the form of micro credit groups as well as savings and credit associations are proliferating. Two Ethiopian micro-credit providers are now among the world's largest (ranking 6th and 31st largest according to the Microfinance Information Exchange). More than two dozen micro-credit providers now serve two million clients and have lent over 4.6 billion Birr (2 percent of GDP).

Looking ahead, the banking sector is set to enter a somewhat challenging period. Monetary policy is being tightened, including through recent moves to raise reserve requirements (now 15 percent from just 5 percent two years ago), increase liquidity requirements (now 25 percent), and limit broad money growth to just 20 percent for FY2008-09. Other central bank directives have the potential to hurt private bank earnings: for example, a requirement that all export letters of credit for trade with China be conducted via the state-owned CBE can hit the fee income of several banks hitherto reliant on such business. Earnings may be affected going forward by rising loan-loss provisions in those banks where recent lending growth took place without adequate risk management. The uneven playing field—stemming from the unique benefits enjoyed by state banks—will also continue to pose challenges. Only state-owned or development banks, for example, have had access to foreign borrowing, including to long-term loans that can be used to extend long-term credit; this provides public sector banks with the advantage of offering services—such as mortgages—that involve long-term maturities.

Still, the overall outlook for the sector remains broadly positive. The attractiveness of Ethiopian bank shares relative to other investments will continue to propel capital and asset growth. Over the medium-term, growth in deposits and assets should match nominal GDP, which implies growth of at least 15-20 percent annually at a minimum for the next few years. If costs are kept under control, this level of growth might also be seen as the floor for future bank earnings. Indeed a review of banking systems in African countries shows that, even over extended periods, returns on equity have averaged 20 percent (see the World Bank's "Making Finance Work for Africa"). Moreover, from a price-earnings perspective, the shares of Ethiopia's private banks (though not fully traded) are still cheap with a price-earnings ratio of just three to five, compared to banking sector P/E ratios that are more than double or triple these levels in countries like Kenya, Nigeria, and Uganda. And any potential liberalization would bode well for the sector's prospects, if for example Ethiopia follows the examples of China and Vietnam (where even state-owned banks allow foreign equity ownership) and if WTO accession works to open up the sector to foreign participation (the CBE's recent decision to launch operations in Sudan may be followed by calls from trading partners to get reciprocal treatment in Ethiopia).

A fledgling private share issuance market is beginning to take hold. In the past year alone, close to ten (non-bank) businesses have sought to raise a total of more than 1.0 billion Birr by selling shares directly to the public (Chart 6.4). This aggregate figure represents about a quarter of bank lending to the private sector last year, indicating the potential role of non-bank capital market financing. This is a welcome development that could be a precursor to the eventual establishment of corporate bond issues and of an active domestic stock market. ■

Recent/Ongoing Planned Share Issuance by non-bank companies (in Birr millions) [Chart 6.4]

Access Real Estate	100
Habesha Cement	600
Messob Foods	20
Sheger Meter Taxi	50
Sky Bus	60
Jacaranda Integrated Agro-Industry S.C.	100
Hagere Construction Share Company	300

Source: Information from companies and press reports

7 Can high growth continue?

KEY POINTS:

- **Double-digit growth is unlikely this year for the economy as a whole. Even with relatively good kiremt rains, several other factors—tighter monetary and fiscal policies, a sharply slowing global economy, and sector-specific effects (e.g., power cuts)—will all work to cool overall economic activity, which we expect to show near 8 percent growth for FY 2008-09.**
- **Still, selected sub-sectors can manage to record double-digit growth this year; in our view, these include agri-business, mining, cement, steel, and banking.**
- **From a medium-term perspective, we believe the recent spike in growth will not be a short-lived phenomenon; growth in the 6-8 percent range should be possible to sustain in the coming years assuming a favorable macroeconomic environment and supportive policies.**

We expect the five-year run of double-digit growth will come to an end in FY2009. Several developments point to slowing growth for this fiscal year :

- **Supply-side factors:** Extensive power cuts hit the manufacturing sector for several months in the early part of the fiscal year, and will likely show up in reduced industrial growth figures.
- **Demand-side factors and macroeconomic policies:** Both monetary and fiscal policies will exert a contractionary effect this fiscal year. As noted earlier, rising reserve and liquidity requirements together with a commitment to reduce broad money growth to just 20 percent this year will dampen growth in credit. Similarly, the planned halving of the budget deficit—to 1.5 percent of GDP this year from near 3 percent of GDP last year—as well as the government's recent commitment to zero domestic borrowing will also work to reduce aggregate demand.
- **External factors:** The adverse external environment can potentially be a major drag on growth this year, as exports, tourism income, remittances and private transfers show reduced growth.

Growth will slow but not fall off sharply. We project that growth in agriculture will be 10 percent (based on the FAO's January 2009 Crop Assessment Report on this year's harvest); that industrial activity will rise by 7 percent (a slowdown from last year in part due to supply-side shocks and slowing demand); and that services will expand by just 6 percent this year (reflecting tighter macroeconomic policies, much slower growth in government spending, and the reduced growth in tax receipts observed for the first half of this fiscal year). Given the shares of the three sectors in aggregate GDP, these sector growth assumptions translate into economy-wide growth of around 8 percent for FY2009 (Chart 7.1). Access Capital's projection is somewhat above the median growth projection for Ethiopia, which we have compiled on the basis of nine forecasters with published projections of Ethiopia's expected growth rate (Chart 7.2). In our view, other forecasters are assigning too much weight to the impact of the slowing global economy on Ethiopia's growth.[8]

While overall growth is not expected to reach double-digits this year, selected sub-sectors are still likely to do so. These include, in our view, agri-business, mining, cement, steel, and banking.

