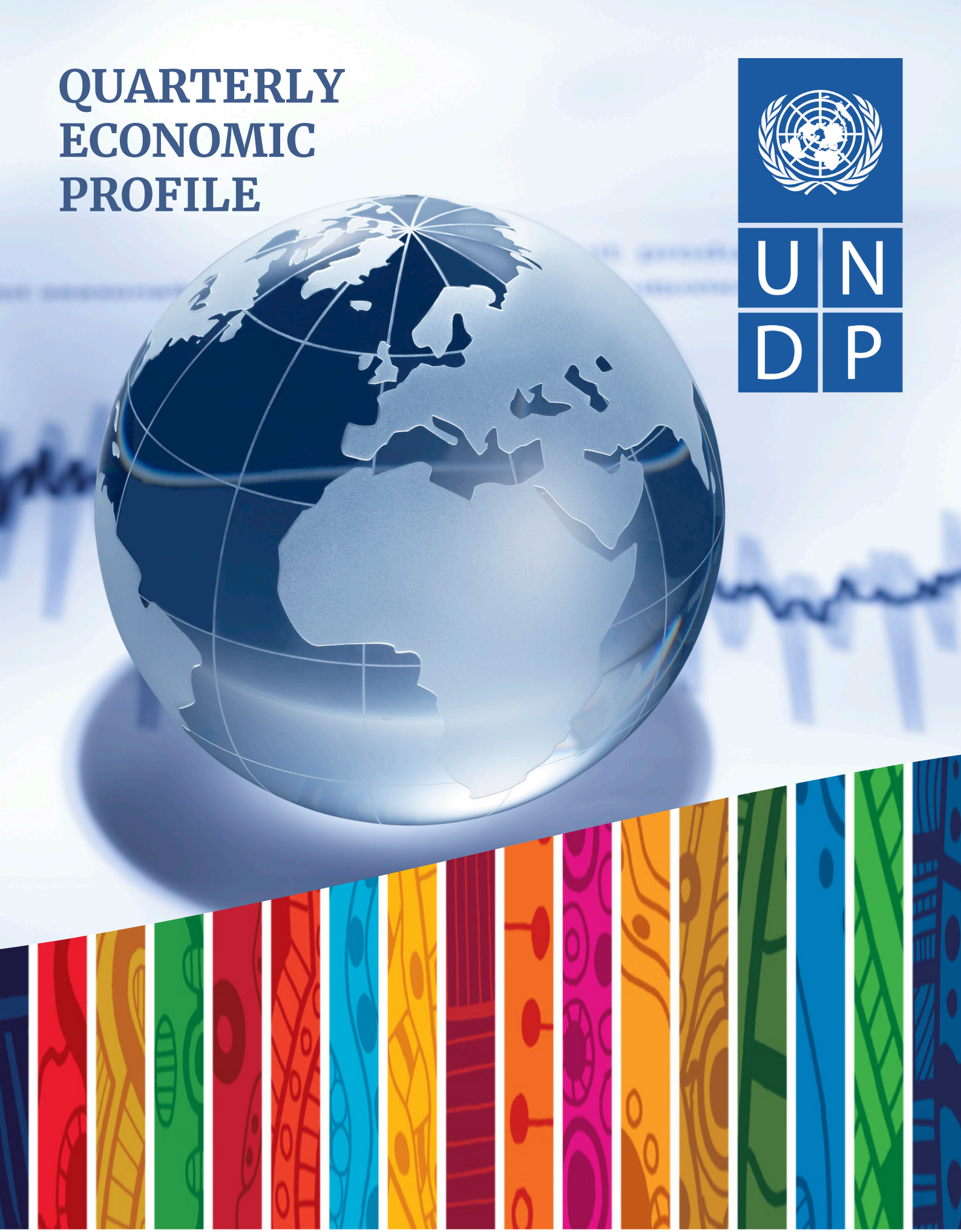
QUARTERLY ECONOMIC PROFILE



ETHIOPIA

July 2022

Key Highlights

What's changed since Q1 2022?

- **Growth:** Official estimate for real GDP growth in 2022 is 6.6%, while UNDP projects 3.0% and IMF 3.8%.
- **Inflation:** Worsening of inflation to 37.2% in May 2022 and 34% in June 2022 compared to 33.6% in February 2022. Inflations remains high with a slight deceleration reported in June 2022, which may not suggest an emerging trend.
- **Fiscal Out-turns 2022:** The fiscal deficit/GDP is widening and is estimated at 5.1% for FY2022
- **Fiscal Plan 2023:** The deficit in FY2023 is budgeted to fall to 3.4% of GDP, due to tighter expenditure control.
- **Monetary aggregates:** Reserve money is projected to grow at 32% in FY2022.
- **Foreign exchange:** Foreign exchange reserves in May 2022 are at $US 1.5 billion and have been dwindling.
- **Current account balance:** The current account deficit is projected at 5.3% of GDP in FY2022.
- **BoP:** Overall BOP deficit in FY2022 is estimated at $US 2 billion, requiring significant external financing support.

- The Ethiopian economy continues to face challenges in 2022 due to the domestic uncertainty, Ukraine conflict, drought, global supply shocks, and a difficult global and regional environment. Both 2021 and 2022 have been challenging years for the Ethiopian economy. The multiple shocks render macroeconomic management challenging.
- Estimates by the UNDP Ethiopia team project a rebound in 2023[1] to 4.8% mainly on account of services sector rebound, and slower growth in agriculture and manufacturing.
- Inflation has reached 37.2% in May 2022, largely driven by food inflation which is 43.9%. June 2022 data indicates a slight decline in inflation to 34%, but the future trend is unclear. By leading to cost-of-living increases, this is having a strong impact on the purchasing power of households and exacerbating poverty trends in the country.
- Due to the high fiscal cost on the budget, in July 2022, the Government started reducing the fuel subsidy by increasing the retail fuel prices at the pump stations. The Addis Ababa petrol price increased by 30% to Birr 47.8 per liter. The Ministry of Trade has committed to progressively lift the subsidy during the year.
- There has been a widening of the twin deficits in 2022, raising sustainability concerns. The fiscal deficit has widened from less than 3% of GDP in 2021 to more than 5% of GDP in 2022 due to the increase in spending to finance defense and humanitarian expenditures, while the current account deficit is widening to more than 5% of GDP to finance the growing import bills of fuel, fertilizer, and wheat.
- The reserves position is currently at $US 1.5 billion, which is less than 2 months of imports. Exports and remittances continue to provide buffers for the economy.
- The black-market exchange rate is now at close to 75 birr/ $US, according to traders, suggesting reduced confidence in the current parity.
- The parliament approved a federal budget of Birr 787 billion ($US 15 billion) for fiscal year 2023. In terms of composition, the recurrent budget accounts for 44%, capital budget 28%, subsides to regional governments 26% and for SDGs 2%.
- In September 2021, the Government approached the IMF requesting a lending program. In June 2022, a technical IMF team visited Ethiopia to assess the macroeconomic situation.

