Ethiopia

QUARTERLY ECONOMIC PROFILE

March 2023

Key Highlights

What's changed since 2022?

- **Economic Growth:** Growth in 2023 is projected to rebound to 5% in 2023 according to UNDP projections.
- **Inflation:** There has been a slight decline in headline inflation at 33.9% in January 2023 compared to 37.2% in May 2022 and 34% in June 2022.
- **Fiscal:** The fiscal deficit/GDP widened and is estimated at 4.2% for 2022. Projections for 2023 suggest a significant fiscal deficit.
- **Foreign Exchange:** Foreign exchange reserves in May 2022 were at USD 1.5 billion and may be significantly less than one month of imports in February 2023.
- **BoP:** Overall BOP deficit in 2022 was USD 2.1 billion. From July to December 2022, there was a decline in BOP deficit to USD 400 million, partly due to remittances and FDI inflows.

- Growth is projected to rebound to 5% in 2023.[1] The key drivers of the rebound are: resumption of economic activities due to the Pretoria Peace Agreement of November 2022, better performance of agriculture, and a rebound in the services sector. Despite continued global headwinds, including high oil and fertilizer prices, Ethiopia's performance will be in the top third of African economies in 2023. This is above the IMF projection of the mean of SSA countries, which is 3.7% in 2023.
- In 2023, the Government of Ethiopia continues to seek IMF programme support, resumption of ODA and debt restructuring with creditors under the G-20 common framework.
- The fiscal deficit in terms of GDP has widened to 4.2% in 2022 from 3.3% the previous year. The 2023 budget is heavily oriented towards defense and debt service, with reduction in social sector spending as a share of GDP. The Government spending has continued to tilt towards current expenditure. The focus on recurrent expenditure is expected to continue into 2023.
- Ethiopia's current account continues to face significant pressure in February 2023. The external sector has been largely affected by commodity price shocks. In 2022, there were USD 18.1 billion in imports and USD 4.1 billion in exports. The merchandise trade deficit from July to December 2022 reached USD 7.3 billion, showing a 10% increase compared to the level in the preceding year.
- Inflation continues to be in a high trajectory, including both core inflation and non-core (food and energy). Headline inflation stood at 33.9% in January 2022. Although the IMF forecast shows that global commodity prices may recede gradually through 2023, inflation in Ethiopia is expected to average above 30% in 2023.
- Exchange rate depreciation has continued into 2023. The official rate was Birr 53.5819/ USD but the black-market rate as of February 2023 was close to Birr 100/USD.
- Ethiopia's total stock of public debt stood at USD 57.15 billion (with external debt stock at USD 26.9 billion) at end of September 2022 which is 50.1% of GDP. External debt servicing payments of USD 2.1 billion in 2023 presents liquidity challenges. A USD 1 billion Eurobond is owed in December 2024. In December 2022, Fitch, an international ratings agency, downgraded Ethiopia's ratings due to lack of external financing to meet financing gaps. Standard and Poor's rating has been downgraded to CCC in 2022, and has remained with negative outlook. Moody's also rated Ethiopia Caa2, with negative outlook.
- The medium-term macro outlook is mixed and will depend on several parameters: the international environment, the reform programme, external financing, and debt restructuring among others.

