QUARTERLY ECONOMIC PROFILE

ETHIOPIA

MARCH 2022

Key Highlights

- The **conflict in Northern Ethiopia** has hampered economic growth and worsened macroeconomic imbalances. Empirical projections from DPRH (UNDP) suggest that real GDP growth in FY22 will be 3%, half of what was projected before the conflict. All sectors of the economy have been hit, leading to a **lower growth scenario** than anticipated. A substantial number of manufacturing industries, health centers and schools, and electricity infrastructure have been damaged in Amhara and Afar by the war. High-frequency data show **significant declines** in cement production (-4.5%), capital goods imports (-5.9%), SOE Bond issuance (-12.0%), ECX traded crop volumes (-19.3%), NBE reserves (-23.2%), tourist visitors (-35.3%), external loans (-57.1%), external grants (-17.5%) (Cepheus, 2022).
- The **current drought** is affecting human lives, livestock, and agriculture production in some parts of Oromia, SNNP and Somali regions. Overall crop production in FY21 grew only by 2% (CSA,2021). With a continued drought coupled with conflict, agriculture production growth in FY22 can further drop to a negative growth rate.
- The **conflict between Russia and Ukraine** will have an adverse effect on Ethiopia's economy since **Ethiopia imports 25 percent of its wheat** from the global market. Of its total wheat imports, more than 30 percent comes from Ukraine and Russia. Besides the potential effects on domestic wheat prices and household consumption affordability, another effect of the Ukraine conflict can be a cutback on **development financing** for Ethiopia and other emerging economies.
- The conflict is exacerbating the fiscal position, with a possible **doubling of the fiscal deficit** to GDP ratio from a 2% projection before the conflict to a more than 4% at present. The combination of **higher spending for the war** (both defense and humanitarian) and **reduced grant and loan aid** is leading to an increase in direct advances from NBE and issuance of T-bills to finance the deficit. Ethiopia will need international aid to help finance reconstruction and recovery.

Box 1: Crisis in Ukraine: Projected Impacts on Ethiopia

Ethiopia is one of the African countries that will be significantly impacted by the Ukraine-Russia conflict. Russia and Ukraine together produce a quarter of the world's wheat, and Russia is a major non-OPEC oil powerhouse. An UNCTAD Rapid Assessment finds that in 2018–2020, Africa imported $3.7 billion in wheat (32 per cent of total African wheat imports) from the Russian Federation and another $1.4 billion from Ukraine (12 per cent of total African wheat imports). Moreover, the study notes that on average, more than 5 per cent of the import basket of the poorest countries are products that are likely to face a price hike resulting from the ongoing war in Ukraine (UNCTAD, 2022). Ethiopia imports 25% of its wheat consumed from foreign countries. Of that, more than 30 percent is from Ukraine and Russia, with a much larger share from the former. It also imports from Turkey, India, Argentina, and the United States (food aid). The conflict can lead to a 10 percent decline in wheat imports and force Ethiopia to find substitutes in a challenging global environment. Second, this can also have a ripple effect on domestic wheat prices and food affordability. Third, the roller coaster behavior of oil prices can also impact fuel costs for Ethiopia and lead to further inflationary surges. Finally, a protracted Ukraine conflict can adversely impact future development financing for Ethiopia given the competition for scarce aid resources.

- The country is experiencing a **forex crisis** as **foreign reserves** have fallen to less than USD 2.0 billion, covering less than 2 months of imports (NBE, November 2021). Effective January 6, 2022, the National Bank of Ethiopia has issued a directive requiring that for exporters, 70 percent of forex be surrendered to the National Bank, 10 percent reserved for the banks, and the remaining 20 percent be given to the exporters (which can be reinvested or repatriated). The foreign exchange shortage is leading to import delays and is an obstacle to growth in key economic sectors.
- A **supplementary budget** of Birr 122 billion to top-up the originally approved Birr 562 billion for FY22 has been approved by the parliament in January 2022. The fiscal deficit during July-October 2021 was Birr 27.8 billion, substantially higher than the previous year level.
- **High and rising inflation and depreciation** of the Birr have been persistent. In February 2022, annual headline inflation stood at 33.6% and food inflation, 41.9%. The official exchange rate reached 50.62 Birr/USD in February 2022, indicating an annual depreciation of more than 27% and above 30% parallel market premium. Containing inflation will be a policy challenge for monetary authorities in FY22 as a result of the spike in food inflation, monetary financing of the budget deficits, the removal of fuel subsidies, and steady depreciation of the Birr.

In February 2022, annual headline inflation stood at 33.6% and food inflation, 41.9%. The official exchange rate reached 50.62 Birr/USD in February 2022, indicating an annual depreciation of more than 27% and above 30% parallel market premium.

- **Total public debt**, at 52% of GDP, remains high. The Government has applied for **debt restructuring** with the G20 CF in January 2021 on which negotiations began in September 2021. Nonetheless, no concrete decisions have been reached so far.
- **External sector performance** of the first five months of FY22 shows that the value of both export and import of goods grew by 21.8% and 24%, respectively. The balance of payments position had shown a USD 1.5 billion **deficit** during this period compared to USD 0.25 billion at the same period the previous year.
- **The Grand Ethiopian Renaissance Dam (GERD)** has started power production in February 2022. The GERD power plant, upon completion, is envisaged to generate 5,150 MW of electric power and strengthen the coverage gap of the country and expand exports to neighboring countries such as Djibouti, Sudan, and others.

Economic Growth

According to Government data, real GDP grew by 6.3% in FY21 which is comparable to the 6.1% growth of FY20. However, the high growth momentum of the past two decades has slowed down as the economy faces the triple challenges of COVID 19 (2019), a complex conflict situation in the Northern Ethiopia since late 2020, and drought in some parts of Oromia, Somali and SNNP regions. The DPRH (UNDP) real GDP projection for FY22 is 3%, reflecting pronounced shocks to manufacturing, services, and agriculture from the combined impact of the war and the drought. A significant number of manufacturing industries, electricity infrastructure, schools, and health service facilities in Amhara and Afar regions have been damaged by the war[1] The combined crop production of Amhara, Tigray and Afar regions accounts for nearly 40% of the total production, where Amhara region alone contributes more than 30% of the total production. The overall crop production is projected to decline in FY22 owing to ongoing drought and conflict affected agriculture production systems.[2]

High-frequency data show compared to a year ago, a significant decline in: cement production (-4.5%), capital goods imports (-5.9%), SOE Bond issuance (-12.0%), ECX traded crop volumes (-19.3%), NBE reserves (-23.2%), tourist visitors (-35.3%), external loans (-57.1%), external grants (-17.5) (Cepheus, 2022). In the service sector, hotel occupancy rates have fallen significantly during the war to close to 50%, but now have started to rebound.

