Quarterly Economic Profile

Ethiopia

November 2021

Table of contents

Key Highlights *1*

Economic Growth ..... *2 & 3*

Sectoral Contribution to GDP *4*

Inflation ..... *5 & 6*

Monetary Policy *7*

Exchange rate developments *8*

Government Finance *9*

Debt *10*

Trade ..... *11 & 12*

Private Sector Investment/FDI *13*

Key Highlights[1]

- The conflict in northern Ethiopia, which started in end 2020, has put increased pressure on the country's economy. A latest government report shows that real GDP grew by 6.3% in 2021[2], indicating resilience compared to the 6.1% growth reported in 2020. The number is threefold higher than the IMF projection of 2% and below the official Ten-Year Plan of 10%, which owes to the twin shocks of COVID-19 pandemic and northern Ethiopia conflict.
- Preliminary data indicate potential further adverse effects on growth, but it is too early to assess the war's impact, especially since the conflict is ongoing. The cloud of sanctions can also deter investors in 2022.
- In December 2021, to address the growing impact of the war, the Ministry of Finance restructured the budget and replaced some capital spending with expenditure for military and humanitarian efforts. Originally, nearly one third of the budget was allocated to finance capital expenditures while on the financing front, domestic revenue collection was envisaged to take the lead and external loan and grants were to cover more than 20 percent of the budget. However, the situation has now changed.
- For current 2021/22 fiscal year, the budget deficit can reach more than 5 percent of GDP depending on the evolution of the conflict. The Parliament has approved a 561-billion-birr budget, with 200 billion birr being used to subsidize regions.
- As a consequence of the war, the drying up of donor grant aid in 2021, which has been close to 1 percent of GDP, has also led the Government to finance the deficit through other debt instruments, including issuance of Treasury Bills and some advances from the Central Bank. Out of 36 billion Birr worth of Treasury Bills up for auction by the Central Bank on November 3, 2021, close to 19.4 billion Birr have been sold. The Government has historically been reluctant to avoid direct central bank financing by using Treasury Bills instead. National Bank of Ethiopia data indicate that government borrowing from the central bank showed a 169.4 percent yearly increase during April-June 2021 compared to April-June 2020.
- Currently Ethiopia is in the third wave of Covid-19 Delta variant with positivity rate of over 10% and with only 3% of the population fully vaccinated.
- Rapidly rising inflation and depreciation of the Birr have been persistent. In September 2021, annual headline inflation grew by 34.8% and food inflation by 42%. Key drivers include: conflict, the Covid - 19 pandemic and locust infestation. The official exchange rate reached 46.1 Birr/USD, indicating an annual depreciation of 25%.
- Debt at close to 60 % of GDP remains high and growing. The Government has applied for debt restructuring under the G 20 Common Framework while its program with the IMF under the Extended Credit Facility program for USD 2.9 billion had expired and is in negotiation for a new program.
- On the external front, in 2021 the value of goods export grew by 21%, while import growth contained at 3%. Continued remittance and FDI inflows have led to a positive balance of payments in 2021.

[1]*This brief has been prepared for information purposes and does not represent the official views or policies of UNDP.*
[2]*The year 2021 refers to the Government fiscal year (from July 2020 to June 2021).*

Economic Growth

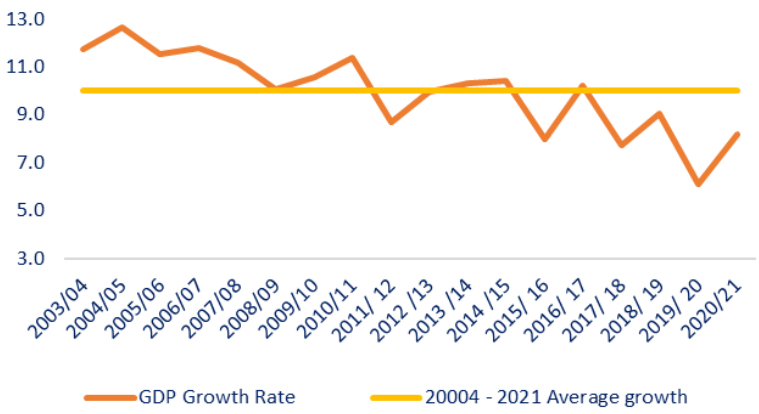

Figure 1: Real GDP Growth 2004-2021

Until the recent conflict, Ethiopia had witnessed impressive economic growth in the past two decades, with real GDP growing by an annual average rate of close to 9% between 2001 and 2020 (Figure 1). High growth momentum was recorded during the middle years of the two decades (2004-2015) with an annual average growth rate of 10.9%. Since 2016, however, there has been a relative slowdown in economic growth owing to the El-Nino induced drought in 2015 and subsequent droughts, sluggish export performance, public unrest, and ethnic clashes in the country (Figure 2).