For the medium-term, we expect growth in the 6-8 percent range should be possible to sustain in the coming years.[9] More specifically, we do not believe that the recent spike in growth was just a short-lived phenomenon. Several considerations support this conclusion:

- **Low initial starting base:** As a country starting from a very low income base, high growth in a country like Ethiopia should be the norm, not the exception. Growth in settings such as Ethiopia's is mainly a matter of ensuring that factor inputs (labor, capital, land) are all deployed and is, in principle, "simpler" than growth in middle-income or higher income, where most factor inputs have already been largely employed and where extra growth comes from more 'difficult' elements such

Access Capital Growth Outlook [Chart 7.1]

Sector	FY08 (%)	FY09 (Access Capital Projection, %)
Agriculture	7.5	10.0
Industry	10.4	7.0
Service	17.0	6.0
Overall Growth	**11.6**	**8.0**

Source: CSA for FY08 data

Growth projections for FY 2008-09 [Chart 7.2]

Organization	Growth projection (%)
Economist Intelligence Unit	8.6
Global Insight	8.5
Standard Bank	7.1
International Monetary Fund	6.5
World Bank	7.3
United Nations (ECA)	7.5
African Development Bank	7.5
OECD African Economic Outlook	7.4
Ethiopian Government (MOFED)	11.2
Access Capital	**8.0**

Source: Publications of organizations listed above

[8] A simple empirical model exploring the link between growth in Ethiopia and in the rest of the world shows very limited correlation, pointing to the dominant role of internal developments (especially in agriculture). At 6 percent of GDP, the impact of slower export growth will be much more limited in Ethiopia than elsewhere.

[9] Given the dominant role of rain-fed agriculture, Ethiopia remains susceptible to weather-related shocks and one-time drops in growth rates will be unavoidable in years when rainfall is particularly low. However, the discussion of medium-term growth below abstracts from such periodic shocks and is focused instead on trend growth (i.e. multi-year averages).

as productivity, innovation, and technological advances. In this respect the low growth rates of the pre-2003 era might be more appropriately be viewed as a deviation from the norm, and the subsequently higher levels as more in line with the economy's characteristics.

- **Growing links with three large and dynamic trading partners:** As elaborated earlier, Ethiopia's growing links with the economic blocs represented by China, India and the Mid-East offers considerable potential for export-driven growth. Ethiopia also stands to benefit from FDI inflows from these regions, especially if their large stock of investable resources—from oil savings, Sovereign Wealth Funds, and their globalizing corporations—are deployed in even a very small scale in large African countries such as Ethiopia.

- **Potential neighborhood recovery:** Ethiopia's recent growth has taken place despite very adverse 'neighborhood effects,' including next-door countries that are largely blocked off from the outside world due to political factors (Sudan), in a tense political and economic stalemate with Ethiopia (Eritrea), or in the midst of complete state disintegration (Somalia) . That growth could be so positive despite this set of affairs in the immediate region suggests that any material improvement in economic and political conditions in these countries should have positive spillovers for Ethiopia.

- **Payoffs from public investments:** Large scale investments in infrastructure and education should over time spur further expansion in economic activity and also allow for a shift to productivity-driven growth. Despite the methodological caveats involved, empirical estimates from other countries suggest that the magnitude of public investment undertaken in Ethiopia could by itself add several percentage points to growth.

- **Rising fertilizer use and commercialization in agriculture:** Fertilizer use has been rising steadily in recent years (to near 400,000 tons in FY 2008 from around half that level in FY 2004), and the likely continuation of this trend should bring rising yields in the agricultural sector. Commercial farms are also rising—judging by the tripling in annual investment approvals in just the past two years– and this promises to accelerate the share of agriculture produced under modern/mechanized farming conditions to well beyond what is only 4 percent of the total farmed land at present. One additional boost working to raise agricultural output is the rising level of credit being provided to the sector: CBE loans for the agricultural sector, for example, now exceed Birr 2 billion (a four-fold increase since FY 2004) and have for the first time surpassed total CBE lending to manufacturing.

- **Growing use of preferential trade deals with two of the world's largest markets (AGOA for the US, EBA for EU):** Relatively open trade access to the US and Europe could—if exploited—be a significant source of growth in the Ethiopian economy. Taking advantage of these trade deals involves demanding logistical, quality, and other standards, but to the extent that those are sufficiently addressed over time, the preferential trade deals offer the potential for virtually unlimited demand for Ethiopia's goods and services. The early signs are encouraging in this area, as seen from a doubling (to $ 18 million) of Ethiopia's AGOA exports to the US last year-- though this largely reflects a still low base.

8 When will we see a return of single-digit inflation?

KEY POINTS:

- **Reducing Ethiopia's inflation rate to single-digit levels will take time; as shown by recent IMF research, very few countries which start from inflation levels above 30 percent are able to successfully lower it to single-digit levels within a year. With an extended period of such high inflation, the purchasing power of consumers will thus be strained for some time.**
- **The good news, however, is that inflation has most likely peaked and should be on a downward trajectory from here on. Given the very high level jump in food prices, and in light of what have been good keremt rains this year, additional price level increases in foodstuffs (which make up more than half the CPI basket) are very unlikely in FY 2009; this is corroborated by the month-on-month decline in food inflation now seen for three consecutive months. Sharply falling global fuel and commodity prices will provide added relief on the inflation front.**
- **Access Capital projects year-average inflation to be just below 40 percent this fiscal year, up from 25 percent in FY 2008; year-average inflation is unlikely to fall below 10 percent until at least FY 2011. By a different metric, namely inflation on a 12-month basis (e.g., June 2009 versus June 2008), the latest price trends point to 12-month inflation dropping to below 5 percent by end-June 2009.**

International experience with reducing inflation from 30-percent plus levels suggest that it generally takes an extended peroid of time, as revealed in a recent thorough review of this issue in an IMF research paper (see IMF's Ethiopia Selected Issues Paper, July 2008). Once inflation exceeds 30 percent, the median time countries have taken to fall to single-digit levels is 2 years (Chart 8.1). If this norm is assumed for Ethiopia, single-digit inflation will not be realized until FY2011.

