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Crisis, Resilience and Opportunity:

# Poverty, Human Development, and the Macro-Economy in Ethiopia, 2020-23

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Ethiopia

**Working Paper Series**

Crisis, Resilience and Opportunity:

# Poverty, Human Development, and the Macro-Economy in Ethiopia, 2020-23

**September 2022**

**Note:** This Working Paper Series is designed to bring the analytic work of UNDP-Ethiopia and its partners to a broad audience, as a contribution to the policy debate in Ethiopia. It does not represent the official policy or views of UNDP.

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> **In recent years, Ethiopia has faced a confluence of shocks, some emerging from within the country and some from the global economy.** Beginning with the COVID-19 pandemic that started in early 2020, followed by the conflict in Northern Ethiopia, continuing with the drought in southern Ethiopia, the Ukraine conflict starting in February 2022 and a sharp drop in external financing during 2020-22, primarily driven by official development assistance (ODA), these shocks have led to slowing growth and development, supply disruptions, humanitarian crises, and heightened food insecurity. They also threaten to slow the pace of economic and other reforms that are vital for rapid recovery, peacebuilding and the expansion of Ethiopia's development frontier.

These developments are indicative of a broader phenomenon: that of a variety of shocks occurring simultaneously and with increased frequency and severity compared to the past – some as 'black swans' – presenting a clear challenge not just to a country like Ethiopia but to governments and societies across the world, whether developed or developing. The ability to anticipate and reduce risks and rebound successfully from shocks – resilience – is, therefore, a policy preoccupation of increasing importance and urgency, in Ethiopia and also globally.

> **Shocks have both direct and opportunity costs. They can also generate either localised or economy-wide effects. With the possible exception of the drought, all other shocks that have affected Ethiopia recently have triggered ripple effects throughout the economy.** The Northern Ethiopia conflict, a major fall in external financing and the war in Ukraine have undoubtedly had the biggest negative effects. The internal conflict has been costly in terms of lives lost, damage to infrastructure and services, reversal of development gains and absorption of scarce resources. As this paper tries to show, the conflict has already adversely impacted GDP growth and poverty reduction, eroded fiscal buffers, and created uncertainty – and the longer it remains unresolved, the greater will be the 'tax' that it imposes on Ethiopia's development prospects, including progress towards the SDGs. The internal conflict has also led to diversion of attention and resources. These developments have been associated with a large fall in external financing that, among other things, is important for pursuing critical economic reforms and for investments in human development and productive assets. The COVID-19 pandemic has had a less pronounced effect compared to many other African countries, while the drought has had a significant but smaller and more localized economic effect. Overall, it is difficult to disentangle the exact impact of each of the shocks, but this paper provides a preliminary and first order approximation of their cumulative effects, making attributions to individual shocks, where possible.

> **Consideration of the fall-off in external financing as a shock may seem unusual but is in fact warranted by the evidence.** Critical elements are the delay and suspension of the IMF programme, the slow pace of implementation of the G20 Common Framework on debt restructuring and a significant decline in ODA, including the temporary suspension of direct budget support (DBS), which have had important cumulative effects on Ethiopia's internal and external balances. To provide some background, the IMF Board approved a three-year, $US 2.9 billion programme in December 2019 to support macroeconomic balances and reforms. The programme disbursed $US 309 million until it was suspended in September 2021. In the same month, the Government of Ethiopia formally requested the Fund for a new loan programme. In parallel, the Government requested support from international creditors to finalize the G20 Common Framework for debt treatment as Ethiopia seeks to rework nearly $US 30 billion in external debt and average annual payments of about $US 2 billion in debt service that constitute a major drain on reserves and the budget. Finally, the decline in ODA from $US 4.7 billion in 2020 to $US 2.7 billion in 2022 has added to the pressure. One way to look at the cumulative impact of debt service, the absence of an IMF programme and a fall in ODA is to see what the loss is in terms of months of import cover: this adds up to about 3 months of imports at the substantially higher level of world prices reached in 2022. This is coincidentally the minimum level recommended by the IMF.

> **In response to multiple shocks, the Ethiopian Government has demonstrated resilience in economic management and showed its commitment to macroeconomic stability and continuation of reforms, performing well in comparison with peer countries in Sub-Saharan Africa.** First, the country is managing its fiscal situation as prudently as possible through internal domestic financing, especially focused on the newly-developed Treasury bills market, with reliance on central bank advances acknowledged as an issue and designed to be temporary in nature. Second, on the fiscal side, the authorities have tried to manage pressures by protecting important macro-sensitive (e.g. debt payments) and social spending whilst dealing with rising security costs. This has been accompanied by prioritisation of growth-sensitive capital projects and, broadly, a temporary reallocation of spending from investment to recurrent items. Third, in the agriculture sector, the Government is implementing a major national wheat programme, which aims to increase wheat production for national food self-sufficiency and export through expanding irrigated wheat production in the lowlands and intensification of production in the highlands. Finally, the Government is opening-up the banking sector to foreign investors and liberalizing capital markets.

> **Stepping back and looking ahead, Ethiopia faces three development challenges in the short – and medium-term.** First, the resumption of conflict, as has happened just recently – or a prolonged period without a resolution of the issues that gave rise to the conflict in Northern Ethiopia – will slow down the pace of poverty reduction and human development and, at worst, exacerbate them. Further conflict – including lower intensity but, nevertheless, significant insecurity in other parts of Ethiopia – risks holding back growth and development, by creating uncertainty, dampening business confidence, and deterring investment. Second, despite prudent macroeconomic management by Government, persistently high inflation, falling foreign exchange reserves, and a widening gap in external financing threaten to undermine the macroeconomic progress Ethiopia has made over the past two decades. Equally, they risk a slowing – and, in the worst case, reversal – of reforms, both economic and governance-related, that are crucial for stabilising conditions in the country, preventing a deterioration of the security situation and laying the groundwork for recovery and accelerated development in the near-term. Finally, connected to the previous point, a focus on resolution of immediate shocks risks diverting attention from planning for the medium-term, amid at least four major structural transitions in the country[1]. **Ethiopia has been resilient so far – but resilience has its limits.**

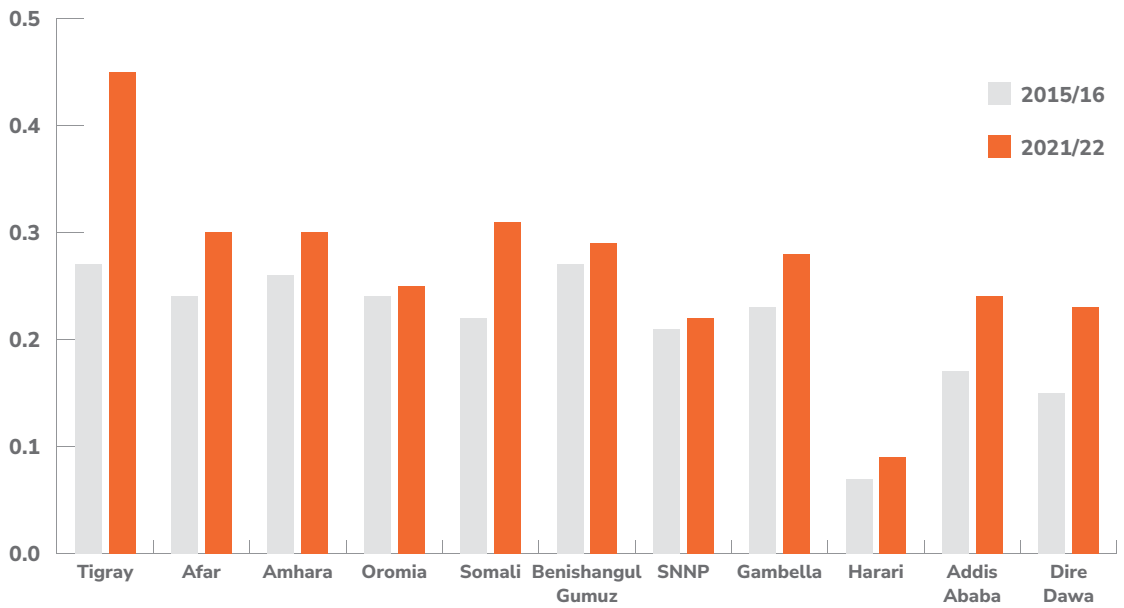
## POVERTY

> **The shocks have had an impact on consumption patterns and the overall incidence of poverty.** Detailed analysis (simulation) was carried out using the 2015/16 Household Consumption Expenditure Survey (HCES) and Welfare Monitoring Survey (WMS) to understand the impact of the shocks on poverty. The analysis uses an empirical method to assess the impact of rising inflation on household purchasing power and poverty headcount. It adjusts poverty lines for each region to account for inflation and then uses data on income distribution to estimate the proportion of the population that would fall below the adjusted (higher) poverty line. The dominant effects can be traced to a combination of internal conflict and the global disruption of production and supply chains as well as recent increases in food and fuel prices in commodity markets. For example, Ethiopia relies on imports of wheat to satisfy 25% of local demand for cereals, although there are recent gains in production through the national wheat programme. Furthermore, more than 20% of the price of cereals is due to transportation costs so that any increase in the price of fuel in the short run tends to worsen the problem, creating a 'double shock'.

1 These structural transitions are: an impending demographic transition; the climate emergency; the transformation of Ethiopia's economic model; and movement towards a more open political system.

> **UNDP's simulation analysis indicates that poverty has risen in Ethiopia due to the shocks and the rising cost of living, especially for food.** Rising poverty has impacted urban and war-affected areas the most, with significant variations among regions. The simulations show that rates of poverty (headcount ratio) have increased in all regions compared to 2015/16 (Figure 1). In Tigray, for example, poverty increased from 27% in 2016 to 45% in 2022, a likely under-estimation, given the level of disruption and damage in this region. Equally, other regions in Northern Ethiopia have not been spared from the adverse effects of conflict. Amhara and Afar regions have seen their headcount poverty rate rise to 30%, significantly above the national average, from 26.1% and 23.6%, respectively, in the pre-conflict period. Again, it is possible that these numbers may be undercounting the scale of downside effects. UNDP's analysis also reveals that there has been an exacerbation of poverty in Addis Ababa and Dire Dawa, urban areas that are net buyers of foods. The results show that the head count ratios for Addis Ababa and Dire Dawa in 2022 might reach as high as 24% and 23%, respectively, compared to 17.8% and 15.4% in 2016.

**Figure 1: Simulations of Trends in Headcount Poverty (%)**




**Source: UNDP-Ethiopia estimates.**

> **A big development and policy question remains whether these impacts will prove to be transitory or have lasting effects.** The answer depends on the out-turn over the next 12-18 months on four major variables: the duration and scale of the conflict that has now resumed in Northern Ethiopia, the duration of the Ukraine crisis and its global effects on food, fuel and fertiliser prices, the scale of external financing that will be available to Ethiopia over the next two fiscal years and the characteristics of the population groups and sectors affected adversely by shocks. In the latter case, losses in income, for example, are likely to be more amenable to recovery than the cognitive or health and nutrition losses suffered by children.

Conflict is likely to be the main or determinant factor overall but the others will have strong effects as well. Should these variables move in a positive direction, then a robust recovery can be envisaged by 2024, especially on livelihoods and income. The alternative would be the persistence of lower growth, slower progress on human development, continued pressure on

external and internal balances, sustained inflationary pressures, and reduced fiscal space for financing basic social services and vital capital expenditures. Should this come to pass, then the long-term growth and development potential of Ethiopia will be diminished.

## HUMAN DEVELOPMENT

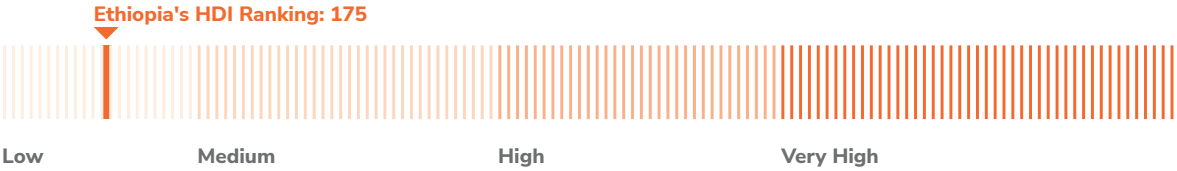
**There have been significant impacts of the shocks, especially the Northern Ethiopia war, on the humanitarian situation in the country, as well as service delivery and human development indicators.** An emerging dataset being collected by Government and UN agencies has allowed for a preliminary assessment of the situation. Overall, data compiled for Tigray in the Government's Emergency Recovery Plan for this region (ERP-T) provides extensive documentation of the scale and impact of conflict in that region and requirements for recovery and reconstruction. On-going conflict impact assessments and recovery planning work being led by the Federal Government will provide additional data and documentation for the relevant metrics in other regions – Afar and Amhara, in particular, but also Benishangul-Gumuz and parts of Oromia and SNNP – where impacts have been very serious as well.

> **Human Development Index (HDI).** The latest Global UNDP Human Development Report[2] shows that Ethiopia's HDI was 0.498 during 2021, placing the country in the low human development category. The good news is that, contrary to 90% of countries globally, developing *and* developed, which saw at least one year of decline in their HDI after the outbreak of the COVID-19 pandemic, Ethiopia has not gone backwards. The concerning aspects are that the value of Ethiopia's HDI has not changed much recently and the rate of change has not improved over the past few years although still positive (Figure 2). Most importantly, it is possible that the human development impact of shocks – especially those that are internal to the country plus the war in Ukraine, as detailed below – have not yet fed through fully into the data. This calls for vigilance on downside risks to the HDI in 2022-24.

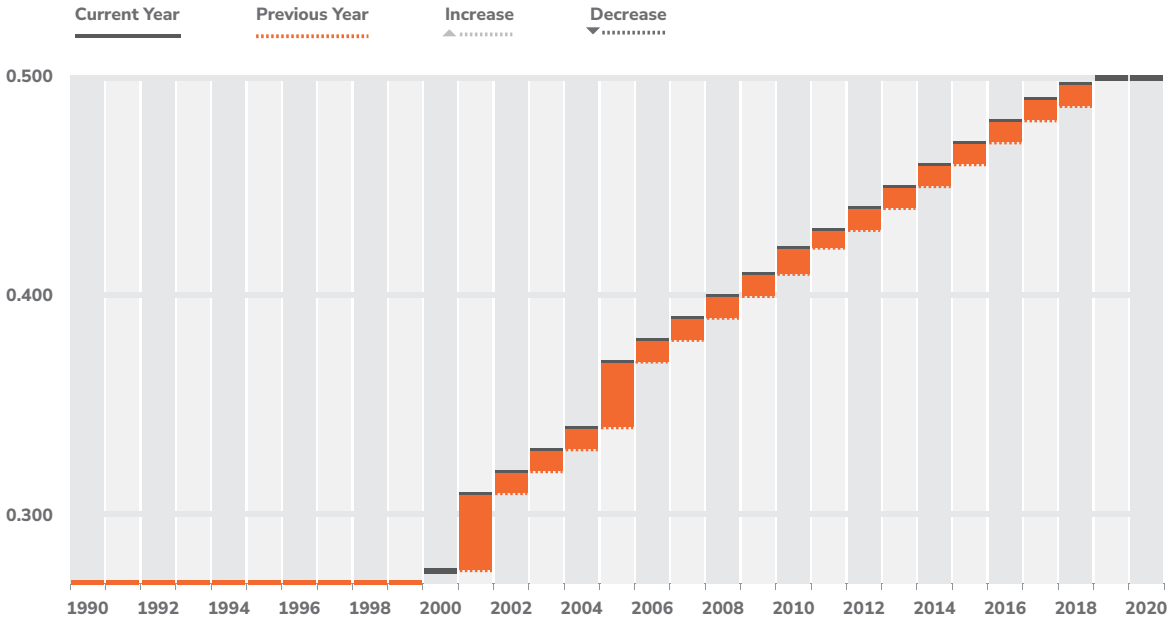
2 UNDP, Human Development Report 2021-22, Uncertain Times, Unsettled Lives: Shaping our Future in a Transforming World.

**Figure 2: Human Development in Ethiopia**

| HDI Value (2021) | Human development classification | Developing region |
|---|---|---|
| **0.498** | **Low** | **Sub-Saharan Africa** |




**Trends in Ethiopia's HDI 1990 - 2021**




**Source: UNDP, Global Human Development Report, 2021-22.**

> **Mortality and morbidity.** COVID-19 has had an impact on the health of the Ethiopian population. As of September 1, 2022, there have been less than 500,000 confirmed cases with more than 7,500 deaths. The war in Northern Ethiopia has also led to thousands of deaths but there are no confirmed estimates of the total number of deaths and injuries. This is a major lacuna in estimating the full impact of the conflict, as it detracts from a fuller understanding of the human toll that has accompanied war. In the same vein, the human cost of lower intensity but, nevertheless, significant insecurity in other parts of Ethiopia – such as Benishangul-Gumuz and western Oromia (the Wallegas, in particular) – is also like to be substantial but has not been assessed in its totality yet.

> **Humanitarian caseload.** According to the 2022 Humanitarian Response Plan (HRP), which focuses on the combined impact of conflict and drought, close to 24 million people are estimated to need humanitarian assistance in Ethiopia in 2022, nearly three quarters of whom are women and children.[3] Across southern and southeastern Ethiopia, prolonged drought, attributable to

3 Ethiopia 2022 Humanitarian Response Plan.

three consecutive years of below-average rainfall since late 2020, has affected the lives of 6.8 million people. The 2022 Ethiopia Humanitarian Response Plan (HRP), therefore, requires $US 3.09 billion to assist almost 24 million people across the country. This includes 5.5 million internally displaced people (IDPs), 18 million other affected people, and 42,000 returned migrants. There has also been the death of 1.5 million livestock due to the drought in southern Ethiopia, affecting farmer incomes. Looking at the big picture, this means that close to one in five Ethiopians will need humanitarian assistance in 2022, a worrying level of need, suggesting a significant deterioration compared to the trend over the past five years.

> **Safety nets.** The war has constrained the reach and effectiveness of safety net programmes, some of the largest in Sub-Saharan Africa. The rural productive safety net programme (RPSNP) has been absent in Tigray since November 2020 and has been reduced in Afar and Amhara, temporarily being unable to support more than 1.6 million people across the three regions.

> **Basic social services.** There has been extensive damage to health facilities across Northern Ethiopia, from health posts to hospitals, substantially impairing service delivery and putting lives at risk. A survey by the regional health bureau indicates that 90% of Tigray's 40 hospitals and roughly 1,000 smaller clinics have been damaged. Likewise, in Amhara and Afar regions, more than 2,000 health facilities, including hospitals, health posts and blood banks have been damaged. At the same time, insecurity in other parts of Ethiopia – such as Benishangul-Gumuz, Gambella and specific areas within Oromia – are quite likely to have disrupted delivery of basic services to populations in need, an aspect that has perhaps received less attention than the effects of the conflict in Northern Ethiopia.

> **Schooling.** According to UNOCHA Ethiopia Situation Report in June 2022, 2.53 million children are out of school due to conflict and about 400,000 children are out of school because of drought. The UNOCHA report finds that 85% of schools in Ethiopia's Tigray region need desks and blackboards, as well as 4,400 schools in parts of Ethiopia's Afar and Amhara regions.[4] The cognitive losses arising from this situation are likely to be considerable and, worryingly, increasingly irreversible. Beyond the direct human development impact, this phenomenon implies a loss of social capital, productivity and output in the future, thus, tangible, sustained and non-zero costs to the economy over the medium – to long-term.

> **Food insecurity.** According to the World Food Programme (WFP), severe drought has caused 7.4 million people to be food insecure in southern and southeastern Ethiopia. In non-drought affected areas, there has also been food insecurity. In Amhara region, 783,909 hectares of food crops, 244,953 hectares of industry/cash crops and 266,852 hectares of export crops have been damaged. Similarly, in Afar region, in 5 zones and 13 woredas 4,500 hectares of farmland have been damaged. UNOCHA notes a significant level of food insecurity among 5.2 million IDPs and 15.2 million non-displaced people.

4 UNOCHA Ethiopia Situation Report, (June 2022). School feeding programmes for more than one million primary school children have been impacted by school closures.

## MACRO-ECONOMY

**Compared to the baseline in 2019, the combined shocks have had an unambiguously negative effect on macro balances.** The basis for this conclusion derives from analysis conducted using the following sources:

a. A **baseline assessment** taken from the IMF January 2020 Article IV Report which shows the projections of the IMF team for 2020 to 2022 for four key macro variables – GDP, inflation, reserves, and the fiscal deficit.[5]

b. The **actuals (shocks scenario)** derived from a combination of sources: real GDP (UNDP); reserves (National Bank of Ethiopia) inflation (Ethiopia Statistics Service), and fiscal deficit (MoF's Medium-Term Macro Economic Financing Framework (MEFF)).

**The main findings are as follows:**

> Real GDP would have grown by 7% rather than 3% in FY2022 (Figure 3).[6] The difference between targeted and actual GDP growth rates in FY2021 and FY2022 suggests that more than $US 2.0 billion of potential output was unrealised due primarily to the impact of conflict.

> Inflation (end of year CPI) reached 34% in June 2022, falling from 37.2% in May 2022, rather than a baseline projection of 8% (Figure 4).

> In the absence of shocks, reserves could have reached more than $US 7.4 billion in 2022 (according to the IMF 2019 programme) rather than $US 1.5 billion (Figure 5).

> The fiscal deficit is projected at over 5% of GDP rather than less than 3% of GDP in 2022 (Figure 6).