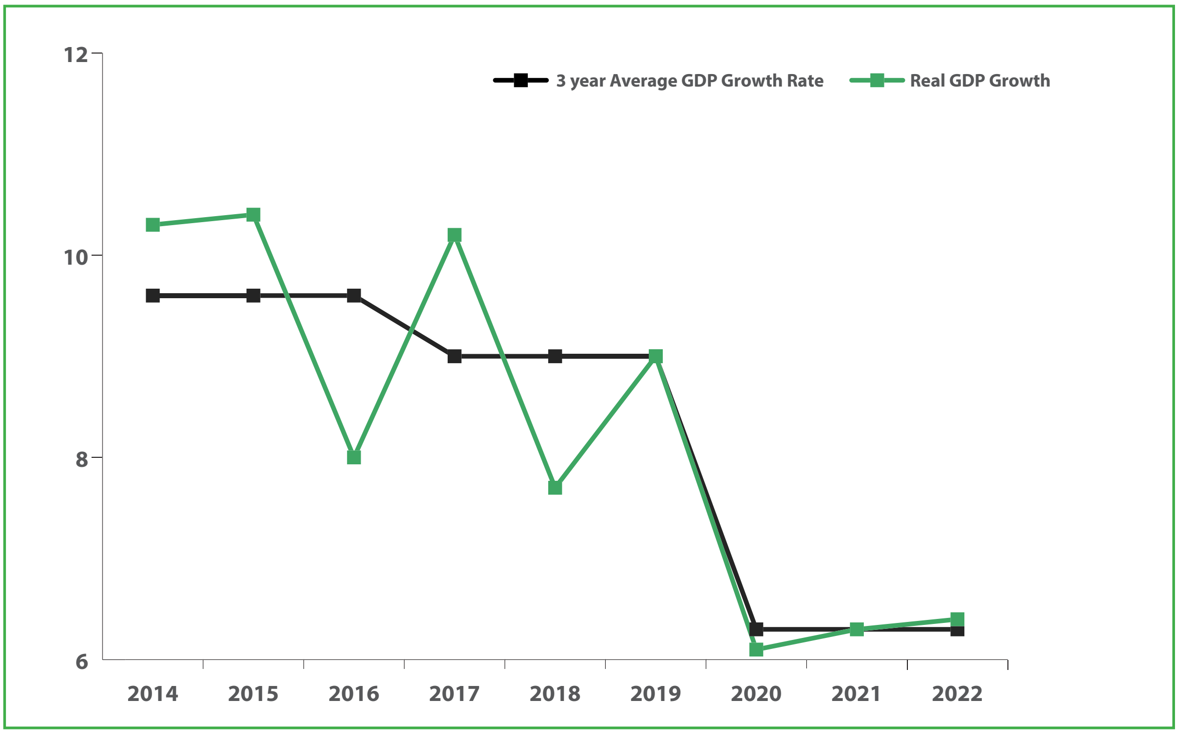
1 This is a UNDP estimate for the fiscal year.

1. Economic Growth

Ethiopia is emerging from multiple shocks that have been occurring in the past three years.[2] These shocks have adversely impacted the economy, resulting in a growth of the economy by annual average of 6% between 2020 and 2022 according to official data. This has been the lowest recorded growth since 2004.

The outlook for 2023 is expected to be less constrained than the previous three years. The cessation of hostilities in northern Ethiopia, decline in confirmed COVID cases with a scaled up vaccine administration,[3] and moderation in global oil prices will help improve economic performance. The key drivers of the rebound are resumption of economic activities due to the Pretoria Peace Agreement of November 2022, better performance of agriculture, consumption, and a rebound in the services sector. Nonetheless, policy slippages, particularly in relation to the macroeconomy, can negatively impact the country's growth prospects.

Figure 1: Trend in Real GDP Growth (%)



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

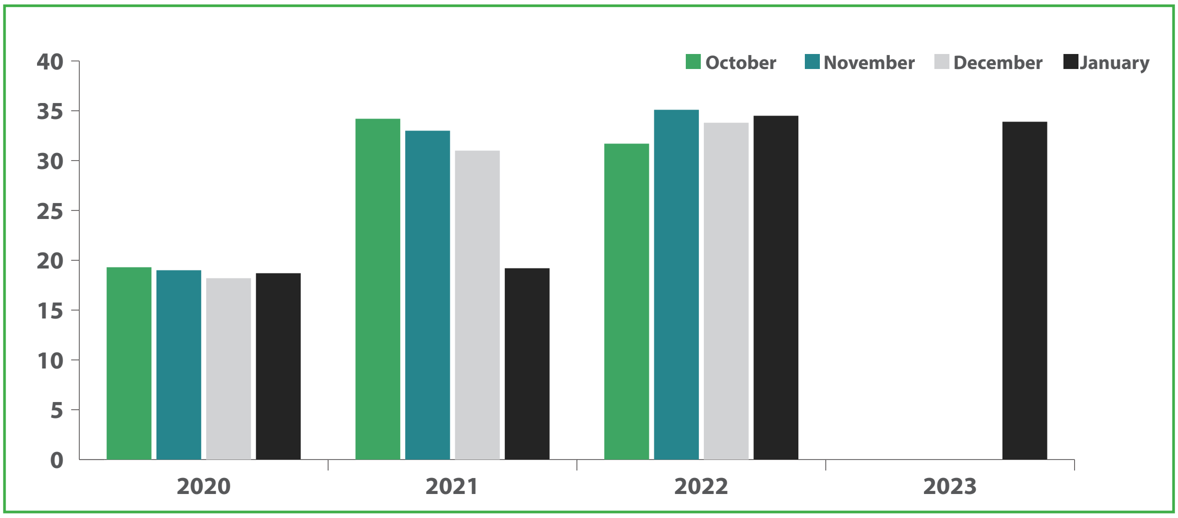
There is a persistent current account deficit, foreign reserves shortage, and high risk of debt distress, if remaining unaddressed, will lead to slowed economic growth. The IMF projection shows that the GDP growth in 2023 at 5.3% will be higher than that of 2022 (3.8%). UNDP projects a 5.0% growth in 2023, reflecting mainly a solid recovery. Agriculture, which has been impacted by conflict in the past two years is expected to rebound. This is especially true for wheat, where production is projected to increase from 8.2 million tonnes in 2022 to 10 million tonnes in 2023. The Government of Ethiopia has been procuring wheat in food surplus regions and is envisioning the export of wheat to neighboring countries.