High growth momentum, which has been recorded since early 2000 and highly driven by huge public investment, has shown a sign of reaching its limit, manifesting itself in macroeconomic imbalances - significant current account deficits leading to dwindling international reserves, high debt accumulation, lingering inflation and pressures on the exchange rate. A three-year reform agenda was adopted to correct the macroeconomic imbalances and sustain the high growth trajectory of 10% annual average real GDP growth for the period 2021 - 2030. Nonetheless, growth has shown a declining trend over the years (Figure 1). A three-five-year average growth rates for the period FY07 - 21 shows that the average growth rate fell from 11% (FY07-11) to 9% in (FY12-16) and further to 7.9% in the last five years (FY17 – 21).

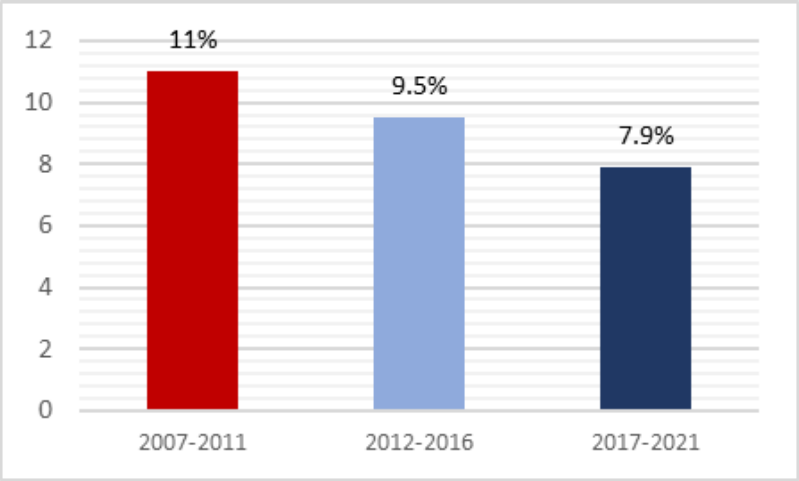

Figure 1: Average Real GDP Growth Rate (five-year average %)
Source: Constructed based on GDP data from MPD

[1]*More than 80 manufacturing industries, 1000 schools and number of electricity infrastructures have been reported damaged by the Amhara Regional Government, Amhara Region President Bureau.*

[2]*Preliminary assessments of the conflict on crop production in Amhara region indicates 20 – 25% of crop land is either unplanted or damaged as a result of lack of attendance as the conflict forced farmers to migrate to other areas*

The slowdown reduced the increase in per capita GDP in FY21 to 1.1%, in sharp contrast to an 11% average increase between 2011 and 2019 (Figure 2).

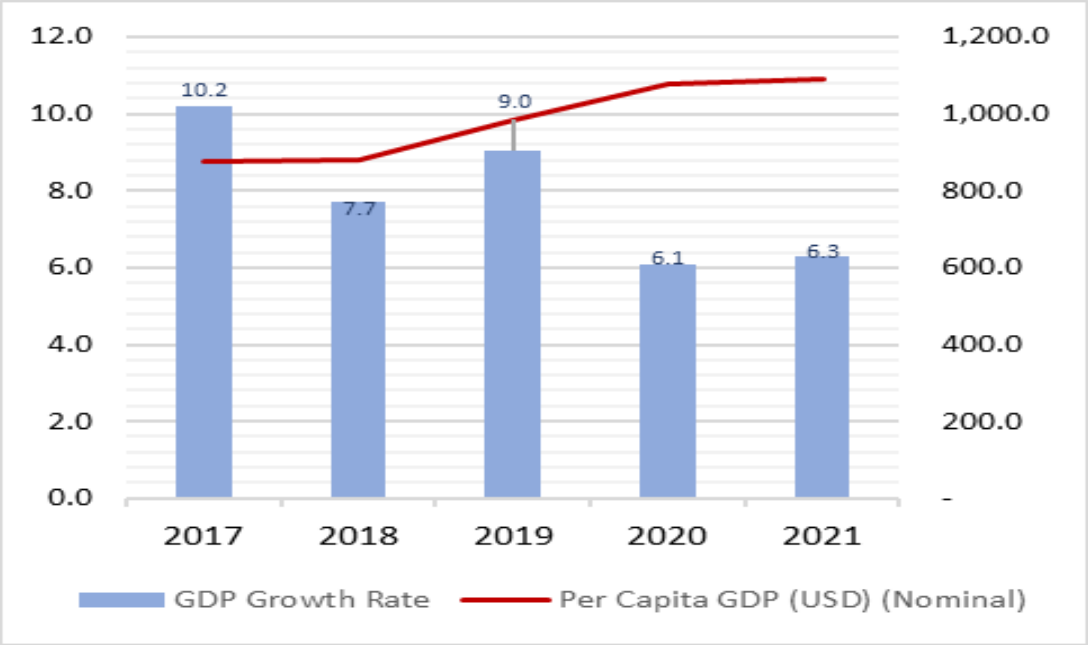

Figure 2: GDP Growth (Left Axis) and Per Capita Income (USD) (right Axis) 2017-2021
Source: Constructed based on GDP and Per Capita Income data from MPD

Disruptions in production systems, shifts in government resources to finance the war, and shortage of foreign exchange reserves have led to a slowdown in sectoral growth. As can be seen in Figure 3 below, the sectoral growth, particularly that of industry sector has slowed down in recent years. Industry was growing at an average rate of 20.4% during FY12 – 20, which slowed down to 9.6% in FY20 and further to 7.3% in FY21. Growth in the service sector has shown a slight pick-up in FY21 to 6.3% from 5.3% in FY20 while agriculture grew by 5.5% in contrast to its growth of 4.3% in FY20. The service sector is expected to have lower growth in FY22, and agriculture may even contract.