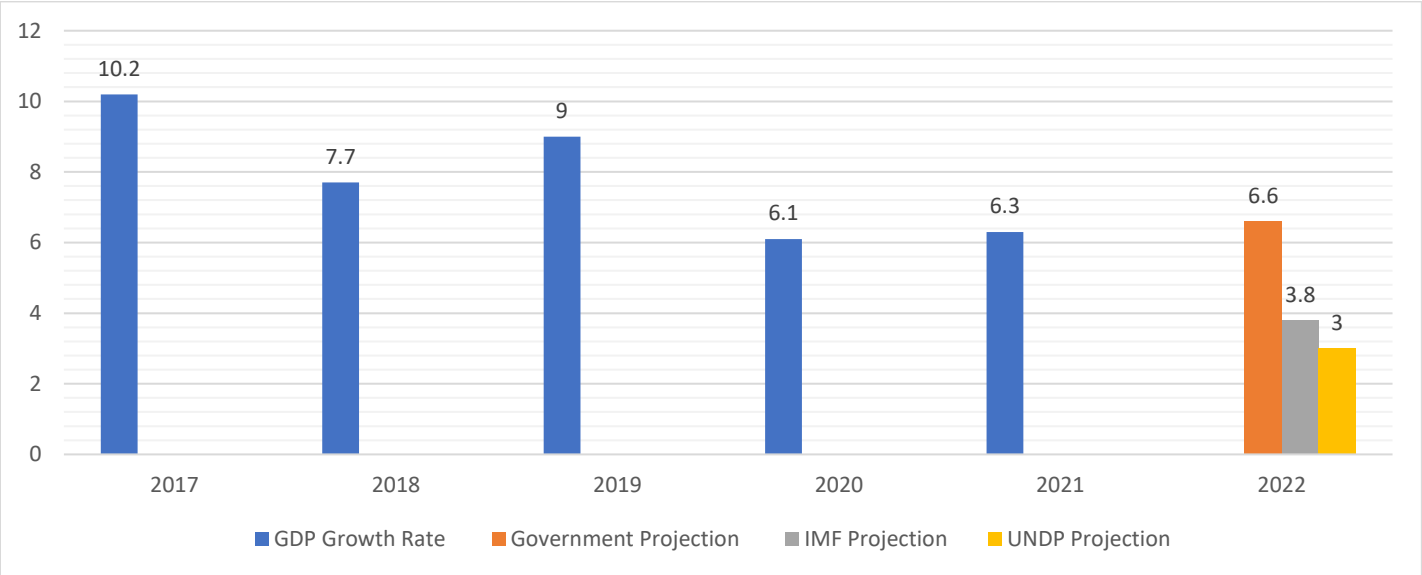
[1] The fiscal year is from July 8, 2022, to July 7, 2023.

1. *Economic Growth*

The Ethiopian economy in the past three years has been faced with multiple shocks of differing natures; the COVID 19 pandemic, internal conflicts and the northern Ethiopia war, drought and most recently, the Ukraine crisis. The government has lowered its growth projections to 6.6% from the original projection of 8.7% for FY2022 (Figure 1). The complexity of managing the shocks has made policy choices challenging. Several parts of the country have also been hit by worst drought in forty years, affecting human lives, livestock, and agriculture. Nevertheless, in the past three years, the economy had shown some degree of resilience and recorded a positive rate of growth. In sub-Saharan Africa, average growth has also been positive at 4.5% in 2021 (IMF,2022).

FY2022 GDP projections of UNDP stood at 3%, reflecting pronounced shocks to manufacturing and agriculture from the combined impacts of the war and drought. The shocks have affected human development, pushing many people, especially in the north and in the urban cities, into greater poverty, impairing economic activities and deepening macroeconomic imbalances.

Figure 1: Real GDP Growth (%)



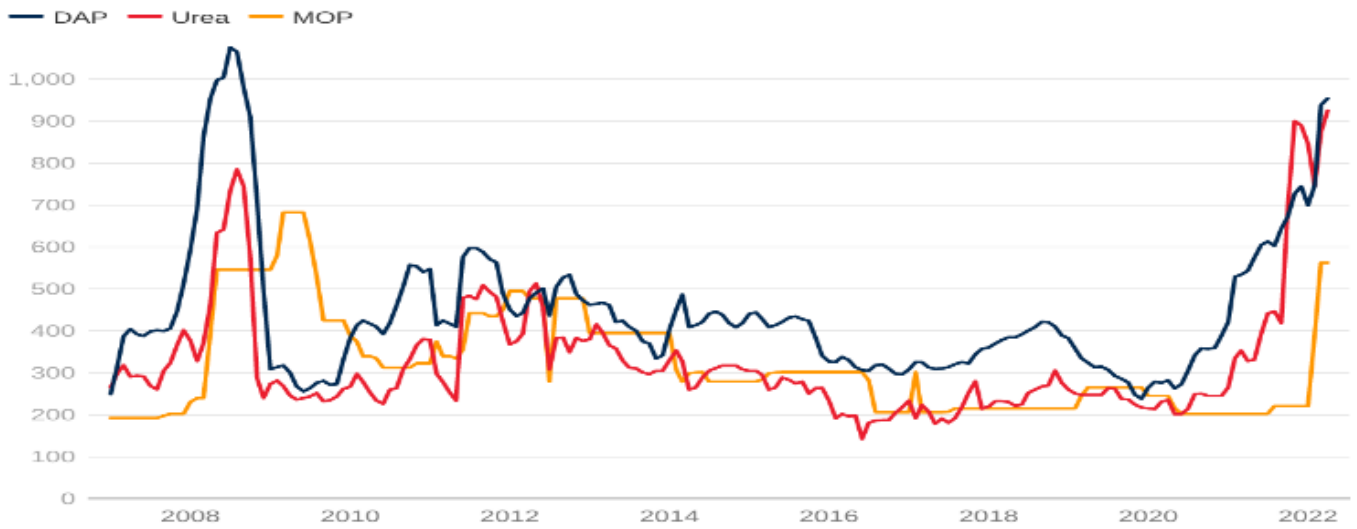
Source: Constructed based on GDP data from MPD and IMF and UNDP projections.

Agriculture in FY2022 is projected to be affected by both the conflict as well as the current drought. Although the drought has affected mostly the pastoral parts of Oromia, Somali and SNNPR, it has caused displacement of people in search of fodder and water for their livestock.

Due to the conflict, significant damage was faced in agriculture. In the Amhara region, an estimated damage of more than Birr 100 billion was reported by the regional government. Under normal times, the Amhara region contributes more than 30% of the total crop production of the country. Increased cost of fertilizers is also another main challenge for the sector's performance. As Figure 2 shows, there has been a sharp increase in fertilizer prices at the global market. The Ukraine crisis has further exacerbated the price situation given the fact that Russia is a source for 16% and 12% of

the Urea and Dap, respectively. According to a report by OCHA (June 7, 2022), Ethiopia is one of the eastern African countries that has seen a sharp increase in fertilizer prices at local markets.

Figure 2: Trends of Global Fertilizer Prices (US$/mt)



Note: DAP = diammonium phosphate. MOP = muriate of potash. Last observation is April 2022.

Source: The World Bank

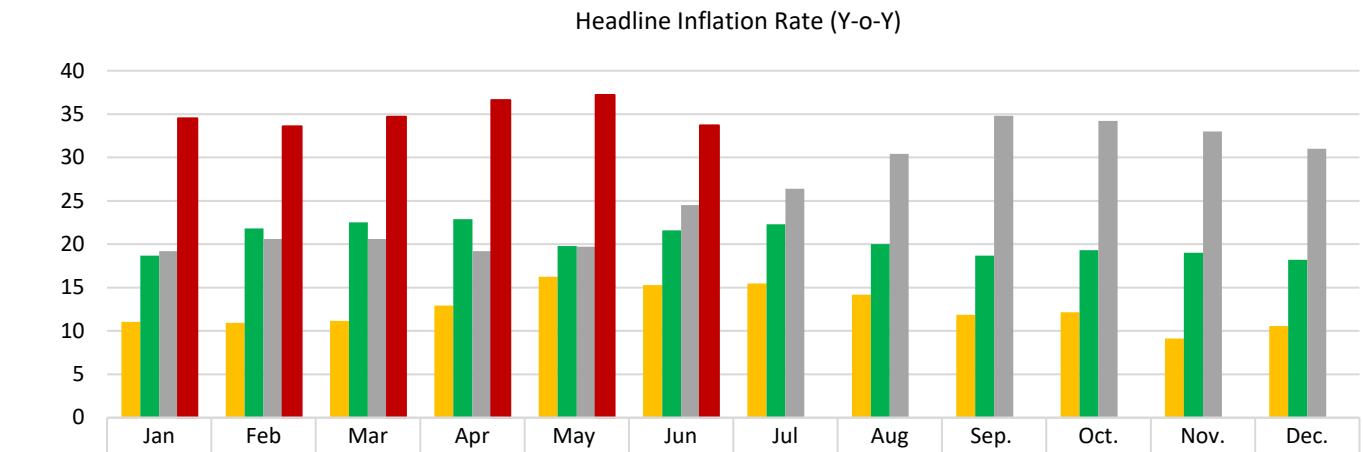
Although the gradual rebound has started in the services sector, complete rebound in some of the areas is yet to come. According to Ministry of Planning and Development, the first two quarters of FY2022 have witnessed only a marginal growth of 1.5% in the services sector. For example, the shocks have had an adverse effect on hotel occupancy rates, which have fallen significantly first due to the COVID-19 pandemic and then due to the northern Ethiopia war. The conflict had led to a 50% drop in hotel occupancy, and recently started to rebound. However, it will take time for a complete recovery to pre-pandemic days.