2 COVID 19, drought, Northern Ethiopia war, Ukraine crisis.
3 Total dose administered per 100 population reached 45.67 between March 2021 and February 2023 (WHO, 2023)

2. Inflation

Year-on-year headline inflation in January 2023 stood at 33.9% (Figure 2). This has been higher than the inflation rate during the same month in 2021 (19.2%) and 2020 (18.7%) but slightly lower than that of January 2022. Inflation had been on a generally high trajectory for the past two years. Both food and non-food components, affected by global and domestic shocks, have contributed to high and volatile inflation.

Figure 2: Headline Inflation Rate (%) (YoY)

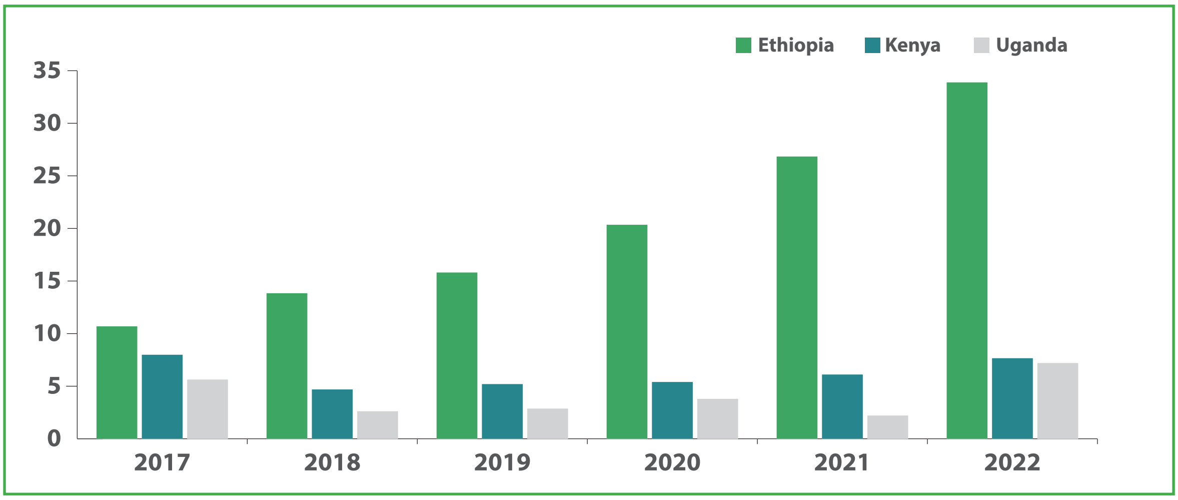


Source: *Constructed based on data from CSA*

Inflation also has a significant import component in Ethiopia. Most consumer goods, including food and cereals, manufacturing products, and agricultural inputs are imported. In 2022, the value of total imports accounted for 14% of GDP. The global commodity price increase has led to increased import bills for essential goods.

Ethiopia has been among countries experiencing the highest inflation rates globally. Due to the supply shocks, the global average inflation rate has gone up from 4.7% in 2021 to 7.4 % in 2022 while the Sub Saharan African average inflation was 5.3% in 2021. Ethiopia also has had the highest inflation compared to its peers in East Africa. Figure 3 shows Ethiopia's inflation trend compared to Kenya and Uganda.