We think inflation has reached its peak and is on a downward path from here on, reflecting the following three main factors:

Reducing inflation from very high levels [Chart 8.1]

	Country	Peak inflation	Years to return to single-digit levels
1	Ecuador	91.0	2
2	Slovenia	89.6	3
3	Guinea-Bissau	86.7	6
4	Sao Tome and Principe	80.5	2
5	Indonesia	77.5	1
6	Nigeria	76.8	5
7	Malawi	74.9	1
8	Mozambique	70.2	3
9	Sierra Leone	66.9	1
10	Uganda	64.4	1
11	Rwanda	64.4	2
12	Madagascar	61.2	2
13	Uruguay	58.9	6
14	Peru	56.7	5
15	Kenya	54.7	1
16	Benin	54.0	1
17	Mexico	52.0	5
	AVERAGE no. of years	...	**2.8**
	MEDIAN no. of years	...	**2.0**

Source: IMF WEO (Restricted to sample where inflation < 100 %).

- **Food harvest of FY 2009:** With food comprising the largest component of the Ethiopian price index, the annual harvest dominates inflation developments. The record in this area is relatively promising, as rains have been adequate in most food-producing regions and estimates are for a 10 percent higher harvest. The food price index is already down 16 percent from its September 2008 peak, suggesting strongly that food prices are unlikely to be a source of inflation this year.
- **External factors to provide welcome relief on the inflation front.** Both fuel and food prices have collapsed from their mid-2008 peaks, and this is translating into lower import prices on these commodities which are gradually being passed on to consumers . Retail fuel prices, for instance, are already down 26 percent from their peak (to just Birr 7.47 per liter from a high of Birr 10.15 per liter). Many more commodity prices (e.g. steel) have seen dramatic price drops in recent months as have the shipping costs of importing freight from abroad.
- **The depreciation of the Birr, though accelerating recently, still remains relatively controlled.**

On balance, Access Capital projects year-average inflation to be just below 40 percent by the end of this fiscal year (Chart 8.2). By a different metric, namely inflation on a 12-month basis (e.g., June 2009 versus June 2008), we expect inflation to be below 5 percent by end-June 2009, as the unusually high level of the index last June sets a very high base of comparison (negative year-on-year inflation is actually possible by end-June 2009 given this unusual base effect). Both these projections assume month-on-month inflation will average 1 percent for the remainder of the year (actual month-on-month inflation has been negative 1 percent for the past six months; Chart 8.2). For FY2010, we project a reduction in year-average inflation to 12 percent assuming another year of good rains, the sustained implementation of tighter monetary and fiscal policies, and still subdued levels likely for key import prices. ■

Ethiopia General Consumer Price Index [Chart 8.2]

Month	Price Index	Month-on-Month Inflation	Year-on- Year Inflation	Year – Average Inflation
Jan-08	120.2	1.5	19.7	18.1
Feb-08	125.7	4.6	22.9	18.5
Mar-08	135.2	7.6	29.6	19.3
Apr-08	137.2	1.5	29.7	20.1
May-08	147.8	7.7	39.0	22.0
Jun-08	166.7	12.8	55.2	25.4
Jul-08	179.9	7.9	64.1	29.7
Aug-08	182.3	1.3	61.8	33.6
Sep-08	184.1	1.0	59.7	37.2
Oct-08	182.0	-1.1	55.4	40.3
Nov-08	175.1	-3.8	49.4	42.8
Dec-08	164.9	-5.8	39.3	44.4
Jan-09	165.6	0.4	37.8	45.6
Feb-09	**166.4**	**0.5**	**32.4**	**46.1**
Mar-09	**167.3**	**0.5**	**23.7**	**45.2**
Apr-09	**168.9**	**1.0**	**23.1**	**44.2**
May-09	**171.5**	**1.5**	**16.0**	**41.7**
Jun-09	**174.9**	**2.0**	**4.9**	**36.8**

Source: CSA for historical data (projections in italics)

9 Where is the Birr heading?

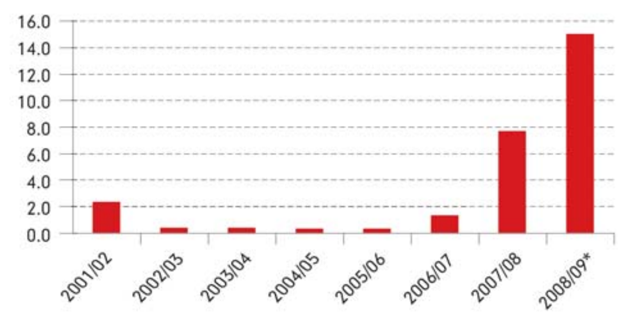
KEY POINTS:

- **The Birr has depreciated by 15 percent so far this fiscal year, roughly double the rate of depreciation seen last year and one of the largest annual depreciations in some 30 years.**
- **Access Capital projects that the official exchange rate will be near 11.5 Birr/USD by the end of this fiscal year (June 2009) and cross the 12 Birr/USD threshold in FY2010; we do not foresee any unusually sharp depreciations (of beyond say 15 percent) taking place in the coming year.**
- **Even after the recent depreciation, foreign exchange demand continues to exceed supply, as evidenced by widespread delays (of 3-6 months) that private business still faces in securing foreign exchange. Such delays will continue until the rate moves closer to a level that balances supply and demand conditions, for which the parallel market rate (of near 12.8 Birr/USD) is a good proxy.**
- **Foreign exchange availability for the private sector should begin to improve in FY2010 as inflation moderates and the authorities consequently become more comfortable with further depreciation. This assumes, however, that policymakers will in the coming months better recognize the unduly high costs of current exchange rate policies—in terms of foregone income for exporters, disruptions to import-dependent businesses, and the unwelcome reliance on non-market means of foreign exchange allocation.**

Ethiopia's exchange rate followed a fairly predictable pattern in the five years to June 2007, with relatively modest depreciations of only around 1 percent per year. Excluding a large step devaluation in 1993 (from 2.07 to 5.2 Birr/USD), large one-time exchange rate depreciations have long been avoided by Ethiopian policymakers.

