ETHIOPIA

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Country Economic Brief

Analysis Issue No. 1/Feb.2014

Outlook

The Ethiopian economy has experienced impressive growth performance over the last decade with average GDP growth rate of 11 %, which is about double of the average growth for Sub Saharan Africa. 2012/13 was markedly successful in terms of maintaining macroeconomic stability and fiscal management as witnessed by inflation falling to a single digit, which had been a major challenge in the past two years. The medium term outlook shows that the growth will continue albeit at a slow pace than the previous years. To attain the national vision of achieving the MDGs by 2015 and becoming a middle-income country by 2025, the country faces some challenges that could impede on the growth and transformation agendas. These challenges include:

- A possible financial risk associated with growing stock of external debt (at 24.3% of GDP for 2012/13), foreign exchange shortage and limited financing options for the growth and transformation plan.
- Low levels of domestic savings and financial intermediation aggravated by negative real interest rates which continue to act as a disincentive to savings mobilization while hampering credit access.
- A decline in export value due to vulnerability to international commodity price fluctuations and few commodity choices for export market.
- The need to nurture a competitive private sector to drive the growth and transformation agenda.

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I. Overview of Developments in the Ethiopian Economy

1.1 Introduction and overview

Ethiopia has registered remarkable economic performance with annual growth averaging 10.9% over the past ten years. This is double the Sub Sahara Africa and triples the world average growths over this period and has led to Ethiopia being rated as one of the fastest growing economies in the world.

Huge public investments with focus on infrastructure and pro-poor sectors explain much of the economic performance from the expenditure side. Government investments have mainly been carried out from domestic resource mobilization and augmented by external resource inflows. Domestic savings has been growing significantly in the past few years from 12.8% of GDP in 2010/11 to 17.7% of GDP in 2012/13. The newly introduced savings instruments (bonds) and expansion in financial services through the aggressive opening of banking branch networks have contributed to the surge in the domestic savings.

From the production side, looking at the Major sectoral classifications the growth remained robust and broad based as all sectors registered positive and significant growth.

The growth in the industry sector was very strong in the past three years. This sector was the highest performer in 2012/13 by registering 18.5% annual growth rate, which was buoyed by the construction boom and expansion in mining and manufacturing sub-sectors. Agriculture grew by 7.1%, recovering from 4.9 % growth in the previous year mainly attributed to increased crop production as a result of Increases in productivity and expansion of area under cultivation.[1]

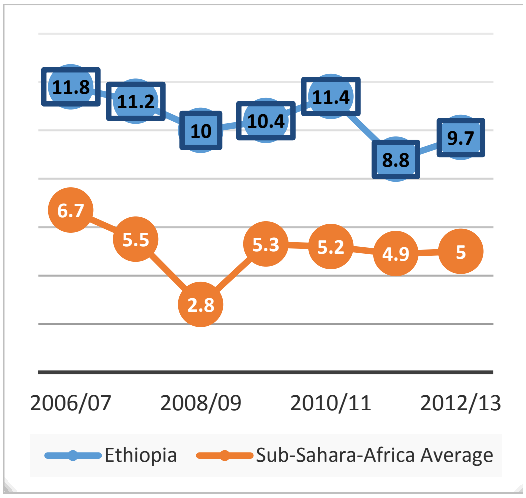
The main reasons for the increase in the agricultural productivity and production were favorable weather and good rainfall, strengthened agricultural extension services, better access to agricultural inputs, improved access to market and pursue of enhanced policy and advocacy.

In 2012/13 the service sector registered 9.9% 9.9% annual growth and stood out in terms of its contribution to the overall output.

[1] In 2012/13 crop production increased by 13.2 % to 280.9 million quintals, which is the result of an increase Total area under cultivation had increased by 1.6 % in 2011/12 to reach 13.9 million hectares.