The strong growth was mainly driven by strong public investment, which was not sustainable, and resulted in macroeconomic imbalances, leading to a deteriorating current account deficit, acute foreign exchange shortage, lingering inflation, accumulation of huge debt stock and limited access to credit by the private sector.

Political and economic reform, with the objective of addressing these issues, has been taking place since April 2018 with the ascent to power of Prime Minister Abiy Ahmed.

Despite the reform measures however, the growth momentum was not maintained as the global COVID-19 pandemic hit countries in 2020, leading the Ethiopian economy to slow down to 6.1% in 2020, which was the slowest economic growth registered since 2004.

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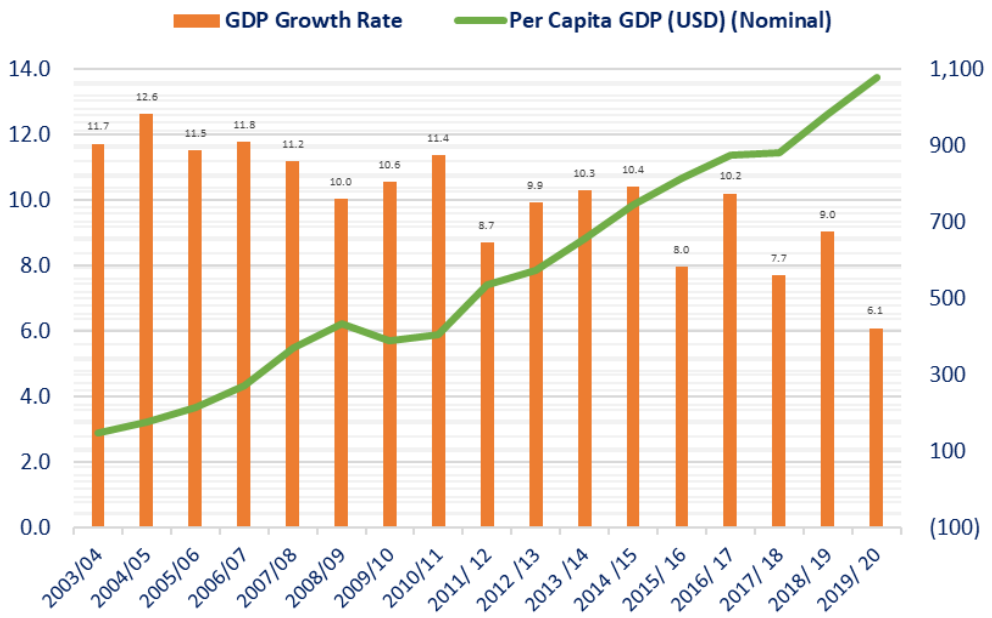

Figure 2: GDP Growth Dynamics 2004-2020

With the ongoing COVID 19 pandemic and the conflict in Northern Ethiopia, which has expanded to other regions, socio-economic challenges have surmounted in 2021. The crisis has led to aggravated fiscal pressures in financing the conflict, and a slowdown in economic activities (agriculture, manufacturing, and services), leading to headwinds that impede trend growth. Despite this, the economy is estimated to grow in 2021 by 6.3%[3], higher than the 3.7% Sub Saharan Africa average growth projected by IMF for 2021[4]. Some economic indicators suggest that the crisis is hurting growth:

- Agriculture. The war has adversely impacted agriculture, which will affect food security. There is no harvest in all of Tigray and some parts of Amhara and Afar regions due to the conflict. Government data shows that there has been a loss of 14.5 million quintals of crops (13% of annual production) in Amhara. In Tigray and Afar, there is evidence of land that has been uncultivated or abandoned due to the war. The share of Tigray and Amhara real GDP in the total for 2018 is estimated at 3% and 18%, respectively.
- Mining. The nascent mining sector in Tigray has been affected by investor aversion and decline in artisanal mining. Ethiopia's Ministry of Trade and Industry notes that factory and mining site closure in Tigray since early November is costing the Ethiopian economy around $20 million per month. According to Ministry of Mines and Petroleum, of the more than 2,500 kilograms of gold exported by Ethiopia, more than 600 kilograms come from Tigray region, close to a fourth of total production.
- Services. The sizeable withdrawal of expats from Addis has affected the restaurant and hospitality industry. Hotel occupancy rates have fallen as a result of pandemic[5].
- Infrastructure. Prime Minister Abiy Ahmed said in July 2021 that infrastructure repair could cost up to $2bn[6].