Recent exchange rate movements are a departure from past practice and indicate a willingness (and an urgent need) to accept much larger depreciations in the exchange rate. The Birr/USD rate has been allowed to fall by 8 percent in the year to June 2008 and has moved by 15 percent so far this fiscal year, one of the largest such movements in 30 years. (Charts 9.1). The large movement seen so far this fiscal year follows two step-devaluations (of 5 percent each) undertaken by the authorities on January 5 and 16, 2009.

Birr depreciation (%) [Chart 9.1]



Source: NBE and IMF

The sharper depreciation of the past two years reflects the widening gap that has developed between what Ethiopia earns in foreign exchange (from exports, remittances, grants, loans) and what it spends on imports, debt service, and other external payments. On the inflow side, although large increases have been seen in key foreign exchange earners—exports, tourism and transportation receipts, remittances, aid, FDI, and loans—the pace of this increase has not kept up with the country's foreign exchange outflows (Chart 9.2). In particular, foreign exchange spent on imports has doubled within the space of three years, driven primarily by developments in oil and other commodities but also reflecting consumer goods (the counterpart to rising private and government spending) as well as capital goods (in line with rising overall investment). Also given the relative size of exports and imports (imports are nearly five times the size of Ethiopia's exports, or $6.8bn versus $1.5 bn), growth in exports needs to be more almost five-fold the growth of imports just to avoid a deterioration in the trade balance. By contrast, Ethiopia's average export growth was below import growth (25 percent versus 30 percent) in the recent five-year period.

The very recent gap between Ethiopia's inflows and outflows of foreign exchange has been covered by drawing down foreign exchange reserves. These reserves are now reaching very low levels, however, at about $0.8 billion or about 1 month import cover at end-2008, from a peak of more than three months of cover just two years earlier. In such circumstances, the normal course of action would be to let the currency depreciate so that imports are restrained and exports encouraged, eventually bringing more of a balance between inflows and outflows of foreign currency. Exchange rate policy in Ethiopia, however, has allowed only a limited depreciation of the currency and instead addressed the resultant excess demand by forcing a queuing (of those seeking to access foreign exchange) for periods of as much as three to six months.

Judging whether the recent exchange rate depreciation is sufficient needs to take into account a number of macroeconomic factors:

- **Supply and demand of foreign exchange:** In principle, the correct level of the Birr should be that level at which foreign exchange inflows and outflows are broadly balanced; if outflows exceed inflows by a large amount, as is the case in Ethiopia at present, a deprecation is needed so that demand for foreign exchange can be reduced and its supply enhanced. For countries like Ethiopia, the effects of a depreciation tend to take place more quickly through a cutback (or slower growth) in

Ethiopia's Balance of Payments (in USD millions) [Chart 9.2]

Balance of Payments—conventional presentation	FY07	FY08	Balance of Payments—alternative presentation showing inflows and outflows of foreign exchange	FY07	FY08
Current Account	**-870**	**-1487**	**Inflows of foreign exchange**	**5,343**	**6,898**
Exports	1,189	1,466	Exports	1,189	1,466
Imports	-5,128	-6,811	Net services and income	175	159
Net Services	161	126	Private and public grants	2,895	3,699
Net Income	14	33	Foreign Investment	482	815
Private Grants	1,696	2,393	Official borrowing, gross	345	759
Public Grants	1,199	1,306	Other inflows	257	...
Capital Account	**954**	**1224**	**Outflows of foreign exchange**	**-5,258**	**-7,161**
Official borrowing, net	239	742	Imports	-5,128	-6,811
Foreign Investment	482	815	Debt repayment	-106	-17
Other private flows	-24	-89	Short term capital flows	-24	-89
Other flows (E & Os)	257	-244	Other outflows	...	-244
Overall balance	**85**	**-263**	**Overall balance**	**85**	**-263**
o/w NBE net foreign assets change (+ is increase)	39	-244	o/w NBE net foreign assets change (+ is increase)	39	-244
o/w Banks net foreign assets change (+ is increase)	45	-19	o/w Banks net foreign assets change (+ is increase)	45	-19

Source: IMF and NBE

imports, which immediately become more expensive, but can also occur over time through an increased supply of foreign exchange earnings as exporters seek to capture greater local currency returns from the more depreciated exchange rate.

- **Reserves stock:** The demand and supply of foreign exchange need not be (and rarely is) balanced at all times; a temporary shortfall in earnings can be offset by drawing down on foreign exchange reserves until such a time that a 'normal' level of inflows is re-established. Such a coping strategy has been used in Ethiopia for some time now, but this option has reached its limits in Ethiopia unless the authorities want to deplete reserves to very low levels.

- **Export growth, debt sustainability considerations, and the REER:** Separate from the immediate supply-demand conditions and developments in reserves, the level of the exchange rate should also be broadly sufficient to encourage export growth and maintain debt sustainability. For example, very weak export growth might suggest an insufficiently depreciated exchange rate, which could also be the case if a country covers chronic balance of payments gaps by borrowing heavily from abroad (creating future debt problems). Additionally, the appropriateness of a currency's level can be judged by the Real Effective Exchange Rate (REER), which essentially offers one measure of how expensive are a country's products in export markets given trends in its exchange rates and inflation relative to its trading partners. In Ethiopia's case, this measure is up 25-30 percent in the past few years, and exporters have thus been facing uphill challenges (at least since FY 2005) as a result of exchange rate policies. We calculate, for example, that exporters to the Euro area (such as flower producers hurt by a 15 percent strengthening of the USD versus the Euro since last summer) would be fully compensated for the impact of the changing USD/Euro rate had the Birr exchange rate moved close to the (reported) parallel market rate of near 12.8 Birr/USD (Chart 9.3).