**Figure 3: GDP Growth Baseline vs Shocks (% of GDP)**

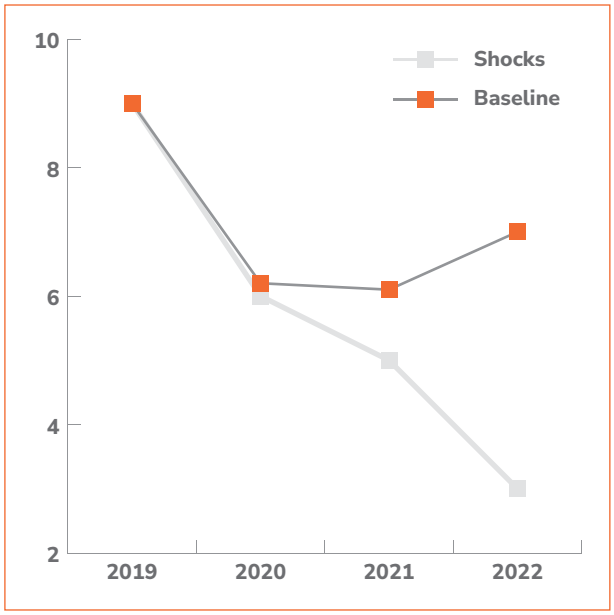
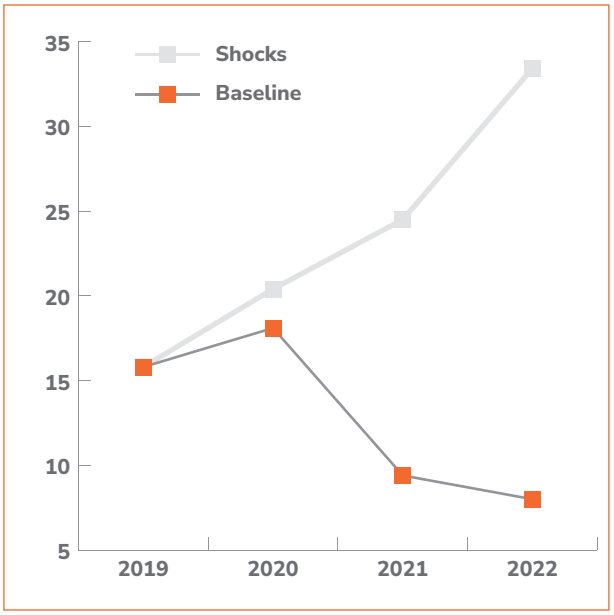



**Figure 4: Inflation Baseline vs Shocks (%)**




5 The analysis is the last IMF assessment prior to the COVID pandemic, to provide a sense of expectations prior to the onset of shocks. These projections have since been revised by the Government and IMF

6 In the report, a year relates to the fiscal year (FY) from July 8 to July 7 and not the calendar year. The UNDP estimate of real GDP growth uses as its point of departure the sectoral composition of GDP in 2021 and associated sectoral growth rates, adjusting them in its projection for 2022 utilizing a wealth of microeconomic, including high frequency, data to arrive at an estimate that reflects the real level of economic activity.

**Figure 5: Reserves Baseline vs Shocks ($US billions)**

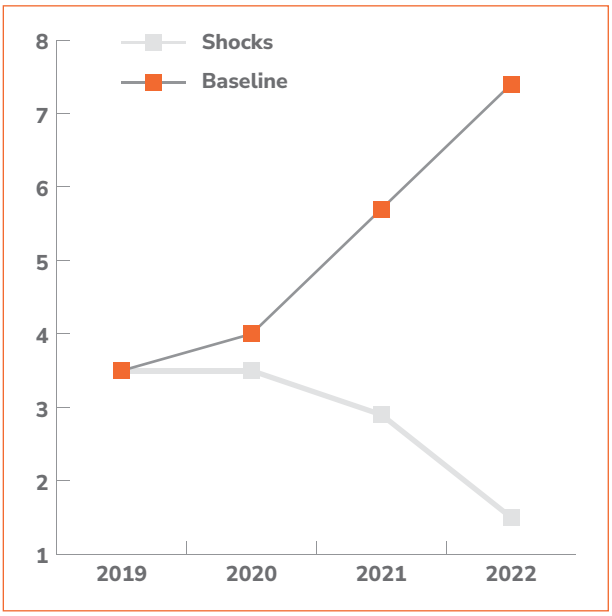
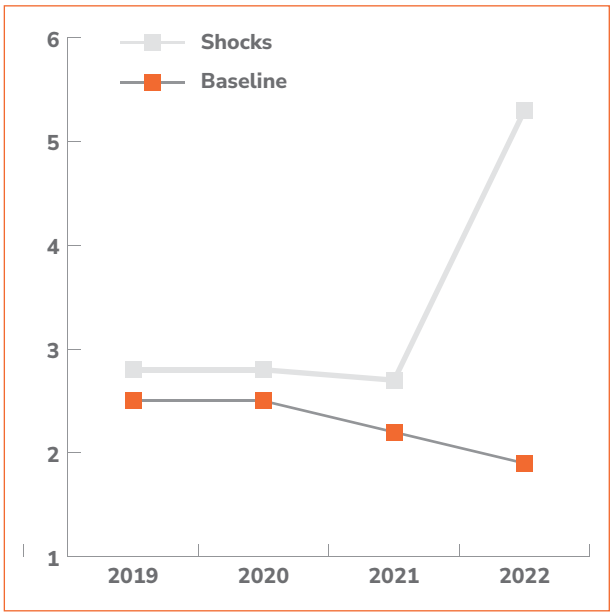



**Figure 6: Fiscal Deficit Baseline vs Shocks (% of GDP)**




**Source: IMF Article IV, MoF, UNDP estimates.**[7]

## *Internal Balances*

> **Internal balance,** defined as the level of output consistent with both full employment and a sustainable rate of inflation, has worsened. As pointed out above, the shocks have led to a **decline in economic growth** compared to a baseline scenario. In 2021, according to Government estimates, the economy grew by 6.3% (Figure 7), lower than the official projection of 8.7%. Contractions in industry accounted for much of this decline. There is some increase in wheat production, but it has not yet offset the deficit in the sector. The UNDP projects growth to be 3% in 2022, and the IMF projects growth at 3.8% in 2022.

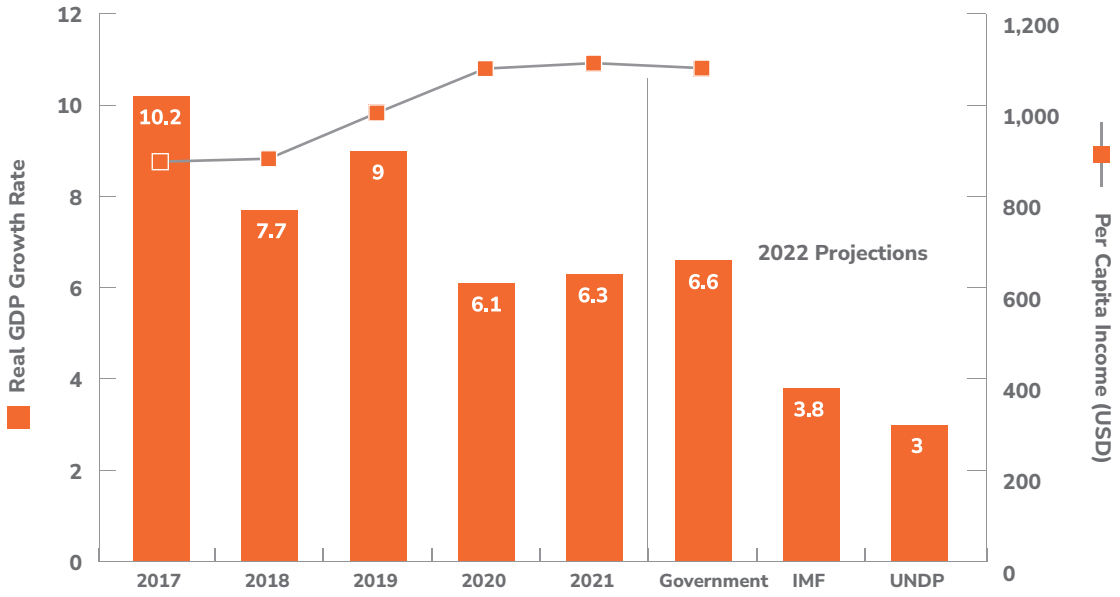
> **Inflation reached a high of 37.2% in May, with a slight deceleration to 32.5% in August 2022.** The August 2022 year-on-year food inflation rate was lowest in Addis Ababa at 29%, in contrast to all other regions where it ranged between 35% and 40%[8]. To put these developments in context, Ethiopia was already experiencing double digit inflation prior to the outbreak of conflict internally and in Ukraine, pointing to shortfalls in productivity, logistics, infrastructure and market integration, especially in food production, as structural bottlenecks that continue to have significant negative effects after stripping out the effects of shocks.

> **The widening fiscal deficit in Ethiopia** is due to a combination of revenue shortfalls and increased spending on the war and humanitarian assistance. It will be hard, at least in the short-term, to dampen inflationary pressures using fiscal measures due to a combination of factors: the absence of strong buffers that makes it difficult for the Government to maintain the fuel subsidy or reintroduce the wheat subsidy which was phased out a few years back; limits on local debt financing; significant reliance already on financing from the central bank that could be inflationary; and falling aid flows.

7 Note: The IMF projections were prepared at the end of 2019 before the pandemic. After the onset of COVID-19, the IMF and the Government of Ethiopia revised the macroeconomic framework

8 The May 2022 year-on-year rate of food inflation at the regional level was as high as 57.8% in Gambella and 57.2% in Benishangul-Gumuz, while the lowest was in Addis Ababa, Somali, and Dire Dawa, oscillating around 39%, still at a very high level.

**Figure 7: Real GDP Growth 2017-2022 (%)**




**Source: Ministry of Finance, IMF, UNDP.**

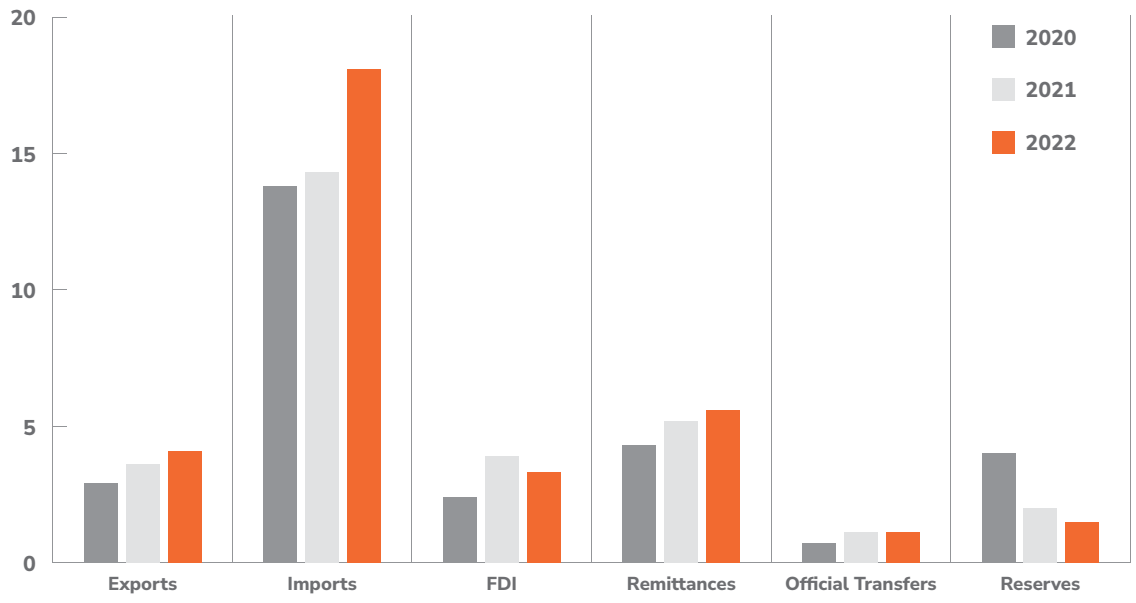
## *External Balances*

> **The country's external balance has worsened, due to a widening current account deficit and a fall in reserves.** The current account deficit is projected to widen, partly due to the increase in wheat and fuel prices, from less than 3% of GDP in 2021 to more than 4% of GDP in 2022. This is not yet at a dangerous level but suggests that any further shocks could have a serious downside effect on external balances. The value of imports increased to $US 18.1 billion in 2022 as Ethiopia was affected by the growing disruption in the global trade in wheat, edible oil, fuel, and fertilizers driven by the Ukraine crisis (Figure 8). The country imports 10% of its wheat from Ukraine although recent increases in domestic production, if sustained, will reduce and possibly eliminate exposure on this front. Exports of coffee and gold have also increased but not enough to offset the rise in import prices. As a result, in 2022, foreign reserves fell to $US 1.5 billion, less than two months of imports compared to about $US 3.5 billion in 2020 before all the combined shocks, thus, on a clear downward trend and below the accepted threshold of three months of import cover. This points to another important source of vulnerability in the economy. The country's external financing requirements are, therefore, widening and call for greater attention and vigilance. Remittances are the clear silver lining, serving as a stable counter-cyclical buffer, reaching $US 5.6 billion in 2022. Official transfers, which are grants and used to be more significant, are estimated to have fallen to less than $US 1.1 billion in 2022, representing a deceleration from inflows of $US 1.5 billion and $US 1.4 billion in 2020 and 2021, respectively. According to Ministry of Finance, official development assistance (ODA), which also includes loans, declined from $US 4.7 billion in 2020 to $US 3 billion in 2021 and $US 2.7 billion in 2022.[9]

9 Net official development assistance (ODA) consists of disbursements of loans made on concessional terms (net of repayments of principal) and grants by official agencies of the members of the Development Assistance Committee (DAC), by multilateral institutions, and by non-DAC countries. It includes loans with a grant element of at least 25%, as opposed to official transfers, which are solely grants.

> **Ethiopia can be impacted by potential decreased inflows of FDI.** Despite the shocks, Ethiopia has benefited from the privatization of its telecom sector. Government data shows that FDI increased from $US 2.4 billion in 2020 to $US 3.9 billion in 2021 and declined to $US 3.3 billion in 2022. The concern is that the Ukraine conflict may lead to a longer-term worsening of the global environment for investment which would add to investor concerns connected to any lack of progress towards resolution of the conflict in Northern Ethiopia.

**Figure 8: Ethiopia External Sector Performance 2020-2022 ($US billion)**




**Source: NBE Annual Report, UNDP estimates.**

> **The exchange rate remains misaligned.** The government's strategy to manage the currency has focused on depreciating the Birr by about 25% per year. Anecdotal evidence from traders suggests the black-market premium rate reached over 70% in September 2022, indicating increasing pressure on the local currency. The rising black-market premium, coupled with falling reserves, remain significant risks in the short-term.

> **Debt.** Ethiopia's total debt-to-GDP ratio of 50.7% is high, leaving little room for debt to function as an important source of financing for recovery and development. About 25.1% represents domestic debt and 25.6% external debt. The number has declined in the last few years as the country has taken timely action to avoid contracting new external debt and reduce payments to state-owned enterprises. A reasonably high debt service-to-exports of goods and services of ratio of close to 20% in June 2022 remains another challenge.[10] There have been discussions with the G20 on possible debt restructuring under the Common Framework to reduce debt vulnerabilities. In July, the creditor committee meeting, co-chaired by China and France, took place in Paris. Discussions are ongoing as of September 2022, including the possibility of an IMF lending programme provided several enabling conditions are met. **As is clear from the analysis of the macroeconomic situation in Ethiopia, the country needs a *reduction* in its external debt servicing obligations – and soon – to create fiscal space for recovery and sustainable development as well as relieve pressure on its external accounts.**





10 In 2022, the Government of Ethiopia paid $US 2.1 billion in debt service, according to the Ministry of Finance.

## MACROECONOMIC OUTLOOK 2023

**The combined shocks have dampened the medium-term macroeconomic outlook for Ethiopia and introduced risks that necessitate careful monitoring and management as is being done by Government.** In this context, UNDP has prepared a **forward-looking macroeconomic assessment for 2023** based on an analysis of the country context (Table 1 below), noting that there are high levels of uncertainty in the environment which will require further adjustments in estimates as conditions either improve or, unfortunately, deteriorate whether due to external or internal factors.

**Assumptions in the UNDP's Macroeconomic Analysis**

- Despite the fresh outbreak of conflict in August 2022, the balance of probabilities still favours an end to hostilities early enough in the fiscal year to contain downside impacts.
- No radical changes in the global or country context beyond what has transpired already.
- Higher prices for oil, wheat, and fertilizer will persist in 2023. However, there will be slight decrease in international oil prices due to global supply response. The IMF forecasts oil prices will average $US 106.83/barrel in 2022 and $US 92.63/barrel in 2023.
- Exports will be limited by weakening global demand given the state of the global economy. Coffee exports surged in 2022, and forecasts show growing risks of a global downturn in 2023.
- There will be considerable delays in the G20 debt restructuring process.
- There will be a pass-through of international oil prices to domestic consumers.
- There will not be any significant increase in ODA.

- **Growth.** According to the UNDP, growth will go down to 3.0% in 2022 and will be followed by an increase to 4.8% in 2023.
- **Inflation.** Inflation is projected to decrease to below 30% in 2023. Supply chain shortages and relatively high fuel prices are expected to persist in 2023.
- **Fiscal deficit.** The fiscal deficit, which reached more than 5% of GDP in 2022, is expected to decrease slightly to 4.6% in 2023. The cost of financing recovery, coupled with the cost of debt servicing, will continue in 2023.
- **Current account deficit.** The current account deficit will narrow slightly in 2023 and is expected to remain close to 4% of GDP in 2023.
- **Reserves.** Under the present trajectory, the level of reserves will be at less than 2 months of imports in 2023. External financing, whether through the IMF and/or other donors would provide crucial help to boost the country's reserves position, substantially reducing an important source of short-term risk in the macroeconomic outlook.
- **Debt.** Total debt is expected to stay at close to 52% of GDP in 2023. The debt servicing scenario could change significantly if there is a deal under the G20 Common Framework.
- **Financing.** Ethiopia will continue to have a significant financing gap in 2023 at close to $US 1.3 billion due to high import expenses and not enough offsetting inflows, under current assumptions. Exports and remittances will continue to provide some buffers, but are not projected to grow very significantly due to an uncertain global environment and recession risks.

**Table 1: Macroeconomic Framework 2020-23**

| | 2020/21 | 2021/22 | 2022/23 |
|---|---|---|---|
| **Macro** | | | |
| GDP Growth (%) | 5.0 | 3.0 | 4.8 |
| Inflation (%) | 21.5 | 34.0 | 30.0 |
| **Fiscal** | | | |
| Fiscal Deficit (% of GDP) | -2.8 | -5.3 | -4.6 |
| **Trade** | | | |
| **Current Account** | | | |
| Current Account Deficit (% of GDP) | -2.9 | -4.2 | -3.8 |
| Exports ($US billions) | 3.6 | 4.1 | 4.4 |
| Imports ($US billions) | 14.3 | 18.1 | 17.9 |
| Fuel ($US billions) | 1.9 | 3.5 | 3.4 |
| Cereals ($US billions) | 1.3 | 2.2 | 2.0 |
| Net services ($US billions) | 0.3 | 0.6 | 0.6 |
| Private transfers ($US billions) | 6.1 | 7.5 | 7.5 |
| Official transfers ($US billions) | 1.4 | 1.1 | 1.1 |
| **Capital Account** | | | |
| Other investment ($US billion) | -0.7 | -0.6 | 0.0 |
| **Foreign direct investment ($US billion)** | **3.9** | **3.3** | **3.0** |
| **Overall Balance of Payments ($US billion)** | **0.3** | **-2.1** | **-1.3** |
| **Financing ($US billion)** | **-0.3** | **2.1** | **1.3** |

**Source: UNDP estimates; MoF fiscal forecasts.**

**Note: The growth projections are from the UNDP.**

## MACROECONOMIC RISKS

**Moving forward, Ethiopia faces several macroeconomic risks.** Its ability to continue to mitigate the adverse impacts of shocks is limited, whether in terms of fiscal space, ability to take on additional debt, or the state of its external accounts. Ethiopia's widening fiscal and current account deficits and its weakened reserves show the country's continued vulnerability, especially at a time of high food and fuel prices. The country's points of resilience which speak well to the Government's management of the economy – exemplified by generally prudent macroeconomic policies, stable inflows of remittances, continued rising exports of coffee (a 57.3% increase in value and a 22% rise in volumes from 2021 to 2022), and a rebounding services sector – will help to partially shield the economy. However, continued inflows of development assistance – and at a sufficiently high level – are essential for Ethiopia to successfully navigate the cumulative impact of domestic and external shocks. Finally, a resolution of the conflict in Northern Ethiopia will be fundamental to a sustained recovery.