The macroeconomic imbalances are affecting investment and manufacturing. The current macroeconomic situation is characterized by significant current account deficits leading to dwindling international reserves and high debt accumulation. Shortage of foreign exchange and rising inflation are the main challenges affecting investment in the country. Capital goods imports have been compressed and declined by 24.6% in the first 10 months of FY2022. Imports of raw materials declined by 21%, agricultural inputs fell by 43.8%, and industrial inputs by 27.3%. This will have an adverse impact on output and productivity.

2. *Inflation*

Headline inflation in May 2022 stood at 37.2% and fell to 34% in June 2022 (Figure 3). This has more than doubled compared to its level a year ago (19.7%). Inflation had been in high trajectory since June 2021 where it hit 24.7% and showed a persistent increase since then. The economy had been impacted by multiple shocks in the past 3 years, the COVID 19 pandemic, conflict in northern Ethiopia, drought and recently the Ukraine war. These shocks have created fiscal and monetary policy pressures and at the same time they have created expectations that have influenced economic decisions by economic agents.

Figure 3: Headline Inflation Rate (%) (YoY) January 2019 – June 2022

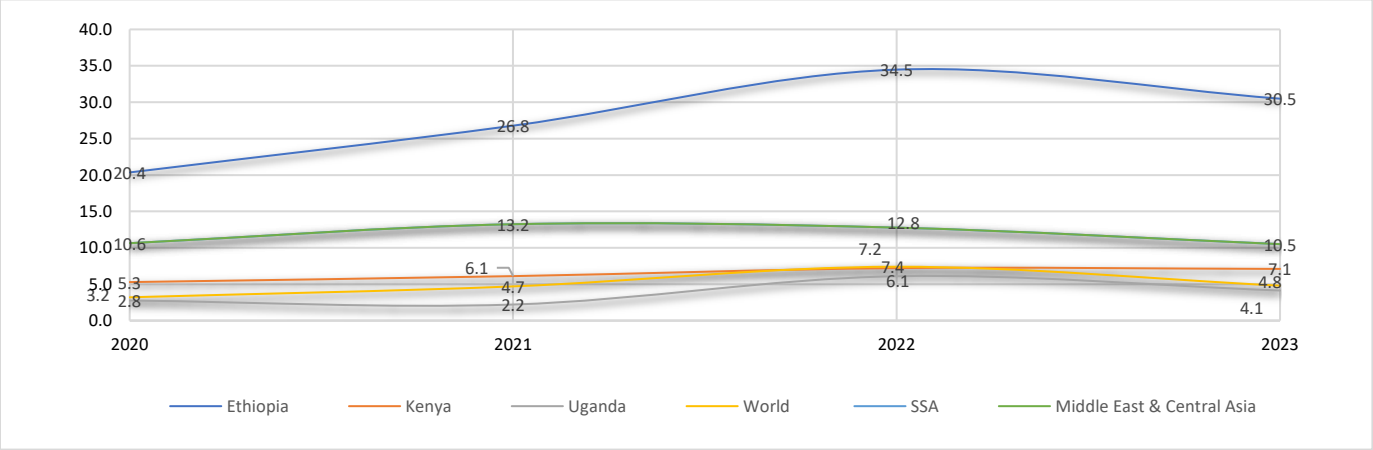


	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep.	Oct.	Nov.	Dec.
FY2019	11.064585	10.952753	11.149425	12.912371	16.24856	15.277547	15.490173	14.169217	11.875665	12.1414319	9.1215895	10.571204
FY2020	18.68484	21.81900	22.525244	22.8739	19.8	21.6	22.3	20	18.7	19.3	19	18.2
FY2021	19.2	20.6	20.6	19.2	19.7	24.5	26.4	30.4	34.8	34.2	33	31
FY2022	34.5	33.6	34.7	36.6	37.2	33.7						

Source: Constructed based on data from CSA

Ethiopia is also being impacted by the global commodity price hikes. Ethiopia is an open economy, largely dependent on imports for its manufacturing goods, agricultural inputs, petroleum products, medicines, and majority of its consumer goods, including cereals. On average, the annual goods import values of Ethiopia range from $US 13-15 billion, which is about 12-15% of GDP while exports range from only about $US 3 - 4 billion, financing only a quarter of the import bill. Imported inflation, coupled with the internal shocks, has led to persistent and high Inflation rates, that are significantly higher than what has been experienced by its neighboring countries (Figure 4). Due to the supply shocks, the global average inflation rate has gone up from 4.7% in 2021 to 7.4 % in 2022; in contrast, the inflation rate in Ethiopia was averaging above 30% between the 2nd half of 2021 and May 2022.

Figure 4: Inflation Rate (%) in Ethiopia and other parts of the world



Source: Constructed based on data from IMF, World Economic Outlook, April 2022

Regions in Ethiopia are also facing significant price increases, mainly due to increases in cereal and bread prices. The price situation in the country has resulted from a cumulative effect of multiple shocks, with the recent Ukraine crisis leading to a compounded effect on commodity prices in the country. Ethiopia imports 25% of its wheat consumption yearly from abroad. Like most African countries, Ethiopia has wheat imports that originate from Russia and Ukraine. Although they are not the main or only sources for Ethiopian imports, Ethiopia has been affected directly from its trade relation with the two countries and indirectly from the impact that the crisis is creating on the global commodity prices.

A sharp increase in import bills has significantly worsened government finances and has been partially transferred to commodity prices at local level. Cereal and fuel import bills have risen to $US 4.5 billion in the first 10 months of FY2022 which was 80% higher than the import bill of same period the previous year and above 30% of the total import bill.

Ethiopia had followed a path of protecting the economy from fuel price volatility at the global level using its Fuel Stabilization Fund which was enacted in 2001. However, given the recent fiscal strains that resulted from the multiple shocks and unsustainable nature of subsidies; the government had been moving away from full subsidies of wheat and fuel and adopted a systematic and targeted subsidies that aims on protection of the poor. In July 2022, the Government increased the fuel price by 30 percent to align it closer to market value.

Moreover, regions are facing a record high food inflation. During the month of May 2022, Gambela and Benishangul faced 57.8 % and 57.2% food inflation on a year-on-year basis.