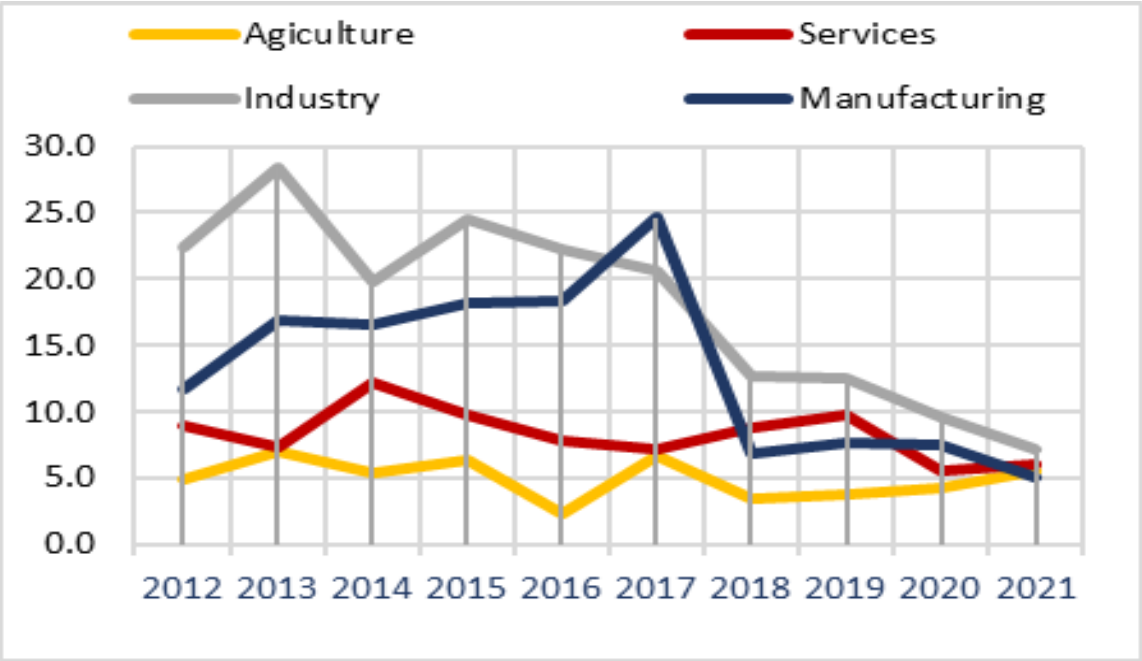

Figure 3: Growth Rate in GDP Components
Source: Constructed based on data from MPD

Sectoral Contribution to GDP

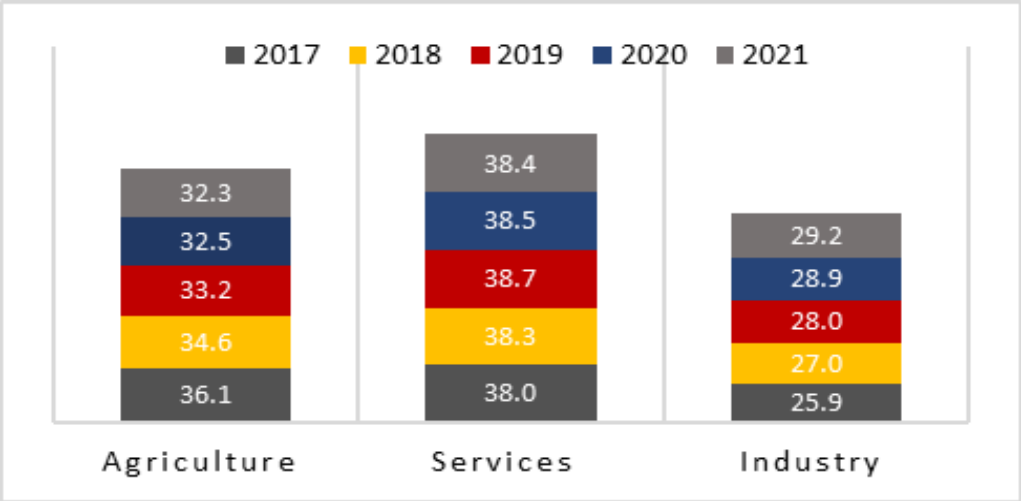

Figure 4: GDP Decomposition (% share) 2017 – 2021
Source: Constructed based on MPD GDP data

Inflation

Inflation has remained high in FY22. Year-on-year headline inflation in February 2022 stood at 33.6% (Figure 5). Headline inflation had increased at a declining rate from October 2021 – February 2022. However, inflation has increased significantly compared to its level a year ago which was 19.2%. The increase in government expenditure (24% in FY21) through accommodative monetary policy, steady depreciation of the nominal exchange rate of the Birr, supply chain bottlenecks and rising global commodity prices are the main driving forces for the rising inflation.

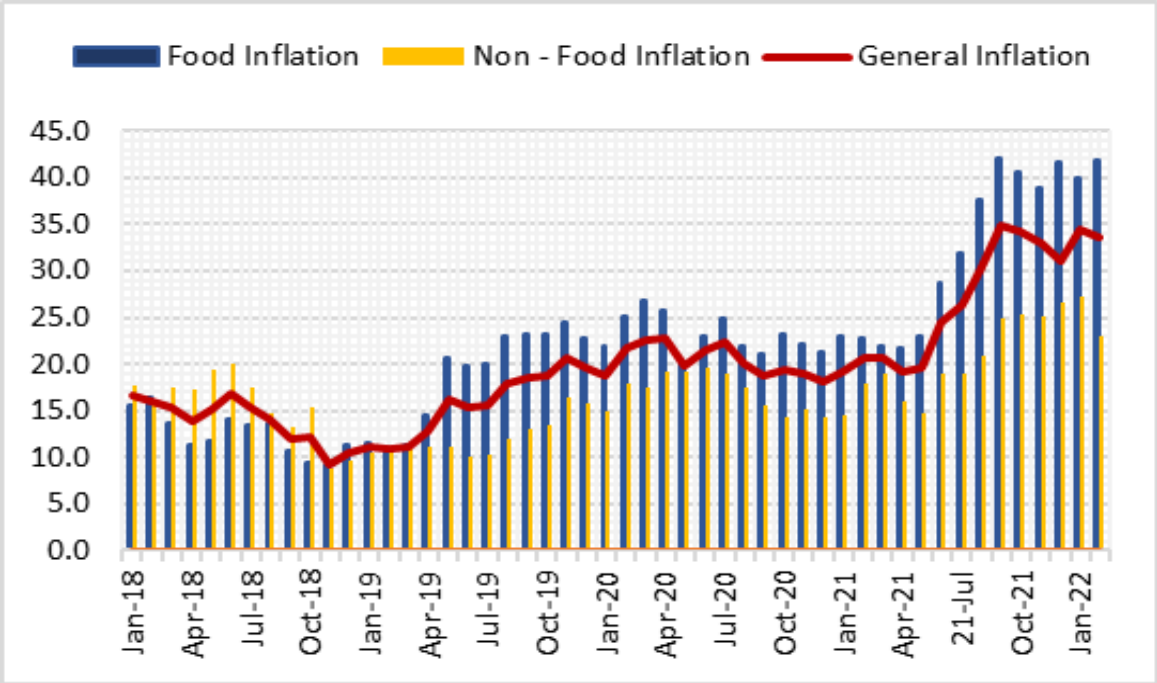

Figure 5: Inflation Rate January 2018 – January 2022 (%)
Source: Constructed based on data from CSA

Containing inflation will remain a significant policy challenge in the coming months:

- Drought: This has been exacerbated in various parts of the country, affecting crop production and livestock.
- Fuel price increase: A recent regulation passed by the Council of Ministers for the progressive removal of fuel subsidies, which were intended to absorb global price shocks, will be passed to the consumer in the form of higher prices at the pump.
- 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 will contribute to keep prices up in the coming months of the year (refer the Monetary Policy Section below).
- Depreciation in the nominal exchange rate: With persistent depreciation of the birr, the exchange rate pass-through to inflation will continue, contributing to higher consumer prices (refer Exchange Rate section below).