Figure 3: Inflation Rate (%) in Ethiopia and East African countries

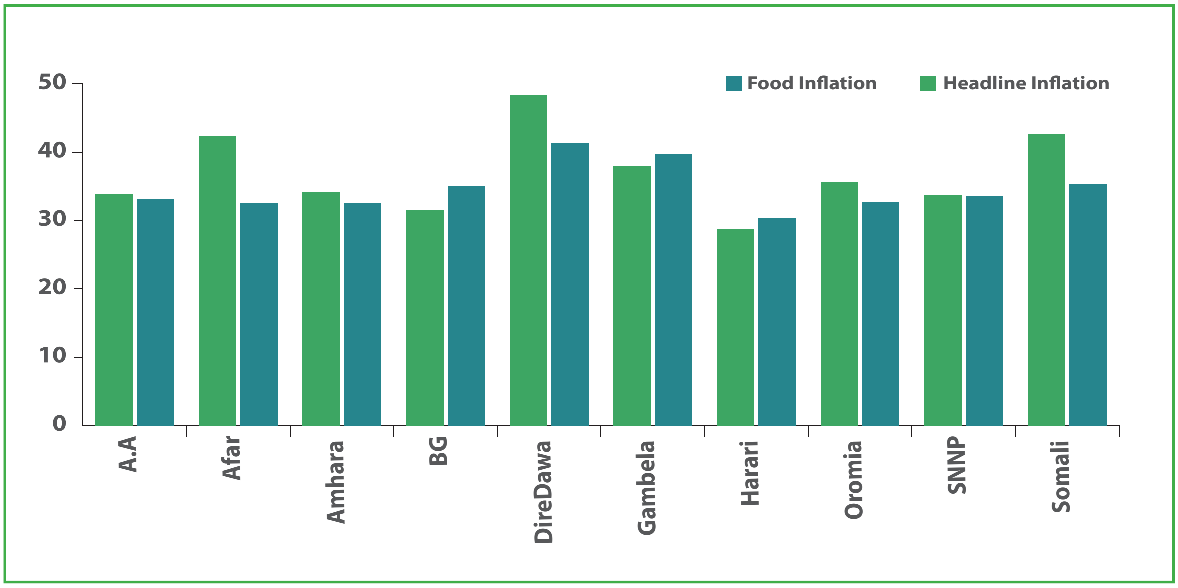


Source: *Constructed based on data from IMF, World Economic Outlook, October 2022*

Inflation has not eased in many regions of Ethiopia in 2022. Afar, Dire Dawa and Somali had the highest headline inflation (42%, 48%, 43%, respectively) while food inflation was at its peak in Dire Dawa (41.3 %) and Gambela (39.8 %). In the other regions, food inflation has hovered between 30 and 35% (Figure 4). The price situation in the country has resulted from a cumulative effect of multiple shocks. Ethiopia imports 25% of its wheat consumption yearly from abroad. Like most African countries, Ethiopia has wheat imports that originate from Russia and Ukraine. Although they are not the main or only sources for Ethiopian imports, Ethiopia has been affected directly by its trade relation with the two countries.

The government has been working on an initiative to boost wheat production and achieve wheat self-sufficiency. This can potentially ease some of the pressure on the foreign reserves and inflation. Cereal imports from July to December 2022 stood at USD 0.7 billion and 35% below the same period in the preceding year.[4]

Figure 4: Inflation at Regions (YoY, December 2022)



Source: *Constructed based on data from CSA*

Despite the shocks, Ethiopia is transitioning into a more open and market-oriented economy and less dependent on government subsidy and support, while necessary, this has the potential to exacerbate inflation. In the face of soaring global fuel prices that contributed to fiscal challenges, a long-lasting fuel subsidy programmewas halted in December 2021. Retail fuel prices at the pump station have been revised three times since then partially reflecting the global price pass-through into consumers.

Inflation in Ethiopia is expected to average above 30% in 2023 and is likely to remain a pressing challenge in the years to come:

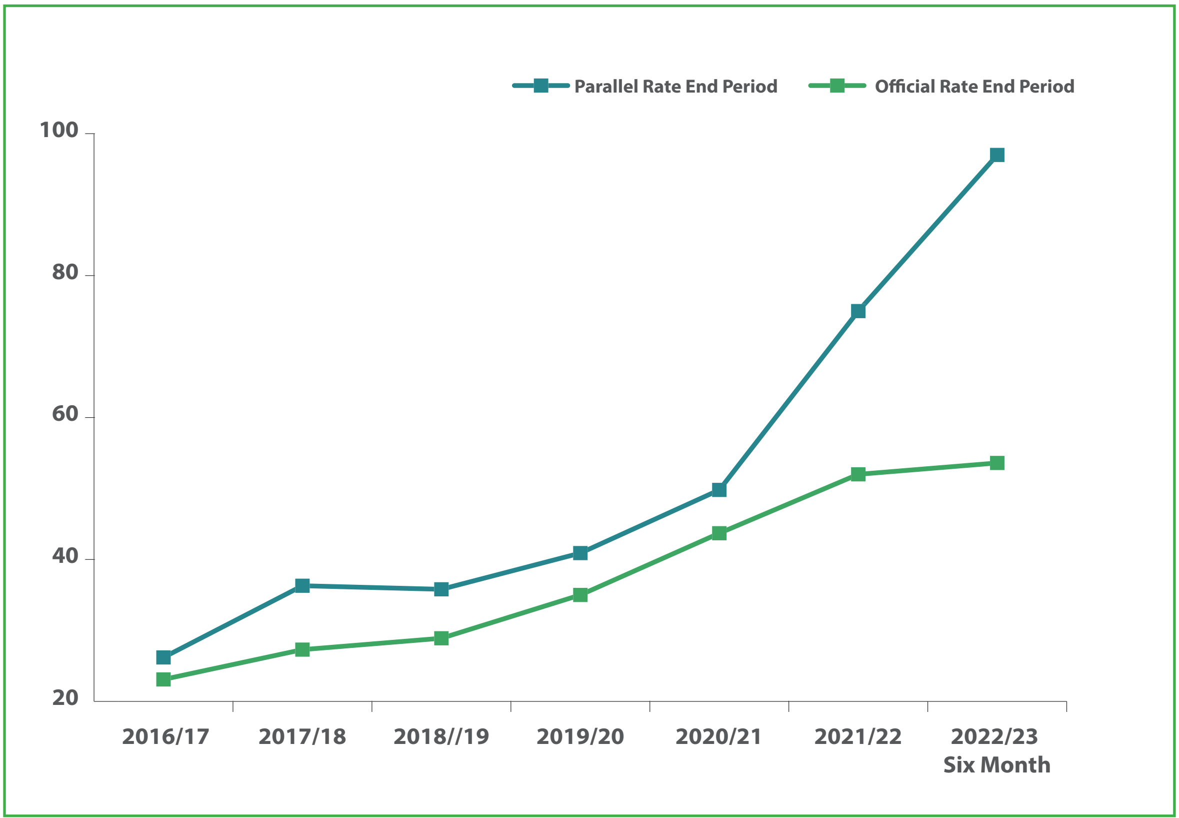
- **Global inflation is to slow down but will remain high in 2023:** IMF estimates global inflation to lower from 8.8% in 2022 to 6.6% in 2023. However, this is almost double the global inflation rate before COVID-19 emerged in 2019.[5] Despite the move of the government to reduce import costs by limiting imports of selected items, the total import bill is likely to remain comparable to its level of the previous year. The import bill from July to December 2022 was 7.8% higher compared to the same period last year, while exports declined by 7%. This will lead to the pass-through of external inflation to domestic prices.
- **Persistent wide gap between official and parallel market exchange rates:** The chronic shortage of foreign reserves will keep the difference between the two rates wide and have an impact on consumer prices.
- **Limited policy space:** The foreign exchange problem may not have any quick fix, given the structural rigidity in the overall economy and the external sector.
- **Drought**: Various parts of the country are affected by drought, particularly the Southeast areas leading to significant loss of livestock (4.5 million by September 2022), as well as severe disruption of livelihood activities and supply chains.
- **Fuel price increase**: With the removal of the subsidies gradually closing the gap between the international and local fuel price at pumping stations.
- **Production and supply shocks**: Disruption of economic activities due to sporadic conflicts happening in the country.
- **Monetary financing of budget deficits/accommodative monetary policy**: Continued financing of the government budget gap through borrowing from NBE.

4 National Bank of Ethiopia, external sector database
5 IMF 2023, World Economic Outlook

3. Exchange Rate Developments

Exchange rate depreciation is continuing in 2023. The official rate reached Birr 53.5819/ USD.[6] The trade balance or the gap between merchandise export earnings and import payments was wider in 2022. This trend continued in 2023 with declining export earnings. As a result, the current account deficit has continued to deteriorate in 2023, leading to further drawdown in foreign reserves. This adds to the demand and supply gap in the foreign exchange market, as reflected in the parallel market. The premium between the parallel and official exchange rates reached a peak (more than 80%) between October and December 2022 (Figure 5).