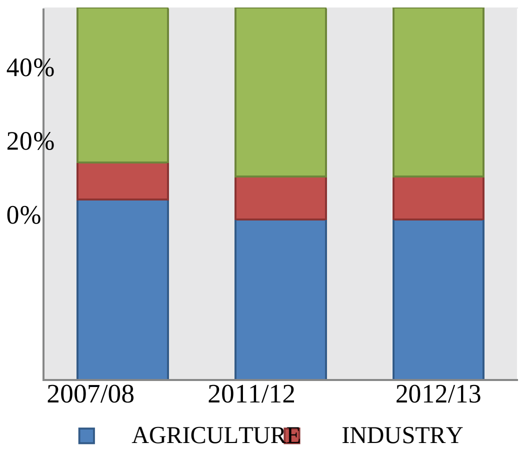
Figure 1 and 2 below depict the trends in growth and sectoral shares of the economy in the past few years.

Figure 1: Real GDP growth trends (in %)



Source: MoFED (National Accounts) and IMF (WEO)

Figure 2: Trends in Share of Major Sectoral Components in GDP (%)



Source: MoFED (National Accounts) and IMF (WEO)

Structurally, the service sector has slowly taken over the lead from agriculture in terms of its contribution to the gross national product. In 2012/13 the respective shares of agriculture, industry and service sectors in the GDP stood at 43%, 12% and 45%.

The share of the service sector to GDP increased from 38% to 45% in the past 10 years while the share of agricultural declined from 52%t to 43% in the same period. However, agriculture will continue to be the main source of employment as the service sector has not been able to generate much employment. This implies though that the productivity of the much fewer service sector workers far outweighs labor productivity of the large number of people employed in the quality agriculture sector. It also means that the quality of jobs and wages/incomes in the service sector is higher than those in the agriculture sector.

In this context, measures to raise productivity in the smallholder agriculture as well as to boost private investments in commercial agriculture is imperative to the growth and transformation of the whole economy through diversification and linkages with other sectors, improving the quality of employment and reducing rural poverty.

Meanwhile, the industry sector has maintained modest increments over the years in terms of value added. Table 1.1 shows growth trends in selected economic indicators.

Table 1.1 Trends in Selected Economic Indicators (percentage growth rates)

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Real GDP Growth rate	11.8	11.2	10.0	10.4	11.4	8.8	9.7
SSA average	6.7	5.5	2.8	5.3	5.2	4.9	5.0
Agriculture (%)	9.4	7.5	6.4	7.6	9.0	4.9	7.1
Industry	9.5	10.1	9.7	10.6	15.0	17.1	18.5
Services	15.3	16.0	14.0	13.0	12.5	10.6	9.9
GDP per capita US$	270	359	419	377	389	510	550
Inflation (year average)	15.1	55.3	2.7	7.3	38.1	20.5	7.4
Exchange rate (year average)	8.68	9.24	10.42	12.89	16.1	17.5	18.3
Gross reserve (in month of import)	2.1	1.2	1.8	2.1	3.1	2.0	1.9
External debt (% of GDP)	11.8	10.4	13.5	18.1	22.0	21.5	24.3
Mid-year Population in millions	72.4	74.9	76.8	78.8	80.9	83.0	84.8

1. Source: MoFED (National Accounts)
2. Ethiopia Fiscal year runs from July 8 to July 7

2012/13 was a markedly successful year in terms of maintaining macroeconomic stability and fiscal management as witnessed by inflation falling to a single digit, which had been a major challenge in the past two years. The exchange rate (Birr against US dollar) continued to slowly depreciate while there was a slight decline in international reserves of the country.

Real interest rate remained negative, posing a great challenge to incentivizing and mobilizing domestic savings and to further deepen financial intermediation. The central bank's policy on interest rate is setting the minimum (floor) bank deposit rate while lending rates are freed. Currently, the minimum deposit rate is set at 5% but banks are free to pay above the minimum and to set their own lending rates. In 2012/13 due to continued vulnerability to international commodity price fluctuations, export values suffered a marginal decline by 2.3% while imports increased by 4.1%. Private transfers, specifically remittances, continued to surge, while there have been a declining trend in official transfers since 2010/11. Official transfers however, have rebounded in the first quarter of 2013/14 to reach US$538.8 million compared to US$184.1 million in the same quarter of the previous year. Meanwhile, remittances increased by 5.3 % and stood at US$619.6 million in the first quarter of 2013/14.