Food inflation has shown a certain seasonality as harvest-related decline has been sustained only in the months of September and October 2021; a 41.9% food inflation had been recorded in the month of February 2022 compared to same month the previous year (Figure 6). The food inflation rate nearly doubled compared to its level a year before. Growth in grain crop production has slowed to 2% in 2021 from its level of 6.2% in 2020, while cereal production grew only by 1.8% (CSA, 2021).

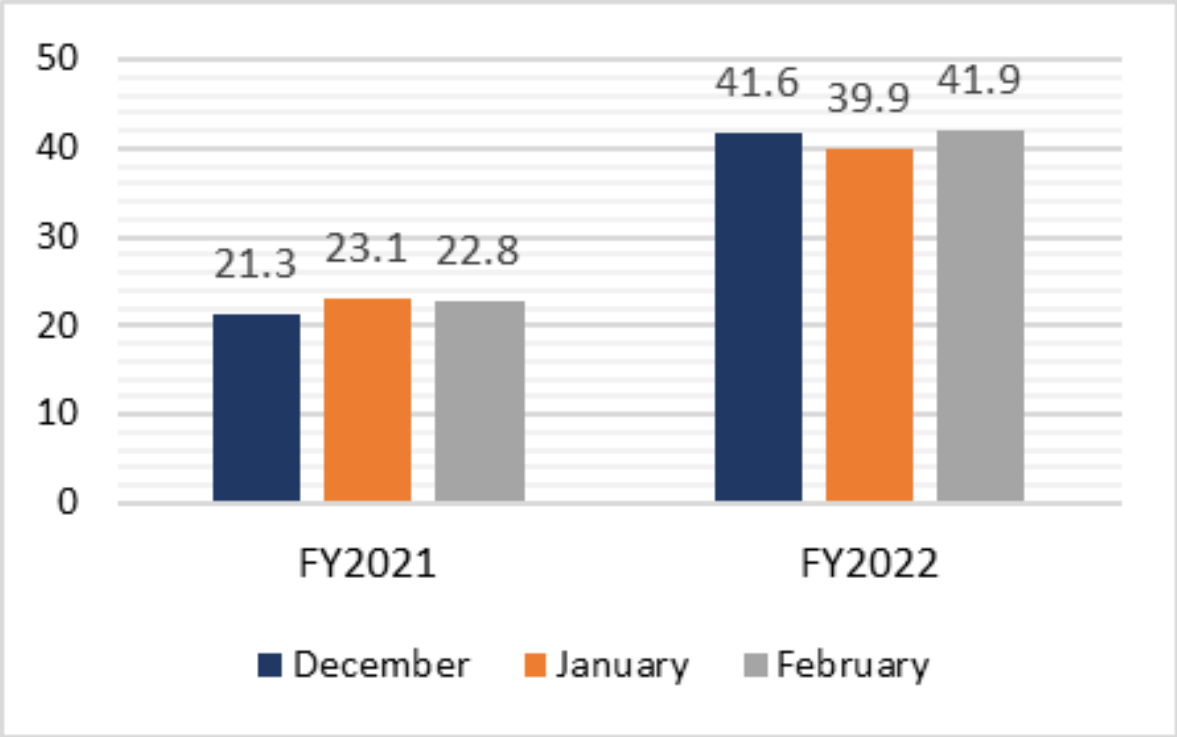

Figure 6: Food Inflation Rate (%)
Source: Constructed based on data from CSA

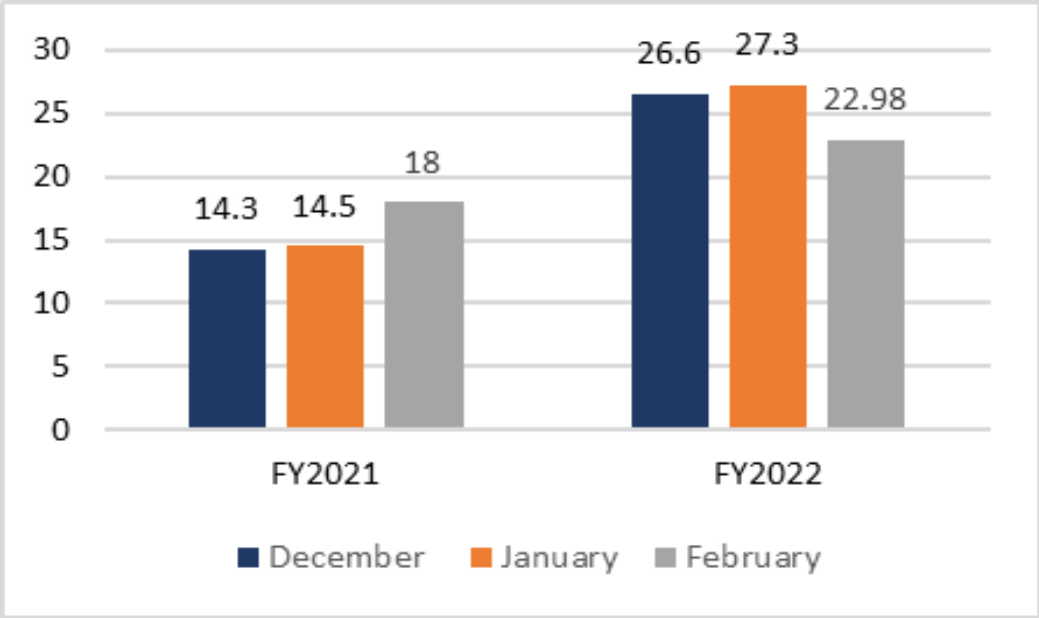

Figure 7: Non-Food Inflation Rate (%)
Source: Constructed based on data from CSA

Despite its volatility in the past year, non-food inflation continued to grow since the beginning of FY22 and reached a peak of 27.3% in January 2022 which has dropped to 22.9% in February 2022 (Figure 7)

Monetary Policy

Monetary policy from July to November 2021, despite restrictive measures by the National Bank of Ethiopia on freezing collateral credit and increased reserve requirements of commercial banks, continued to be expansionary due to need to finance growing fiscal deficits. Domestic credit reached Birr 1.59 trillion in November 2021, 27.8% higher than its level a year before. Of which credit to government stood at Birr 287 billion, more than doubling by Birr 162 billion annually. In the first five months of FY22, credit to the government has increased by Birr 73 billion or 34%. By contrast, new loans disbursed to the private sector between July – November 2021 were 20% lower than the level a year before. Despite a negative real interest rate, deposit mobilization by the banking system in the first five months of FY22 reached Birr 1.44 trillion, 22.6% higher than its level a year before. Nearly two-thirds of the deposits mobilized is by the largest state-owned Commercial Bank of Ethiopia, CBE; while private commercial banks collectively mobilized the balance, their individual share is less than 10%. Fresh loans disbursed during the first five months of FY22 totaled Birr 108.67 billion posting a 1.6% decline compared to the amount disbursed during the same period of the previous year. There was a decline in credit disbursement of private banks (Figure 8). However, CBE's fresh loans were composed of 40% to the private sector and 60% to the public sector.