Figure 5: Annual Average Official and Parallel Exchange Rates



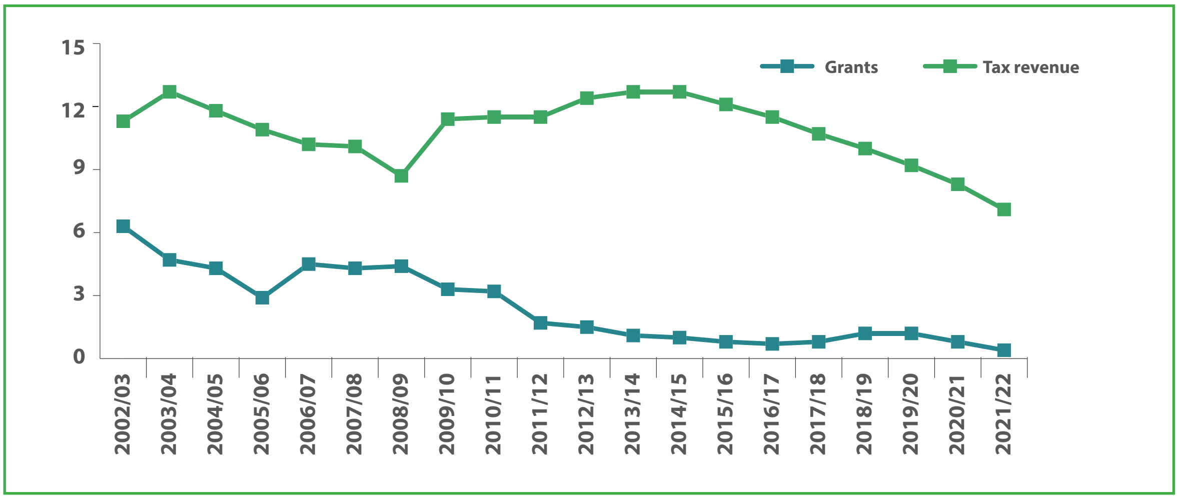
Source: *Constructed based on data from NBE*

6 NBE, February 10, 2023

4. Government Finance

From July to December 2022, general government revenue and grants totaled Birr 200.4 billion, showing an increment of more than 20% compared to same period last year. During this period, there was no inflow of external grants. Despite the increase in annual tax revenue generation, the revenue to GDP ratio has continued to decline (Figure 6).

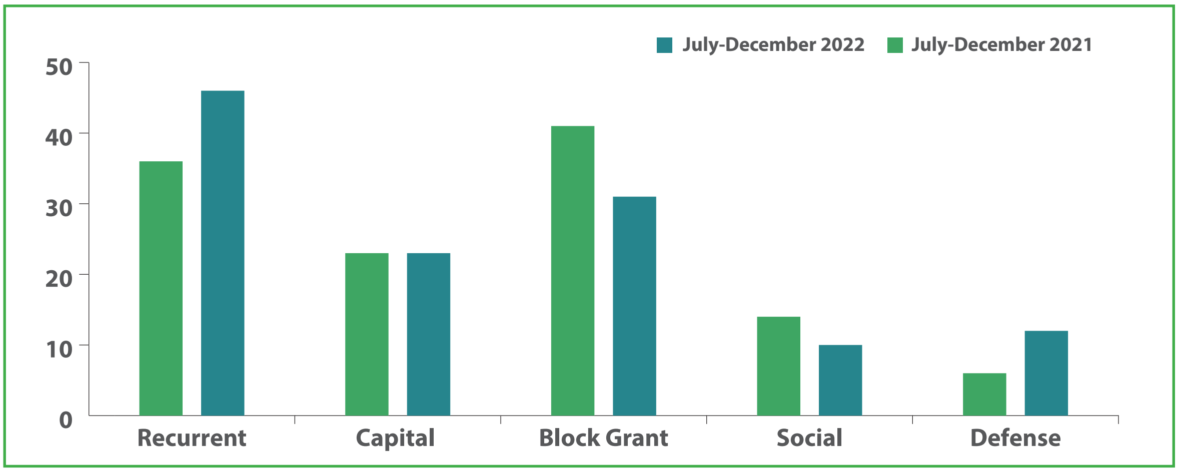
Figure 6: Tax Revenue and Grants in % of GDP



Source: *Constructed based on data from MoF*

On the expenditure side, recurrent expenditure continued to increase from July to December 2022 (Figure 7). At Birr 143.7 billion, it was 68.5% higher than that of the same period last year. However, growth in capital expenditure has been slower, particularly compared to growth in recurrent expenditure, refl ecting a trend for the past few years. As a ratio to GDP, recurrent expenditure has overtaken capital expenditure since 2017. The multiple shocks in the past three years have further exacerbated this situation. These developments are a cause for concern for the development prospects of the country. Poverty targeted expenditures have also been declining since 2017. Poverty targeted expenditure, which was at 2.9 % of GDP, was the lowest in 2022.[7] Share of spending on defence has been on the increase in the past two years while poverty related expenditures were declining.