[3] MPD
[4] IMF, Regional Economic Outlook, October 2021
[5] Hotel Owners Trade Sectoral Association, The Impact of Covid-19 on the Addis Ababa Hotel Market, April 2020
[6] https://african.business/2021/10/trade-investment/bad-sign-as-imf-withholds-ethiopia-growth-forecast/

Sectoral Contribution to GDP

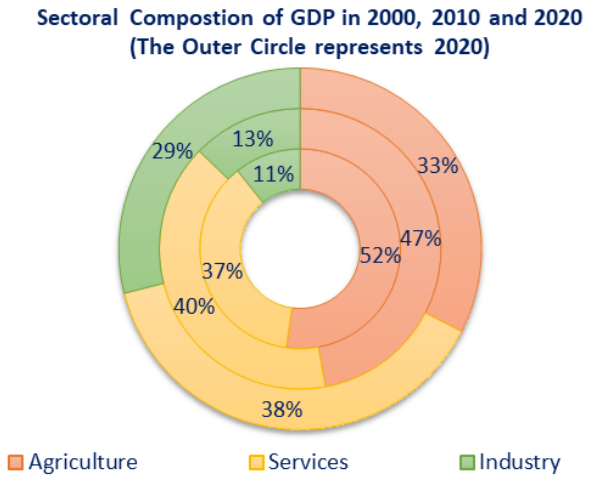

Figure 3: GDP Decomposition 2020

Growth in the past two decades was mainly due to services and significant public investment in the infrastructure, unlike previous decades, where growth was predominantly dominated by agriculture (Figure 3). As a result, the value added of the Industrial sector in the economy, which had been 10.7% by the turn of the millennium, grew to 28.9% in 2020 mainly due to construction boom, while agriculture's contribution dropped to 32.5% from 52% during the same period.

Although there has been an increase in the contribution of industry sector in the economy, a closer look at value-added of the manufacturing sector in the past two decades shows that the growth is inadequate - a mere 2.2 percentage points increase from 4.7% in 2000 to 6.9% in 2020. This indicates an underperformance of the manufacturing sector, relative to Government expectations.

Furthermore, there is still a strong share of agriculture in the economy, absorbing more than two-thirds of the labor force by 2019 with only 10% of the labor force shifting to other sectors in the past 20 years from its level of 76.7% in 2000. By contrast, the industrial sector has absorbed only 9.3% of the labor force in 2020.[7]

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[7] https://data.worldbank.org/indicator/SL.AGR.EMPL.ZS?locations=ET

Inflation

In the past few years, inflation has been a major challenge for the Ethiopian economy. The first quarter of 2021/22 has witnessed a rapidly rising inflation.

Year-on-year, headline inflation in September 2021 increased by 34.8%. The food price index, which accounts for 54% of the weight in the CPI, has been a major contributor and grew by 42% (Figure 4), while nonfood inflation (proxy for core inflation) increased by 25% in September 2021.

A combination of both demand and supply factors have contributed to the rapid surge in consumer prices. Global factors, such as supply chain disruptions, as well as domestic factors, such as the Tigray conflict and slowdown in agricultural production, which resulted from desert locust infestation in some cropping areas, have played a role. Consumer goods account for a significant share of the county's imports (38% in 2021). A global supply chain crisis, coupled with growing demand as global economies began to rebound, is one significant factor that together with forex reserve reduction, contributed to a depreciation of the Birr (25%) in September 2021. Given that some inflation is driven by external factors, these factors render government policy interventions at macro level to control inflation less effective.