1.2 Price Developments

The principal objectives of the monetary policy continue to be maintaining price and exchange rate stabilities. Price stability is important in setting favorable environment for investment and economic growth.

1.2.1 Inflation

Historically Ethiopia has been one of the low inflation economies with average inflation rate of less than 5 %. Since 2006 however Ethiopia has no longer been considered a low inflation country and in July 2008 an all-time high inflation rate of 64 % was recorded. The major causes were the then high fuel and food prices shocks, weaker foreign exchange earnings, and rising demand for imports that depleted international reserves of the country. The highest price increase was observed in food, housing, fuel and transport services, making the urban poor the most vulnerable to the impacts of inflation.[2] Owing to strong policy measures and abated world price shocks inflation tumbled down to single digit in 2010 and 2011.Inflation re-emerged in 2012 and reached a peak of about 40 % in September 2012. Looking at the components, the food and nonalcoholic beverages category has been the main drivers of overall price movements (see Fig 3). Both internal and external factors contributed to the hike again in inflation. Well-coordinated monetary and fiscal policy stance coupled with slowdown in the world commodity prices have resulted in significant decline in inflation.

Hence, year-on- year food and nonfood inflation rates contained back to single digits in 2013. In January 2014 while headline inflation became 7.8 %, food inflation tumbled down to 5.1 % and non-food inflation to 10.9 %. Although inflation is low compared to the previous two years there are signs of the rate increasing in recent months especially in the non-food category.