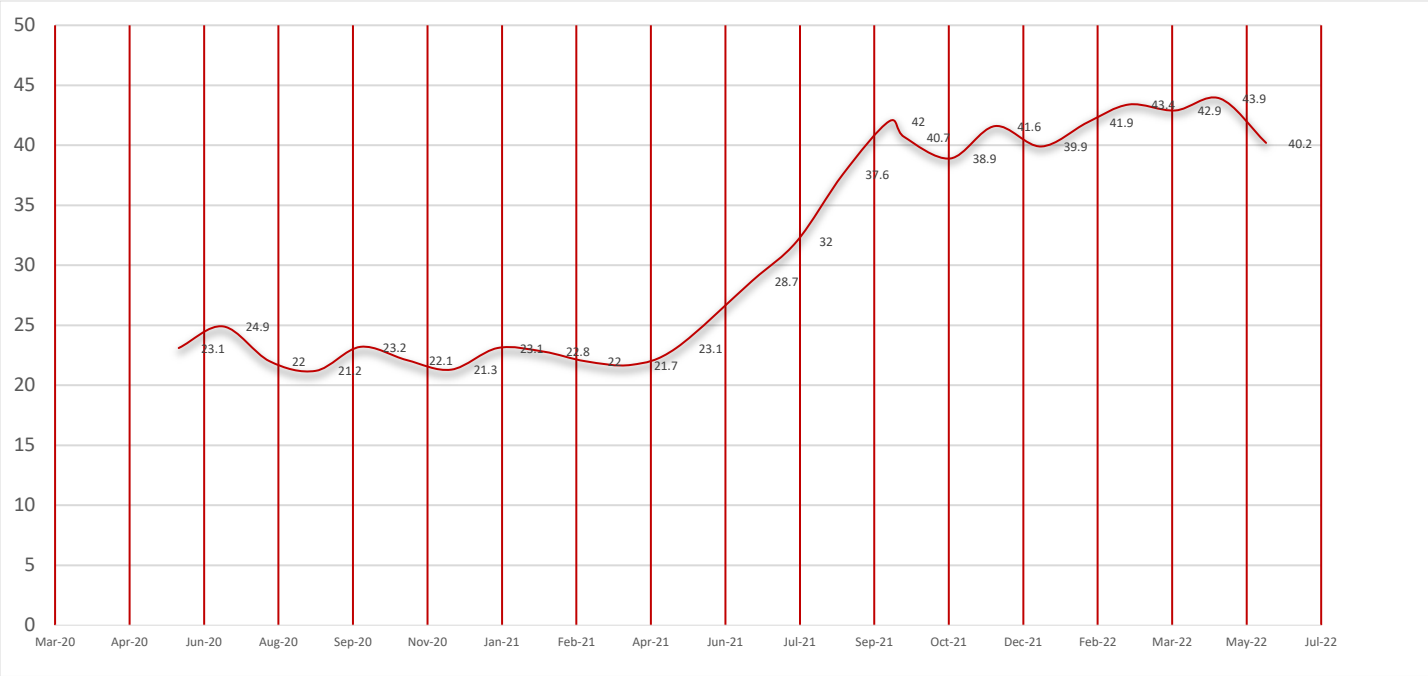
There are several challenges in containing inflation:

- **Global inflation due to supply shocks:** global inflation has reached record high (7.2% in April 2022). Demand and supply gaps at global level from the rebound of economies from the pandemic were further fueled by supply shocks from the Ukraine crisis. Inflation is projected to recede to 4.8% gradually in 2023. (IMF, 2022)
- **Limited policy space:** The fiscal space has been significantly narrowed. The Government projection of fiscal deficit to GDP ratio has widened to a high of over 5% in 2022. There has been a high expenditure need for debt repayment reconstruction, and humanitarian spending but capacity and policy restrains limit the expansion of revenue generation. Grants have declined, while tax revenue generation has limited space to increase in the short term.
- **Drought**: This has been exacerbated in various parts of the country, leading to significant loss of livestock, migration, and disruption in production and livelihood.

- **Fuel price increase**: With a gradual removal of subsidies to fuel, the international price of fuel will continue to pass through the economy. There has been a 30% retail fuel price increase at the pump stations in early July 2022.
- **Production and supply shocks:** Disruption of economic activities due to the conflict.
- **Monetary financing of budget deficits/ accommodative monetary policy**: Continued financing of the government budget gap through borrowing from NBE.
- **Depreciation of the nominal exchange rate**: The exchange rate has been depreciating within a range of 20 – 25% annually since 2018. This will have a strong pass-through effect.

Food inflation had hit the pick of 43.9% in the month of May 2022, which is nearly double of its level a year before; however, the pace of increase has shown a decline to 40% in June 2022 (Figure 5).

Figure 5: Food Inflation Rate (%) Year on Year (January 2018 –June 2022)

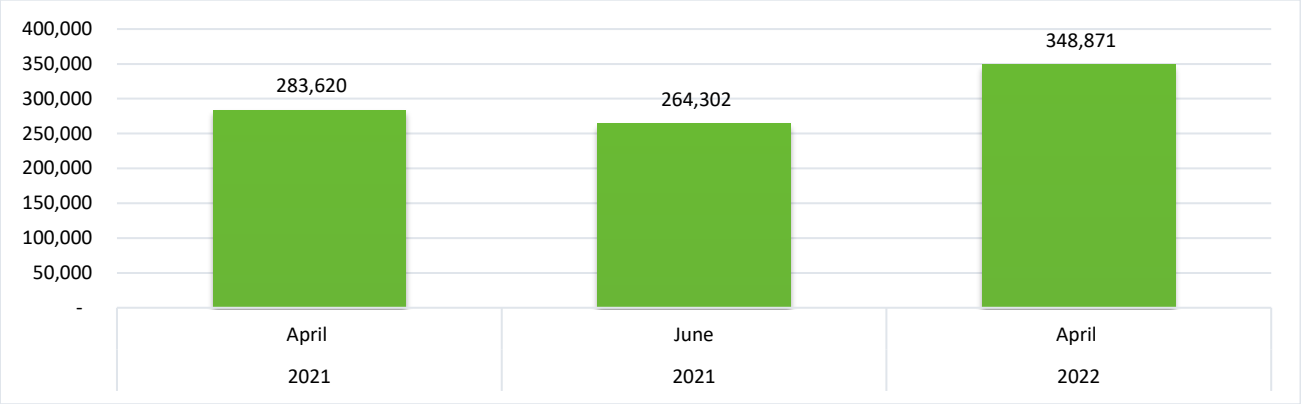


Source: Constructed based on data from CSA

3. *Monetary Policy*

With multiple shocks to deal with and limited policy space, monetary policy had remained on the accommodative side in the first 10 months of FY2022. The National Bank of Ethiopia has cut the reserve requirements of commercial banks to 5% with an objective of enhancing commercial banks liquidity. Broad money and reserve money have expanded by 24.9% and 32%, respectively (Figure 6). Prior policies to contain inflation have affected the latter, as bank deposits with NBE have shown an increase of 30%.

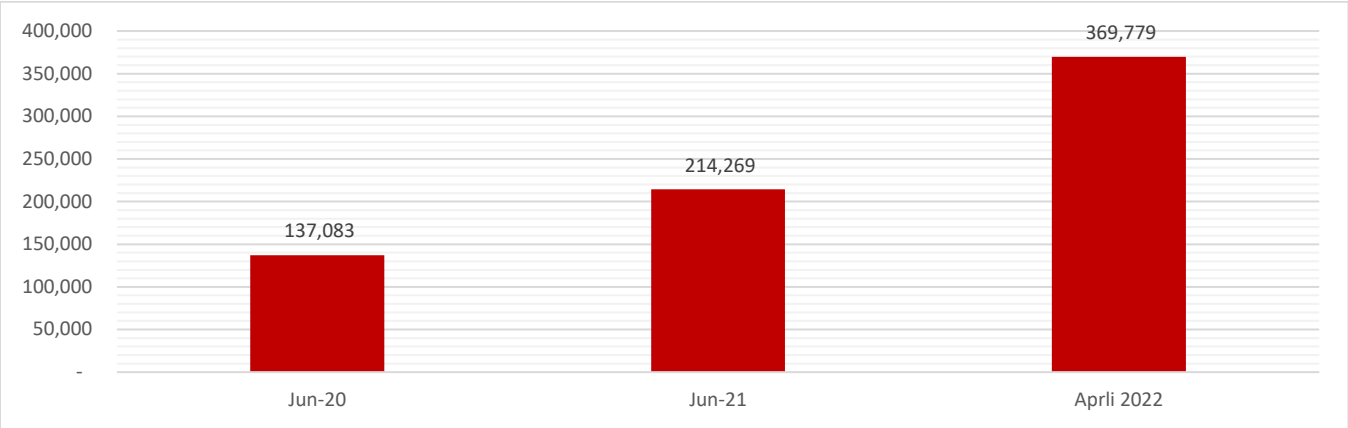
Figure 6: Reserve Money (Million Birr)



Source: constructed based on data from NBE

The stock of domestic credit reached Birr 1.8 trillion in April 2022, 28% higher than its level a year before. Of the total credit, 20 percent is directed to the government. This credit to government in the first 10 months of FY2022 has more than doubled from its level in the previous year (Figure 7).