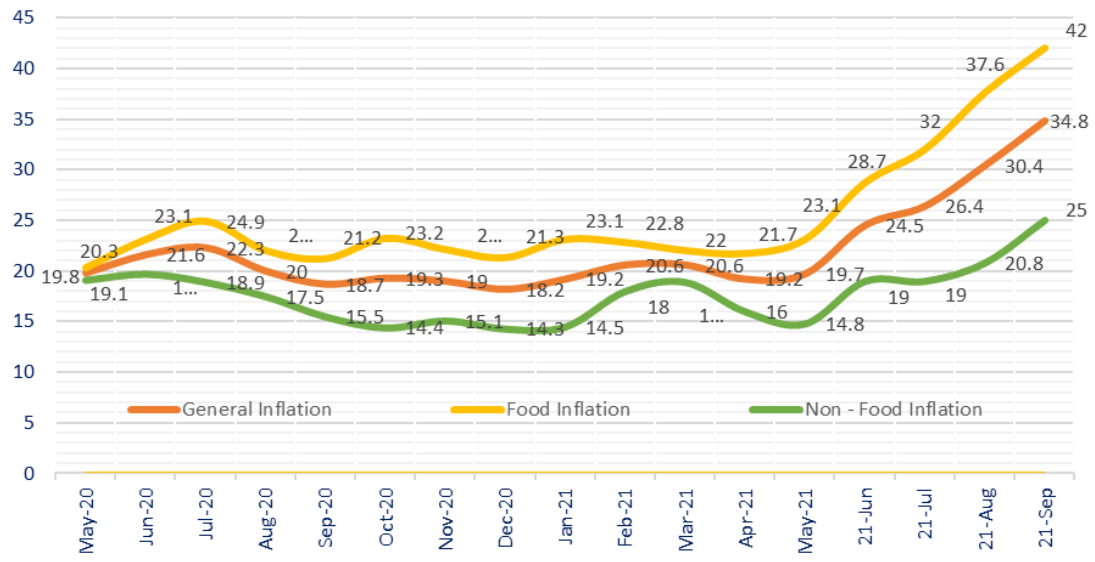

Figure 4: Inflation in 2020 - 2021

[8]A monetary policy measure to contain money supply in the economy has been adopted by the government by restricting commercial banks from advancing any form of collateral-based credits

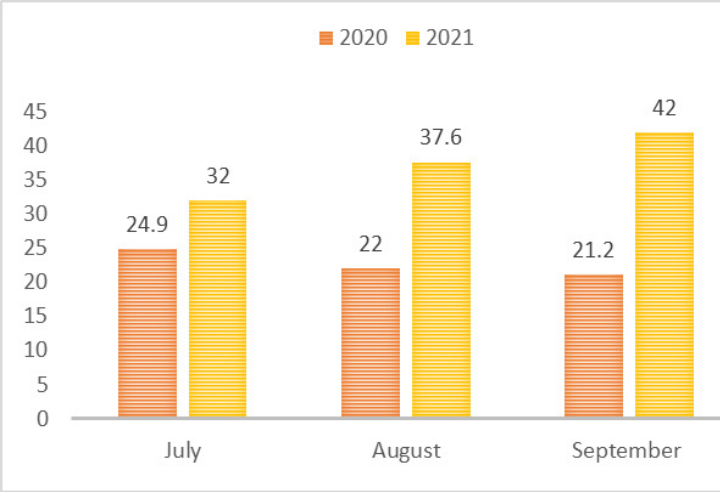

Figure 5: Food Inflation 2020-21

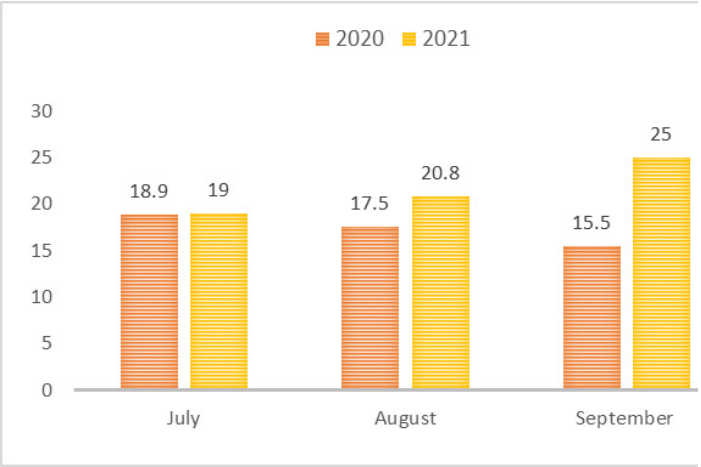

Figure 6: Non-Food Inflation 2020-2021

The 42% food inflation in September 2021 (Figure 4), compared to same month the previous year, is attributed to significant price increases in all items in the food basket, the highest being edible oil (102%) followed by bread and cereals prices (48%). Ethiopia covers up to 60% of its cooking oil demands through imports-906 million metric tons annually.

Because of desert locust infestation in some areas, growth in grain production has slowed to 2% in 2021 from its level of 6.2% in 2020, while cereal production grew only by 1.8%[9]. Furthermore, Ethiopia has a growing demand for wheat, which, despite increase in wheat production, needs to be met through imports.

Despite its volatility in the past year, non-food inflation reached a peak of 25% in September 2021 (Figure 6).

The surge in non-food prices was consistent during July - September 2021. Housing, health and education indices have shown increases by 20%, 39.3% and 31%, respectively. The key drivers of high and rising inflation include the northern Ethiopia conflict, covid-19 pandemic, locust infestation and increases in global commodity prices.

The northern Ethiopia conflict, which has expanded to other regions, has left about 7 million people affected in Tigray, Amhara and Afar regions. Close to 500 people have been killed and nearly a million people are displaced in Amhara and Afar regions.