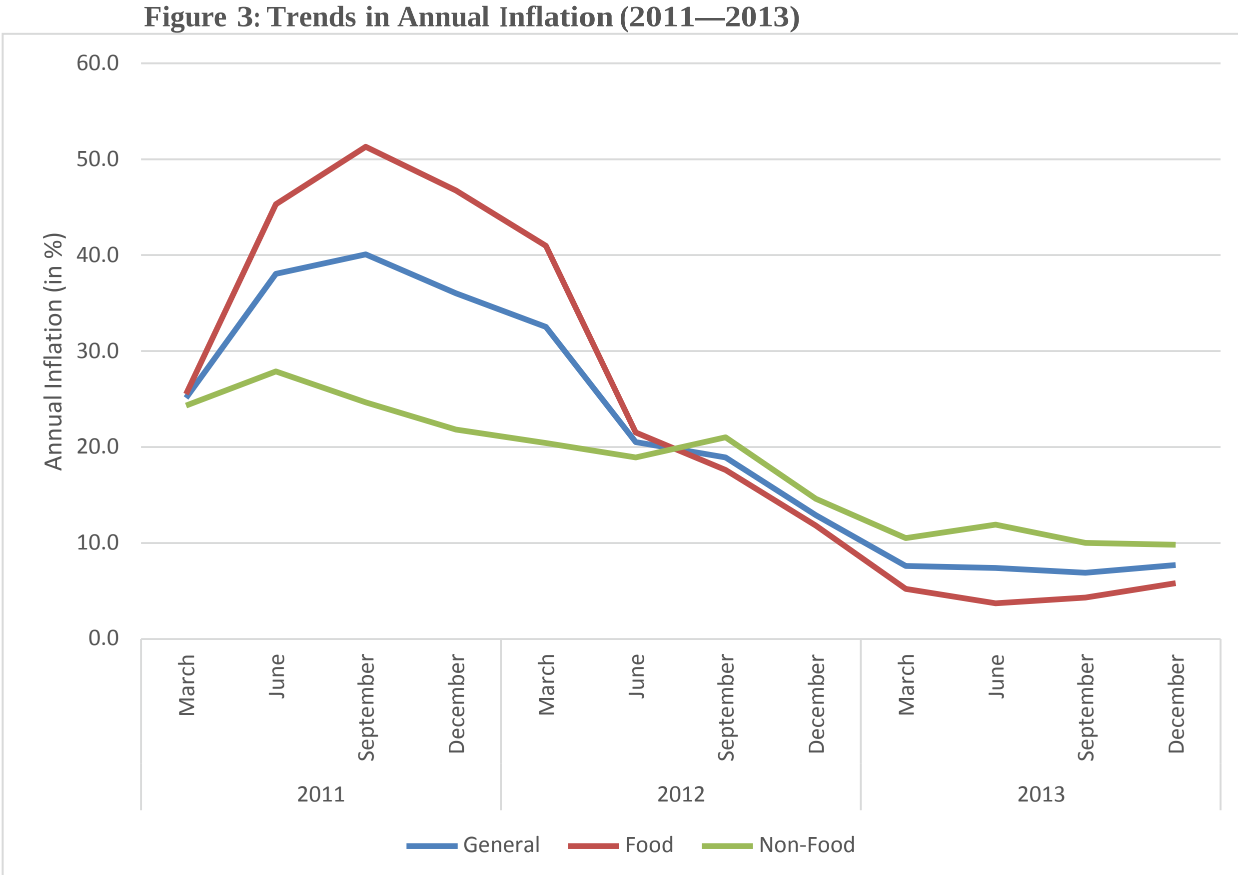
1.2.2 Interest Rates

The central bank's policy on interest rate is that it sets the minimum (floor) bank deposit rate, currently at 5 %, but the banks are free to pay above the minimum and to set their own lending rates.

While the minimum bank saving rate was controlled at 5 %, average saving rate was 5.4 % and lending rate at 11.88 % in 2012/13. Real saving rates remained negative as the inflation rate is still higher than the nominal interest rate. The relatively insensitive nature of savers to interest rate, due to the absence of alternative financial instruments, has allowed the banks to hover around the minimum deposit rate.

[2] According to the latest (2010/11) survey on household income and expenditures, households on average spent 53 % of their income on food and non-alcoholic beverages (the percentage is higher for households in the lower expenditure quintile), 16.3 % on housing, water, electricity and fuel with urban households in the lowest expenditure quintile tending to spend more on this category (29 %).

Figure 3: Trends in Annual Inflation (2011—2013)



Source: Central Statistical Agency

1.2.3 Exchange Rate

The National Bank of Ethiopia (central bank), follows a managed floating exchange rate regime where the local currency Birr is pegged to the US Dollar.. Accordingly, drastic movements in the nominal exchange rate are not expected. The Birr continued to depreciate but at a very slow rate and it reached 18.19/US$ at the end of 2012/13. This gradual depreciation is in line with the goal to enhance competitiveness of Ethiopian exports and attract FDI.