Figure 7: Credit Claims on Government (Million Birr)

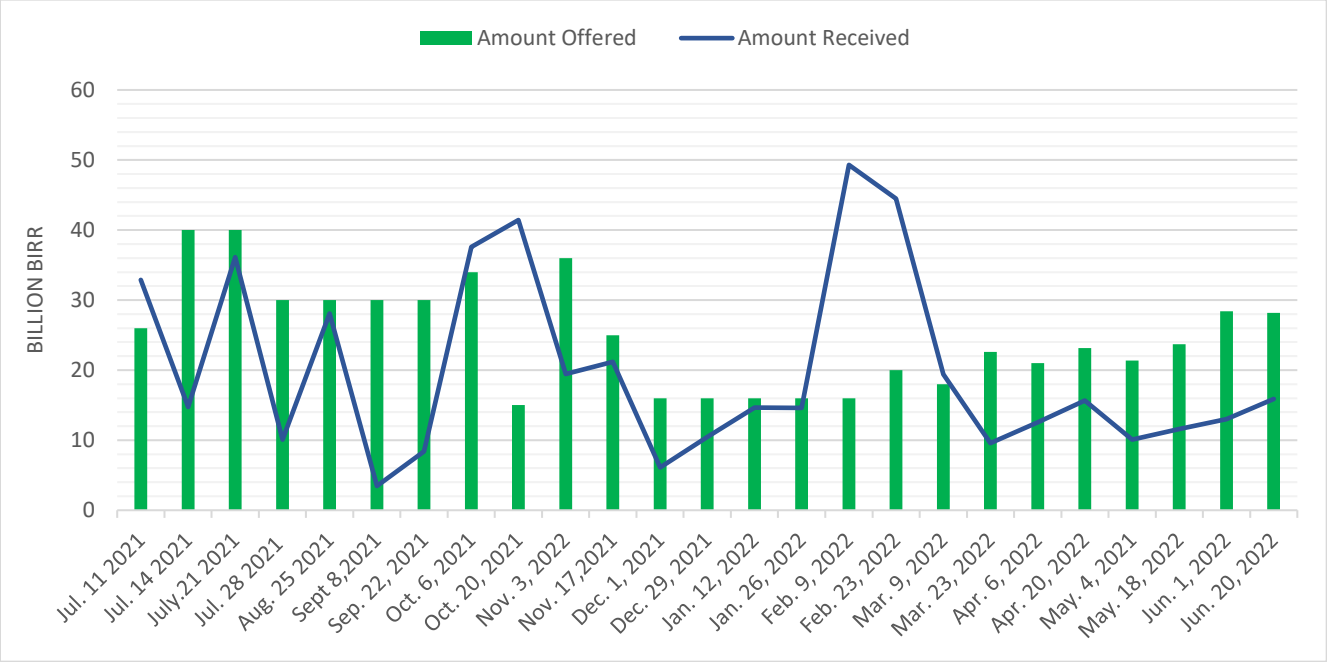


Source: constructed based on data from NBE

Despite a negative real interest rate, deposit mobilization by the banking system in the first 10 months of FY2022 reached Birr 1.6 trillion, 25% higher than its level a year before. Deposit mobilization by both public and private banks has been on the increase. More than half of the deposits are mobilized by the state-owned banks, while the private commercial banks collectively mobilized the remainder.

The Treasury Bills Market, with maturity dates varying from 28 days to 364 days, has supplied the Government with a total stock of Birr 501 billion during FY2022 (NBE website) which is 80% of what has been offered in the T bill auction market by the government (Figure 8). With a widening fiscal deficit, the government has become increasingly reliant on T-bills. Although the participation rates have improved, the market is still predominantly limited to pension funds and private and public commercial banks. Given the high inflation, an increasingly negative real interest rate limits the rate of participation of private firms in the T-bill market.