[9]CSA, Agriculture Sample Survey, 2021

Monetary Policy

The principal objective of Ethiopia's monetary policy is maintaining price stability, but it has been difficult to achieve in recent years, especially when monetary policy has been used to help support government expenditure. Monetary policy stance has been expansionary as money supply grew by 30% in 2021 mainly driven by growth in domestic credit as net credit to government and credit to other sectors have respectively increased by 56% and 22%. Partly due to high inflation, the real interest rate has been negative.

Despite the real negative interest rate, deposit mobilization in 2021 of Birr 1.3 trillion was 30% higher than its level a year before. This was largely driven by the demonetization of old currency notes by the government in the same year. Fresh loan disbursement was Birr 329.4 billion in 2021, which was 21.5% higher than the previous year.

The composition of credit signals an encouraging development: private sector has better access to credit. In 2021, 69% of credit was channeled to the private sector, while that of public enterprises was 20.4% which is significantly lower than its level in 2020 (39%) and 2021 (35%) (Figure 7).

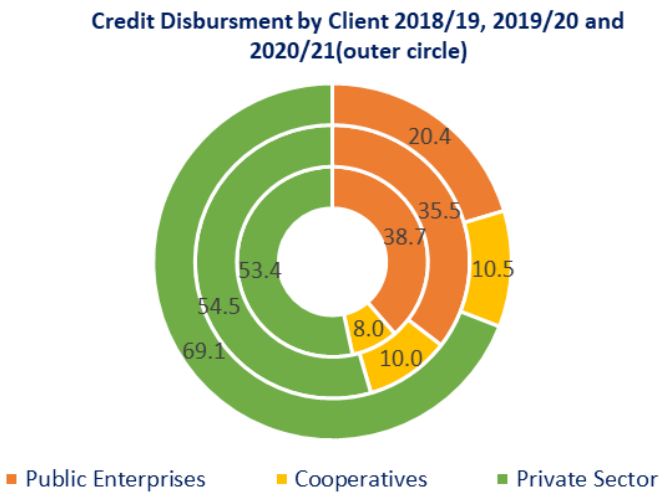

Figure 7: Credit Flows 2018-2021

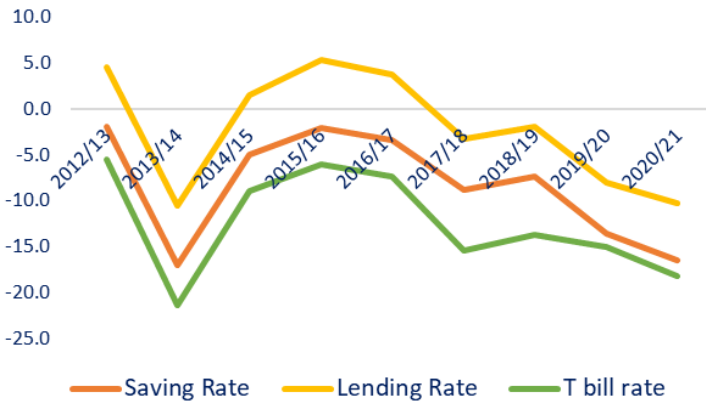

Figure 8: Real Interest rates 2013-2021

Despite government efforts towards a more developed and market-determined Treasury Bills market to serve as both monetary policy tool and source of deficit financing, the negative real yield rate which went as high as -18% in 2020/21 has made the market challenging (Figure 8).

Nevertheless, National Bank of Ethiopia data indicate that government borrowing from the central bank showed a 169.4 percent yearly increase during April-June 2021 compared to the same period a year before. The situation continues to evolve as the Government will be increasingly reliant on T-bills to finance its obligations in 2022. Out of 36 billion Birr worth of T-bills up for auction by the Central Bank on November 3, 2021, close to 19.4 billion Birr have been sold.

Exchange rate developments

Ethiopia follows a tightly managed floating exchange rate regime, where the daily rate is determined by the central bank depending on market conditions and its policy objectives. The Birr has been steadily depreciating, and the annual depreciation rate in September 2021 reached 25%. Because of the excess demand for foreign exchange, there is a parallel (black market) foreign exchange market and the rate in this market signals the equilibrium rate.

The premium between the official and parallel rates has been in the range of 10 to 20 % but due to the conflict and aggravated macro imbalances, this premium has recently sparked to over 45%. While the official nominal exchange rate is 46.10/USD the rate in the parallel market went up to Birr 70/USD in October 2021, indicating a premium of more than 50%.

A sharp increase is seen in current expenditures of poverty related expenditures as well as defense and military expenditures (90%).