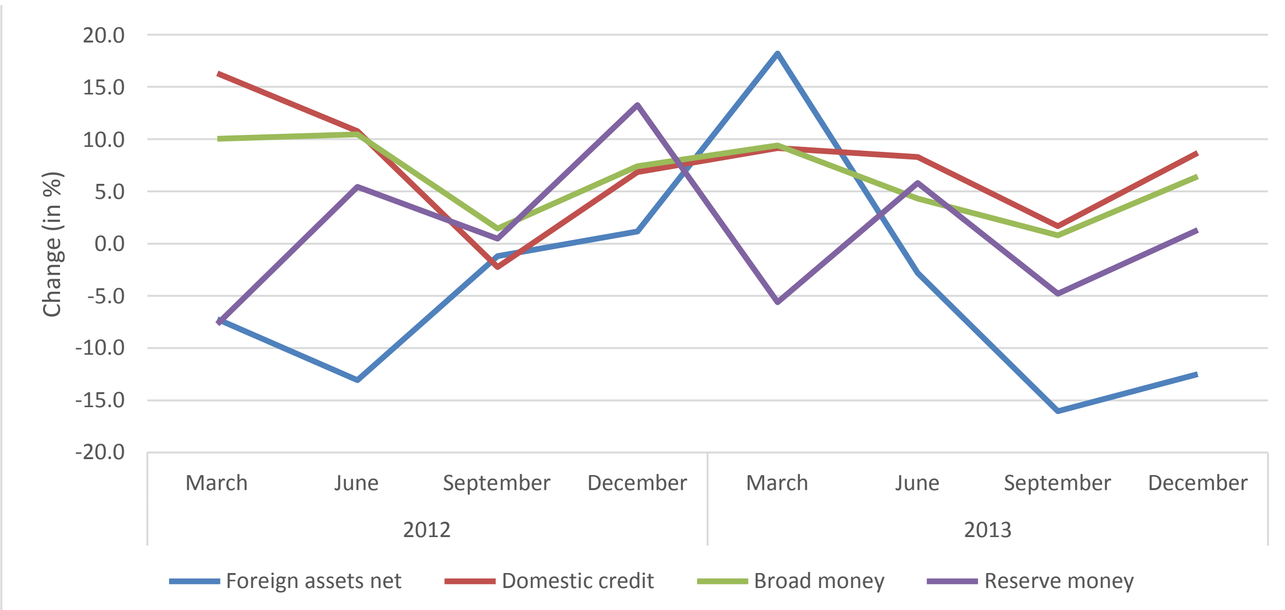
The average exchange rate of the Birr against US dollar in the official market showed annual depreciation of 5.4 % since 2011/12. In January 2014, the exchange rate reached 19.107 Birr/US$, a 4.85 % depreciation since January 2013.

1.3 Monetary Developments

In 2012/13 domestic liquidity, measured by broad money supply, had increased by 24.2 %. Reserve money also increased by 13.6 % and net foreign assets built up by 14.7 %, following two consecutive years of sterilization measures. In the same period credit to government increased by 1.9 % and credit to non-government sectors (including public enterprises) went up by 26.2 %.

The central bank pursued a tight monetary policy in 2011/12, where the reserve money showed 4.4 % annual decline, which have contributed to the decline in inflation. But there are signs that the bank is pursuing expansionary monetary policy as reserve money registered a growth of 13.6 % in 2012/13; this is in contrast to a decline of 4.4 % in the preceding year. In addition the bank lowered reserve requirements ratio of commercial banks further to five % in March 2013 from 10 %.

Figure 4: Trends in Monetary Aggregates (quarterly)



Source: National Bank of Ethiopia

1.4 Developments in Financial Sector

The financial sector, mainly banking and insurance services have been broadly stable and growing in terms of expanding its services. The sector continues to tap into new opportunities for mobilizing savings through establishment of new banks and expanding their branch networks as well as introducing new financial instruments. As of 2012/13 Ethiopia has 19 commercial banks and 15 insurance companies from 17 and 14 respectively in 2011/12.

The fact that banks are still required to allocate 27 % of their loan portfolio in central bank bonds has been a constraint on the private commercial banks liquidity and is one of the reasons limiting credit access to the private sector. Commercial banks were able to increase their deposit mobilization by 22 % in the first 10 months of the year under review (2012/13). However, disbursement of new loans shrunk from Birr 56 billion to Birr 53 billion in 2012/13, this trend has continued in the first quarter of 2013/14 where commercial banks disbursed Birr 9.6 billion fresh loans, 28 % lower compared to the same quarter of the previous year. Agriculture, trade and transport and communication suffered most of the decline while the industry sector took the lion's share (35.8 % of the newly disbursed loans) in 2012/13 and 29.1 % in the first quarter of 2013/14. However, only 21 % of the total bank loans went to the private sector during the first quarter of 2013/14.