Illustrative Impact of US dollar appreciation on Ethiopian Exporters [Chart 9.3]

	Jul-08 At Bank rate	Feb-08 At Bank rate	Feb-08 At Parallel rate
Exporter's Euro Earnings:	100.0	100.0	100.0
USD/Euro rate:	1.58	1.28	1.28
Exporter's USD Earnings	157.5	128.1	128.1
USD/Birr rate:	9.63	11.03	12.8
Exporter's Birr Earnings	1516.7	1412.9	1639.7
Birr Loss due to Exchange rate	...	-103.8	...
Birr Loss in percent	...	-7%	...

Source: : Bloomberg for USD/Euro rate, NBE for Birr/USD rate

On balance, macroeconomic considerations suggest that the recent Birr depreciation still falls short of what is needed. The first two criteria listed above suggest a need for a sizeable depreciation, both to close the BOP gap and to put an end to the depletion of reserves. But the third criteria offers mixed messages in that, although the REER has appreciated by 25-30 percent in recent years and is deemed to be overvalued by a similar magnitude according at least some empirical estimates (see the IMF's July 2008 staff report on Ethiopia), the exchange rate is not—yet—so far out of line as to generate worries about exports and/or debt sustainability. In fact, with Ethiopia's debt reduced sharply, it can in principle raise its external borrowing for some time before debt levels become problematic. But it is worth noting that all three of these are generally metrics to judge the exchange rate over extended periods of time; in the near term, two strong indications of a misaligned exchange rate are the shortages faced by businesses and the more depreciated rate that prevails in what can be considered the 'true' market (i.e, the parallel market). On the latter basis, there is a clear indication of a need for the official exchange rate to move towards the current (reported) parallel market rate of near ETB 12.8 per US dollar. And in our view, this should be seen as the minimum level at which the currency should be trading to restore normal and balanced market conditions in the official foreign exchange market.

Although there may be strong macroeconomic reasons for further Birr depreciation, whether this actually takes place is dependent on government policy choices. Policy makers facing a foreign exchange shortage can choose to avoid a depreciation by running down reserves or relying on a system of de facto rationing and queuing, whereby scarce foreign exchange funds are allocated only selectively and periodically, contributing to widespread delays in accessing foreign exchange. This, in essence, has been the prevailing policy in recent months. However, the sharp step-devaluations of January 2009 provide the strongest signal to date of a willingness to allow further movement in the exchange rate.

In addition to government policy preferences, the impact of the current global financial crisis will also be important for the exchange rate outlook; our view in this respect is that the global financial crisis will have a net impact that is negative but only modestly so. While exports will show a slowdown from last year's growth rates, they should still register increases in the range of 10-15 percent, judging by the 16 percent jump in exports seen in the first six months of this fiscal year. In addition, a sharp slowdown in import growth—we think to around 15 percent—is likely to help the balance of payments significantly (the collapse in commodity prices since late 2008 is not yet reflected in the 44 percent import growth rates seen so far this year). Encouragingly, other large sources of foreign exchange income—namely private transfers, grants, and FDI—seem to be holding up well according to data for the first half and/or first quarter of the year (the normal seasonality of these inflows is also such that they tend to be much higher in the second half of the year so the strong inflows seen so far bode well for the year-total figures). A key unknown is the extent of new borrowing that will be undertaken by the government and public enterprises this year: we estimate that new borrowing of around $800 million is needed—given our assumptions on the current account and FDI—to avoid the overall balance of payments position from posting a deficit this year. To do better, i.e., to achieve an overall balance of payments surplus and thereby ease foreign exchange scarcity conditions, the supply of foreign exchange would have to increase well beyond our projected levels; this could occur with even more new government borrowing or if various other balance of payments items show unexpectedly positive surprises (i.e. a sharper drop in import growth or better-than-expected exports, grants, transfers and FDI). While possible, we think these outturns are unlikely and thus foresee foreign exchange shortages till at least the end of this fiscal year (Chart 9.4). At the same time, we believe that a third alternative to addressing balance of payments pressures—namely a reliance on steady depreciations in the exchange rate—will be used more deliberately in the coming months.

Balance of Payments (BOP) projections, in USD millions [Chart 9.4]

Balance of Payments—conventional presentation	FY09	Assumptions
Current Account	**-1804**	
Exports	1,656	13% growth for year (half-year growth is 16% but allowing for a slowdown)
Imports	-7,832	15% growth for year (half-year growth of 44% not yet showing price drops)
Net Services	176	10 % growth
Net Income	0	Falls to zero (from slight positive figures last year) due to higher debt service
Private Grants	2,752	15% growth
Public Grants	1,444	10% growth
Capital Account	**1,818**	
Official borrowing, net	800	$800 million of new loans keeps overall balance from posting a deficit
Foreign Investment	1,018	25% growth
Other private flows	0	Zero level assumed given modest positive and negative figures in recent years
Other flows (E & Os)	0	Zero level assumed for projections
Overall balance	**14**	**Proj balance with $800 mn new loans; BOP in deficit if new loans lower.**
o/w NBE net foreign assets change (+ is increase)	14	
o/w Banks net foreign assets change (+ is increase)	0	

Source: Access Capital projections

Given all of the above considerations, we expect the official exchange rate to reach near 11.5 Birr/USD by June 2009 and to lie in the range of 12.5-13.0 Birr/USD in the upcoming fiscal year (Chart 9.5).[11] We see several indications—including some already noted—pointing in this direction. First, inflation should moderate next year, and this will enable the authorities to allow a depreciation without fears of further aggravating what is already a very severe inflation problem. Second, we think the global financial crisis will accelerate the pressures to accept further movement on the exchange rate, given what we project to be a modest net negative effect and especially as other African and developing countries—potential competitors to Ethiopia—are using currency depreciations to cope with external shocks, including in much larger magnitudes than has been the case in Ethiopia. Third, there will be much reluctance to make further use of reserves given that they have fallen to very low levels. Fourth, we think that policymakers are increasingly recognizing the unduly high costs of current exchange rate policies. In particular, it should become apparent that non-market means of foreign exchange allocation (i.e. queuing) are punishing Ethiopia's exporters, severely disrupting the operations of import-dependent businesses, and potentially becoming major deterrents to future growth if foreign investors begin to fear and/or encounter difficulties in repatriating profits earned on their growing Ethiopian businesses. Finally, with Ethiopia just recently signing onto an IMF program (on January 23, 2009), we believe that adherence to more flexible exchange rate policies will be accorded high priority. In fact, if the IMF program is to put in place a more sustainable macroeconomic framework, a restoration of normal foreign exchange market conditions should be expected—which implies continued Birr depreciation towards a level that more accurately reflects (as does the parallel market) actual supply and demand conditions.