Figure 8: T-Bills Offered and Received (Billion Birr) July 2021 – June 2022

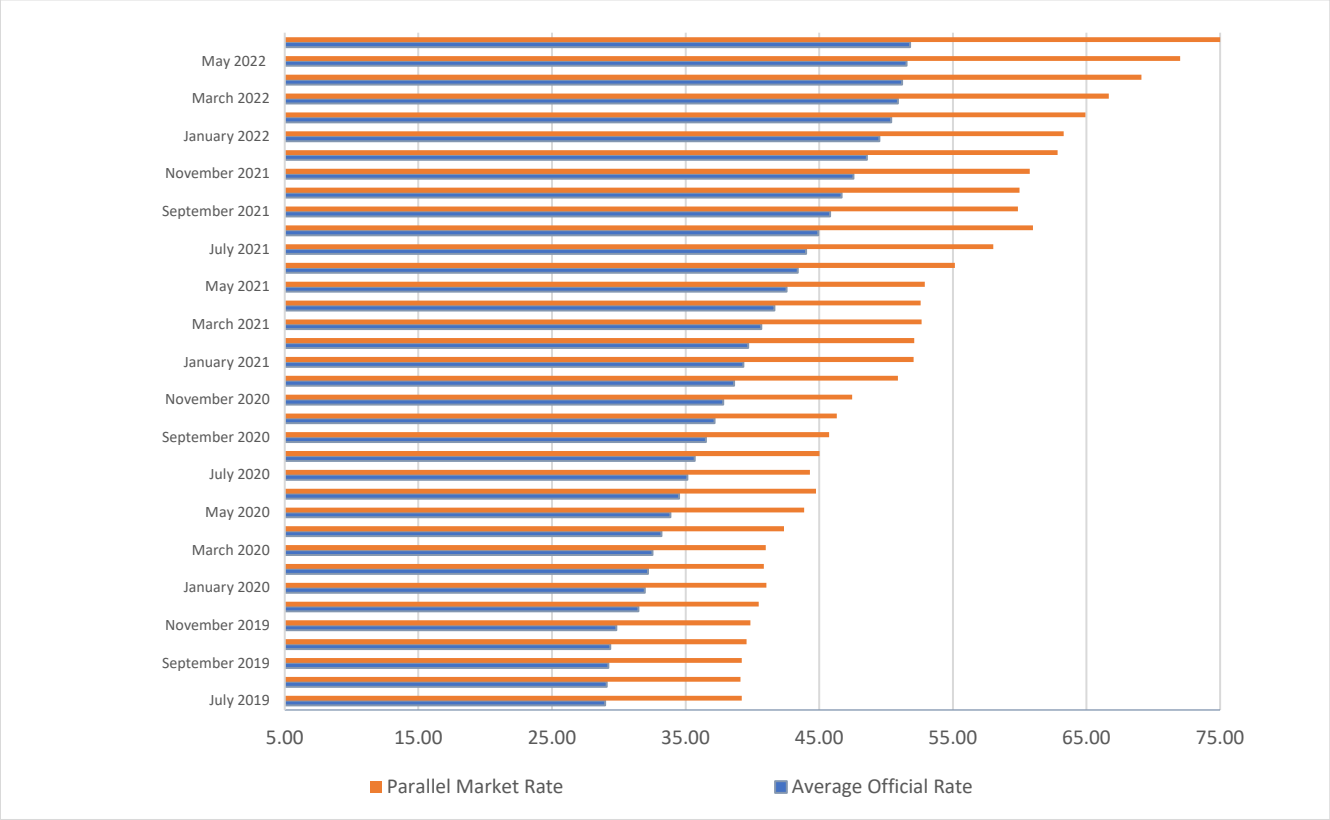


Source: Constructed based on data from NBE

4. *Exchange Rate Developments*

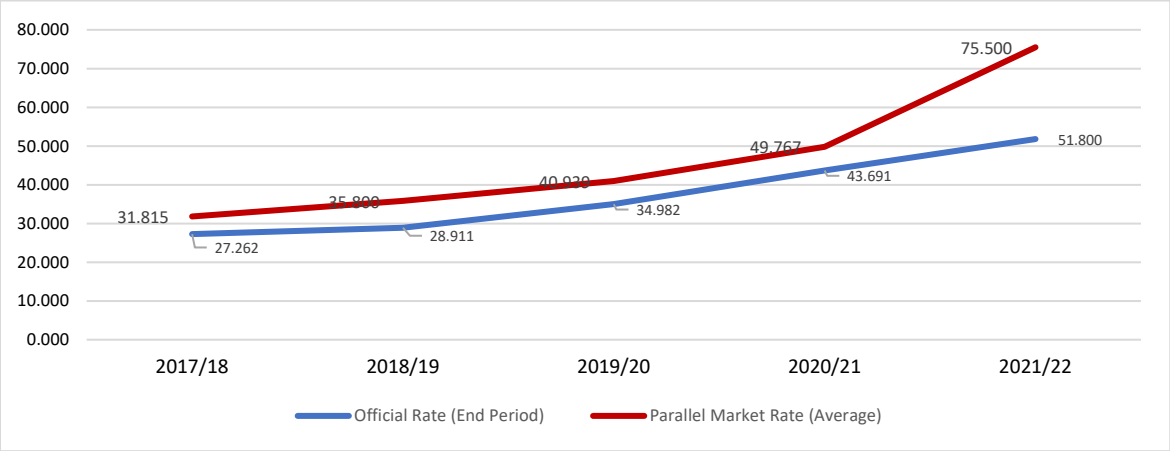
The volatility in the foreign exchange market continues to be persistent. The exchange rate has been depreciating within a range of 20 – 25% annually since 2018. A 20% annual depreciation of the Birr in terms of official exchange rate has been registered during June 2022 compared to the previous year. Despite well - performing exports, a gap between import bills and export earnings, as well as decline in external financing, had been persistently adding pressure on the foreign exchange rate market. The parallel market is a direct reflection of this. In May 2022 the premium between the parallel and official exchange rates has reached 35% (Figure 9 and Figure 10).

Figure 9: Official and Parallel Exchange Rates (Birr/$US July 2019-May 2022)



Source: Constructed based on Data from NBE

Figure 10: Annual Average Official and Parallel Exchange Rates 2018-2022 (Birr/$US 2018-2022)



Source: Constructed based on Data from NBE

5. Government Finance

During the first half of FY2022 general government revenue and grants totaled Birr 273.7 billion or 44.6% of the annual budget. Domestic and tax revenues, accounted for 95.6% and 87.2% of the collected revenue, respectively. External grants were Birr 12.1 billion or 15.8% of the annual budget. On the expenditure side, Birr 297.9 billion or 42.2% of the annual budget was spent during the six months. In terms of composition, Birr 204.1 billion or 68.5% was recurrent expenditure, while 31.5% was for capital spending.

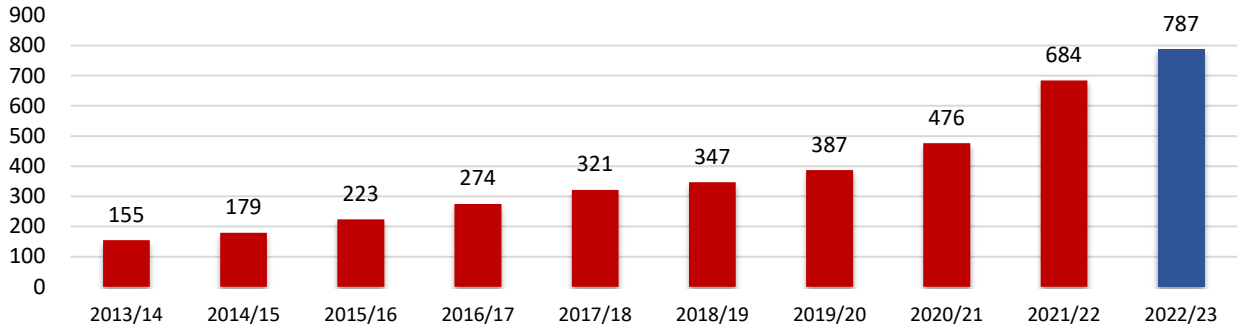
Federal government revenue and grants during the first eleven months of FY2022 reached Birr 321 billion or 87.3% of the budget and increased by 10.8% compared with the same period of the preceding year. Tax revenue accounted for 93.6% of the revenue collected. Total expenditure during the same period reached Birr 502 billion or 85.3% of the budget and increased by 33.8% compared to the amount spent during the same period last year. This expenditure comprises Birr 213 billion recurrent expenses, Birr 109.5 billion capital expenditure and Birr 179.5 billion transfers to regional governments. The overall deficit during the first eleven months of FY2022 reached Birr 181 billion. This was fully financed from domestic borrowing mainly through issuance of Treasury bills.

The complete picture of the national fiscal performance will be known when the consolidated general government finance is compiled later in August or September 2022.

6. Federal Government Budget (2023)

On July 7, 2022, the Ethiopian parliament approved a record Birr 786.6 billion ($US 15.2 billion) federal government budget for the fiscal year 2023 which runs from July 8, 2022, to July 7, 2023 (Figure 11). The budget was made at an exchange rate of 52 birr/$US. This indicates a 15.1% annual increase compared to Birr 683.7 billion approved for last year, including the supplementary budget of Birr 122 billion. The budget comprises Birr 345.1 billion ($US 6.7 billion) recurrent budget, Birr 218.1 billion ($US 4.2 billion) capital expenditure, Birr 209.4 billion ($US 4.0 billion) for transfers to regional governments and Birr 14 billion ($US 271 million) for SDGs.

Figure 11: Trends in Federal Government Budget (Billion Birr)



Source: Constructed based on data from MoF

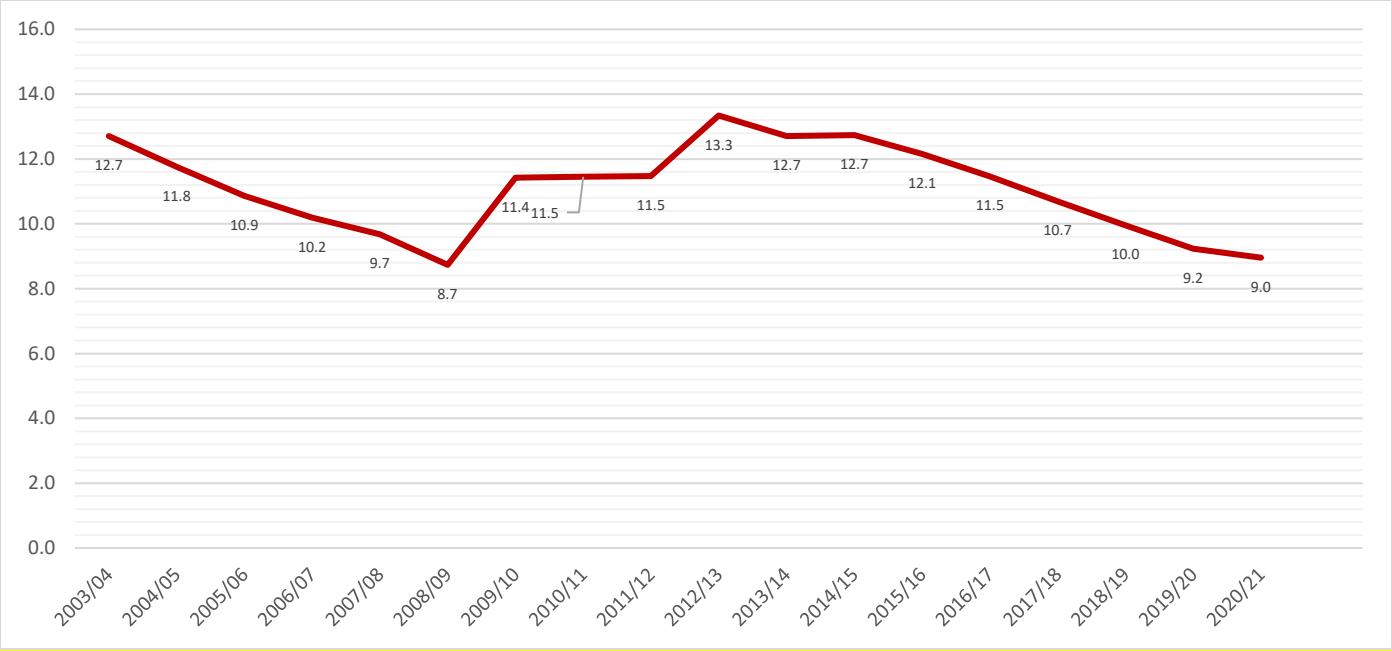
The recurrent budget accounts for 44% of the total budget, which will be focusing on debt repayment, humanitarian assistance, reconstruction, and national defense. The capital budget will take 28%, transfers to regional governments 26% and the SDGs 2% of the total.