1.5 Developments in External Sector

The foreign reserve of the country, measured by months of imports cover, has deteriorated in the past two years. The gross reserve reached 1.9 months of imports in 2012/13 against 3.1 months of imports in 2010/11 and target of 3.0 months of imports. This is mainly because of Ethiopia's export continued to be primary agricultural commodities (70 %) indicating that export diversification is still low and the earnings from the sector has not been growing as planned as it vulnerable to price fluctuations. Agricultural products such as coffee, oilseeds, khat, leather and leather products, pulses, cut flower, fruits and vegetables and live animals constitute 70 % of Ethiopia's exports. Coffee continues to be the leading export item accounting for 24 % of total export values, followed by gold (19 %), oil seeds (14 %), Khat (9 %), pulses (8 %), flower (6 %) and live animals (5 %).

These leading seven export items account for over 85 % of export earnings of the country indicating that export diversification efforts need to be harnessed. Secondary sector exports, especially manufacturing, are still low although increasing. In recent years, there has been rapid growth in non-traditional exports with the share of non-coffee exports rising to 75.8 % in 2012/13 in contrast to 40% in 1997. The destinations of Ethiopian exports were mainly Europe (43.6%) followed by Asia (30.3%) and Africa (21.3%).

Figure 5: Share of major exports in million USD from total in 2012/13

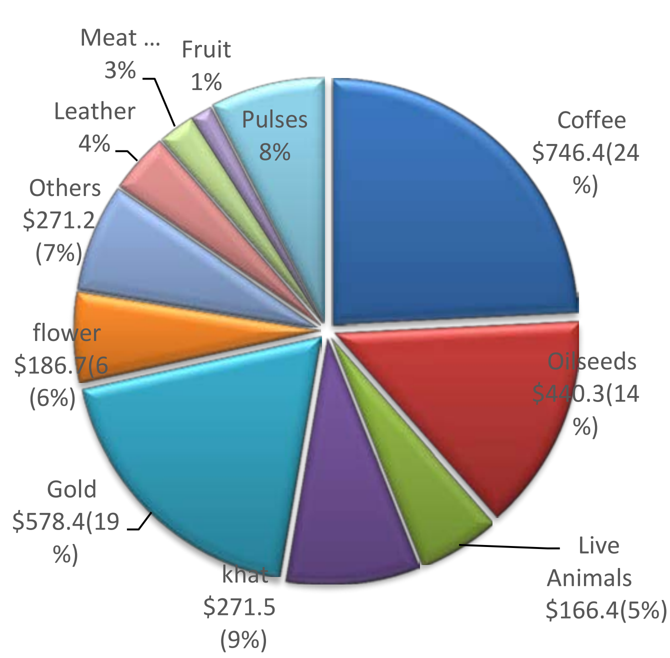
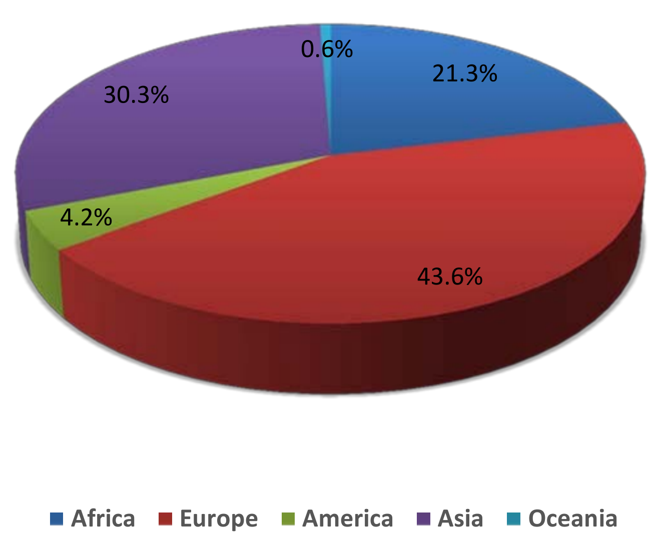