Are there risks of a very sharp depreciation? We think not. A depreciation of the magnitude envisaged above (i.e., not exceeding 15 percent), together with the IMF program, should help the release of any donor funds held back on account of macroeconomic concerns. Funds aimed at helping countries cope with the global financial crisis should also be forthcoming. All this will work to improve foreign exchange availability next year. But even if this should not happen and foreign exchange shortages persist, we think policymakers would rather revert to a de facto system of rationing/queuing rather than allow a sharp free-fall in the exchange rate.

Extrapolations of the Birr's Exchange Rate Movement Using Different Criteria [Chart 9.5]

Using monthly trend seen in past 12 months	
Average monthly depreciation, in Birr cents:	13.00
Implied exchange rate at end-June 2009, in Birr/USD:	**11.55**
Using monthly trend seen in past 12 months, excluding Jan 2009	
Average monthly depreciation, in Birr cents:	7.00
Implied exchange rate at end-June 2009, in Birr/USD:	**11.31**
Using weekly trend seen since Jan 2009 devaluation	
Average weekly move since Jan 2009 devaluation, in Birr cents	0.885
Implied exchange rate at end-June 2009:	**11.19**
Using trend of exchange rate seen between Feb and June of recent years	
Average ratio between June and February exchange rate in recent years	1.026
Implied exchange rate at end-June 2009:	**11.32**
Average of four approaches:	**11.34**

Source: NBE data for historical trend references

[11] These rates refer to the exchange rate at which commercial banks buy dollars from clients. This rate stood at 11.04 Birr/USD at end-February 2009.

10 What remains for sustained private sector development?

KEY POINTS:

- **In the immediate term, private sector activity would be helped most by efforts to control inflation and ensure greater foreign exchange availability.**
- **Over the medium-term, growth will require high levels of investment, which in turn must come from either domestic savings (presently held down by interest rate policies) and/or foreign savings (which is far short of levels it could be whether in terms of official sources, i.e., aid, or private ones, e.g. FDI).**
- **A more inclusive and transparent regulatory and policy environment could deepen the scope of private sector development on multiple fronts—by encouraging even higher foreign and diaspora investment; by unlocking larger amounts of foreign aid; by providing early feedback on policy errors before they become entrenched; and by safeguarding competitive business operating conditions.**

The most urgent near-term priority, both for macroeconomic stability and business operating conditions, is controlling inflation and easing the presently severe foreign exchange shortages. Appropriate policy responses to address these challenges have been initiated in recent months, including a tightening of monetary policies through three successive increases in reserve requirements and a commitment to limit the scale of borrowing and imports being undertaken by both the government and state-owned enterprises. However, these efforts are still in their early stages, and have yet to be in place for a sufficiently sustained period of time to roll back some of the excessive fiscal and monetary policy stimulus of recent years. Nonetheless, policy adjustment—if sustained— can clearly make a difference to controlling inflation, as suggested by other countries that have also exhibited prolonged periods of double digit growth in recent years without showing the excessive inflation or low reserves seen in Ethiopia's case (Chart 10.1). With respect to improving foreign exchange availability, we see no means of easing shortages without allowing a further depreciation of the exchange rate; this clearly helps exporters but also actually stands to benefit many importers who are willing to pay as much as the more depreciated parallel market rate to buy their imports but are currently simply unable to use this alternative market since regulations require that imports be channeled through banking sector channels alone. (This reflects the prohibition of *franco valuta* imports whereby importers could have imported goods by using their own sources of foreign exchange, such as externally held accounts or other sources).

Sustaining Ethiopia's recent growth record requires raising investment—from current levels of near 21 percent of GDP—and securing the needed financing from both domestic and foreign sources. The former is held back by interest rate policies that discourage domestic

Double-digit growth countries: macroeconomic indicators (2004-2008 average) [Chart 10.1]

Country	Growth (%)	Inflation (%)	Money growth (%)	Current Account (% GDP)	Reserve cover, 2008 (months)	REER change, 2007 vs 2004 (%)
Afghanistan, I.R. of	10.4	13.1	23.4	-2.2	...	...
Angola	17.5	16.9	48.7	14.6	7.4	47.8
Armenia	12.3	4.2	10	-3.9	3	40.6
Azerbaijan, Rep. of	20.9	14.4	62.5	11.3	8.1	26.4
Belarus	10	11.5	38.8	-4.1	1.5	-6.4
Cambodia	10.3	8.4	30.9	-4.3	1.8	2.4
China,P.R.: Mainland	10.7	3.6	13.9	8.2	19.9	6.9
Equatorial Guinea	15.6	4.5	32.4	-0.8	9.2	10.3
Qatar	15	11.2	36.6	31.2	3.9	19.1
Turkmenistan	12.3	9.4	63.4	12.6	35.9	5.7
Venezuela, Rep. Bol.	10.7	21	55.7	12.7	4.9	15.8
Average of double-digit growth countries	**13.3**	**10.7**	**37.8**	**6.9**	**9.6**	**16.9**
Ethiopia	**11.8**	**17.0**	**18.8**	**-5.8**	**1.9**	**19.1**

Source: IMF WEO

savings which, in any case, has recently been directed mostly towards the public rather than the private sector. With respect to foreign sources of savings, maximizing inflows will mean doing better to attract two distinct types of foreign capital flows: official support through grants and loans from international institutions and bilateral donors as well as private investor inflows through equity and other channels. Ethiopia has not done poorly on each of these fronts, but neither has it benefited from a major 'scaling up' as have many countries in comparable conditions.