Figure 7: Expenditure Decomposition (% of total expenditure)



Source: *Constructed based on data from MoF*

The overall deficit during the period from July to December 2022 reached Birr 111 billion. This was largely financed from domestic borrowing mainly through issuance of Treasury bills. Financing from the banking system, including direct advances from NBE has been increasing during July to December 2022. The budget deficit to GDP ratio, at 4.2 % has expanded during 2022.

The 2023 budget is heavily oriented towards defense and debt service, with reduction in social sector spending as a share of GDP. The Government spending towards current expenditure is expected to continue into 2023 and years to come given the pressing fiscal needs of reconstruction. From July to December 2022, there has been a slight nominal increase in spending for the social sectors, but it is too early to see a pattern.

7 MoF fiscal data, 2023

5. Debt

Ethiopia's stock of public debt stood at USD 57.15 billion in September 2022 which is 50.1% of GDP. About 68% (USD 19 billion) of the debt stock is owed by the central government. External debt is USD 26.8 billion or 50.4 % of the total debt stock of which: 52% is from official multilateral, 25% non- Paris Club bilateral creditors, and 3% from Paris Club while the remaining 19% is from private creditors. Ethiopia pays above USD 2 billion yearly on debt servicing (MoF, May 2022). A Eurobond of USD 1 billion is scheduled to reach maturity in December 2024, posing challenges for Ethiopia's liquidity management. Looking into the debt service to export ratio (22% in 2022) which is above the IMF threshold of 15% for Ethiopia, debt servicing has become a challenge for Ethiopia[8]. In November 2022, Fitch, an international ratings agency, downgraded Ethiopia's ratings due to the lack of external financing to meet substantial external financing gaps. Moody's and Standard and Poor's have also downgraded Ethiopia's debt rating.

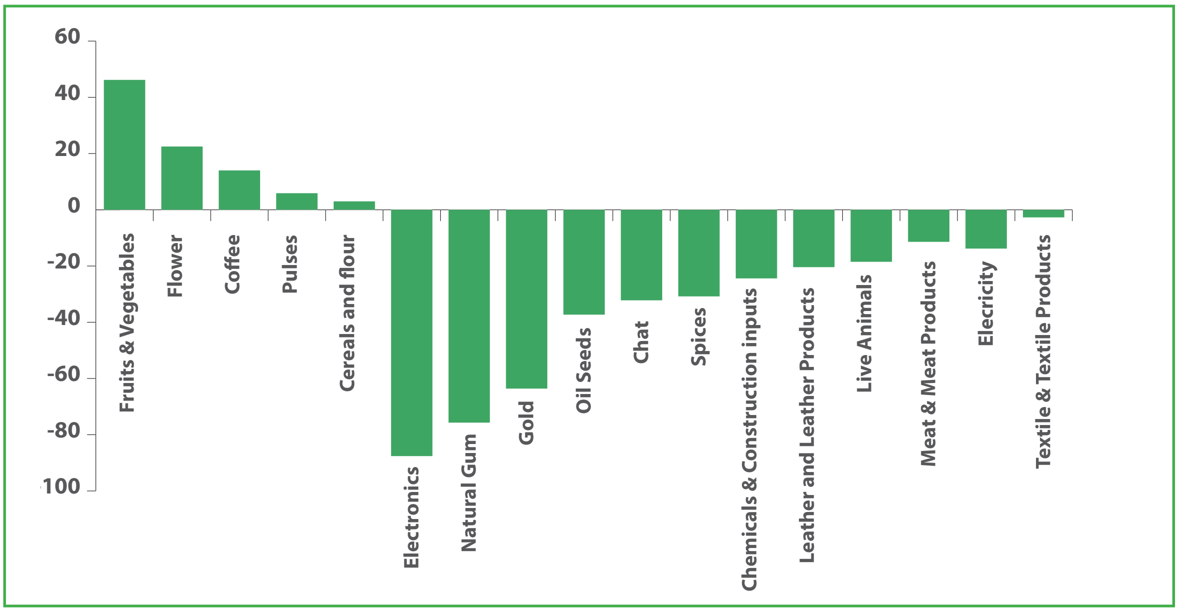
Debt restructuring within the G20 Common Framework has started but has made little progress. This is because the parties in the Common Framework (multilateral creditors, China and private creditors), have had difficulty finding a shared perspective. The country's debt vulnerability is one of the factors affecting access to finance.

8 IMF, 2019. Article IV consultation Staff Report.

6. External Trade and BOP

The merchandise trade deficit from July to December 2022 has reached USD 7.3 billion, showing a 10% expansion compared to the same period last year. With continuing price increases in the global market, total imports were 7% higher while export earnings declined (Figure 8) by the same amount.