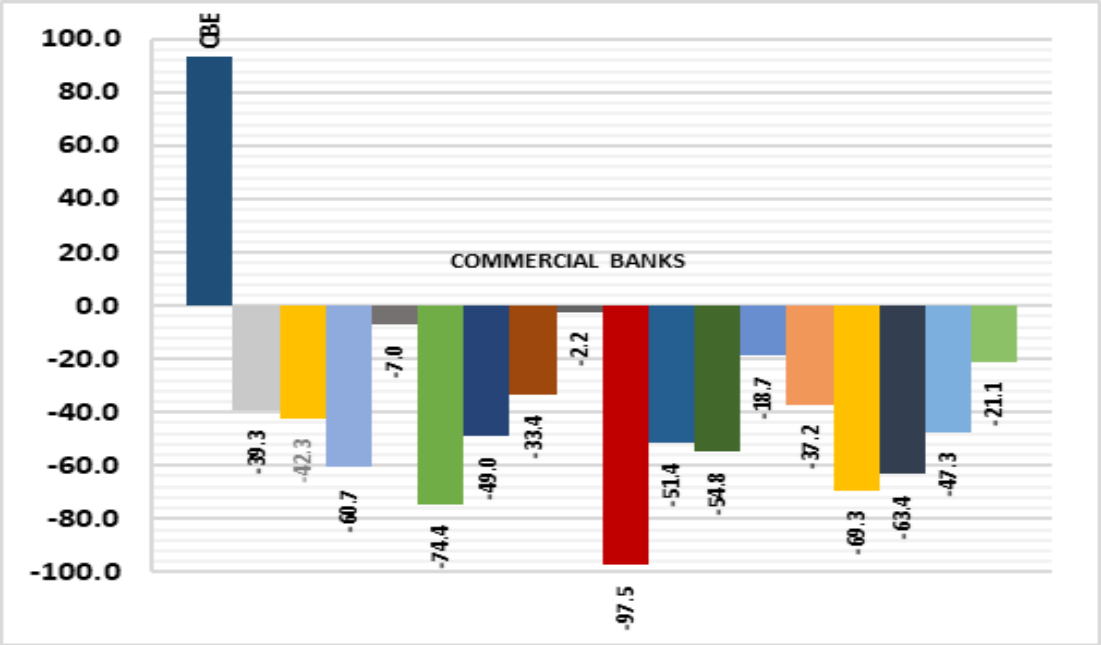

Figure 8: Annual Growth in Credit Disbursement (July – November 2021)
Source: Constructed based on data from NBE

The Treasury Bills Market with maturity dates varying from 28 days to 364 days has supplied the Government with a total of Birr 276.8 billion during July – December 2021 (NBE Website). This is only 74% of Birr 368 billion that has been offered in the T bill auction market by the government. There is a widening gap between the auction offered and received, which can be explained by the negative real T bill interest rate reaching as low as -20.5% in November 2021.

Nonetheless, with a widening financing gap and declining external resources, the Government will be increasingly reliant on T-bill auctions for the remainder of FY22. The T-bills are currently mostly purchased by pension funds and commercial banks, but there will be medium-term sustainability considerations due to the size of this market.

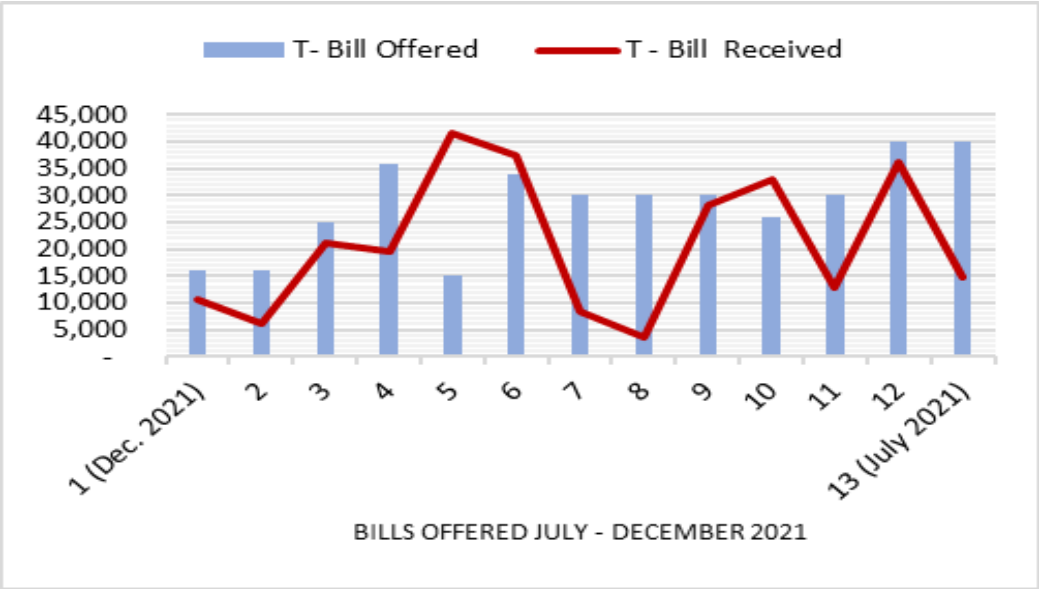

Figure 9: T-Bills Offered and Received (Billion Birr) July – December 2021
Source: Constructed based on data from NBE

Exchange rate developments

Ethiopia's foreign exchange market continues to be volatile, with some degree of loss of confidence. A 27% annual depreciation of the Birr in terms of official exchange rate has been registered during February 2022 compared to the previous year. With the public investment driven growth approach adopted for the past two decades, the limits are being reached, as shown by the significant parallel market premium of more than 30%.

There has been a depreciation in the exchange market driven by a combination of factors, such as increased import spending, weakened current account position, and depleting external resources. The decline of forex reserves to less than USD 2.0 billion (less than 2 months of imports) is a cause for concern.

Government Finance

An adverse effect of the Northern Ethiopia conflict is seen on the fiscal position - in constraining resources as well as investment for long term development priorities. The war is slowing revenue collection (Figure 10). Ethiopia is a country with low tax to GDP ratio ranging between 10 -12%. In the past two years, the tax to GDP ratio has gone below 9%.

Partly due to the drying up of grant and loan aid, a reorientation of spending from investment spending to recurrent spending, and the plan to remove the fuel subsidy, the government has faced fiscal challenges. Resources have been mobilized via the public and the diaspora. One million Ethiopian diaspora have been invited to support the country.