Over the medium-term, a greater openness to private sector and foreign investor involvement offers one of the best avenues for meeting the country's investment needs. Allowing the private sector to engage more deeply in various areas currently spearheaded by the government could, by itself, offer a big boost to investment. As noted earlier, the state has recently extended its activities (for example in to residential construction and railroads) beyond its already dominant roles in areas such as finance, air transport, power and telecom. Within Africa, for example, Ethiopia remains one of only two countries in the whole continent (alongside Eritrea) where the banking system remains state-dominated.[12] In contrast to this approach, many developing countries welcome foreign investment in banking and other areas. Even more, they are opening their economies in areas that have not been traditional destinations of foreign investor flows—including for example, into Public Private Projects (PPPs) in infrastructure; into local currency issues of corporate and government debt; into equity stakes in state-owned banks; and into large-scale telecom privatizations. These developments are taking place not just in the well-established emerging markets such as China or India but also in many so-called frontier markets (Vietnam, Uganda, Malawi, Mozambique) with economic circumstances more similar to Ethiopia. For Ethiopia, a major advantage to drawing in such foreign investment, including in non-traditional areas, is that they can provide needed financing without—as current policy is doing—heavily running down existing foreign exchange reserves, crowding out the private sector, or sacrificing quality and innovation in key economic products and services (e.g., in telecom, power, railways, finance and the like).

Finally, a more inclusive and transparent regulatory and policy environment—arguably welcome for its own benefits—would also help deepen and broaden Ethiopia's private sector, including by: (i) encouraging even higher foreign and diaspora investment; (ii) unlocking more foreign aid that can be deployed towards raising public investment; (iii) providing early feedback on policy errors before they become entrenched; and (iv) safeguarding competitive business operating conditions.

- **Higher Foreign and Diaspora Investment:** Despite levels of foreign and diaspora investment that are high in historical terms, it is likely that a still sizeable sub-set of this investor group is holding back on new investments on account of shortcomings related to the legal, policy, and institutional environment. Such investment can only be attracted by genuine efforts to address the issues that figure prominently in the selection and decision-making criteria of this investor group.

- **Maximizing foreign aid:** Ethiopia still receives relatively limited foreign aid by most objective metrics, including for example the ratio of aid-to-GDP or aid per capita. Compared to its peers, for example, Ethiopia has not seen much of an aid scaling up following the 2005 initiative of the G-7 and multilateral donors to raise aid to developing countries. Ethiopia has also not yet qualified for some key bilateral aid initiatives, such as the US's Millennium Challenge Account which has offered very large sums of assistance to many African countries. In the latter case, a key condition to securing stepped up financial assistance is the openness of the country's economic and governance systems.

- **Early correction of policy mistakes:** A system of regular dialogue with the private sector can help ensure that policy initiatives are sufficiently discussed and debated before becoming binding laws and regulations. This is relevant for initiatives in a wide range of areas (e.g., macroeconomic, customs, tax, and banking sector policies). A more inclusive and transparent policy-making process can ensure that entities most affected have an opportunity to present their perspectives, thereby helping avoid what can turn out to be unworkable or impractical economic policies.

- **Safeguarding competitive business conditions and growth-conducive economic and social policies:** As experience around the world has shown, a vibrant market economy can be helped immensely by economic and financial institutions that promote private sector and consumer interests— such as an independent central bank focused on price stability, well-functioning investment and licensing bureaus that facilitate growth and entrepreneurship, as well as effective (even powerful) anti-trust and regulatory agencies that promote a level playing field for the benefit of all businesses and entrepreneurs. In addition, greater transparency in key economic institutions can promote a more open, timely, and consistent dissemination of critical economic data (for example, on the country's international reserves and the operations of its largest public enterprises), providing major benefits to the business community and to the public at large. In all these areas, while Ethiopia has seen some progress over the years, there remains substantial scope for improvements that could have potentially large and immediate payoffs.

[12]See the World Bank's "Making Finance Work For Africa" (page 43). Togo is the only other country listed as have a state-dominated banking system, but has launched reforms that are reshaping the financial sector.