Government Finance

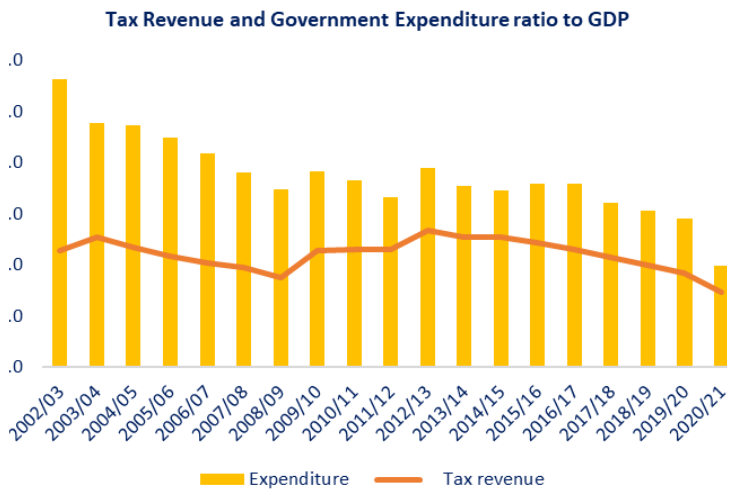

Figure 9: Government Fiscal Position 2003-2021

Prior to the conflict, in the past several years, Ethiopia has been pursuing a prudent fiscal policy with a less than 3% of GDP budget deficit. However, due to the conflict, the fiscal position has weakened, with potential deficits to reach more than 5 percent of GDP in 2022. From July 2020 to March 2021, there was a sharp increase in government budget deficit (birr 66.1 billion), which nearly doubled of similar period of the previous year. The financing was tilted towards domestic non - bank sources such as Treasury bills which grew by 24% while financing from external sources has shown a decline of 20%.

For the current fiscal year 2022, the Parliament has approved a 561-billion-birr budget, with 200 billion birr being used to subsidize regions. Furthermore, nearly one third of the budget has allocated to finance capital expenditures while on the financing front, domestic revenue collection was envisaged to take the lead and external loan and grants were to cover more than 20 percent of the budget. However, to finance the war, by December, 2021, the Ministry of Finance has restructured the budget and replaced some capital spending with expenditure for military and humanitarian efforts. As grant money was dwindling in 2020-2021, the Government sought T-bills and bank advances to support its fiscal position.

During the same historical period, the tax revenue collected totaled Birr 290.5 billion, which is 20.4% higher than the preceding year level and 7.3% of GDP. Expenditure on the other hand grew by 31% compared to the same period in the previous year, owing to both current and capital expenditures, 36% and 23%, respectively. A sharp increase is seen in current expenditures of poverty - related expenditures as well as defense and military expenditures (90%). At the end of 2021, this has led to a reallocation of expenditures away from public investment by the Government.

Ethiopia's tax to GDP ratio averaged 11.2% between 2004 and 2020 (Figure 9). However, with a declining rate of economic growth caused by COVID 19, political instability, and macroeconomic imbalances, domestic revenue collection is likely to be lower than anticipated. A considerable amount of the budget (24%) was envisaged to be financed through domestic and external loans. Given the present indebtedness of the country and the conflict, financing the economy would remain a challenge for the government in 2021/22

Debt

Ethiopia's stock of public debt stood at the equivalent to USD 53.8 billion at March 2021 which is 59.3% of GDP, which is considered high compared to international comparators. External debt is USD 29.9 billion or 54.5 % of the total debt stock of which, 79% is from official multilateral and bilateral creditors while the remaining 21% is from private creditors. Ethiopia's debt servicing during from July 2020 to March 2021 was USD 1,429.3 million which was 39% of export receipts.

According to the joint World Bank - IMF debt sustainably analysis, Ethiopia has been rated at high risk on its external as well as overall debt status. The onset of COVID 1 9 pandemic, like for many developing countries, gave a headwind to Ethiopia's financial as well as external position. This is in line with the impact on many African economies.

Ethiopia is one of the eligible countries for Debt Service Suspension Initiative of the G20 countries, that helped to put the debt service payments on hold at present. Ethiopia's request for debt restructuring under the G20 Common Framework is also under negotiation. Due to these factors, rating companies have been repeatedly downgrading Ethiopia's rating, the most recent one being that of Moody's in October 2021.

Furthermore, expiration of the Extended Credit Facility program with the IMF before the credit has been disbursed puts further financial stress. Ethiopia will be a beneficiary of the $650 IMF SDR allocation in August 2021, which is expected to provide more than $400 million, providing some fiscal relief.