**The bottom-line is that Ethiopia faces heightened risks BUT the economy is not in the 'red zone' yet. It still has some internal policy flexibility to adjust to shocks – but this flexibility is not unlimited, indeed, is now impaired significantly. On the other hand, Ethiopia has the elements necessary to not only stage a relatively rapid comeback but also, potentially, return to its pre-conflict trend rate of growth and development within two-three years, if sustained peace is restored, economic and governance reforms accelerate significantly, and there is sufficient external financing.**

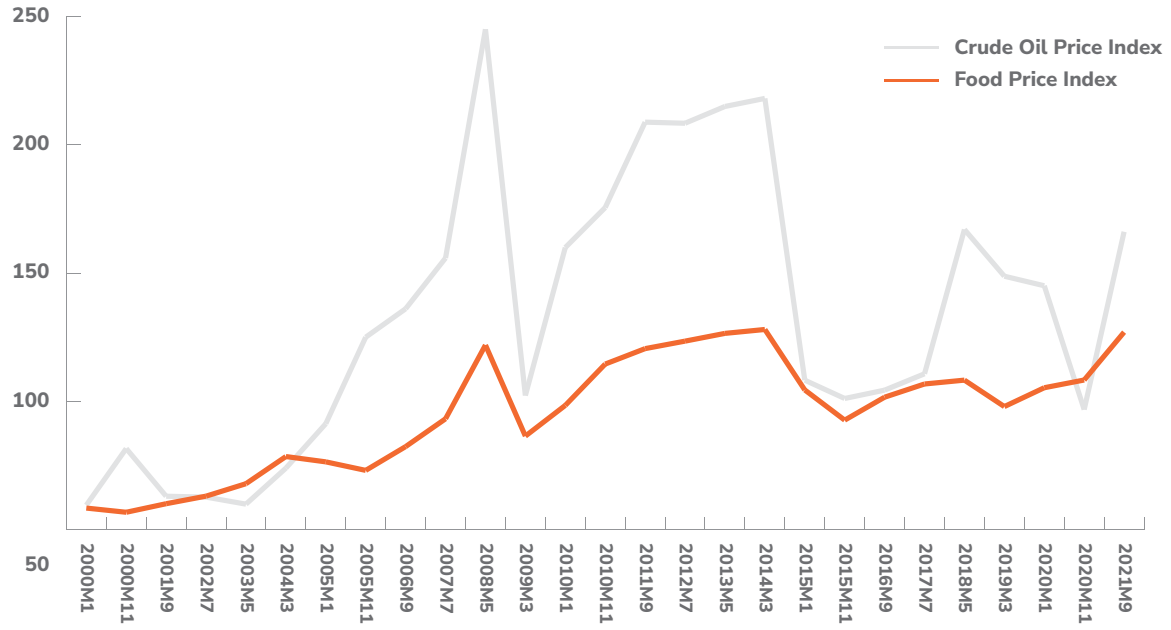
For proposed policy responses in this context, please see section VII. These policy recommendations are focused on options that could help Ethiopia navigate near-term macroeconomic risks whilst safeguarding human development, thus, protecting the foundations for sustainable growth and development in the medium-term. **It is worth emphasising, however, that the path ahead will not be easy due to the dilemma at the core of the choices confronting Ethiopian policy-makers: how to address unavoidable and pressing short-term priorities – such as debt servicing – without slowing down, if not reversing, the momentum of vital economic and other reforms.** The reality is that the tighter the fiscal and external financing situation turns out to be, the more acute will be the pressure to adopt measures, out of necessity rather than choice, that jeopardise medium-term to long-term growth and development objectives. **Allowing Ethiopia to reach this point is not in the interests of anyone. It could turn a tough situation into an intractable one.**

## A. Context

**The Ethiopian economy has suffered from a series of shocks in recent years.** Beginning with the COVID-19 pandemic in early 2020 and followed by conflict in Northern Ethiopia, drought and the Ukraine crisis, these shocks have had ripple effects on the country's economy and damaged Ethiopia's growth prospects and contributed to reversals in development gains. The Northern Ethiopia war has significantly damaged productive capacity and social services in the affected regions and rendered macroeconomic management more difficult, while the ongoing war in Ukraine is adversely impacting the world economy by disrupting global trade in energy and grain and leading to higher prices, with attendant adverse effects on Ethiopia (Figure 1). The drought in southern and southeastern Ethiopia has had more localised effects but these have been quite severe. In the same vein, in terms of additional localised effects, **an aspect that has been relatively overlooked are the economic and, more broadly, development impacts of lower intensity but, nevertheless, significant insecurity in other parts of Ethiopia** such as Benishangul-Gumuz, Gambella and Oromia. Given that some of these areas are also among the poorest in the country – and Oromia a significant contributor to GDP – points to an urgent need to better understand the impacts of lower intensity but persistent insecurity on growth and development.

The UNDP has projected Ethiopia's economic growth in 2022 at 3.0%, much lower than the official projection of 6.6%. **To be clear, though, Ethiopia is not alone in feeling the blowback from a deteriorating global economic environment and has, to-date, managed to contain the downside effects, for example, by maintaining growth during the peak of the pandemic and conflict in 2020-21.** Due to the combined impacts of COVID-19 and the Ukraine crisis, the global economic growth projection for 2022 has fallen by 1% and now is set at 2.6% (UNCTAD,2022). According to UNECA (2022), even before the Ukraine crisis, the COVID-19 pandemic had already led to the worst economic recession in half a century across Africa with real GDP contracting by 3% in 2020. Africa's real GDP growth is projected to contract by an additional 0.7 percentage points due to the Ukraine crisis, substantially complicating efforts to emerge from the COVID-19 pandemic.

**Figure 1: Food and Oil Price Indices 2000-2022**




**Source: IMF WEO dataset.**

## B. Analytical Framework of the Study

**The study focuses on assessing the impact of the shocks – COVID-19, conflict, the war in Ukraine and drought – on the economic well-being of the population through several channels.** Table 1 provides an analysis of the primary transmission channels of the shocks. The shocks with the greatest impact in terms of growth, human development, mortality, and morbidity have till recently been the Northern Ethiopia war and COVID-19, with the war in Ukraine now outweighing the lingering effects of the pandemic. The shocks have differing transmission channels, with varying impacts by region, sector and population group.

**Table 1: Anatomy of Shocks**

| | Primary Transmission Channels | Regions Affected | Sectors Affected | Population Groups Affected |
|---|---|---|---|---|
| **COVID 19** | > Direct health impact<br>> Reduction in domestic demand<br>> Slowdown in investment<br>> Reduction in global trade<br>> Supply chain disruption<br>> Job losses, especially among MSMEs in services<br>> Fiscal pressures<br>> Impact on remittances | Addis Ababa and Oromia are the most affected regions<br>Urban population more than rural | The labour-intensive informal sector and hospitality industry had been affected significantly while the effect on manufacturing was relatively muted | All groups of population but the impact estimated to be higher on the urban poor, dependent on precarious livelihoods |
| **Northern Ethiopia War** | > Unknown loss of life<br>> Conflict – driven disruption of economic activity and livelihoods, especially in agriculture and among MSMEs<br>> Large-scale displacement of population<br>> Interruption and/or reduction of governance services including rule of law and justice<br>> Interruption and/or reduction of health, education and WASH services<br>> Interruption or complete stop to safety net programmes (notably, PSNP)<br>> Damage to infrastructure impeding recovery and reconstruction<br>> Degradation of environmental resources<br>> Heightened fiscal pressures and 'fiscal diversion' (from investment to current spending and to defence) | The war has been localized in the regions of Afar, Amhara and Tigray but with economy-wide effects | Agriculture, manufacturing, and tourism in affected regions have been most affected<br>Kombolcha and Mekelle Industrial parks have been damaged by the war<br>War began at the time of harvest in Tigray and planting season in Amhara region. | All groups of the population have been affected significantly<br>Women, children, and the elderly most exposed to conflict impacts, especially IDPs |

| | Primary Transmission Channels | Regions Affected | Sectors Affected | Population Groups Affected |
|---|---|---|---|---|
| **Drought** | > Slowdown in economic activity<br>> Food insecurity and malnutrition<br>> (Temporary) loss of livelihoods<br>> Internal displacement<br>> Heightened fiscal pressures | Parts of Somali,<br>Oromia and SNNP regions | Agriculture and animal husbandry<br>Exports | All groups of the population<br>Women and children<br>Rural areas in affected regions |
| **Ukraine War** | > Pressure on external balances<br>> Pressure on forex reserves and exchange rate<br>> Possibility of import compression<br>> Reduced access to imported raw materials and intermediate inputs<br>> Inflation from increased cost of fuel, fertilizer, edible oils, and wheat<br>> Decline in the use of fertilizer affecting agricultural productivity in the 2022-23 season<br>> Fiscal pressures arising from implicit subsidy regime | Economy-wide effects | Agriculture, transport industry | Farmers and the urban poor, especially those engaged in precarious livelihoods in the informal sector<br>Prolonged duration could see impacts extending to the urban formal sector |

The analysis looks at the following points:

> **Potential impact on poverty conducting statistical simulations using the 2015-16 Household Consumption Expenditure Survey (HCES) and Welfare Monitoring Survey (WMS) which are the most recent data sources available at the moment.**[11] As the inflationary impact has increased, more and more people are falling below the poverty line due to the increased cost of living. The analysis makes a set of assumptions to model the poverty impact on households.

> **Human development impact using Government and partner assessments.** This paper uses global analysis and data from surveys undertaken by Government and agencies as well as detailed information from UNICEF, UNOCHA, WFP and WHO.

> **Direct impact of the shocks on economic output via the effect on real GDP.** This assessment looks at direct impact, not the indirect effects and looks at a wide range of transmission channels, including domestic production, external trade, prices, and FDI inflows. It assesses the impact of the various crises on supply chains, transportation bottlenecks, and formal and informal sector economic activities. It uses annual data from national account statistics and supplements that with other relevant data. For prices, the analysis uses monthly CPI price data published by the Ethiopia Statistics Service (ESS).

> **Indirect impact of the shocks.** The analysis does not factor in some of the indirect longer-term behavioural impacts of the conflict, though it does consider the impact of lost schooling years. It also does not provide a microeconomic assessment of productivity losses.

11 New rounds of both of these surveys were conducted in 2021 and the data is still being cleaned and analysed. UNDP will update its figures once this information is made available by CSA.

**The COVID-19 pandemic and the Ukraine conflict have had a negative impact on global GDP**. The pandemic led to the largest global recession since the Great Depression and a collapse in global output in 2020. According to the IMF World Economic Outlook (IMF, April 2022), global growth is projected to slow from an estimated 6.1% in 2021 to 3.6% in 2022, while growth in Sub-Saharan Africa will fall from 4.5% in 2021 to 3.8% in 2022 (Figure 2).

**Figure 2: Global and Sub-Saharan Africa Real GDP Growth 2017-2022 (%)**


**Source: IMF WEO dataset.**

## A. COVID-19 Pandemic Shock

**The COVID-19 pandemic started in December 2019 and spread throughout the developed and developing worlds, leading to loss of human lives, socio-economic crisis, supply chain disruptions and reduced output.** It has been one of the worst pandemics in history and had caused more than 6 million deaths by June 2022. It had, however, reduced in significance by mid-2022. Global recovery from the pandemic has been uneven mainly due to vaccine equity issues and differential impacts across countries. Although the World Health Organization (WHO) has set a target to reach 70% of the world population with vaccination by 2022, the achievement so far in many developing countries including Ethiopia has fallen short of this figure. As of June 2022, close to 36.7 million people had been fully vaccinated In Ethiopia (two doses) or 44.5% of the target population of 82.5 million.[12] Official statistics from the Government show that the cumulative positivity rate is 10%, although the current positivity rate is lower, and total deaths at the end of June 2022 had been around 7,500.

12 The data is from the Multilateral Leaders Task Force on COVID-19. COVID-19 Task Force Dashboard (covid19taskforce.com)

**At the time COVID-19 struck, Ethiopia was starting further economic and political reforms intended to strengthen the economy and accelerate development.** Although the economy had registered high economic growth for more than a decade, the underlying model of the developmental state with heavy reliance on public investment and limited space for the private sector, had begun to show serious strains and had, in effect, exhausted its potential, a conclusion reached quickly and candidly by the Government that took power in 2018. The major challenges Ethiopia faced during this time included: slowing economic growth, falling from an average growth rate of 10.4% for the period (2005 – 2017) to 7.7% in 2018; rising debt distress, which reached 58.5% of GDP in 2019; low levels of domestic resource mobilization (tax revenue generation at only 9-10% of GDP); high and rising inflation; high youth unemployment; and a still small private sector unable to act as a motor of growth and development. To sustain its achievements in infrastructure development as well as growth and poverty reduction, the Government designed a comprehensive and far-sighted three-year reform programme, the Home-Grown Economic Reform Programme (HGER) aimed at reversing macroeconomic, structural, and sectoral bottlenecks that are hampering the county's development progress.

**The first COVID-19 case was recorded in Ethiopia on March 13, 2020.** The Government took bold measures to address the COVID-19 pandemic. Whilst avoiding the imposition of a national lockdown, it adopted policy measures targeting businesses and protecting livelihoods of the poor, coupled with health screening initiatives. This heterodox approach, which went against the grain of policies in many developing and developed countries – especially the avoidance of any national lockdowns – prevented the country from sliding into a recession and, indeed, kept the economy growing. Nevertheless, the response to the pandemic did not generate significant fiscal pressure due partly to substantial ODA flows in 2020. It did, however, generate adverse effects on segments of the real economy.

## B. Conflict in Northern Ethiopia

**The Northern Ethiopia war started in November 2020.** This conflict had seen the cessation of large-scale fighting during 2022 till another outbreak in August. The Northern Ethiopia conflict had been contained in the Tigray region up to June 2021.[13] Since then, the war has expanded to the neighbouring regional states of Amhara, and Afar with serious consequences for both. It has not directly impacted the southern part of the country. According to assessments, more than 8 million people in Afar, Amhara and Tigray have been directly or indirectly impacted by the conflict (HRP, 2022).

## C. Conflict in Ukraine

**The conflict in Ukraine started in February 2022.** It led to a worsening global economic outlook for 2022 (and quite possibly beyond) and an increase in the price of oil and wheat given that Russia is the second largest producer of oil and both Russia and Ukraine are both significant wheat producers. Indeed, Russia and Ukraine had been the world's main suppliers of agricultural commodities such as wheat, sugar beets, fertilizer, sunflower oil (56% of global production and 64% of global exports), as well as metals (semi-finished iron) and crude oil.

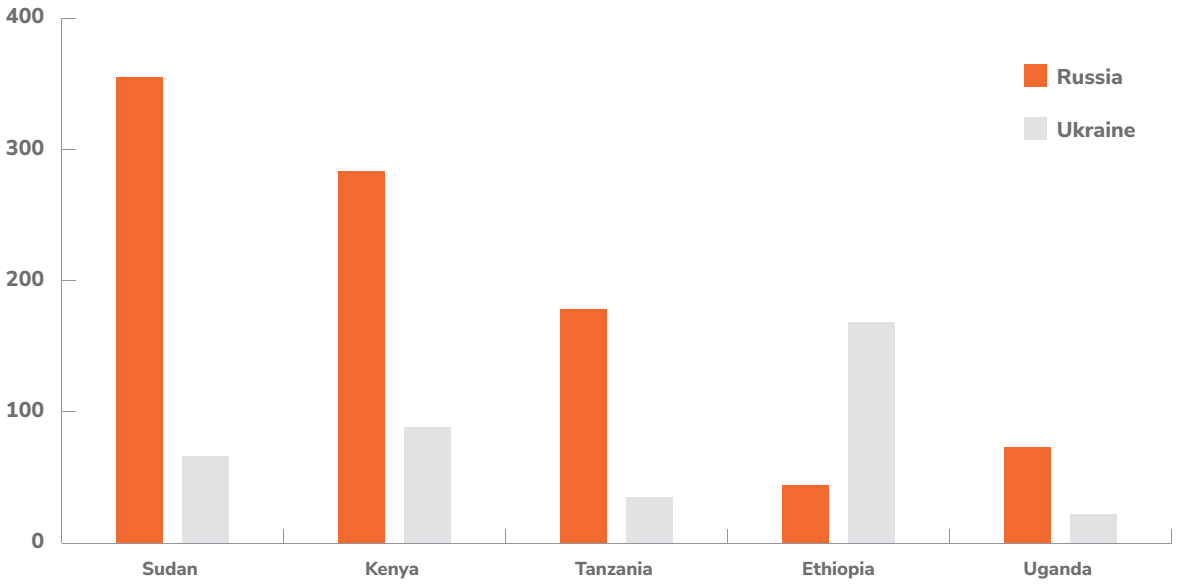
**Global prices for fuel and cereals, which had hit record high even before the outbreak of war in Ukraine as the recovery from the pandemic was gaining strength, were exacerbated by it due to high shipment costs and major supply chain disruptions.** As a result, global inflation is

13 The Tigray region represents about 6% of Ethiopia's population, located in the northern part bordering Afar regional state in the east; Amhara in the south, west and northwest; and Eritrea in the north.

expected to rise by more than 2 percentage points, pushing more people into food insecurity and poverty. According to the IMF World Economic Outlook (April 2022), commodity price increases have led to inflation projections of 5.7% in advanced economies and 8.7% in emerging market and developing economies, significantly higher than earlier projections. Food prices are as high as they were during the Great Recession in 2008.

**Sub-Saharan African countries have strong trade ties with Russia and Ukraine mainly through imports of cereals and semi-finished iron.** The Ethiopian economy is being affected through channels like global commodity and oil price hikes as it is heavily reliant on imports of fuel, fertilizer, wheat, and edible oil. Based on available data from the Observatory of Economic Complexity, OEC, Ethiopia's combined imports from Russia and Ukraine were $US 212 million in 2020 (just 2% of the total import value for the year) out of which 30% was for wheat and other cereals and 55% for iron. Figure 3 gives a perspective on East African imports from Ukraine and Russia.

**Figure 3: Selected East African Countries Imports from Russia and Ukraine 2020 ($US millions)**



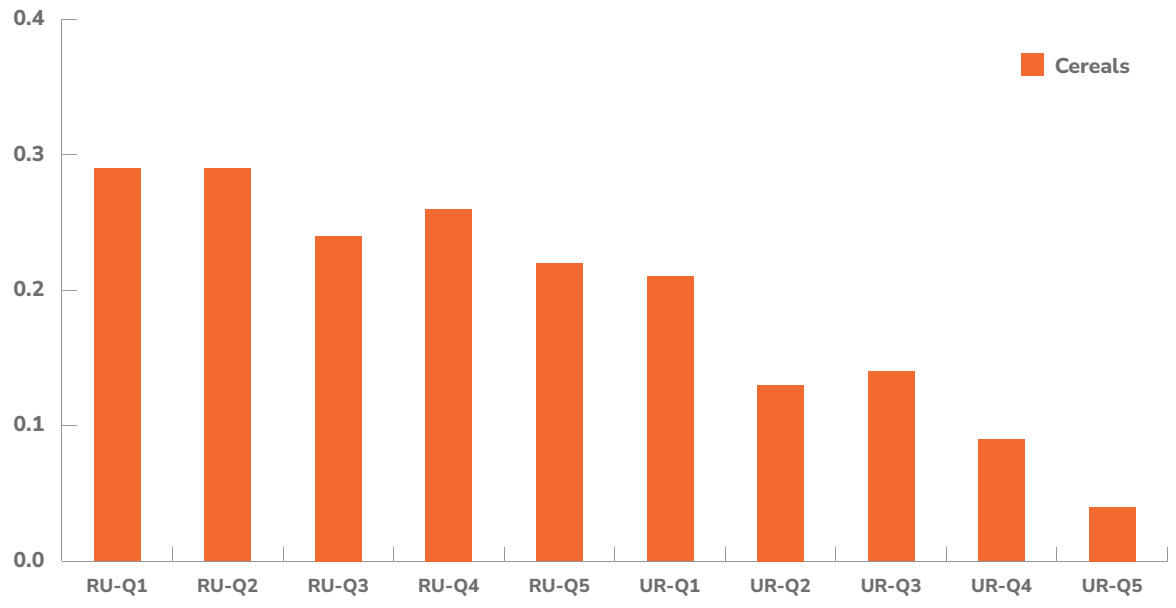

**Source: Observatory of Economic Complexity, OEC.**

## D. Drought

**The drought in southern and southeastern Ethiopia has led to a humanitarian crisis, a result of four successive failed rainy seasons.** Recurring droughts in Ethiopia have impacted over 2 million people on average each year over the past 20 years. The current drought has affected more than 6.8 million people (according to OCHA); led to the loss of an estimated 2.5 million livestock; and demand for food and water assistance for more than 7.2 million and 4.4 million people, respectively. Many people have been displaced, particularly in pastoral areas. The drought, coupled with high food prices, has led to worsening food insecurity in these areas. The drought has, however, been localized in the southern regions and not had economy-wide effects.

**The multiple shocks have had an impact on consumption patterns and overall poverty.** According to the UN Socioeconomic Impact Assessment of COVID-19 (May 2020), close to 5 million people had been projected to have fallen into poverty due to the pandemic. A key factor driving this analysis is the large share of the income of the poorest urban and rural households that is spent on food: nearly 30% in the case of the poorest urban households, with 21% on cereals alone although this is not just on wheat (Figure 4). Complicating matters, there are second order effects of the shocks on agricultural production and transport costs that can – and do – accentuate food price inflation, adding to the pressure on the poor.

**Figure 4: Share of Cereals in the Total Consumption of Households (%)**




**Source: UNDP computation. Note: RU is rural, UR is urban, and the Q1 refers to quintiles of population with a lower number being a poorer quintile.**

## A. Methodology[14]

An empirical assessment was conducted to fully understand the impact of the shocks on poverty. The analysis uses a time-tested empirical method developed by Foster, Greer, and Thorbecke (1984), which provides a combined measure of poverty and income inequality. The work simulates the poverty impact of the shocks using the 2015/16 Household Consumption Expenditure Survey (HCES) and Welfare Monitoring Survey (WMS).[15] This work remains a simulation and is not based on data collected from the field in 2021.