The Tigray regional government has been allocated Birr 12 billion as part of the budget allocations.

Total revenue and grants in the budget are Birr 478 billion, which comprises Birr 439 billion from domestic tax and non-tax revenues, Birr 31 billion from project support and Birr 8 billion from direct budget support. For FY2023, the budget deficit is projected at Birr 308.6 billion or 3.4% of GDP. Over 86% of the deficit or 3.3% of GDP will be financed from domestic borrowing, mainly from Treasury bills.

The decline in ODA and external assistance in FY2022 has been considered by the authorities. Thus, the budget relies more on domestic resources. About 95% of the budget is assumed to be mobilized from domestic revenue (60.7%) and domestic borrowing (33.8%). This will lead to a crowding out effect on the private sector lending and affect monetary inflation.

Figure 12: Trends in Tax Revenue to GDP Ratio (%)



Source: Constructed based on data from MoF

7. Debt

Ethiopia's stock of public debt stood at $US 56.45 billion at March 2022 which is 50.7% of GDP, which is considered high compared to many international comparators. About 63% ($US 35.5 billion) of the debt stock is owed by the central government. External debt is $US 28.5 billion or 50.4 % of the total debt stock of which: 52% is from official multilateral, 25% Non- Paris Club bilateral creditors, and 3% from Paris Club while the remaining 19% is from private creditors (MoF, May 2022).

Debt restructuring within the G20 Common Framework, has started but has made little progress. The country's debt vulnerability is one of the factors affecting access to external finances. The IMF has indicated that official creditors will meet in July to overhaul the debt burden of Ethiopia, Zambia, and Chad.

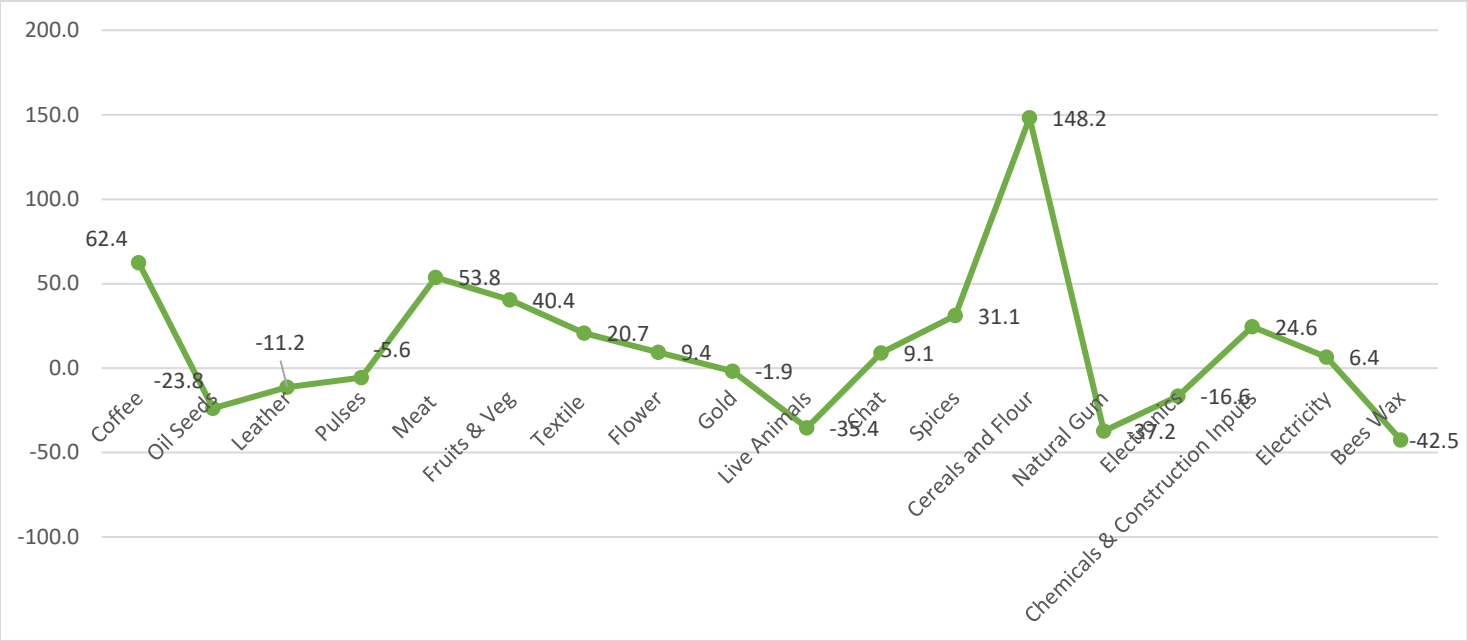
Budget financing of government through direct advances and T-Bills have led to an increase in domestic debt. According to MoF, the stock of T-bills in the first nine months of FY 2022 compared to June 2021 has shown an increase of 139%. The total stock of domestic debt reached $US 28 billion/Birr 1.4 trillion with a composition of central government and SOEs, 58.4% and 41.6%, respectively.

8. External Trade and BOP

Merchandise trade deficits in the first 10 months of FY 2022 had widened by 29% to reach the peak of $US 11.4 billion, an expansion of 29.7%. Crises, from the COVID-19 pandemic to northern Ethiopia conflict and Ukraine conflict, have taken its toll on the external sector. The import bill has been increasing mainly as result of global commodity price increases. The import bill hit the peak of $US 14.7 billion during the first 10 months of FY2022. Cereal and fuel imports took significant portion of import bills. At, $US 1.9 billion and $US 2.6 billion imports of cereal and fuel, respectively were more than double than the level a year before. Annual imports of FY2022 are projected to further increase and reach $US 17 billion (UNDP).