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 Birr 1.03 trillion domestic debt, the composition of central government and SOEs is 49% and 51%, respectively. Borrowing from the central bank had been limited at 5% which is in sharp contrast to its level of 2018/19 at 24%, but it has been increasing significantly.

Trade

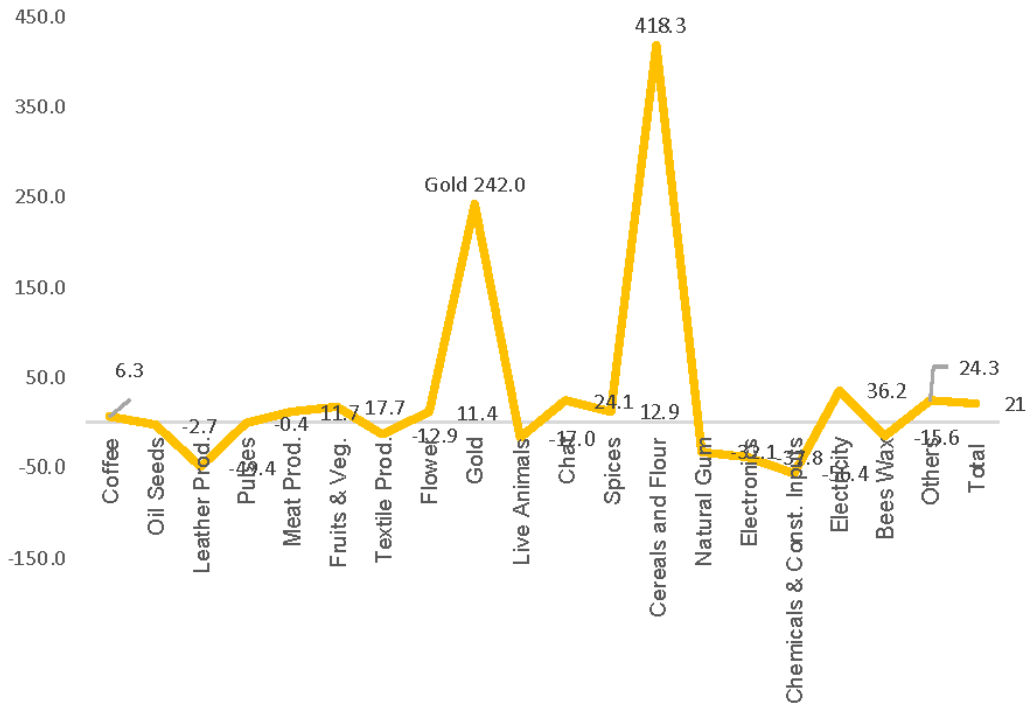

Figure 10: Annual Growth in Export Earnings by Commodity 2021

During the year 2021, Ethiopia's merchandise trade has been challenged by several factors, especially the covid pandemic, international prices, and the Tigray conflict. A total of USD 10.6 billion merchandise trade deficit has been recorded in 2021, 2% below its level a year before. Overall, export performance stood at USD 3.6 billion showing an annual increase of 21%. Export earnings from gold and coffee increased by 242% and 6.3%, while export earnings from textile and leather products declined by 12.9% and 49.4%, respectively (Figure 10). The export prospects in future years remain positive but uncertain, subject to risks.

A renewed focus on the mining sector, of which 90% is gold extraction and which was minimal in-the preceding years, is expected to reap windfalls in future years. Both the home-grown economic reform agenda and the 10-year development plan identified mining as one of the productive sectors with ample potential for foreign exchange earnings and domestic revenue generation. In 2021 gold has become the second most important export item after coffee, overtaking the place of flower exports which grew by 11% during the same year. In the coming years, with global economies slowly rebounding to normalcy, the surge in demand is expected to increase, given gold's unique role as a safe asset. Sustaining gold as an important productive sector would require a focused strategy informed by evolving evidence.

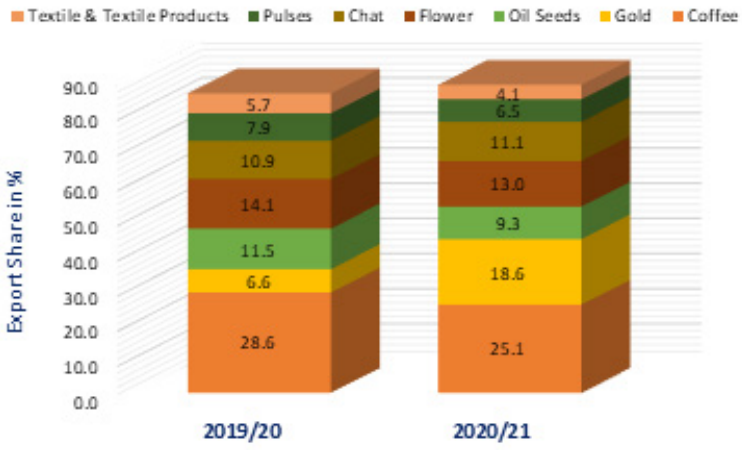

Figure 11 Export Share of Commodities 2020-2021

The 2021 goods import value stood at USD 14.3 billion, which was 3% higher than the previous year. Most import components have shown a decline, except for cereals and aircrafts, which were 58.5% and 97.8%, respectively higher than the preceding year.