Ethiopia: Main Macroeconomic Indicators, FY 2000-2008

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Economic Activity and Prices				(in percent change, unless otherwise noted)					
Real GDP growth	-0.8	7.4	1.6	-2.1	11.7	12.6	11.5	11.5	11.6
By Sector									
Agriculture	3.1	9.6	-1.9	-10.5	16.9	13.5	10.9	9.4	7.5
Industry	5.3	5.1	8.3	6.5	11.6	9.4	10.2	10.2	10.4
Services	10.4	5.2	3.3	6.0	6.3	12.8	13.3	14.3	17.0
GDP at current market prices (Birr millions)	66,648	68,027	66,557	73,432	86,661	106,473	131,641	171,834	245,585
GDP at current market prices (USD millions)	8,188	8,166	7,794	8,559	10,042	12,306	15,164	19,539	26,567
GDP per capita (USD)	131	127	118	126	143	171	205	257	340
GDP per capita (Birr)	1,065	1,056	1,004	1,077	1,236	1,478	1,778	2,258	3,142
Nominal Birr per capita income (Index FY=100)	100	99	94	101	116	139	167	212	295
Real Birr per capita income (Index FY00=100)	100	105	107	100	106	118	127	139	154
Gross domestic investment (% GDP)	15.3	17.8	20.5	22.7	21.3	23.0	24.2	25.0	21.2
Public investment (% GDP)	5.3	8.5	11.5	8.8	9.1	14.7	16.7	18.2	15.3
Private investment (% GDP)	9.9	9.3	9.0	14.0	12.1	8.3	7.6	6.7	5.9
Consumer prices (year-average)	4.2	-5.2	-7.2	15.1	8.6	6.8	12.3	15.8	25.3
Consumer prices (end of period)	0.3	-11.4	-1.0	23.5	1.7	13.0	0.0	15.1	55.3
Money and Exchange Rates				(in percent change, unless otherwise noted)					
Broad money (M3)	14.0	9.5	12.3	10.9	14.7	19.6	17.4	19.7	22.7
Credit to the public sector (Govt & SOEs)	...	-0.6	3.6	8.6	15.7	31.5	16.7	21.1	35.7
Credit to the private sector	...	7.9	-7.4	-4.2	3.7	31.5	28.3	27.3	22.0
Deposit rates (minimum, in percent)	-6.0	-6.0	-3.1	-3.1	3.0	3.0	3.0	3.0	4.0
Lending rates (effective, in percent)	...	...	...	...	8.9	8.8	8.6	8.8	10.0
Exchange rate (Birr per USD, year average.)	8.14	8.33	8.54	8.58	8.63	8.65	8.68	8.79	9.24
Real effective exchange rate (percent change)	-1.2	-12.3	-1.2	5.9	-4.6	8.2	6.0	3.8	24.2
Balance of Payments				(US dollar millions, unless otherwise noted)					
Exports, f.o.b.	486	463	452	483	600	847	1,001	1,189	1,466
Coffee	262	182	163	165	223	335	354	424	525
Non-coffee	223	281	289	318	377	512	647	765	941
Imports, c.i.f.	1611	1557	1,696	1,856	2,587	3,633	4,593	5,128	6,811
Fuel	250	293	268	289	311	669	861	895	1,621
Terms of trade (percent change)	-33.9	-3.6	-11.1	-6.5	-14.6	8.0	4.4	-1.6	2.5
Current account, after grants (% GDP)	-5.3	-3.6	-5.7	-2.2	-4.0	-6.3	-9.1	-4.5	-5.3
Foreign direct investment (% GDP)	...	...	...	1.3	1.5	1.2	2.4	2.5	1.9
External borrowing (% GDP)	1.7	3.8	9.5	5.7	3.9	3.8	0.5	1.2	2.8
External debt (% GDP)	85.7	82.4	97.4	85.4	73.3	48.9	37.3	11.8	13.3
External debt-service ratio (% exports)	52.2	22.7	17.0	7.8	6.7	5.8	5.1	3.7	1.2
Gross official international reserves	349	337	664	931	1,352	1,581	1,158	1,326	1,323
(in months of imports of goods & services)	2.2	2.0	3.3	3.7	3.7	3.4	2.2	2.0	1.9
Government finances					(in percent of GDP)				
Revenue	...	...	...	16.4	17.0	14.6	14.8	12.7	12.1
Tax revenue	...	...	...	12.1	13.3	11.6	10.8	10.1	9.7
Nontax revenue	...	...	...	4.3	3.7	3.0	4.1	2.6	2.4
Grants	...	...	...	6.7	4.9	4.3	3.6	4.4	4.0
Expenditure and net lending	...	...	...	29.1	25.1	23.3	22.3	20.7	19.1
Current expenditure	...	...	...	19.9	14.6	12.4	11.6	10.0	9.3
Capital expenditure	...	...	...	9.3	10.1	10.7	10.7	10.7	9.8
Overall fiscal balance, including grants	...	...	...	-8.1	-3.2	-4.4	-3.9	-3.6	-2.9
External financing of the deficit	...	...	...	5.7	2.9	2.2	1.1	1.1	1.0
Domestic financing of the deficit	...	...	...	2.4	0.2	3.3	1.3	3.6	2.7
Float/statistical discrepancy	...	...	...	-1.1	-2.4	-1.2	1.4	-1.1	-1.1
Gross stock of domestic debt	...	...	...	39.0	35.8	30.0	29.5	26.2	21.0
Memo items:									
Population, mid-year	62.6	64.4	66.3	68.2	70.1	72.1	74.1	76.1	78.2

Source: MOFED (for GDP data); IMF (for monetary, fiscal, investment, BOP data); CSA (for inflation data); and National Bank of Ethiopia.

Access Capital Research

Access Capital Research aims to provide comprehensive and insightful analyses of macroeconomic, sector-specific, and private sector developments and prospects in Ethiopia. Our research products are based on information and data compiled from multiple sources, including domestic economic agencies and statistics providers (the National Bank of Ethiopia, Ministry of Finance and Economic Development, Central Statistical Agency, Ethiopian Investment Agency), multilateral institutions, bilateral donors, private sector companies, industry associations, and international providers of business and economic news.

Any opinions or statements made by Access Capital Research are solely those of the research unit and its authors, and do not necessarily represent the views of the Management or Board of Access Capital. While every effort has been made to ensure the use of reliable data and information, and to qualify the reliability of particular sources when appropriate, Access Capital is not responsible for any errors of data, analysis, or interpretation.

Access Capital—Main Research Products:

1. Macroeconomic Research
Ethiopia Macroeconomic Handbook
Quarterly Macro Report [To be launched]
Macroeconomic Updaters[To be released with key data releases and macro developments]

2. Sector Research [To be launched]
Sector and Industry Backgrounders
Sector and Industry Overview Reports
Sector Updaters

3. Business Databases [To be launched]
Ethiopian Business Database: Compilation of Ethiopian firms by sector, sub-sector, industry.
ETDealMonitor: Compilation of key business deals by sector, focused particularly on FDI

4. Indicators of Business and Economic Activity [To be launched]
ETPulse: High-frequency (monthly and quarterly) indicators of business and economic activity
Quarterly indicators of banking sector activity
Price, cost, and wage indices and indicators for the Ethiopian economy

Contacts:
For additional information, please access the following website:
www.accesscapitalsc.com
For Email correspondence: research@accesscapitalsc.com
Tel: 011- 251-11-5539769
Fax: 011-251-11-5539758
Mail: P.O. Box 28119, Code 1000
Addis Ababa, Ethiopia

Contacts:
For additional information, please access the following website:
www.accesscapitalsc.com
For Email correspondence: research@accesscapitalsc.com
Tel: 011- 251-11-5539769
Fax: 011-251-11-5539758
Mail: P.O. Box 28119, Code 1000
Addis Ababa, Ethiopia