This approach is simple and intuitive. Inflation erodes the purchasing power of people, particularly poor people. Consumer prices have increased, especially for food items. The study simulates the impact of inflation on national and regional poverty lines, utilizing the annual CPI increase (end of period). As poverty lines have gone up due to inflation, the percent of people falling below the poverty line has

14 The **headcount** ratio is the proportion of the poor in the total population according to a defined poverty line, while the poverty gap index (P1) measures the extent to which individuals fall below the poverty line (the poverty gap) or the distance of the poor from the poverty line.

15 The latest data from the 2021 Household Survey is still being reviewed and analysed by the Ministry of Planning and Development..

increased. The analysis considers the more modest gains in income during the period but they were not sufficient to offset the effects of high inflation. Moreover, the impact in individual regions varies according to several parameters: inflationary impact, the poverty profile in 2015/16, the percent of net food buyers, the flow of remittances and the level of aid inflows into the region. Box 1 and Annex 1 provide technical background for the analysis. Annex 2 provides detailed tables as well.

**Box 1: Detailed Poverty Analysis – Assumptions**

> Financial flows into Tigray in the form of remittances and cash assistance (e.g. PSNP) are zero.

> The average prices of cereals is up by 30%.

> The nominal income poverty line rises by 20%.

> There are region-specific shocks.

The analysis carried out detailed poverty analysis using 2015/16 Household Consumption Expenditure Survey (HCES) and Welfare Monitoring Survey (WMS). Latest data from the 2021 round of these surveys are still being cleaned and analysed by CSA.

## B. Results

**Rising poverty** has impacted the urban and war-affected areas the most, with significant variations among regions.

### *Income Poverty*

> The head count index shows that **rates of income poverty have increased in all regions** compared to 2015/16 (Figure 5a).

> **A high rate of change occurred in Addis Ababa and Dire Dawa**, areas with populations that are net buyers of foods. The results show that the head count ratios of Addis Ababa and Dire Dawa might reach as high as 24% and 23%, respectively.

> **The three most conflict-impacted regions show the highest rate of poverty**. The poverty levels have increased in Afar, Amhara and Tigray, documenting the key development impact of the conflict. The poverty level in Amhara region, at 30% compared to 26.1% in 2016 is above the national average, while in Afar, a lowland and predominantly pastoral region where agricultural activities account for only 10% of total activity, the war has been led to a poverty rate of 30% up from its level in 2016 (23.6%). In Tigray, the incidence of income poverty has risen to 45% although this is likely to be a significant under-estimation due to the age of the data.

> Since the lion's share of small holder rural householders in Tigray are beneficiaries of PSNP (Productivity Safety Net Programme), isolation of the region affects the income of those households as well as their food security and poverty levels.

> The incidence of income poverty did not show significant change in SNNP and Oromia regional states. This could be partly because these regions are dominated by small holder rural households who could have benefited from the increase in food prices, where surpluses are marketed, and who secure a large share of their food from their own production.

> In Somali region, the picture is complex as there has been a significant drought impact. The economy in this region is a complex mix of pastoralist, agro-pastoralist, and sedentary farming.

On the one hand, there is an evident spike in poverty in this region in 2021-22, reflecting the impact of drought. On the other hand, there are more than 500,000 farmers in this region that are benefiting from higher food prices and there are similarly some elite pastoralist groups that are benefiting from higher livestock prices.

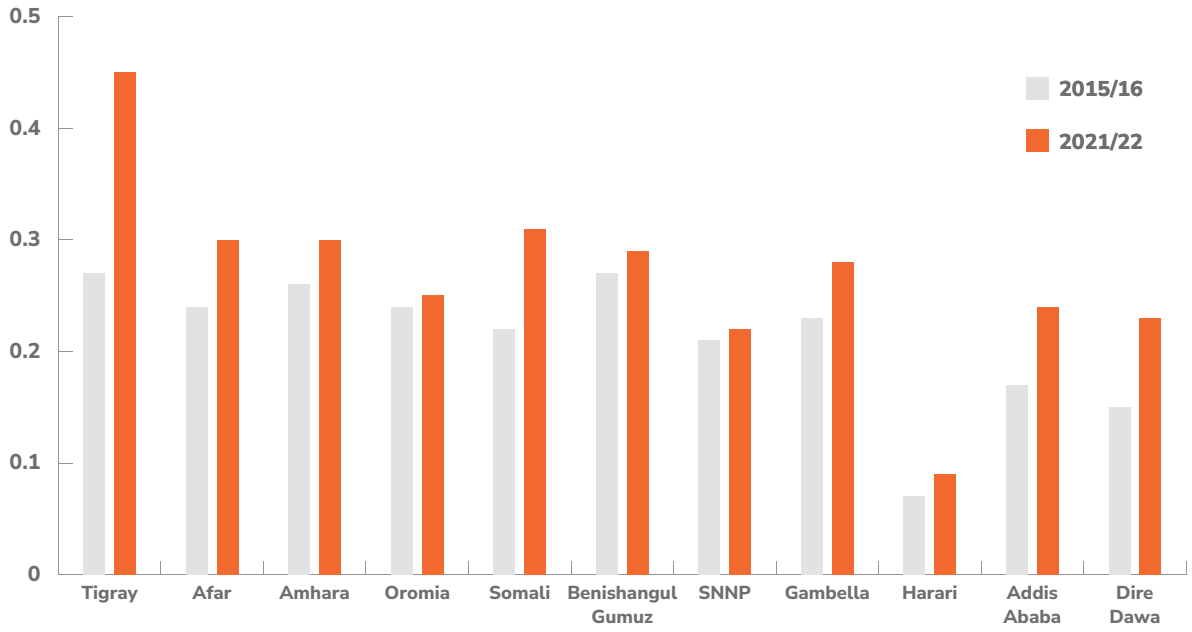
### *The Poverty Gap*

> According to the analysis, **the poverty gap has also increased significantly in some parts of the country**.

> Of all regions, the **poverty gap is the highest in Tigray**. In Tigray, on average, the poverty gap[16] reached as high as 0.17 in contrast to 0.07 in 2016 (Figure 5b). This means that a doubling effort and resources are required to lift every person out of poverty in the region. The severity of poverty has also been computed using the squared poverty gap (poverty severity index or P2).[17] The results also reveal that the severity of poverty is, unsurprisingly, the highest in Tigray compared to other regions (Figure 5c).

> **But the challenges go beyond Tigray as well – and this needs to be kept in mind to avoid underestimating the significance of the situation elsewhere in the country**. The data clearly shows a marked accentuation of the poverty gap in Addis Ababa, Benishangul-Gumuz, Dire Dawa, Gambella and Somali, strongly suggestive of how the widespread nature of the shocks experienced in Ethiopia, including lower intensity but still significant insecurity, is affecting a broad swathe of the country. The analysis of the severity of poverty simply confirms this conclusion.

**Figure 5a: Headcount Poverty Incidence by Region 2016 – 2022 (%)**




**Source: UNDP – Ethiopia calculations.**

16 The **poverty gap** is the distance from the poverty line of poor households. It measures the extent to which the mean income of poor individuals falls below the national poverty line.

17 The **poverty severity index** is related to the poverty gap index. It is calculated by averaging the square of the poverty gap ratio.

**Figure 5b: Poverty Gap by Region 2016-2022 (%)**

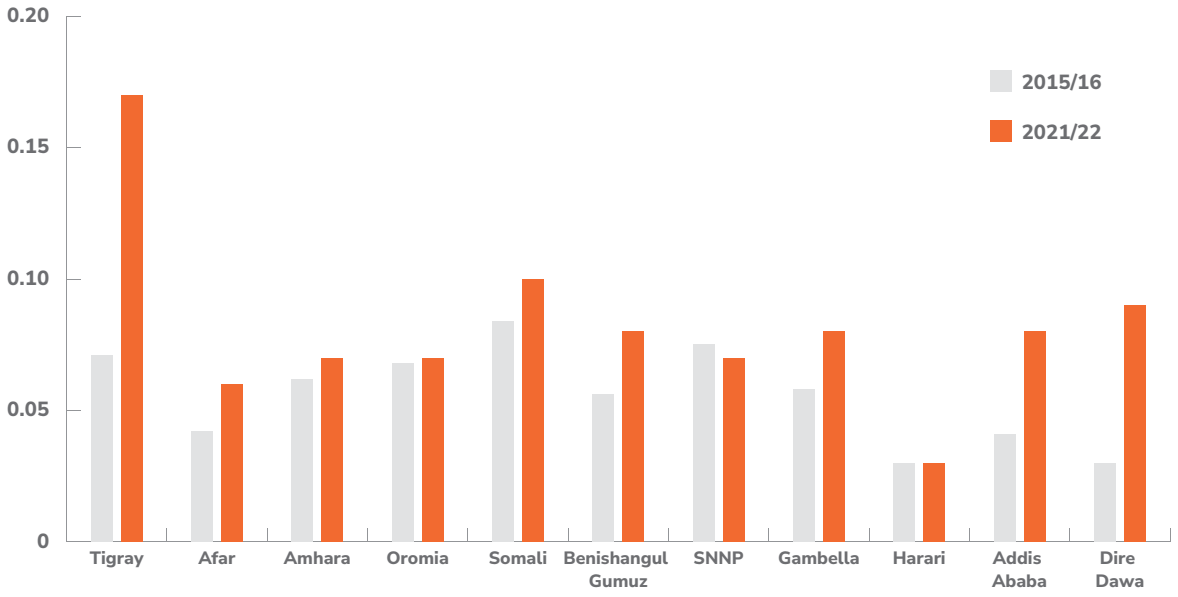
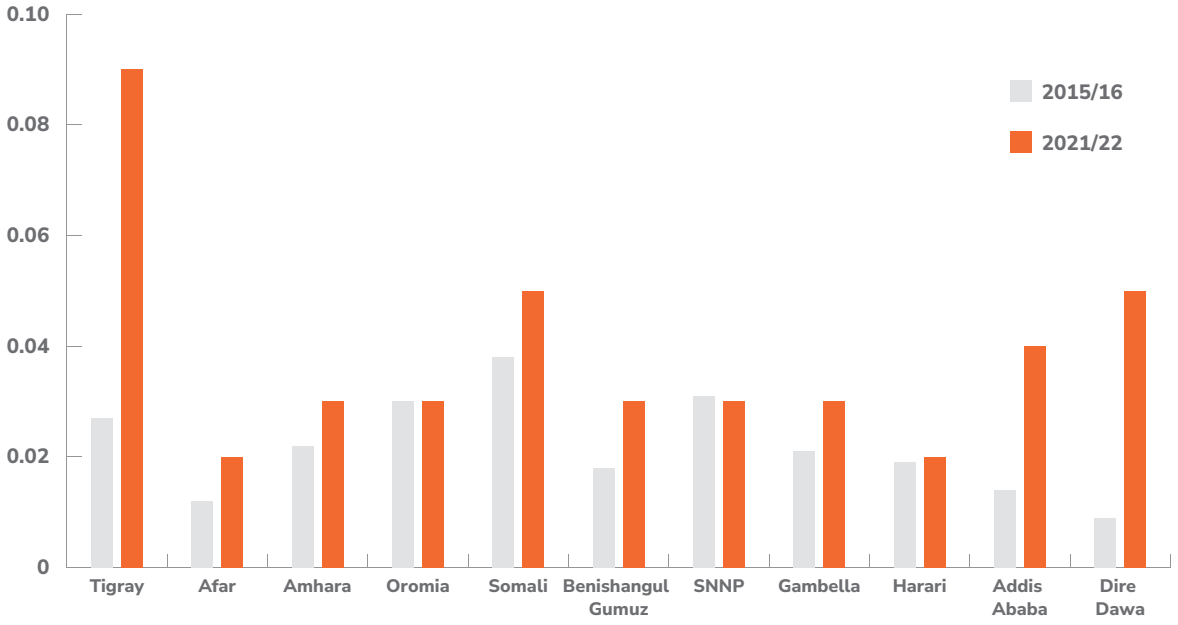



**Figure 5c: Poverty Severity by Region 2016-2022(%)**




**Source: UNDP – Ethiopia calculations.**

**The conflict in Northern Ethiopia has had significant negative effects on Afar, Amhara and Tigray, especially on human development and service delivery[19].** Assessments show that there has been significant damage to infrastructure and a wide range of services, whether economic, social or governance-related, disruption of safety nets, and major negative effects on enterprise and employment provision. Furthermore, the conflict has increased existing food security challenges. This means that the number of people that require the support of social protection services including safety nets and protection services have likely grown significantly. Finally, the conflict has resulted in an increase in GBV, sexual exploitation and abuse, and other harmful practices predominantly affecting women and girls. Some highlights follow below.

At the same time, **insecurity in other parts of Ethiopia – such Benishangul-Gumuz, Gambella and specific areas with Oromia – are quite likely to have disrupted delivery of basic services to populations in need in these regions, an aspect that has received relatively less attention** than the effects of the conflict in Northern Ethiopia.

## A. Human Development Index (HDI) and Related Measures

> **Human Development Index (HDI).** The latest Global UNDP Human Development Report[20] shows that Ethiopia's HDI was 0.498 during 2021-22, in the low human development category. The good news is that, contrary to 90% of countries globally, developing and developed, which saw at least one year of decline in their HDI after the outbreak of the COVID-19 pandemic, Ethiopia has not gone backwards. The concerning aspects are that the value of Ethiopia's HDI has not changed appreciably in recent years and the rate of change has not improved either although still positive (Figure 6). Most importantly, it is possible that the human development impact of shocks – especially those that are internal to the country plus the war in Ukraine, as detailed below – have not yet fed through fully into the data. This calls for vigilance on downside risks to the HDI in 2022-24.

In terms of the decomposition of the HDI, the Inequality-adjusted Index (IHDI) is 0.363 indicating a loss of 27.1% compared to the HDI value. The higher the index value of HDI and IHDI out of an achievable score of 1, the better the performance. The Gender Inequality Index (GII) is 0.520, and the Multidimensional Poverty Index (MPI) is 0.367. For GII and MPI, the higher the number, the worse the result. The Gender Development Index (GDI) is the female to male HDI ratio and is 0.92, reflecting some gender disparity.

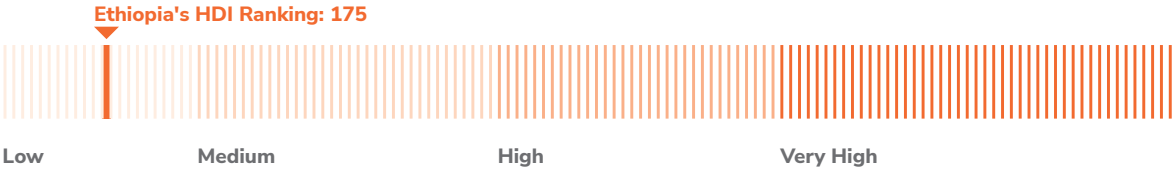
18 The team would like to thank UNICEF for the provision of detailed micro-level data from sub-offices, with key focus on social safety nets, service delivery, health, and education.

19 In Northern Ethiopia, access to services has been significantly curtailed by damage to/destruction of public infrastructure, in addition to the cessation and collapse of public services as well as disruption of electricity, communications and banking services. Measures imposed in conflict-affected areas due to security considerations can, unfortunately and inadvertently, also have significant implications on access to basic services.

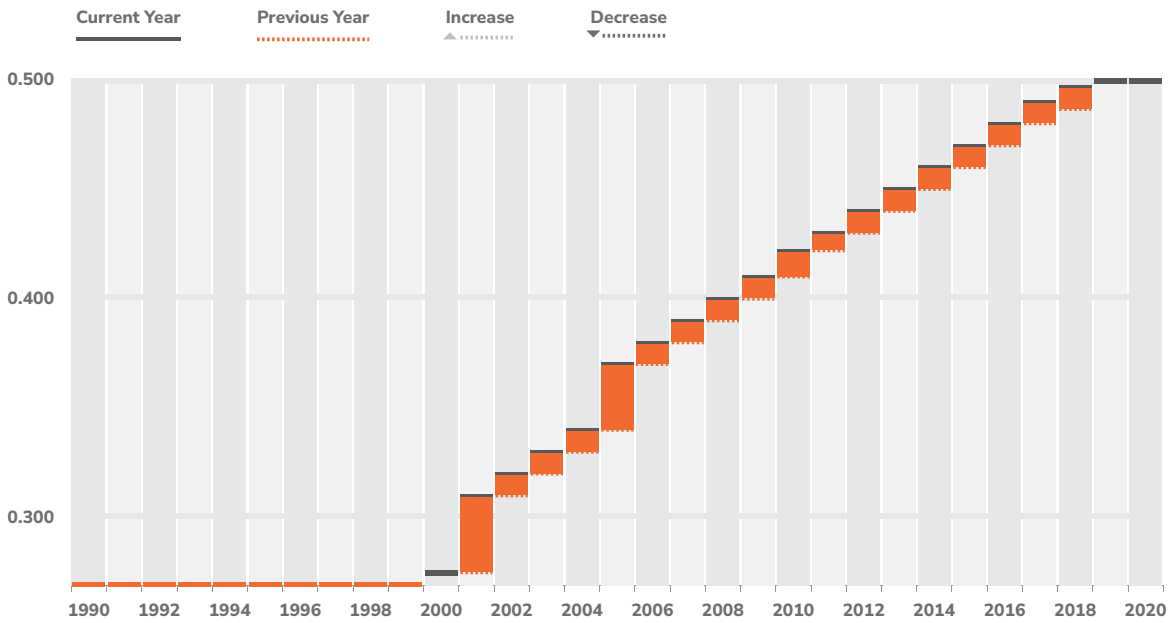
20 With appreciation to UNICEF for some key data. Any errors of interpretation are that of UNDP alone.

**Figure 6: Human Development in Ethiopia**

| HDI Value (2021) | Human development classification | Developing region |
|---|---|---|
| **0.498** | **Low** | **Sub-Saharan Africa** |




**Trends in Ethiopia's HDI 1990 - 2021**




**Note:** All indicators are on a scale of 0 to 1.

## B. Social Safety Nets

> **The war has constrained the reach and effectiveness of safety net programme, particularly in Tigray.** Prior to the war, the Rural Productive Safety Net Programme (RPSNP) was operational in 55 of Tigray's 94 woredas (sub-districts) in all zones except the Western Zone and had a caseload of 1,010,752 people.[21] Between February and May 2021, more than a million people were reached through Government managed PSNP food distribution; however, since June 2021, PSNP is not being implemented in Tigray.

> **In Afar and Amhara regions, the conflict and linked displacement and destruction have hampered the smooth implementation of the RPSNP in several areas.** At the time of the December 2021 programme-wide review, 21 of the 34 PSNP Woredas in Afar and 51 of the 70 PSNP woredas in Amhara were affected by conflict and related displacements where some

21 Out of these, 247,495 are Permanent Direct Support (PDS) clients that receive monthly transfers throughout the year while 763,257 are Public Work clients that receive support between January and June of each year by engaging in various public works activities.

woredas remained inaccessible, even for blanket food distributions.[22] Moreover, PSNP clients in these areas, like all other affected populations, faced displacement and asset losses including crops, livestock, shelter, and household utensils. In terms of ability to continue operations, the assessment showed that as of end of February 2022, in Amhara region, 17 out of 70 PSNP woredas were not war-affected while 49 were war-affected but had resumed operations with significant physical capacity constraints while 4 of them were still inaccessible for programme resumption. In Afar, 17 woredas (50%) are implementing PSNP activities without significant additional capacity support, but 8 have resumed under significant capacity constraints while in 9 PSNP woredas, security is still a challenge to programme operation.

## C. Education

> **The shocks, including the war and the drought, have had a major negative impact on schooling and learning.** These are likely to have both immediate and medium – to long-term effects on children and, more broadly, on human development, socialisation, productivity and output. Overall, 4.2 million children (36% of them girls) and 200,000 teachers and education staff have experienced the effects of conflict. Many schools have been damaged in Northern Ethiopia (Table 2). The greatest impacts are in Amhara and Tigray. Based on the Ministry of Education's (MoE) data, more than 9,000 schools are either fully or partially damaged requiring reconstruction or rehabilitation to ensure children have access to a safe and protective learning environment. Education activities are affected also by the occupation of schools by IDPs and, in some cases, armed groups, rendering these schools inaccessible for children and teachers. Thousands of people have fled their areas of origin and are straining the capacity of already overwhelmed host community schools as available schools and supplies are not able to cater to both host community children and children that are IDPs. Children in significant parts of Northern Ethiopia, are now faced with losing 2-3 years of schooling from the combined effects of shocks; the cognitive losses arising from this situation are likely to be considerable and, worryingly, increasingly irreversible. **Simply put, a generation of children are at risk of losing a large part of their future potential.**

> **The impact on schooling is in line with what many other conflict-affected countries have faced.** Conflict impacts schooling through a multiplicity of channels. On the supply side, it damages infrastructure and lowers teacher presence and general support to operations. On the demand side, conflict affects the risks and incentives for children to go to school risking lower enrolment and learning. A UNESCO study (2010)[23] using household survey data, finds that conflict often leaves an unfortunate legacy for the affected generations: smaller shares of the population with formal schooling, fewer average years of education, and decreased literacy rates, crucially, which persist over time. In many countries existing gaps between marginalized groups, such as women, and the rest of the population worsen during conflict. The expert consensus also emphasises that education has a significant role in building essential intangibles such as social cohesion, inclusion, and resilience. Furthermore, the lack of education increases the likelihood that poverty will be transmitted inter-generationally.