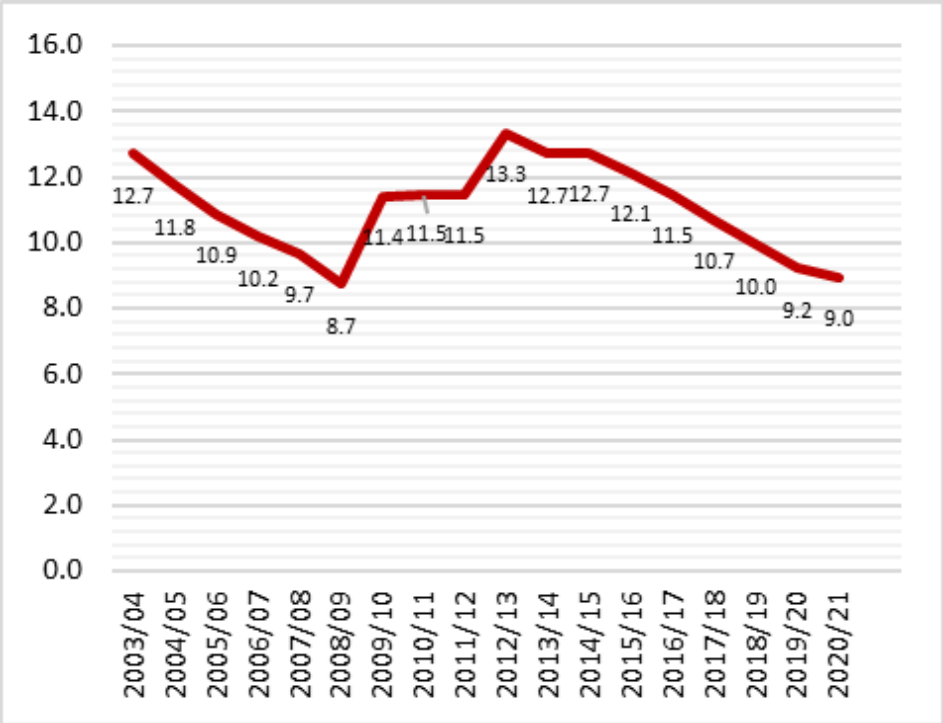

Figure 10: Tax Revenue to GDP Ratio (%)
Source: Constructed based on data from MoF

In FY22, there was an initial total federal budget of Birr 562 billion which has been recently supplemented with Birr 122 billion to finance military and humanitarian spending. The war has bolstered recurrent expenditure, mainly seen in defense and administrative expenditures. During July-October 2021 government domestic revenue had shown a mere 1.4% increase over same period of the previous year, while expenditure went up by 19%. Nonetheless, there is a decline in public investment in the key economic sectors. Capital expenditure during July – December 2021 was 12.7% below its level a year before.

Capital spending in all the sectors has been on a declining path (Figure 10). In terms of GDP, capital expenditure has been the lowest in FY21 (5.2%) (Figure 12). However, the slowdown in capital investment has begun prior to the conflict. In the past five years, the average capital expenditure to GDP ratio dropped to 6.6% from its level of 10% of the preceding decade. The de-investment is now supported by government reforms to shift towards a more private sector-driven economy.

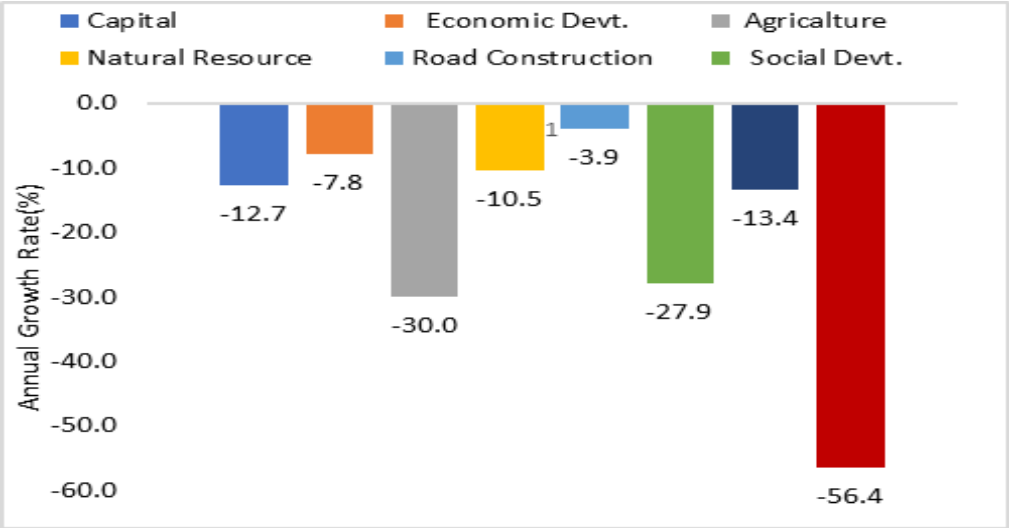

Figure 11: Annual Growth in Components of Capital Expenditure (July – October 2021)

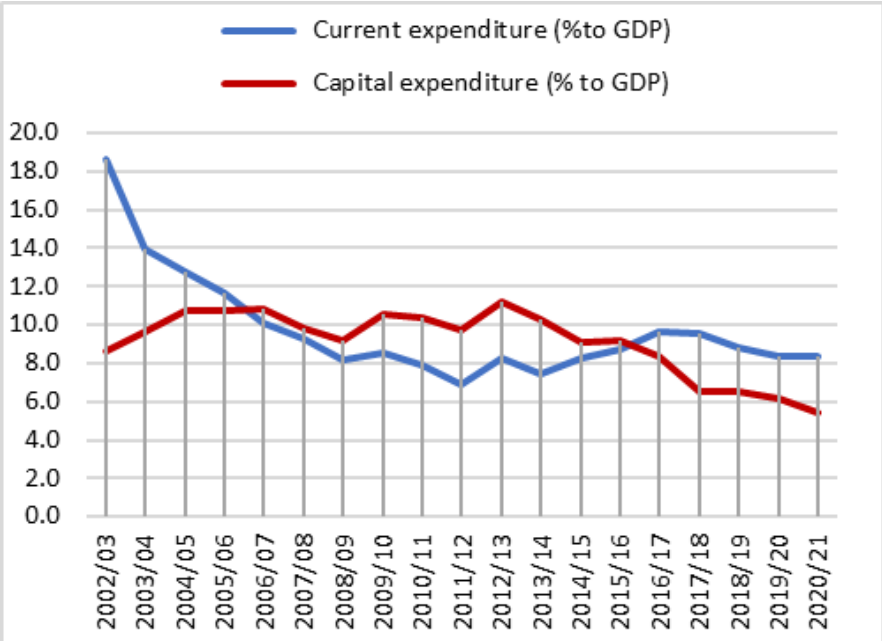

Figure 12: Capital and Recurrent Expenditure in % of GDP
Source: Constructed based on data from MoF

The current fiscal situation is challenging. The fiscal deficit, which was projected at 2% of GDP in FY22 before the conflict, could now reach at least 4 % of GDP in FY22. The fiscal deficit during July – October 2021 was Birr 27.8 billion, substantially higher than same period of the previous year which was Birr 5.1 billion. Nonetheless, in upcoming months, some rebound in economic activities could be seen with the homecoming of large number of Ethiopian diaspora and the recent AU summit which has provided some revival in the economy, particularly to the services sector, and supported tax collection.