Figure 8: Annual Growth in Export Earnings (First Six Months of FY23)

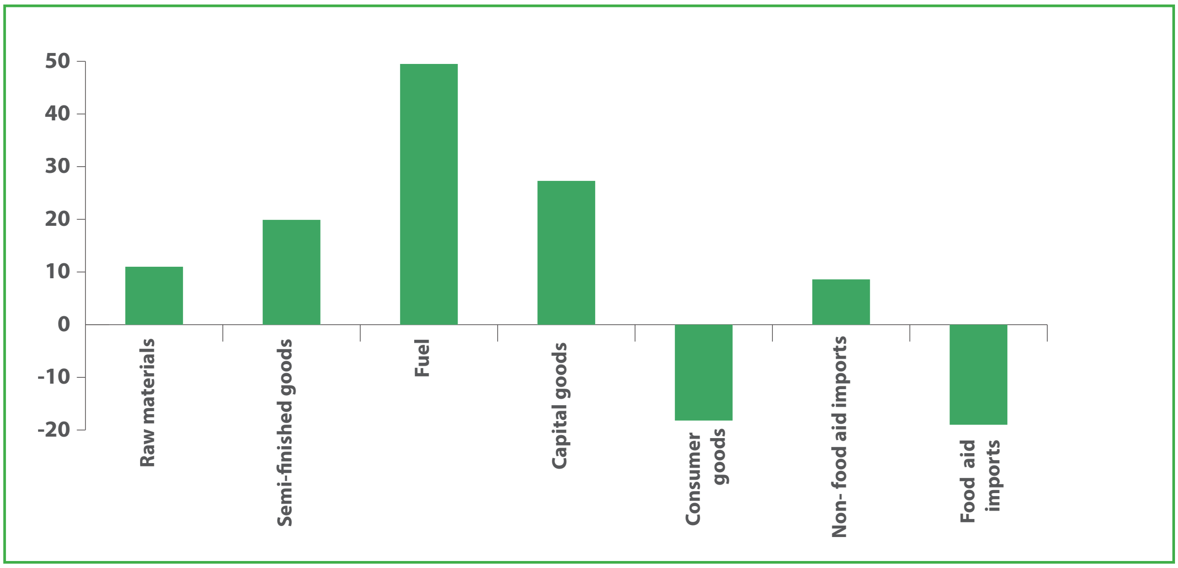


Source: *Constructed based on data from NBE*

Given the foreign exchange shortage, import prioritizing is seen from July to December 2022. Nonetheless, imports like fuel have shown a significant increase (Figure 9). At USD 2.1 billion fuel imports were 49% higher than that of last year, while imports of fertilizer were more than 200% higher than that of last year. The total import bill from July to December 2022 has reached USD 9.1 billion. This trend indicates that annual imports of 2023 could continue increase and reach USD 20 billion.

During the period from July to December 2023, coffee exports valued at USD 0.6 billion have registered a 14% annual increase mainly due to favorable increases in the global price of coffee. The volume of coffee exports declined by 20% during the same period.

Figure 9: Annual Growth in Major Import Commodities (First Six Months of FY23)



Source: *Constructed based on data from NBE*

The current account deficit has shown a marginal widening. During the period from July to December 2022, it reached USD 3.4 billion, more than 1.6% higher than its level in the previous year. On the other hand, private transfers/remittances were 22% higher than the level a year before (USD 2.6 billion). The overall balance of payments during this period stood at USD 0.4 billion. The high current account deficit has put further pressure on the foreign reserves leading to reduced availability of forex for imports. During this same period, FDI inflows had shown an annual increase of 22% compared to its level last year and stood at USD 1.9 billion.

The medium-term macro outlook is mixed and will depend on several parameters: the international environment, the reform program, external financing, and debt restructuring.

Selected Socio-Economic Indicators

Poverty headcount ratio, 2016	National: **23.5%** Urban: **14.8%** in Rural: **25.6%** a
Gender disparity, 2016	Primary Education: **0.91** Secondary Education: **0.93**
Child Mortality, 2016	**67/1000** live births
Maternal Mortality, 2016	**412/100,000** live births
Proportion of population with access to safe drinking water source, 2016	**65%**
Life Expectancy at Birth, 2021	**65** years
Unemployment, 2021	Urban: **17.9%** Rural: **5.2%** National: **8%**
Human Development Index (HDI), 2021	**0.498**

Source: *ESS, MPD, UNDP, UNICEF*

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