22 PSNP supporting infrastructure and facilities including offices, vehicles, equipment, financial services providers including banks, micro finance institutions, grass root institutions such as cooperatives and farmer training centres have been looted or destroyed at a significant scale.

23 UNESCO, The Quantitative Impact of Conflict on Education, UNESCO Institute for Statistics, September 2010.

**Table 2: Impact of Conflict and Drought on Schools**

| | Number of partially damaged schools | Number of fully damaged schools | Total schools damaged |
|---|---|---|---|
| **Afar** | 756 | 186 | 942 |
| **Amhara** | 3,082 | 1,025 | 4,107 |
| **Benishangul Gumz** | 94 | 119 | 213 |
| **Oromia** | 714 | 186 | 900 |
| **Sidama** | 50 | 1 | 51 |
| **SNNP** | 154 | 22 | 176 |
| **SWEP** | 78 | 0 | 78 |
| **Somali** | 780 | 0 | 780 |
| **Tigray** | 575 | 1,238 | 1,813 |
| | **6,283** | **2,777** | **9,060** |

**Source: Out of School Children, UNICEF, 2022**

## D. Health and Nutrition[24]

> **Delivery of essential health services: Essential health services delivery has been hindered in conflict affected areas of Afar, Amhara and Tigray where over 8.3 million people need support.** The displacement of health workers and deferred salary payment of healthcare workforce for more than 15 months have resulted in high turnover and inadequate technical expertise. Damage and looting of health facilities have also affected the delivery of essential health services even though documentation of these remains difficult due to active conflict. Limited access to Tigray, Afar (Zone 2) and Amhara (northern parts of Wag Hamra and North Wollo), combined with fuel shortages prevent partners from reaching populations in need, both in health facilities and through mobile health and nutrition teams (MHNTs), leaving the most vulnerable host community members and IPDs at increased risk of preventable disease and death. There is an insufficient number of health partners available to provide support which prevents adequate coverage of areas in need of support, specifically in Afar (7 partners operational as of 4th week of August 2022 while only 19 health partners are active in Tigray covering approximately 30% of Woredas). Data available with Tigray RHB shows key essential health service indicator coverage in 2021/2021 was at 20 – 30% when compared with the pre-conflict period of 2019/2020.

Whereas gains made in controlling diseases of public health importance such as HIV, TB and Malaria in the pre-conflict period are compromised, damage to the cold chain system coupled with electricity supply disruptions has gravely affected immunization programs. In Afar, approximately 30 – 40% of cold chain facilities are estimated to be dysfunctional in non-conflict affected woredas according to Afar RHB reports.

> **Acute malnutrition (AM): Public Health Emergency Management (PHEM) data show that severe acute malnutrition (SAM) remains part of the top 5 causes of morbidity in 2022 across the 3 regions of Northern Ethiopia.** The trends have continued to rise by the week since the beginning of the year 2022 and the caseloads are at least 20% higher as compared to the same reporting time in the previous year. EPHI estimates the proxy GAM rate

24 With appreciation to WHO key data and analysis. Any errors of interpretation are that of UNDP alone.

for Under-fives in conflict-affected areas in Amhara at 21.3% with SAM rates reaching 5.9%. Although no comprehensive nutrition surveys have been possible in the three regions, a rapid nutrition assessment conducted in four IDP sites in mid-April 2022 in Tigray revealed U5 GAM rate of 62%, which is critically higher than the emergency threshold of 15%. In Afar, the latest rapid nutrition assessments conducted in 5 IDP camps showed GAM rates reaching 40.7%. Similarly, the find treat campaigns carried out in the three regions show very high levels of acute malnutrition among PLW with highest rates peaking at 65.3% in Tigray, 50.7% in Afar and 40% in Amhara. Moreover, stable households like civil servants including teachers and health workers have equally become vulnerable due to unavailability of cash for salaries for several months. The cost of food has exponentially increased with reducing spending power of the community thus increasing the number of food-insecure households and minimal yield from farming. 1.6 million children under five years and pregnant and lactating women in Tigray, 1.4 million in Amhara and an 80,000 in Afar are in need malnutrition preventative and treatment interventions.

> **Morbidity trends: The consequence of the conflict and associated weakening of the healthcare system poses serious threats on the affected population especially in exacerbating disease outbreak risks.** These include waterborne diseases (cholera, typhoid fever, typhus, leptospirosis, amoebiasis, E.Coli associated diarrhea, scabies, etc.), airborne/contact diseases (ARTI, measles, meningitis, monkeypox), and vector borne diseases (malaria, dengue). Numerous malaria cases have been reported, specifically in Amhara and Tigray, following the interruption of control activities in the conflict-affected woredas and kebeles. According to PHEM data, higher malaria caseloads have been observed in January to August 2022 compared to a similar period in 2020. As of week 26, 2022 (mid-year), the number of suspected/confirmed measles cases reported by PHEM were more than double in the same period in 2021 reflecting the adverse impacts of the ongoing humanitarian situation in the northern region and resultant interruptions in the health services delivery interrupting routine immunizations. This is further compounded by overcrowding in residential camps that greatly increases the risk of this infection. Continuing remedial measures are undergoing, including catch-up vaccination campaigns, extensive case finding, laboratory investigation, clinical management, and case isolation.

The ongoing COVID-19 pandemic is adding a burden to the overstretched healthcare system in northern regions. Whereas Ethiopia stands out as one of the countries with the highest vaccination coverage in Africa, conflict-affected areas in Afar, Amhara and Tigray are largely deprived of access to vaccines. The reporting of COVID-19 cases has been frequently disrupted in Tigray, due to lack of testing materials (reagents, RDTs). Available data shows, with interpretation caveats, positivity rates above the national average with 2% in Afar, 8% in Amhara and 41% in Tigray (week 20/2022). Finally, conflict-affected regions are marked by limited community awareness and adherence to preventive measures and weak capacity for treatment due to limited functionality of ICUs and previously designated treatment centres as well as limited availability of critical supplies (e.g., oxygen).

> **As the figures above attest, there has been extensive damage to health facilities across Northern Ethiopia, from health posts to hospitals, substantially impairing service delivery and putting lives at risk.** While there are no estimates of excess morbidity and mortality caused by the combined impact of shocks, the reduction and or absence of vital services – immunization, maternal and child health (MCH), disease surveillance and management, COVID-19 vaccination and treatment – can be expected to have had serious effects. Compounding matters, water supply and sanitation (WASH) services – whether hand dug wells and bore holes in rural areas or piped water supply systems in urban areas – have also suffered substantially, increasing the likelihood of waterborne diseases and higher related morbidity and mortality. The combination of food scarcity and increased morbidity also make themselves evident in substantially higher rates of child malnutrition. The overburdened health system, with more than 2,000 non-functional health facilities, as estimated in the Federal Ministry of Health (FMOH) Recovery Plan, cannot cope with increasing health needs.

## E. Gender

> **While reliable numbers are difficult to obtain due to the nature of the issue, sexual and gender-based violence (SGBV) has been a serious concern associated with the conflict in Northern Ethiopia, as reported by the Ethiopian Human Rights Commission (EHRC) in its joint report with UNOHCHR.** While the Government has expressed some reservations about the report, it has committed itself to addressing many of the issues raised in it, including on SGBV, with an inter-ministerial task force and prosecutorial teams set up to ensure effective follow-up. Indeed, documentation is being gathered already in more than 10,000 cases, according to Ethiopia's Ministry of Justice. Follow-up action on accountability is, thus, the next logical step in this process.

## F. Agriculture and Food Security

> **The Ministry of Agriculture Recovery Plan (2022) shows that the conflict in various parts of the country, particularly Northern Ethiopia, has had significant impact on farming activities given their overlap with major farming preparation and harvesting seasons.**[25] Impacts go beyond the immediate loss of food and seed stocks to lowering future productive potential due to lost oxen for cultivation, breakdown in the broader agricultural 'ecosystem' (credit, inputs, extension, cooperatives, marketing), scarcity and rising costs of fertilisers, damage to infrastructure (roads, bridges, power supply, mobile communications and so on), environmental damage (to forests, water sources) and the presence of unexploded ordnances (UXOs). According to the preliminary analysis, ready harvest has also been looted and burned. Food insecurity has worsened in Ethiopia. UNOCHA notes a significant level of food insecurity among the 5.2 million IDPs and 15.2 million non-displaced but at-risk people in Ethiopia at present.

> **The Humanitarian Response Plan (HRP) for 2022, estimates that over 9 million people will require food assistance in the Northern Ethiopia regions throughout 2022.** The numbers could be much higher due to the persistent hard-to-reach areas in Tigray, Amhara and Afar and due to the increased number of IDPs in parts of Amhara and in Afar. UNOCHA notes a significant level of food insecurity among the 5.2 million IDPs and 15.2 million non-displaced but at-risk people in Ethiopia at present.

**Overall, data compiled already for Tigray in the Government's Emergency Recovery Plan for this region (ERP-T) provides extensive documentation of the scale and impact of conflict in that region and requirements for recovery and reconstruction.** Additional data and plans forthcoming from a nation-wide assessment of conflict impacts and recovery and reconstruction needs will provide the same for Afar, Amhara, Benishangul-Gumuz, Oromia and Southwestern regions.

25 In Amhara region, 783,909 hectare of food crops; 244,953 hectares of cash crops; and 266,852 hectares of export crops have been damaged. Similarly, in Afar region, in 5 zones and 13 woredas 4,500 hectares of farmland accounting for 46,351 quintal of food production has been damaged.

## G. Humanitarian Impacts

**Conflict and insecurity in addition to the effects of climate change are the main driver of humanitarian needs in Ethiopia[26].** Recurrent climatic shocks such as floods and droughts continue to lead more people into humanitarian need[27]. The frequency and intensity of extreme weather events is likely to increase over the coming decade, posing a serious threat to biodiversity, ecosystems, water, agriculture, and human health. At the end of 2021 the country witnessed its fourth wave of COVID-19. While the Government has taken several measures to limit the widespread of COVID-19, including launching a vaccination campaign as of March 2021, vaccines were received with some hesitancy. In the drought-affected areas, people are at a higher risk of contracting communicable diseases such as cholera, measles, meningitis, and yellow fever. The intensification of shocks in the country such as conflict, drought, floods, and disease outbreaks have caused a substantial increase in the number of people in need in comparison to previous years.

**The most vulnerable people include displaced populations, those non-displaced population living in conflict and/or drought-affected areas, refugees, and returning Ethiopian migrants[28].** According to the 2022 Humanitarian Response Plan (HRP), which focuses on the combined impact of conflict and drought, a total of about 24 million people are estimated to need humanitarian assistance in Ethiopia in 2022, nearly three quarters of whom are women and children.[29] **This means, in effect, that almost one in five Ethiopian will need assistance in 2022 which is exceptional compared to peak caseloads registered in recent years.**

Across southern and southeastern Ethiopia, prolonged drought, attributable to four consecutive years of below-average rainfall since late 2020, has affected the lives of 6.8 million people.[30] The 2022 HRP, therefore, requires $US 3.09 billion to assist almost 24 million people across the country. This includes 5.5 million internally displaced people (IDPs), 18 million other affected people, and 42,000 returned migrants. There has also been the death of 1.5 million livestock due to the drought in southern Ethiopia, affecting farmer incomes.

26 The conflict in North Ethiopia, during 2021, has intensified and expanded from Tigray to the neighbouring regions of Amhara and Afar. Insecurity has also affected other areas of the country due to violence caused by the presence of Unidentified Armed Groups (UAG), and inter-communal tension in different areas such as Benishangul Gumuz, Oromia and Southern Nations, Nationalities, and People's Region (SNNPR).

27 Many southern and south-eastern pastoral areas experienced consecutive below normal rainfall in late 2020 and early 2021 resulting in lower-than-normal pasture and water availability. At the time of writing, a fifth consecutive below-average season is further intensifying the impacts of the drought which has been spreading to other areas and regions of the country.

28 While all the shocks determining these humanitarian conditions were already present in 2021, these have intensified and expanded to different areas of the country and caused a substantial increase in the number of people in need.

29 Ethiopia 2022 Humanitarian Response Plan.

30 UNOCHA (2022), Ethiopia Humanitarian Fund Allocation Strategy.

**Box 2: Drought Impact in southern and southeastern Ethiopia**

One of the major crises facing Ethiopia is the drought in the southern parts of the country. According to the HRP 2022, the prolonged drought has affected the lives of 6.8 million people living in Oromia, SNNP, Somali and Southwest regions. The drought has deteriorated during the rainy season in March and April 2022.

These regions are mostly agro-pastoral and agricultural lowland regions, relying on crop and livestock production. Remote from the conflict-affected Northern regions, they experience volatile growth and low private investment and are fiscally dependent on central government block grants to support their development programmes.

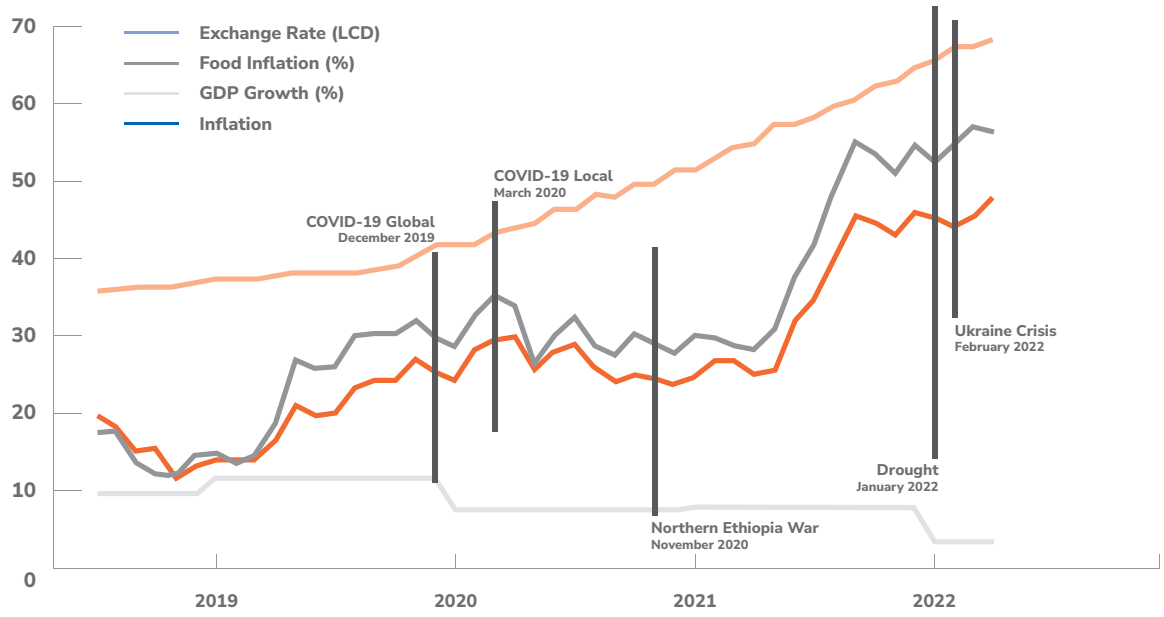
The impact of the recent drought has been significant, in terms of human migration. Nearly 300,000 drought-affected people have migrated in search of water, pasture, or assistance. There are significant risks of starvation. On top of that, there are livestock deaths, diminishing pasture lands, crop losses, and water shortages. According to the International Organization for Migration (IOM), at least 1.5 million livestock have died across drought-affected parts of Ethiopia. UNOCHA estimates that at least seven million livestock have died across drought-affected Horn of Africa (HOA) countries.

The concern among both policymakers and the donor community is that the drought situation in the southern and southeastern regions could turn into a chronic problem. Most recent forecasts project that the October to December 2022 season will also be below average, setting the stage for an unprecedented fifth failed rainy season.

## A. Economic Impact

The shocks have had a significant economic impact. Figure 7 below shows the cumulative negative impacts of the shocks on exchange rate, GDP growth, and inflation from March 2020 to the present.

**Figure 7: Impact of Shocks on the Ethiopian Macro-Economy**




**Source: IMF, NBE, CSA.**

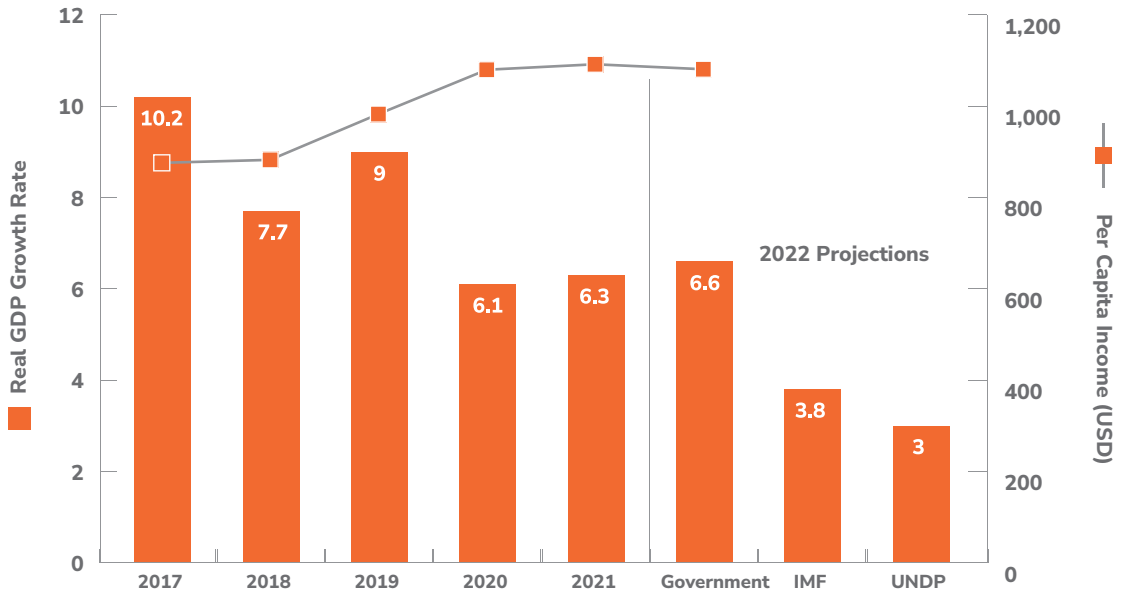
### *Internal Balances*

**The shocks have worsened internal balances.**[31] They have led to a **decline in economic growth**. In 2021, according to the Government estimates, the economy grew by 6.3%, lower than the official projection of 8.7% (Figure 8). This was caused by the negative impact of the multiple shocks on domestic production, coupled with a decline in external support. Government estimates that GDP in 2022 is 6.6% rather than more than 9%. However, the UNDP has estimated a growth rate of 3.0% for 2022 and the IMF has projected 3.8%. A lower estimate has been made by Cepheus, a well-respected Ethiopian consulting firm, which projects real GDP growth closer to 1% in 2022. Contractions across the economy account for lower growth performance. Considerations include damage to agricultural production in Northern Ethiopia: Amhara contributes to more than a third of the total annual grain production in Ethiopia while Tigray contributes about 6%.[32] Moreover, there has also been lower exports orders connected to suspended access to benefits under the African Growth and Opportunity Act (AGOA). The construction industry and tourism have seen declines as well. High frequency data show significant declines in 2022 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%) and external grants (-17.5%) (Cepheus, 2022).

31 The internal balance is defined as the level of output consistent with both full employment and a sustainable rate of inflation.

32 Oromia is the leading grain producer in Ethiopia and accounts for about 50 % of total grain production (Agriculture Sample Survey, Ethiopia Statistics Service, 2021).

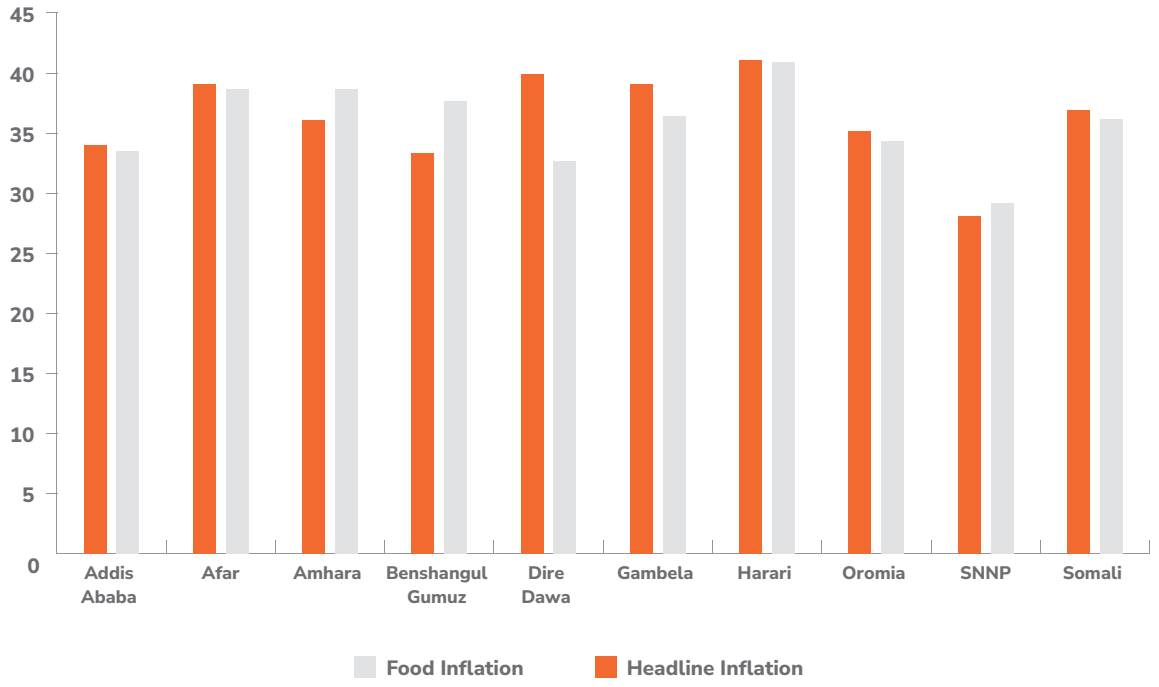
Figure 8: Real GDP Growth 2017-2022 (%)




Source: Ministry of Finance, UNDP, IMF

**Inflation reached a high of 37.2% in May, with a slight deceleration to 32.5% in August 2022.** The August 2022 year-on-year food inflation rate was lowest rate in Addis Ababa at 29%, in contrast to all the other regions which had shown a food inflation ranging between 35 and 40% (Figure 9).