Debt

Ethiopia's stock of public debt stood at USD 56.65 billion at September 2021 which is 52.04% of GDP, which is considered high compared to many international comparators. About 60% (USD33.9bn) of the debt stock is owed by the central government. External debt is USD 29.05 billion or 51.3 % of the total debt stock of which: 51.47% is from official multilateral, 25.48% Non- Paris Club bilateral creditors, and 3% from Paris Club while the remaining 19.95% is from private creditors (MoF, November 2021).

The ongoing conflict and a stalled debt restructuring request with the G20 Common Framework led to repeated downgrades by different rating companies, the most recent being the 'CCC' rating by Fitch in late January 2022. In order to improve the financing for the economy in the face of new spending pressures related to the conflict, domestic debt is on the rise. Of the total stock of USD 27.6 billion/Birr 1.27 trillion domestic debt, the composition of central government and SOEs is 52.7% and 47.3%, respectively.

Trade

During July-November 2021, merchandise trade deficit at USD 5.4 billion had widened by 25%. With ongoing conflict, drought and global market condition, the external sector is faced with multi-faceted challenges. Nonetheless, merchandise exports have benefited from boost in global demand and price increases has affected imports negatively. The import bill, at USD 6.9 billion, during the first five months of FY22 widened by 24% compared to same period of the previous year.

A total of USD 5.4 billion merchandise trade deficit has been recorded during July – November 2021, 25% above its level a year before. Overall, the export performance stood at USD 1.6 billion, showing an annual increase of 21.8%. Individual export commodity performance has shifted to the historically major export product - coffee. During the first five months of FY22 coffee has registered an 87.7% annual increase while gold has declined by 21% (Figure 13). An all-time high global price as well as increases in volume have benefited Ethiopia's coffee exports.

The volume of coffee exported went up by 65% during July – November 2021. Coffee exports have been particularly resilient as much of the coffee-growing area is in the south of the country. On the other hand, gold exports have declined due to both price and volume declines. In the global market with higher inflation and possible monetary tightening measures by central banks, the demand for gold is expected to increase. The export prospects remain positive but uncertain, due to a combination of risks. The majority of exports in the current season are from primary agriculture products. A combination of drought and the recent removal of Ethiopia from AGOA will have adverse repercussions on exports, with US being the 2nd most important destination for Ethiopia's export next to the Netherlands (NBE, 2021).

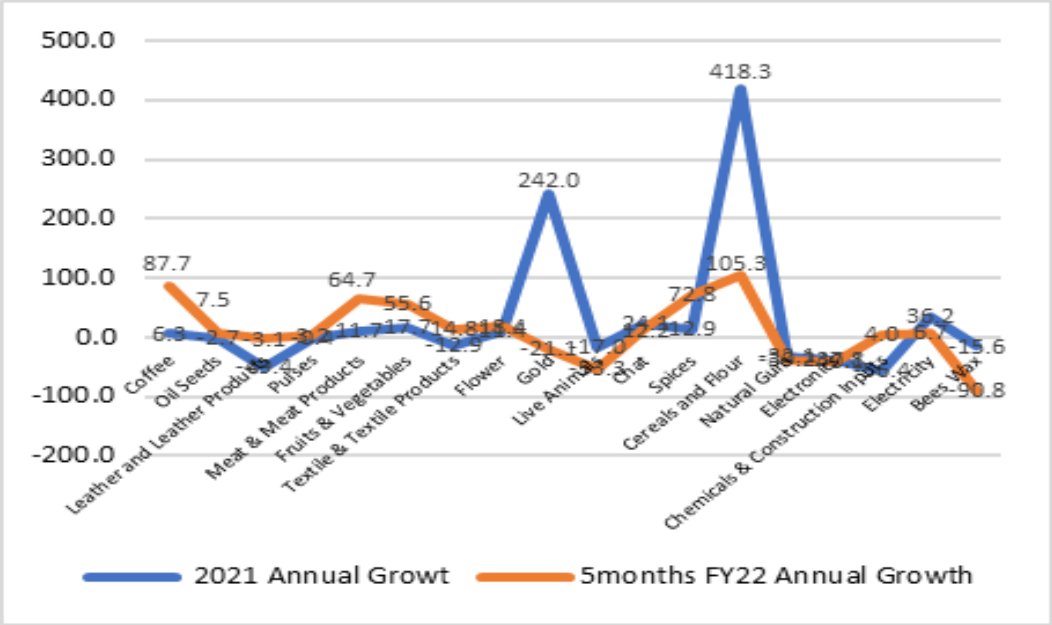

Figure 13: Annual Growth in Export Earnings by Commodity 2021 (%)
Source: Constructed based on data from NBE