The current account deficit, at USD 4.3 billion has shown an annual decline of 27% in 2021, owing to a 22% boost in private transfers, due to increases in both private individuals/remittances and NGO transfers (Figure 12). Remittances accounted for USD 5.2 billion in 2021, 21% higher than the preceding year (Figure 13).

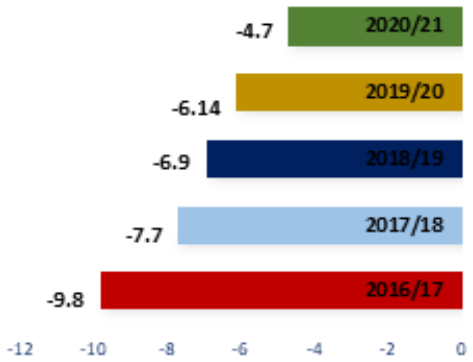

Figure 12: Current Account Deficit (% of GDP) 2017-2021

Despite its reduction in 2020, the remittance inflow has shown some level of resilience and a complete return to its pre pandemic trend. During 2021, a combination of factors, including stimulus measures taken by country of origin and increase of senders using the official channels, helped boost remittance flows. Remittances can be viewed as an effective countercyclical buffer for the Ethiopian economy.

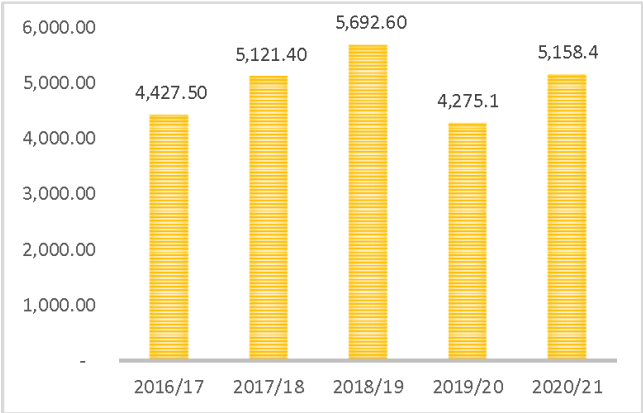

Figure 13: Remittances (millions of USD) 2017-2021

The overall balance of payments during the 2021 has also benefited from the liberalization measures that the country had undertaken. FDI inflows due to the opening up of the Ethio-telecom for foreign private sector investment worth USD 850 million was realized during the year, boosting FDI to USD 3.9 billion, 64% higher than the previous year and significantly improving the balance of payments.

The external economy of Ethiopia will remain impacted with uncertainty, at least in the short run, as many of its parameters are prone to be affected mainly by the Tigray conflict, the pandemic and global economic situation.

Private Sector Investment/FDI

Ethiopia has envisioned to embark on a new economic policy paradigm whereby the private sector is the main engine and driver of economic growth. Under this model, the state is expected to crowd in private investment. To fill the policy and regulations gap for enhanced ease of doing business, policies and regulations have been revised and new ones are being put in place. The commercial code of the country has been revised recently while a new investment law is put in place. Trading regulations have been further liberalized, while WTO accession process was reinstated, and Ethiopia has ratified the African Continental Free Trade Agreement (AfCFTA). Ethiopia is also investing a lot in modernizing its logistics sector. Furthermore, to cope up with the 21st century doing of business, a digitalization strategy has been developed. A bill has been enacted to establish a vibrant capital market. The country expects significant private sector investment in the economy.

During 2021, Ethiopian Investment Commission (EIC) has approved and licensed 192 foreign and 10,467 domestic investment projects. Manufacturing is the main investment attraction for both foreign and domestic investors, 59% foreign investment projects and 32% of domestic investment projects are on the manufacturing sector. This is in line with government policy directions to become a light manufacturing hub of Africa by 2030.

Likewise, the industrial park developments and associated investment incentives attracted investors to the sector. Real estate, constructions and agriculture sectors follow the manufacturing sector in attracting investors from abroad and local. A total of 752 domestic and 33 foreign investment projects became operational in 2021 creating 17,900 permanent and temporary jobs.

Selected Socio-Economic Indicators

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