Figure 9: August 2022 Year-on-Year Inflation Rate at Regions (%)

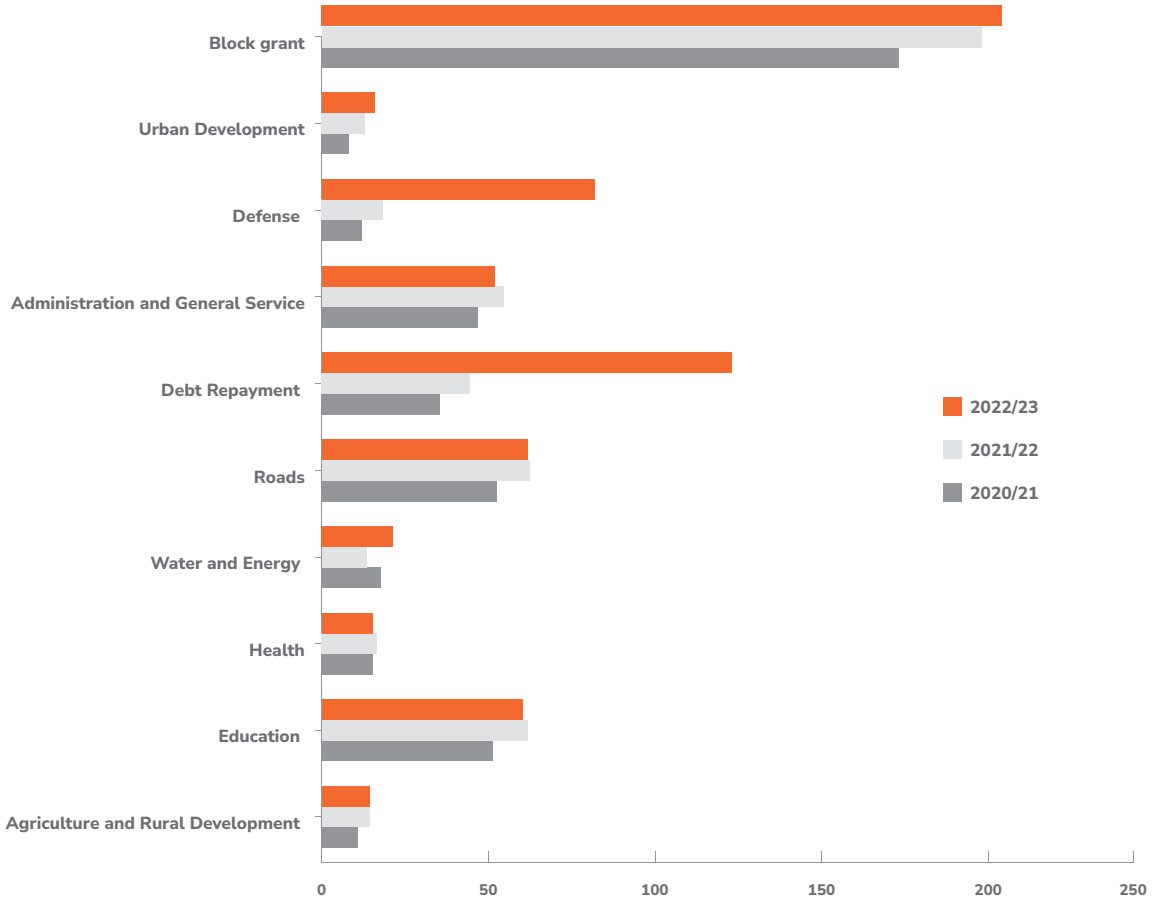



Source: Constructed based May 2022 CPI data from Ethiopian Statistical Services (ESS)

**The fiscal deficit in Ethiopia is projected to increase from less than 3% of GDP in 2021 to more than 5% in 2022**. Historically, Ethiopia has managed its fiscal position well, with the deficit remaining below 3%. The recent departure from this track record is due to a combination of revenues – fluctuating between 9-12% of GDP – not keeping pace with increased spending on the war and

recovery, exacerbated by a reduction in aid. Between July 2021 to March 2022, domestic revenues increased by 7.7% over the same period in the previous year while expenditures were up by 32.6%. The original 2022 deficit plan was Birr 125.7 billion (2.1% of GDP). The fiscal deficit (excluding grants) during July 2021 – March 2022 was more than Birr 150 billion (revenues were Birr 265.4 billion compared to Birr 410.2 billion in expenditures), substantially higher than the figure for the same period of the previous year which was Birr 5.1 billion. A major reason for the expansion in public expenditure can be attributed to increases in defence spending, debt servicing and humanitarian assistance noting, however, that the Government has successfully maintained relatively stable levels of spending (in nominal terms) on social sectors and managed to increase block grants to regions (Figure 10). Financing the deficit through accommodative monetary policy (T-bill issuance and central bank advances), while helping the emergence of a debt market, may have the added risk of crowding out the private sector and fuelling inflation.

**Figure 10: Sectoral Allocations of Federal Budget 2021-2023 (Birr Billion)**



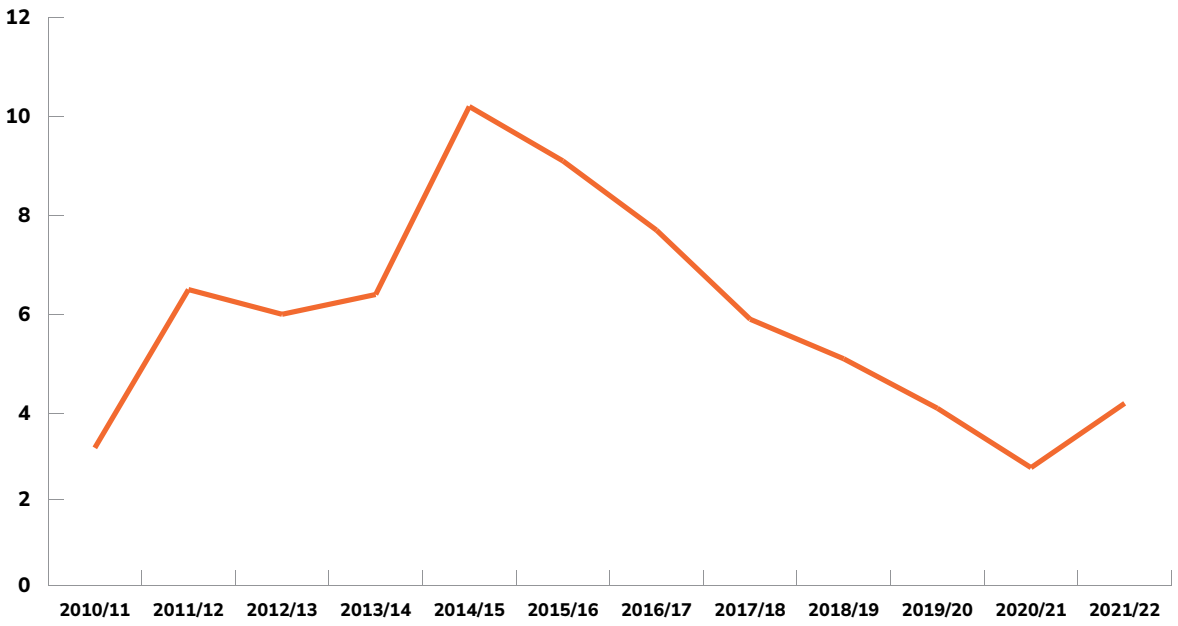

**Sources: Ministry of Finance.**

**Overall, the fiscal deficit remains manageable but a gradual return to fiscal tightening over the medium-term will be necessary.** It will be hard, therefore, at least in the short-term, to dampen inflationary pressures using fiscal measures due to a combination of factors: the absence of strong buffers that makes it difficult for the Government to maintain the fuel subsidy or reintroduce the wheat subsidy which was phased out a few years back; limits on local debt financing; significant reliance on financing from the central bank that could be inflationary if pushed further; and falling aid flows.

## *External Balances*

**The country's external balance has worsened, due to a widening current account deficit,** from 2.9% of GDP in 2021 to 4.2% of GDP in 2022 (Figure 11). Imports increased in 2022 to $US 18.1 billion compared to an average import bill of about $US 15 billion in the preceding two years (Figure 12). The silver lining for Ethiopia has been resilience in remittances inflows, which have been countercyclical in 2022, reaching an estimated $US 5.6 billion. Furthermore, strong performance of coffee exports has provided an additional buffer. The value of coffee exports reached $US 1.4 billion, a 57.3% rise in value and 22% increase in volumes compared to 2021. On the downside, official transfers have fallen $US 1.1 billion in 2022 compared to $US 1.5 billion and $US 1.4 billion in 2020 and 2021, respectively. According to Ministry of Finance, official development assistance (ODA), which also includes loans, declined from $US 4.7 billion in 2020 to $US 3 billion in 2021 and to $US 2.7 billion in 2022.

**Figure 11: Current Account Deficit (including Grants) 2011-2022 (% of GDP)**



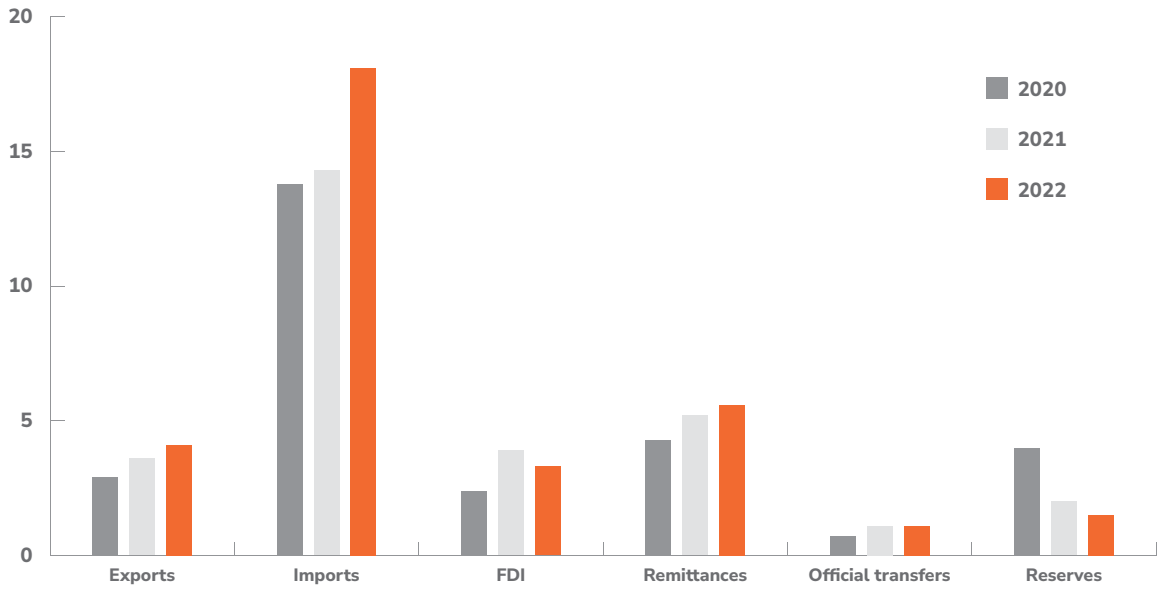

**Sources: UNDP estimates.**

**One major development is the drop-off in external financing.** Critical element are the delay and suspension of the IMF programme, the slow pace of implementation of the G20 Common Framework on debt restructuring and a significant decline in ODA, including the temporary suspension of direct budget support (DBS), which have had important cumulative effects on Ethiopia's internal and external balances. To provide some background, the IMF Board approved a three-year, $US 2.9 billion programme in December 2019 to support macroeconomic balances and reforms. The programme disbursed $US 309 million until it was suspended in September 2021. In the same month, the Government of Ethiopia formally requested the Fund for a new loan programme. In parallel, the Government requested support from international creditors to finalize the G20 Common Framework for debt treatment as Ethiopia seeks to rework nearly $US 30 billion in external debt and average annual payments of about $US 2 billion in debt service that constitute a major drain on reserves and the budget. Finally, the decline in ODA from $US 4.7 billion in 2020 to $US 3 billion in 2021 and $US 2.7 billion in 2022 - a 43% decline over three years - has added to the pressure. One way to look at the cumulative impact of debt service, the absence of an IMF programme and a fall in ODA is to see what the loss is in terms of months of import cover: this adds up to about 3 months of imports at the substantially higher level of oil prices reached in 2022. This is coincidentally the minimum level recommended by the IMF. **This has undoubtedly been a large hit to the economy.**

**Foreign reserves are declining and reaching levels that should be a cause for concern.** In 2022, foreign reserves reached $US 1.5 billion in June closer to one month of import coverage compared to about $US 3.5 billion in 2020, before all the combined shocks, thus, clearly under significant pressure. **Meeting the country's external financing requirements is, therefore, a key challenges in the macroeconomic outlook for the next 12-24 months.**

**Ethiopia could be impacted by potential decreased inflows of FDI.** Despite the triple shocks, Ethiopia has benefited from privatization of its telecoms sector. Government data show that FDI increased from $US 2.4 billion in 2020 to $3.9 billion in 2021 but fell to $US 3.3 billion in 2022. The country attracted 118 investors in manufacturing, services, and agriculture during the first nine months of 2022. The concern is that continued uncertainty around the conflict in Northern Ethiopia, substantial challenges in accessing forex, constraints to the repatriation of profits and the Ukraine conflict may lead to a worsening of the investment environment in Ethiopia and a further drop in FDI.

**Figure 12: Ethiopia External Sector 2020-2022 ($US billion)**




**Source: NBE Annual Report, UNDP estimates.**

**The exchange rate remains misaligned** due to a policy of gradual depreciation, to prevent the currency from sliding too rapidly over a short space of time which would generate an economic shock of its own. The Government's strategy to manage the currency has focused on depreciating the Birr by about 25% a year. Anecdotal evidence from traders suggests that the black-market rate reached 75 Birr/$US in July 2022 – and has gone higher in September to more than 80 Birr/$US – putting pressure on the local currency and reflecting a progressive widening of the gap in the last few years. The rising black-market premium, coupled with falling reserves, remain significant risks in the short-term.

**Debt.** Ethiopia's total debt-to-GDP at 50.7% is high, leaving little room for debt to function as an important source of financing for recovery and development. About 25.1% is accounted for by domestic debt, and 25.6% by external debt. The number has declined in the last few years as the country has taken timely action to avoid contracting new external debt and reduce payments to state-owned enterprises. A reasonably high debt service-to-export ratio of just under 20% in June 2022 remains a challenge. There have been discussions with the G20 on possible debt restructuring (including maturity extensions) under the G20 Common Framework to reduce debt vulnerabilities. In

July, the creditor committee meeting, co-chaired by China and France, took place in Paris.[33] Discussions are ongoing as of September 2022, including the possibility of an IMF lending programme provided several enabling conditions are met. As is clear from the analysis of the macroeconomic situation in Ethiopia, the country will benefit from a reduction in its debt servicing obligations to create fiscal space for recovery and sustainable development as well as relieve pressure on its external accounts. Annex 3 gives detailed data on debt dynamics.

**The bottom-line is that Ethiopia needs a reduction in its total external debt and debt servicing obligations to have the fiscal and forex breathing space to accelerate recovery and return to a high growth and development trajectory. This is an essential policy consideration for the short – to medium-term, together with a restoration of higher aid flows and an increase in domestic resource mobilisation.** Table 3 below provides an assessment of the macroeconomic impact of each shock.

**Table 3: Impact of Shocks on the Macro-Economy**

| Shock | GDP | Inflation | Fiscal | Current Account |
|---|---|---|---|---|
| **COVID-19 PANDEMIC** | Led to lowest economic growth in the past 17 years due to an economic slowdown. Ethiopia was much less affected by COVID-19 than many other African countries. There has not been a recession<br><br>In 2020, economic growth fell to 6.1% from 9% in 2019, in line with the findings of the UN's Socioeconomic Impact Assessment | Pandemic-related closures led to global supply chain disruptions<br><br>Inflation went from 18.9% in January 2020 to 19.2% in January 2021, high but not showing as sharp an acceleration as expected | Led to increased spending and reduced revenues<br><br>Fiscal deficit increased from 2.5% of GDP in 2019 to 2.8% in 2020, well within desired policy parameters | Mixed effects as an increase in merchandise exports, offset by decline in remittances in 2020 by 20% compared to 2019<br><br>There was a decline in the import bill for fuel by about 20% mainly due to the decline in global fuel prices following the pandemic outbreak but the cereal import bill was up by 41% in 2020 |
| **NORTHERN ETHIOPIA WAR** | Likely to have been the dominant factor in contributing to a decline in GDP growth from 5.0% in 2021 to 3% in 2022<br><br>Strong impact on agriculture and services. Limited impact on manufacturing | Contributed to increased inflation | Led to widening fiscal deficit worsening from 2.8% of GDP in 2020 to 5% in 2022<br><br>Cost of financing the war and humanitarian needs has led to a large rise in spending | Led to widening current account due to rising import prices and falling aid<br><br>Worsened pressure on the exchange rate and forex reserves |

33 Ethiopia's main creditors are multilateral creditors, Paris Club, and non-Paris Club creditors, including China, Saudi Arabia, Turkey, and UAE.

| Shock | GDP | Inflation | Fiscal | Current Account |
|---|---|---|---|---|
| UKRAINE CONFLICT | Negative effect on GDP but it is too early to make a quantitative estimate<br>Higher cost of fuel and fertilizer will affect agriculture, services, and manufacturing in 2022-23 | Big driver of inflationary surge to more than 37% in May 2022<br>Led to higher costs of wheat, oilseeds and fertilizer | Not a major direct contributor to a widening fiscal deficit<br>Decline of aid, partly linked to conflict and diversion of donor finance to Ukraine | Significant deterioration in the current account deficit, which doubled in the first six months of 2022, resulting mainly from continued surge in import bills due to global commodity and fuel price hikes<br>Further stress on already strained forex reserves<br>Net FDI staying resilient but uncertainty looms over the horizon |
| DROUGHT | Localised impact on Ethiopian GDP as southeast Ethiopia is not a major contributor to output | Contributed to food inflation but difficult to ascertain relative magnitude | Not a significant driver of the widening deficit | Contributed marginally to widening the current account deficit due to insufficient local production |

## B. Comparison between the 'No Shocks' Baseline and Actuals

**Compared to the baseline in 2019, the combined shocks have had an unambiguously negative impact on macro balances.** The analysis has been conducted using the following sources: the **baseline assessment** is taken from the IMF January 2020 Article IV report and shows the projections of the IMF team for 2020 to 2022 for four key macro variables – GDP, inflation, reserves, and fiscal deficit; and **actuals/estimates** taken from the following sources – real GDP (UNDP estimate), reserves and inflation (National Bank of Ethiopia) and fiscal deficit (MoF's Medium-Term Macro Economic Financing Framework (MEFF)).

> Real GDP would have grown by 7% rather than 3% in FY2022 (Figure 13).[34] The difference between targeted and actual GDP growth rates in FY2021 and FY2022 suggests that more than $US 2.0 billion of potential output was unrealised due primarily to the impact of conflict.

> Inflation (end of year CPI) reached 34% in June 2022, falling from 37.2% in May 2022, rather than a baseline projection of 8% (Figure 14).

> In the absence of shocks, reserves could have reached more than $US 7.4 billion in 2022 (according to the IMF 2019 programme) rather than $US 1.5 billion (Figure 15).

> The fiscal deficit is projected at over 5% of GDP rather than less than 3% of GDP in 2022 (Figure 16).

34 In the report, a year relates to the fiscal year (FY) from July 8 to July 7 and not the calendar year. The UNDP estimate of real GDP growth uses as its point of departure the sectoral composition of GDP in 2021 and associated sectoral growth rates, adjusting them in its projection for 2022 utilizing a wealth of microeconomic, including high frequency, data to arrive at an estimate that reflects the real level of economic activity.