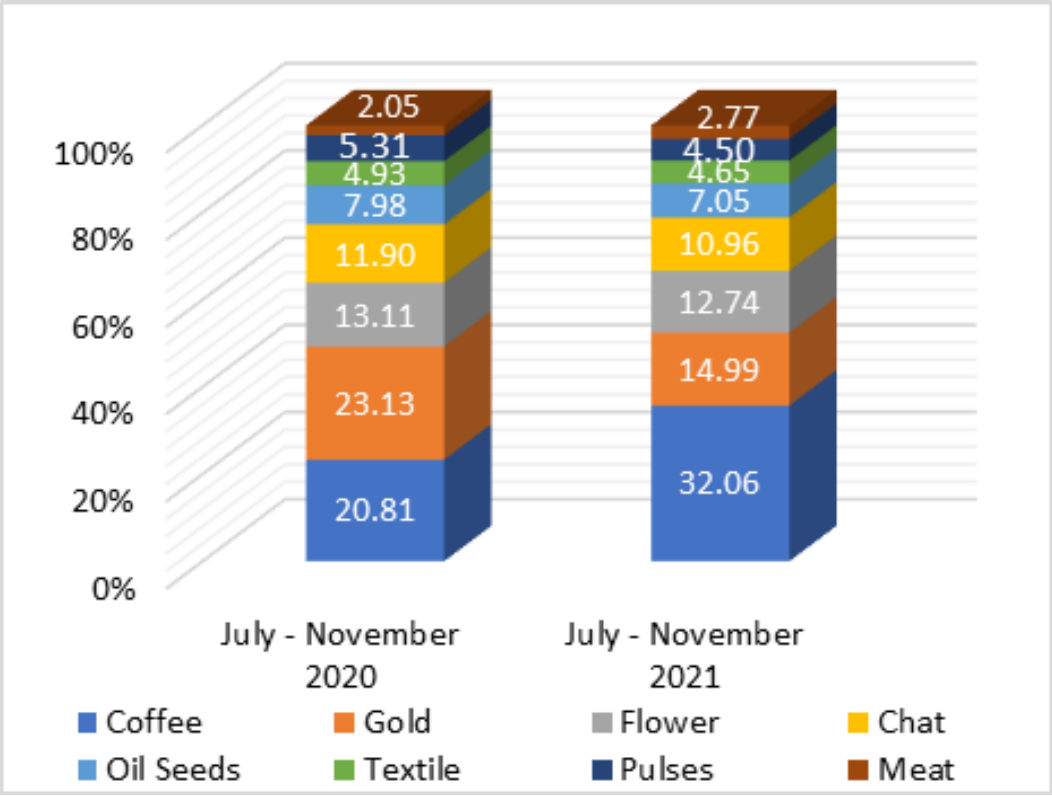

Figure 14: Major Export Commodities Share in Total (%)
Source: Constructed based on data from NBE

From July to November 2021, the import value of goods stood at USD 6.9 billion, which was 24% higher than same period of the previous year. Unlike the preceding year imports, all components have shown a sharp annual increase. The fuel import bill was 89% higher than its level a year before while cereal and aircrafts import bills have more than doubled (Figure 15).

The current account deficit during July – November 2021, at USD 2.5 billion was 64% higher than its level a year before, while private transfers/remittances at USD 1.9 Billion have been at a similar level compared to the previous year. The overall balance of payments during July – November 2021 has widened from USD 0.2 billion same period last year to USD 1.5 billion. FDI inflows of 1.7 billion and the private transfer have offset part of the current account deficit. In the remaining period of FY22, the external sector will remain volatile due to considerable uncertainty, with restrictive monetary policies limiting investment in the private sector. Coffee should continue its favorable trajectory.

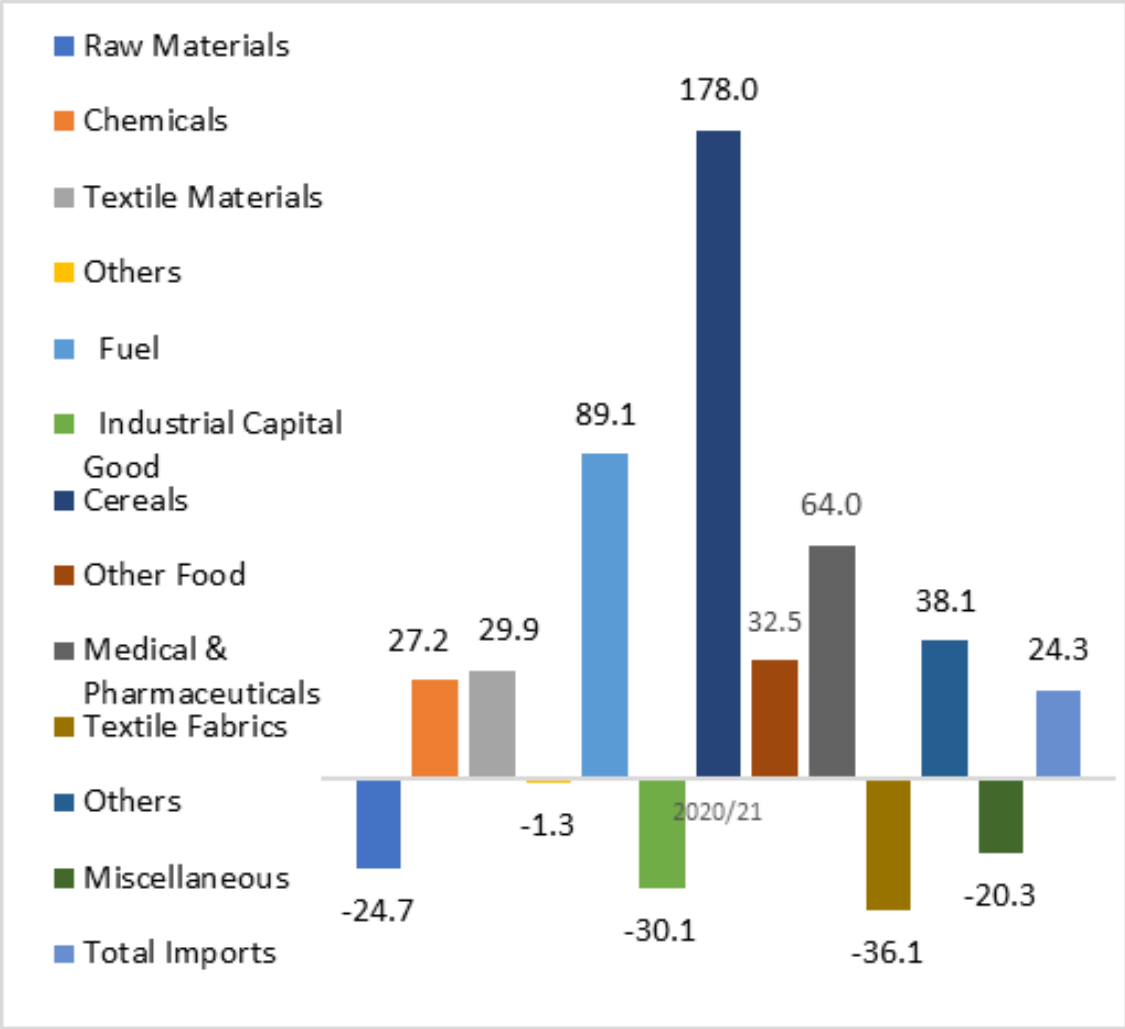

Figure 15: July – November 2021 Annual Growth in Major Import Commodities (%)
Source: Constructed based on data from NBE

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Private Sector Investment/FDI

The inflow of Foreign Direct Investment, at USD 1.3 billion during the first five months of FY22 was 26.9% higher than in the previous year. There is a possibility for this trend to continue in the remaining months of the fiscal year. Nonetheless, the year-end FDI level will be lower than that of FY21 as the privatization proceeds from the Ethio Telecom made FDI performance in FY21 relatively higher. Ethiopia is embarking on a new economic policy paradigm whereby the private sector is the driver of economic growth. Under this model, the state is expected to crowd in private investment. To enhance ease of doing business, policies and regulations have been revised. The commercial code of the country has been revised recently while a new investment law is being put in place. Trade regulations have been further liberalized, the WTO accession process was reinstated, and Ethiopia has ratified the African Continental Free Trade Agreement (AfCFTA). Ethiopia is also investing in modernizing its logistics sector. Furthermore, to cope up with the 21st century doing business, a digitalization strategy has been developed. A bill has been enacted to establish a vibrant capital market.

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%

Development Policy and Research Hub
UNDP-Ethiopia
dprhena.et@undp.org

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