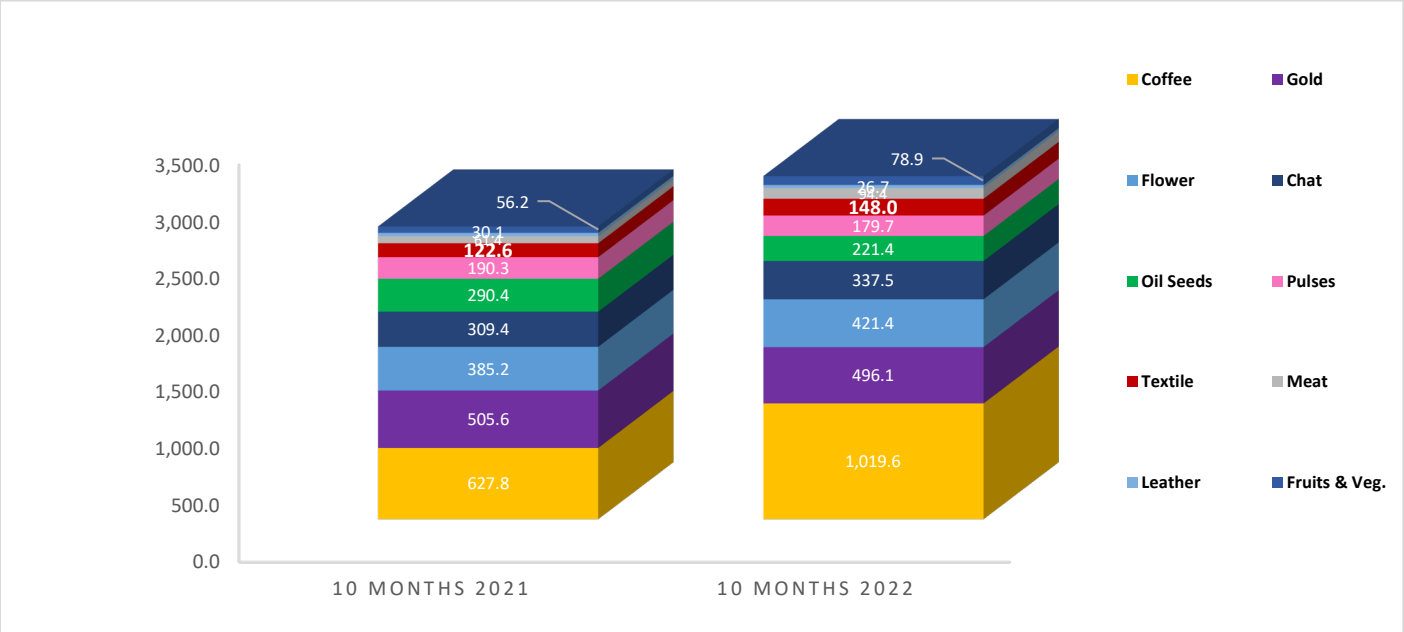
During the first 10 months of FY22 coffee export valued at $US 1 billion has registered a 62% annual increase while oilseeds, leather and live animal exports have shown a decline by 24%, 11% and 35%, respectively (Figure 13). An all-time high global price as well as increases in volume have benefited Ethiopia's coffee exports. The volume of coffee exports went up by 32% during the first 10 months of FY 2022. Coffee exports have been particularly resilient as much of the coffee-growing area is in the south of the country. Most exports in Ethiopia are from primary agriculture products. Ethiopia had taken a bold measure to particularly improve its major import needs of fuel and cereals. Ethiopia is set to increase the country's wheat production by increasing its cultivation through irrigation. This is intended to replace the imports from the rest of world. However, Ethiopia is not yet ready to take advantage of the current global supply shocks, particularly in relation to cereals.

***Figure 13:** Annual Growth in Export Earnings by Commodity 2021 (%)*



Source: Constructed based on data from NBE

***Figure 14:** Development in Major Export Commodities ($US millions)*

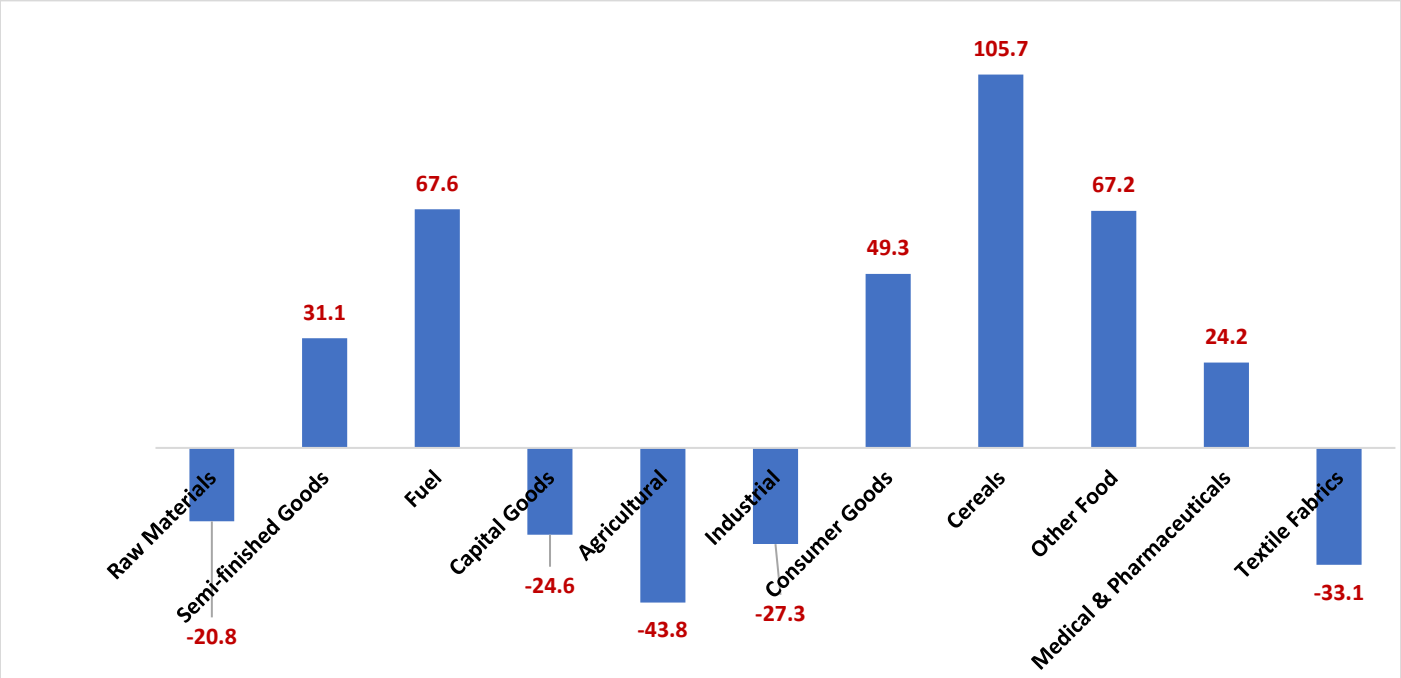


Source: Constructed based on data from NBE

The import value of goods stood at $US 14.3 billion during the first 10 months of FY2022, 26.7% higher than same period of the previous year. Most import items have shown a sharp increase. The fuel import bill was 67% higher than its level same period of the previous year, while the cereal import bills have more than doubled (Figure 15).

In April 2021 FDI inflows had shown a decline (18%) compared to its level same of month of FY2021. Over the year, FDI is expected to reach $US 3.2 billion in 2022. Remittances is a stable counter-cyclical buffer, estimated to reach $US 5.6 billion in 2022. Grants, which used to be much more significant, have fallen to $US 500 million in 2022.

Figure 15: First 10 Months of FY 2022 Annual Growth in Major Import Commodities (%)



Source: Constructed based on data from NBE

Due to combined effect of the shocks, the current account deficit has been widening. During the first 10 months of FY2022, at $US 4.1 billion it was significantly higher than its level at the same period the previous year. The capital account (a sum of official long-term capital, long-term private sector, and FDI) for the first 10 months is $US 2.2 billion. The overall balance of payments during this period has widened significantly to reach $US 2 billion for the year or more than double its level in the previous year. This means that the pressure on forex reserves has increased significantly, constraining the government's ability to fully finance imports. This will require a policy decision by the authorities.

9. Selected Socio-Economic Indicators

Human Development Index (HDI), 2019	0.485
Poverty headcount ratio, 2016	National: 23.5% Urban: 14.8% in Rural: 25.6% a
Gender disparity, 2016	Primary Education: 0.91 Secondary Education: 0.93
Child Mortality, 2016	67/1000 live births
Maternal Mortality, 2016	412/100,000 live births
Proportion of population with access to safe drinking water source, 2016	65%
Life Expectancy at Birth, 2019	66.6 years
Unemployment, 2021	Urban: 17.9% Rural: 5.2% National: 8%

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