**Figure 13: GDP Growth Baseline vs Shocks (% of GDP)**

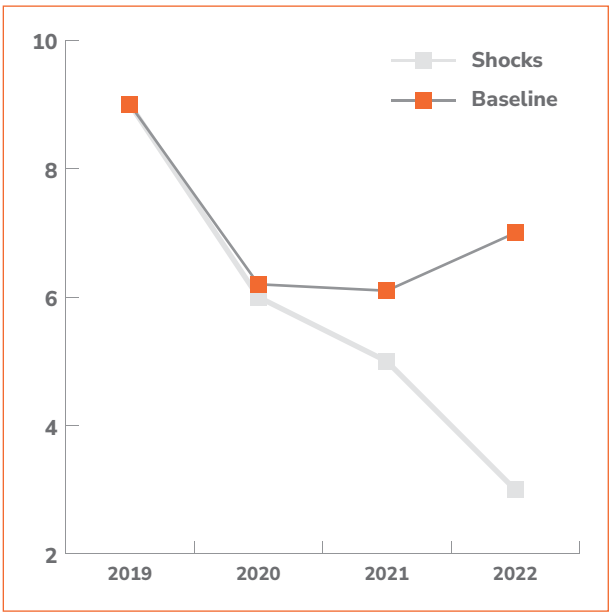



**Figure 14: Inflation Baseline vs Shocks (%)**

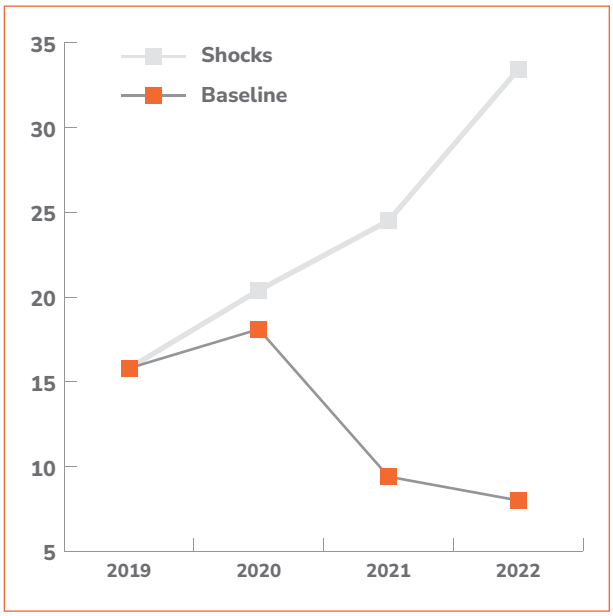



**Figure 15: Reserves Baseline vs Shocks ($US billions)**

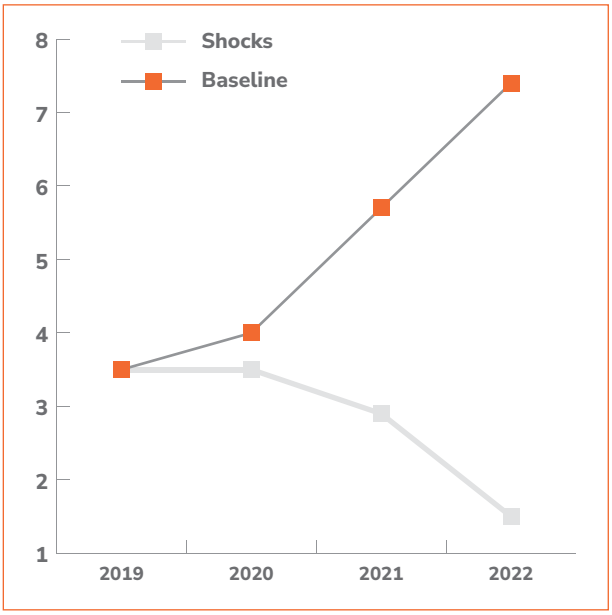
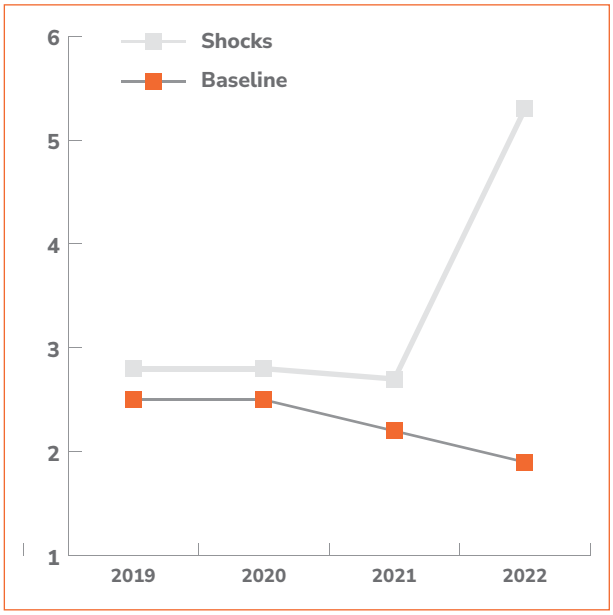



**Figure 16: Fiscal Deficit Baseline vs Shocks (% of GDP)**




**Source: IMF Article IV, MoF, UNDP estimates.**

## C. Macroeconomic Outlook 2023

**The combined shocks have dampened the medium-term macroeconomic outlook for Ethiopia.** In this context, the UNDP has prepared a **forward-looking macroeconomic assessment for 2023** based on an analysis of the country context (Table 4).

**Assumptions in the UNDP's Macroeconomic Analysis**

- Despite the fresh outbreak of conflict in August 2022, the balance of probabilities still favours an end to hostilities early enough in the fiscal year to contain downside impacts.
- No radical changes in the global or country context beyond what has transpired already.
- Higher prices for oil, wheat, and fertilizer will persist in 2023. However, there will be slight decrease in international oil prices due to global supply response. The IMF forecasts oil prices will average $US 106.83/barrel in 2022 and $US 92.63/barrel in 2023.
- Exports will be limited by weakening global demand given the state of the global economy. Coffee exports surged in 2022, and forecasts show growing risks of a global downturn in 2023.
- There will be considerable delays in the G20 debt restructuring process.
- There will be a pass-through of international oil prices to domestic consumers.
- There will not be any significant increase in ODA.

- **Growth.** For Ethiopia, according to the UNDP, growth will go down to 3.0% in 2022 and will be followed by an increase to 4.8% in 2023. In 2023, there will be a projected improvement in agriculture, services, and manufacturing. There will be a rebound of the services sector, especially finance, retail, and tourism, assuming the adverse impacts arising from the resumption of conflict are contained.
- **Inflation.** Inflation is projected to remain high at just below 30% in 2023 due to the combined effects of continued global high wheat and oil prices and exchange rate pass-through from a depreciating currency. A strong global supply response to increase wheat and oil production is also not expected to happen until 2024.
- **Fiscal deficit.** The fiscal deficit is expected to decrease slightly in 2023 to 4.6%, due to a slow increase in revenues (tax administration and indirect taxes) and continued expenditure on defence, debt service and humanitarian assistance. This draws upon the Government's medium-term fiscal framework which suggests that continued reliance on NBE and T-bills financing will be needed.

- **Current account deficit.** The current account deficit will narrow slightly in 2023 and is expected to remain close to 4% of GDP in 2023. Respectable export performance will be offset by a high import bill, due to continuing high prices of wheat and oil. Production of domestic wheat is envisaged to increase offering some relief and, if current projections by Government hold, even some room for exports. Exports will continue to increase but a potentially recessionary global environment could depress demand. Manufacturing exports will continue to underperform. The import bill will continue to remain high, due to expensive fuel, fertiliser and edible oil prices; wheat imports through the humanitarian channel are expected to continue as well in 2023. There may be some further import compression, especially of capital goods, and scarce foreign exchange will be used for debt servicing and essential imports. Public investment projects will continue to be reduced or slowed down. Remittances will increase. Grants are projected to stay the same, while FDI will decline slightly.
- **Reserves.** The level of reserves will remain close to between one to two months of imports in 2023[35]. External financing, whether through the IMF or other donors will be needed to boost the country's reserves position, to substantially reduce an important source of risk in the macroeconomic outlook.
- **Debt.** Total debt is expected to stay at close to 52% of GDP in 2023. Ethiopia's external debt position will continue to be sustainable but challenging. A debt service-to-export ratio of below 20% can still pose a challenge in terms of debt servicing obligations. A breakthrough under the Common Framework, coupled with an IMF lending programme, could help alleviate the debt situation considerably in 2023.
- **Financing.** The Government will continue to face a significant financing gap in 2023. The financing gap is projected to reach $US 1.3 billion in 2023 due to high import expenses and not enough offsetting variables. Exports are projected to increase slightly, while imports are projected to decrease marginally due to substitution through domestic wheat production and a decline in the international oil price. However, there will not be sufficient import compression to strengthen the reserves position. Overdependence on T-bills financing could have long-term crowding out effects on private sector growth. Given the debt overhang, the government will not be able to rely on non-concessional financing to meet external financing requirements, whether for macro or project financing, in 2023.

**Table 4: Macroeconomic Framework 2020 – 2023**

| | 2020/21 | 2021/22 | 2022/23 |
|---|---|---|---|
| **Macro** | | | |
| GDP Growth (%) | 5.0 | 3.0 | 4.8 |
| Inflation (%) | 21.5 | 36.6 | 30.0 |
| **Fiscal** | | | |
| Fiscal Deficit (% of GDP) | -2.8 | -5.3 | -4.6 |

35 The latest official data from the National Bank of Ethiopia show gross central bank reserves of $US 1.5 billion in April 2022. Data from the same month reveal that another $US 1.6 billion was held by commercial banks.

| | 2020/21 | 2021/22 | 2022/23 |
|---|---|---|---|
| **Trade** | | | |
| **Current Account** | | | |
| Current Account Deficit (% of GDP) | -2.9 | -4.2 | -3.8 |
| Exports ($US billions) | 3.6 | 4.1 | 4.4 |
| Imports ($US billions) | 14.3 | 18.1 | 17.9 |
| Fuel ($US billions) | 1.9 | 3.5 | 3.4 |
| Cereals ($US billions) | 1.3 | 2.2 | 2.0 |
| Net services ($US billions) | 0.3 | 0.6 | 0.6 |
| Private transfers ($US billions) | 6.1 | 7.5 | 7.5 |
| Official transfers ($US billions) | 1.4 | 1.1 | 1.1 |
| **Capital Account** | | | |
| Other investment ($US billion) | -0.7 | -0.6 | 0.0 |
| Foreign direct investment ($US billion) | 3.9 | 3.3 | 3.0 |
| **Overall Balance of Payments ($US billion)** | **0.3** | **-2.1** | **-1.3** |
| **Financing ($US billion)** | **-0.3** | **2.1** | **1.3** |

**Source: UNDP estimates; MoF fiscal forecasts.**

**Note: The growth projections are from the UNDP.**

## D. Macroeconomic Risks

**Looking ahead, Ethiopia's ability to continue to mitigate the adverse impacts of shocks is limited, whether in terms of fiscal space, ability to take on additional debt, or the state of its external accounts.** Indeed, a powerful indicator of the country's continued vulnerability, despite generally prudent macroeconomic management, is its international reserves position. This means that continued inflows of development assistance – and at a sufficiently high level – together with debt relief are essential for Ethiopia to successfully navigate the cumulative impacts of domestic and external shocks.

**The risks to growth are real.** Global trade disruptions and related commodity price increases are affecting farmers' use of agricultural inputs and, in turn, risk lowering productivity and output in 2022 and beyond; fuel price increases are feeding into supply chains and putting significant upward pressure on inflation; a depreciating exchange rate has broad impacts across the economy, on food inflation but also on the cost of imported raw materials and intermediate inputs that are utilized in agriculture, manufacturing and construction; and Ethiopia's suspension from AGOA affects the export sector and manufacturing employment. Any further rises in oil prices will lead to a further acceleration in inflation and place severe stress on Ethiopia's external accounts. There has fortunately been limited import compression affecting capital goods so far (a 5.8% decline in 2021), but if this increases, then the impact on medium – to long-term growth prospects could be significant.

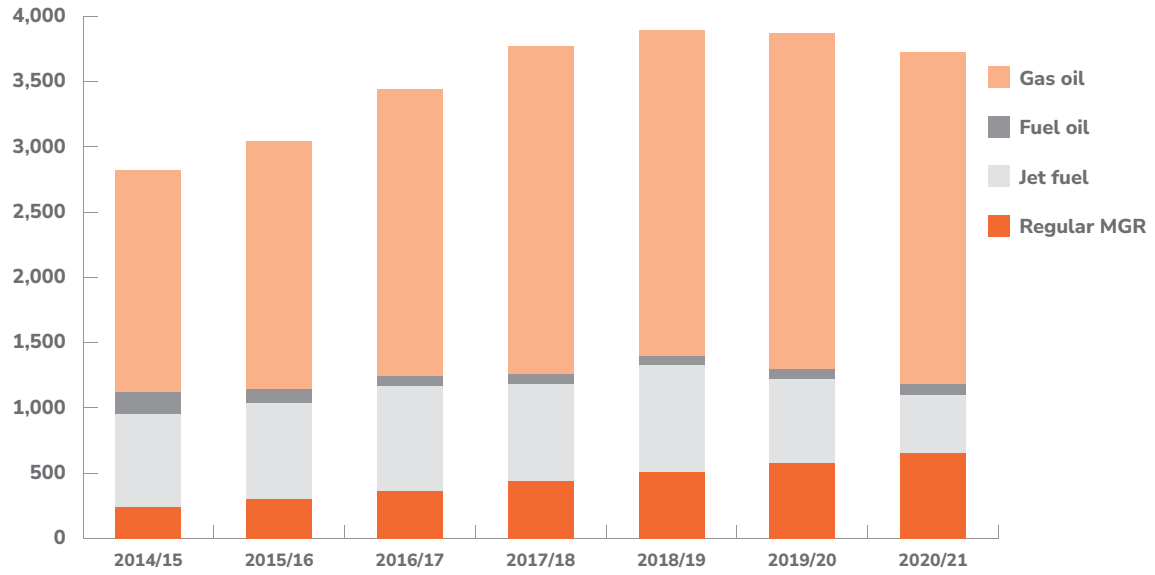
**As opposed to some developing countries, the Government does not officially provide a fuel subsidy but did introduce a Fuel Price Stabilization Fund in 2001.** The objective of the Fund has been to stabilize domestic fuel price by subsidizing the additional cost due to escalation of fuel prices utilizing resources generated when prices drop in the international market without a commensurate downward adjustment of domestic fuel prices. The management of the Fund has been a challenge. It is hard to obtain official data in this regard as there is no line in the budget that provides an assessment of the fiscal cost of the subsidy. UNDP estimates suggest a significant difference between market price and actual retail prices at present, suggesting a gap amounting to about 1 % of GDP (Annex 4).

**Ethiopia is an oil importer and a state-owned enterprise handles imports.** The Ethiopian Petroleum Supply Enterprise (EPSE) imports refined petroleum products including gasoline MGR, jet fuel, fuel oil and gas oil (Figure 17). Being a state-owned enterprise, it is not financed from the Government budget but borrows from the banking sector. Over the past three years, the average annual volume of petroleum import has been 3.8 million metric tons at an average annual cost of $US 2.16 billion. Ethiopia spent 13.5% of its total annual import bill in 2021 (or $US 1.9 billion) on fuel imports; and 19.3% of the total import bill in 2022 (or $US 3.5 billion) indicating a year-to-year increase of 84.2%.

**The domestic retail price of fuel is determined and revised periodically by the Ministry of Trade and these domestic prices are sometimes kept lower than the international price to avoid inflationary pressure.** The difference has been covered by utilising gains made when the international price is lower, using the Fuel Stabilization Fund. However, in the past few years the price of fuel in the international market has been rising, and the Stabilization Fund has been unable to cover the cost difference, thus, the EPSE fills the import gap. The Ukraine crisis has exacerbated the situation and the price gap between the international market and domestic retail price has widened. For example, currently the international price of gasoline MGR is about $US 1.35/litre while the domestic retail price in Addis Ababa is equivalent to $US 0.70/litre indicating that the domestic retail price of petroleum is much lower than the international price. This poses a policy choice either to subsidize or allow to pass-through of the international price. In early July 2022, the Government announced its plan to remove the fuel subsidy. Figure 18 below indicates trends in the fuel retail price in Addis Ababa. In response to increases in the price of fuel in the international market, domestic prices are also increasing but at a slower pace.

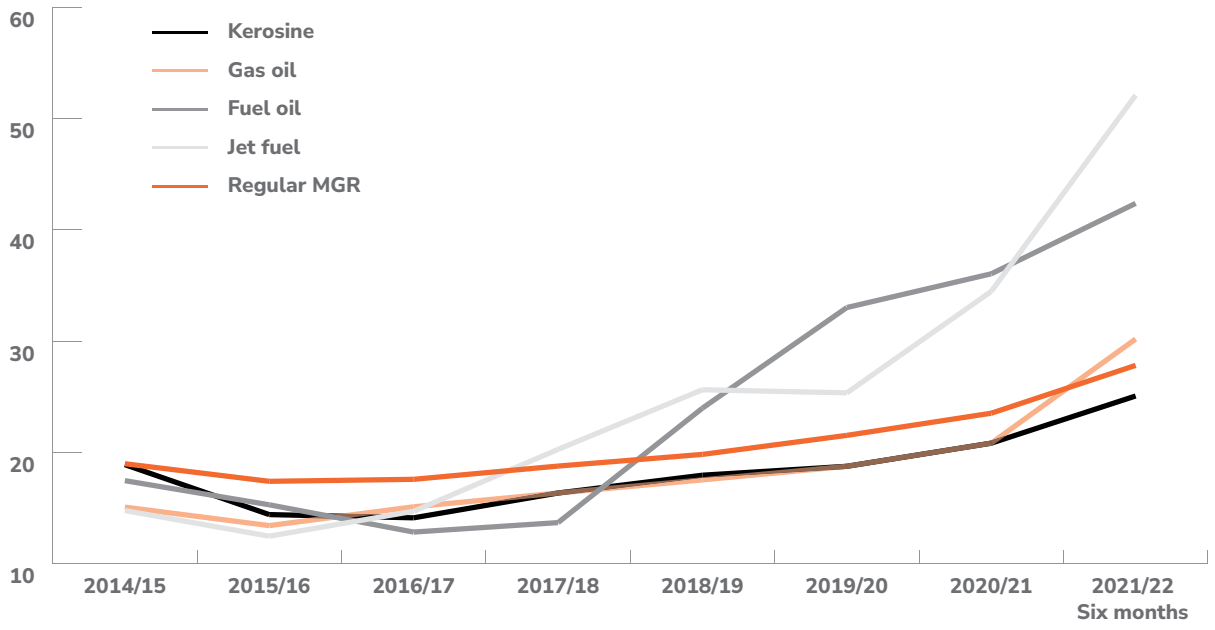
**The Government is planning to provide a targeted subsidy to public transport providers only and allow pass-through of the international price for the rest to address fiscal concerns, but this could have inflationary consequences.** The share of gasoline MGR (benzene) used by private vehicles accounts for about 17% and jet fuel for 13% of the total, while gasoil, which is used by trucks and industries, accounts for two-third of the total implying that the pass-through may lead to cost push inflation.

**Figure 17: Petroleum Imports 2015-2021 (Thousand Metric Tons)**




**Source: NBE annual reports**

**Figure 18: Annual Average Retail Price per Litre in Addis 2015-2022 (Birr)**




**Source: Computed from NBE annual reports**

**As mentioned, Ethiopia has been a net importer of wheat, with imports meeting 25% of its wheat demand yearly.**[36] Trade data indicates that Ethiopia imports 7 to 8 million quintal of wheat and fills the domestic production gap, due to the lack of significant marketable surplus.[37] The

36 Ethiopia imports wheat for both commercial and humanitarian use. The imports are done by both donors and the country's food logistic agency, Ethiopian Grain Trading Enterprise (EGTE).

37 In the past two years import of cereals has been increasing. In 2021 Ethiopia imported cereals worth of $US 1.3 billion and in 2022 cereals imports were valued at $US 2.2 billion indicating annul increase of 63.1%

Government is implementing a national wheat program, which aims to produce wheat for national food self-sufficiency and export through expanding irrigated wheat production in the lowlands and intensification of production in the highlands. In the past, Ethiopia has been importing and distributing wheat to flour mills at subsidized prices to stabilize the market, but that practice has been discontinued. The subsidy no longer exists. As a result, the domestic price remains above the international price, confirming both the absence of subsidy and the lack of market integration in the wheat market in Ethiopia (Annex 5). It is important to note that the global wheat price increased from $US 950/MT (metric ton) in January 2022 to $US 1056/MT in May 2022 and declined to $US 770/MT in mid-August 2022.

**In response to multiple shocks, the Ethiopian Government has demonstrated resilience in economic management and showed its commitment to macroeconomic stability and continuation of reforms, performing well in comparison to peer countries in Sub-Saharan Africa.** First, the country is managing its fiscal situation as prudently as possible through internal domestic financing, especially focused on the newly-developed Treasury bill market, with reliance on central bank advances acknowledged as an issue and designed to be temporary in nature. Second, on the fiscal side, the authorities have tried to manage pressures by protecting important macro-sensitive (e.g. debt payments) and social spending whilst dealing with rising security costs. This has been accompanied by prioritisation of growth-sensitive capital projects and, broadly, a temporary reallocation of spending from investment to recurrent items. Third, in the agriculture sector, the Government is implementing a major national wheat programme, which aims to increase wheat production for national food self-sufficiency and export through expanding irrigated wheat production in the lowlands and intensification of production in the highlands. Finally, the Government is opening-up the banking sector to foreign investors and liberalizing capital markets.

In terms of immediate priorities, the central goal has been to ensure adequate and timely import of pharmaceuticals, fuel, fertilizer, wheat, and edible oils (Ministry of Planning and Development, 2022), contain the fiscal effects, manage the debt load, and unblock the ODA pipeline. This approach has been prudent although some significant data gaps – especially on expenditures – constrain a full assessment of the policy response.

The fiscal year that started on July 8, 2022 can be seen as laying the groundwork for accelerating recovery in 2024, although there is room for debate on whether this will be V – or U-shaped recovery. As noted by Funke, Imam, and Granziera (2008), fast recoveries are robustly related to real exchange rate depreciation, improvements in government stability, the institutional environment, and a timely increase in aid. The timing for the Ethiopian recovery will depend on all of these variables. **At the heart of the matter will be the question of sustainable peace in Northern Ethiopia or at least confidence that large-scale conflict will be contained. The outbreak of fighting in August risks dampening expectations in this regard. The outlook with regard to the war in Ukraine will be another determinant factor as will the level of external financing for the economy.**

The policy recommendations that follow below are focused on options that could help Ethiopia navigate near-term macroeconomic risks whilst safeguarding human development, thus, protecting the foundations for sustainable growth and development in the medium-term. **It is worth emphasising, however, that the path ahead will not be easy due to the dilemma at the core of the choices confronting Ethiopian policy-makers: how to address unavoidable and pressing short-term priorities – such as debt servicing – without slowing down, if not reversing, the momentum of vital economic and other reforms.** The reality is that the tighter the fiscal and external financing situation turns out to be, the more acute will be the pressure to adopt measures, out of necessity rather than choice, that jeopardise medium-term to long-term growth and development objectives. **Allowing Ethiopia to reach this point is not in the interests of anyone. It could turn a tough situation into an intractable one.**

## Fiscal Policy

### *Short-Term (12-18 months)*

> **Reorient fiscal policy** through strategic prioritization and consolidation aimed at: (a) gradually reducing the fiscal deficit and the accumulation of debts to return to the Government's historic path of fiscal prudence; (b) protecting spend on human development-focused investments – social sectors, safety nets and humanitarian investment – if necessary by postponing or delaying lower priority capital investments; (c) gradually restoring funds for investment targeting high-

priority capital projects in jobs-intensive productive sectors and infrastructure development; (d) mobilising and allocating external grants and soft loans primarily to the social sectors, social safety nets and core governance functions to maintain a social and governance 'floor', enable an economic recovery, and generate a peace dividend; and (e) build on the momentum of rising domestic revenue mobilisation.

> Continue to **narrow the gap between global and domestic fuel prices** according to the Government's timeline of June 2023, to free-up fiscal space for investment and address the distributionally skewed benefits of fuel subsidies which tend to accrue disproportionately to higher income quartiles in urban areas. Continue the Government's policy of protecting the poor population through subsidized public transport.

### *Medium-Term (18 – 36 months)*

> Consider more **transparent reporting on** the fuel import system, assess the contingent liabilities imposed on the Government by public enterprises, and provide a **clear accounting** of the Fuel Price Stabilization Fund.

> Make a major push on enhanced **domestic resource mobilization** by improving tax administration and boosting tax collection. The goal needs to be to reach the sub-regional average by 2030 (a tax-to-GDP ratio of 15-16% with the aim of reaching at least 12% of GDP by 2025 through improved tax administration, further broadening of the tax base especially in relation to direct taxes (such as income taxes) and use of new taxes that are distributionally positive such as a property tax in urban areas.

> **Continue reform of SoEs,** as intended already through formation of Ethiopian Investment Holdings (EIH) and an asset management committee, to reduce the fiscal burden on Government and continue the policy of reducing borrowing by public enterprises. The Government's three track policy of keeping profitable SOEs like Ethiopian Airlines and Ethio Telecom in government hands, introducing competition in service sectors such as telecommunications and banking, and privatizing sugar SOEs and other loss-making entities should be sustained.

## Monetary and Exchange Rate Policy

### *Short-Term*

> Depending on the level of available external financing, continue **closing the gap between the official and parallel exchange rates,** to boost exports, improve external balances and increase revenues from trade taxes, especially if inflationary pressures subside heading into 2023-24. The timing of the reform will be contingent on having adequate buffers to manage the exchange rate during the transition.

> Consider a **monetary policy response to commodity price shocks,** especially the wheat and oil shocks. In particular, the National Bank of Ethiopia may want to reconsider its monetary policy framework and reduce broad money growth in 2022-23. Given the inflation situation, the authorities should pursue a tighter monetary stance and ensure that the policy framework corresponds to the realities of inflation.

### *Medium-Term*

> Aim for a **market-oriented exchange rate that essentially eliminates the parallel market premium.**

## Sectoral Policy

### *Short-Term*

> Improve **food security** by: (a) maintaining the push to expand domestic wheat production by improving irrigation-based cluster farming by having smallholders pool resources to purchase inputs and negotiate for better prices; (b) enhancing these measures to cover a wider range of crops and ensure that measures taken are sustainable over the medium – to long-term, going beyond 'quick wins' in output; and (c) prioritising the option of a Strategic Food Reserve.[38]

> Address key vulnerabilities that seem to be emerging in **social service delivery** (staffing, equipment and supplies, operational costs) through a 'Rapid Response Facility (RRF)' funded jointly by Government and development partners, involving flexible implementation modalities (public sector, UN, CSO/NGO) that can inject support quickly to prevent reversals in, and set a floor for, Ethiopia's human development achievements.

> Modelled on the RRF above, use the experience gained through **support for enterprises** during the peak of the pandemic – such as UNDP-supported Business Emergency Units and fast-disbursing grants – to cushion the impact of economic volatility and uncertainty on MSMEs, in particular.

> Examine measures that could unlock partner funding in the pipeline for the **PSNP**, including the urban PSNP.

### *Medium-Term*

> Follow through on the implementation of the recent Government decision on **liberalisation of the financial sector**, to boost financial inclusion, expand financing for MSMEs, and develop the capital market.

> Target an **acceleration of export earnings** through: (a) diversification of the export basket, including processed agricultural products, mining, and services (tourism, the creative industry and ICT/fintech); (b) increased value addition to exports including coffee; (c) strengthened efforts to boost the export potential of industrial parks based on significantly higher local content; and (d) attention to product quality, standards, and labour force development.

> Develop **an organized approach to the movement of labour to foreign markets** in order to: (a) safeguard rights; (b) enable planned growth in movements; and (c) increase remittances especially through official channels.

38 There was an independently managed Strategic Food Reserve (SFR) in the past. In 2020, the Government restructured it and brought it under the National Disaster Risk Management Commission (NDRMC now the EDRMC).

## Debt Management and External Financing

### *Short-Term*

> As the Government is doing already, **redouble efforts to build-up forex reserves** to a minimum of 3 months of import cover (about $US 4.5 billion) and reduce pressure on the exchange rate by: (a) encouraging increased remittances through official channels by creating a dedicated incentive framework for non-resident Ethiopians (much like other countries dependent on this source of income have done); (b) temporarily slowing down capital projects with high forex requirements unless these are deemed high priority; (c) accelerating the opening-up of the financial sector; (d) targeting issuance of the second telecoms license in 2023; and (e) making further progress on enabling conditions – especially, tangible progress towards a durable peace in Northern Ethiopia – that could see an increase in relatively fast-disbursing ODA heading into 2023-24.

### *Medium-Term*

> **Rebuild foreign exchange reserves** to levels covering up to 4-5 months of import cover.

> **Seek a reduction in external debt, not simply longer maturities, to support and sustain accelerated recovery from the impact of shocks,** that reduces pressure on reserves, creates vital fiscal space for investment and underpins an evolving peace process.

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## Annex 1: Technical Annex on Poverty

This technical annex describes in detail the methodological underpinnings of the poverty analysis. The poverty status of households in different regions has been measured using Foster, Greer, and Thorbecke (1984). The Foster–Greer–Thorbecke indices come from a long tradition of empirical poverty analysis. The most used index, this index puts higher weight on the poverty of the poorest individuals, making it a combined measure of poverty and income inequality. It has been used for many countries, especially in sub-Saharan Africa.

It may be written, quite generally, as follows:

$$P_\alpha = \frac{1}{N} \sum_{i=1}^{N} \left( \frac{G_i}{z} \right)^\alpha \quad \alpha \geq 0$$

where $\alpha$ is a measure of the sensitivity of the index to poverty and the poverty line is $z$, the value of expenditure per capita for the $i^{th}$ person's household is $x_i$, and the poverty gap for individual $i$ is $G_i = z - x_i$ (with $G_i = 0$ when $x_i > z$). When parameter $\alpha = 0$, $P0$ is simply the headcount index. When $\alpha = 1$, the index is the poverty gap index $P1$, and when $\alpha$ is set equal to $2$, $P2$ is the poverty severity index.

The index is the lowest parameter to weigh income inequality along with poverty.

## Annex 2: Poverty profile of Ethiopian regional states 2021 – 2022

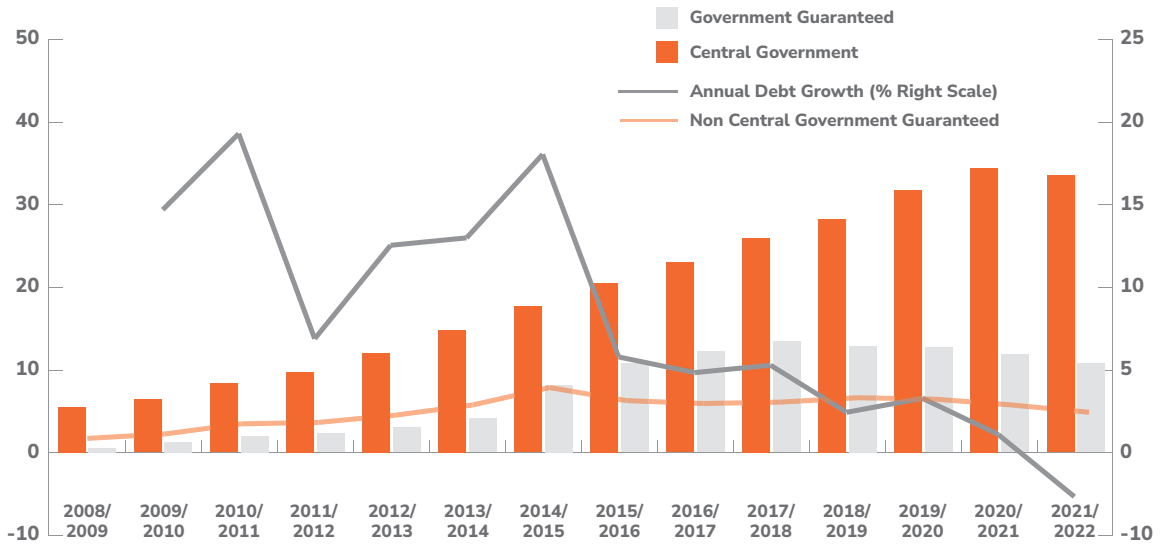
| | Head count | Poverty gap | Severity of poverty |
|---|---|---|---|
| **Tigray** | 0.45 | 0.17 | 0.09 |
| **Somali** | 0.31 | 0.10 | 0.05 |
| **Afar** | 0.30 | 0.06 | 0.02 |
| **Amhara** | 0.30 | 0.07 | 0.03 |
| **Benishangul-Gumuz** | 0.29 | 0.08 | 0.03 |
| **Gambella** | 0.28 | 0.08 | 0.03 |
| **Oromia** | 0.25 | 0.07 | 0.03 |
| **Addis Ababa** | 0.24 | 0.08 | 0.04 |
| **Dire Dawa** | 0.23 | 0.09 | 0.05 |
| **SNNP** | 0.22 | 0.07 | 0.03 |
| **Harari** | 0.09 | 0.03 | 0.02 |

**Source: UNDP – Ethiopia estimates**

## Annex 3: Debt Analysis

### Ethiopia: Debt Dynamics

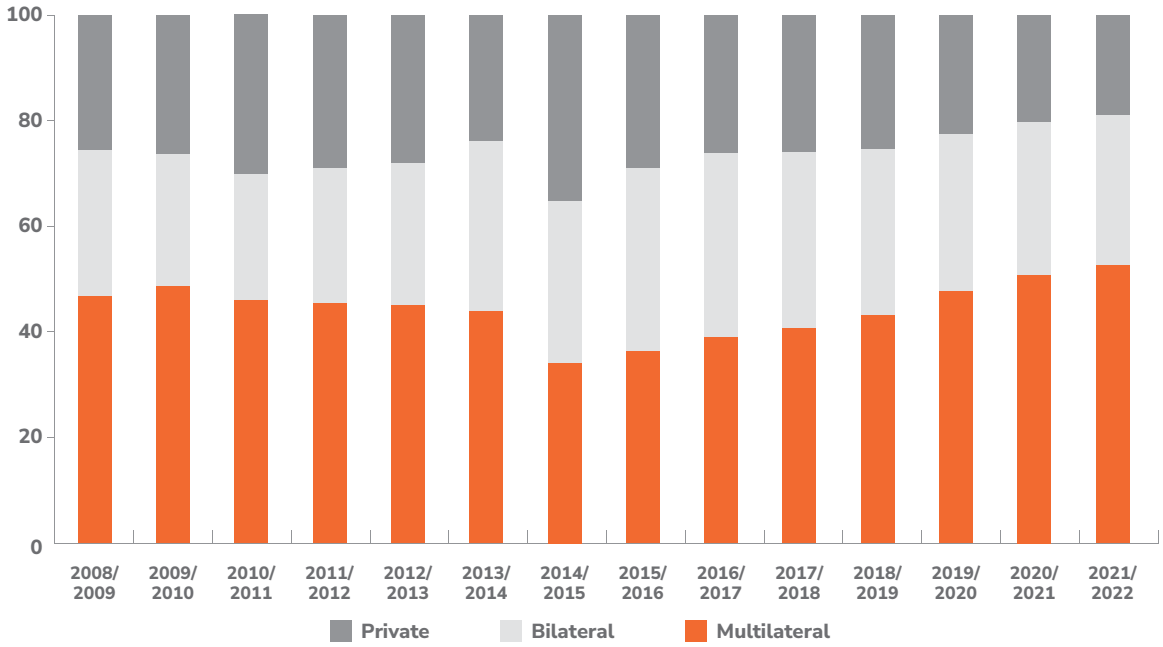
Ethiopia's stock of external debt reached $US 27.9 billion at the end of FY2022. This comprises central government debt of $US 19 billion contracted between the Ministry of Finance and creditors, government guaranteed debt $US 6.1 billion contracted between SOEs and creditors and non-government guaranteed debt of $US 2.8 billion contracted by public enterprises (mainly the Ethiopian Airlines and Ethiopian Telecommunication Corporation) and creditors. Over 60% of the debt is owed by central government followed by SOEs (government granted and non-guaranteed). Although the rate of increase was declining, the stock of debt has increased over fivefold in the past decade from $US 5.6 billion in FY2010 to $US 29.5 billion in FY 2021 but declined to $US 27.9 billion in FY2022 in which the stock of debt declined by 5.3% compared to its level of the previous year. The net resource inflows during the year were negative as disbursements during the year were lower than repayments on debts. Trends in the external debt stock by use and its annual growth are depicted in the figure below.




**Source: Ministry of Finance public sector debt bulletin 2022**

### Sources of debt

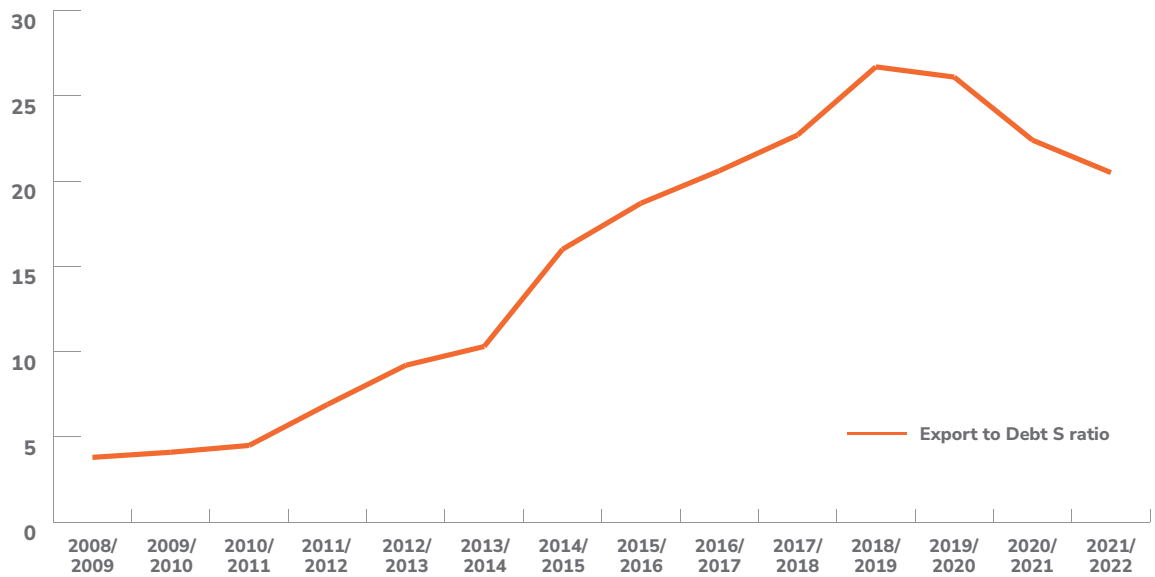
The sources of Ethiopia's external debt are multilateral institutions, bilateral creditors (Paris Club and non-Paris club) and private creditors such as commercial banks, suppliers, and Eurobond. On average over 60% of Ethiopia's external debt stock is from multilateral institutions such as the World Bank Group followed by bilateral creditors accounting for 30% and private creditors for 26%. The major sources of debt from multilateral is the World Bank Group and non-Paris club (China) from bilateral creditors. The figure below depicts the share of multilateral, bilateral and private creditors.




**Source: Ministry of Finance public sector debt bulletin 2022**

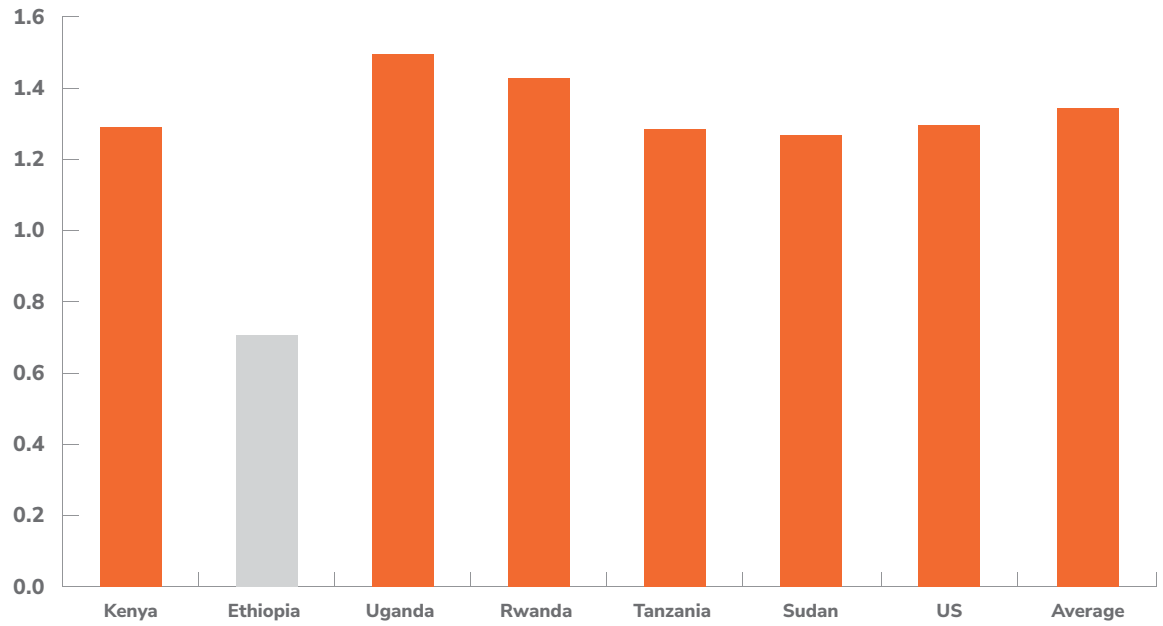
## Debt service to export ratio

According to the WB/IMF Debt Sustainability Analysis (DSA) Ethiopia is classified as high-risk category in the past few years. This is mainly because of high and rising debt service to export ratio. Both Ethiopia's stock of debt to GDP ratio (52%) and present value of external debt to GDP ratio (17.5%) are well below the 60% and 40% threshold, respectively for low-income countries. However, debt service to export of goods and non-factor services ratio has been increasing (see below) and well above 20%. Due to improving export of goods and service in the past two years and decline in the stock external debt, the debt service to exports ratio has fallen in the past two years but may still be above the required threshold to improve the classification to moderate or low risk status.



## Annex 4: Fuel Subsidy

Fuel price in Ethiopia is lower than the international price. Taking the August 2022 average retail price of gasoline in eastern Africa countries $US1.3435/litre, the retail price in Addis Ababa which is $US 0.707/litre covers only 53% of the cost implying that government is subsidizing 47% of the cost (Figure 1). The government spent $US 2.6 billion for fuel imports and according to the above calculation the subsidy is estimated to be $US 1.2 billion which has significant fiscal pressure. As of July 2022, government wanted to pass-through the international price and provide only targeted subsidy to public transport providers. The fuel stabilization fund has been working well for over the last two decades and it would be good to study why the fund did not cover the cost difference this time and take corrective measures.




**Source: UNDP – Ethiopia estimates.**

## Annex 5: Comparison between Global and Local Wheat Prices – An Ethiopian Paradox