Figure 6: Share of Export Destinations in 2012/13



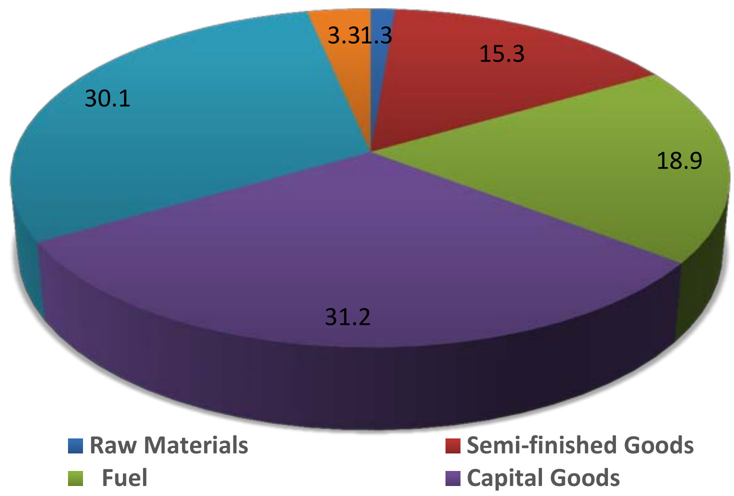
Source: National Bank of Ethiopia

Despite continued efforts to increase volume of exports in 2012/13, value of exports declined by 2.3 %, once again underlining the vulnerability of Ethiopia's export to commodity price fluctuations. The price of most of the country's export commodities, including coffee, has declined, and the gain in export of leather and leather products and pulses was not high enough to compensate for the decline.

Meanwhile, import has increased by 4.1%, mainly due to the increase in the imports of capital goods which constituted about 31% of the total import value. Accordingly the trade deficit has widened by 9.

In the first six months of 2013/14, the total export goods valued at US$1.3 billion which was 21.3 % lower than the value earned in the preceding six months of the previous year. On the other hand, the total import payment has reached US$6.4 billion in the same period indicating a 13.3 % increase compared to same period last year.

Figure 7: Share of Major imports in 2012/13 (in %)



Source: National Bank of Ethiopia

1.6 Public Sector Management

Government revenue has kept rising and Ethiopia's public expenditure continued to focus on the pro-poor sectors. Government overall budget deficit was 2.0 % of GDP in 2012/13. The government mobilized 137.2 billion Birr in revenue and grants in 2012/13, which is an 18.6 % increase from the previous year. This was attributed to 20.6 % increase in domestic revenue collections that reached 124.1 billion Birr, and constituted 90.5 % of the total. The Government initiated and implemented a vigorous tax policy reforms and administration that helped to strengthen tax collection and administration. Tax administration reforms include the streamlining of the revenue authority both in terms of boosting its human resource capacities and upgrading the IT infrastructure and systems.

In 2012/13 government expenditure reached 153.9 billion Birr, a 23.3 % increase compared to the previous year, as capital and recurrent expenditure increased by 25 and 22 %, respectively.

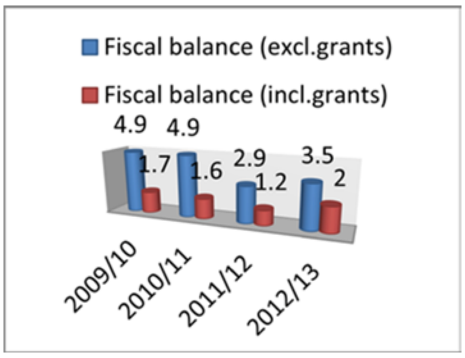
As an indication of the continued attention to the infrastructure sector, 37 % of the total capital expenditure went to road construction in 2012/13, up by 19.5 % from the preceding year.

In the meantime, poverty targeted expenditures increased by 23 % and stood at 107.8 billion Birr in 2012/13. Consequently, the overall budget deficit, including grants, was 16.7 billion Birr or 2 % of GDP. The primary deficit, excluding grants, was 29.8 billion Birr or 3.5 % of GDP.

Ethiopia's external debt is steadily increasing with annual average growth rate of 21% over the past decade. It reached $11.1 billion or 24.3% of GDP in June 2013 from $2.7 billion in 2006.

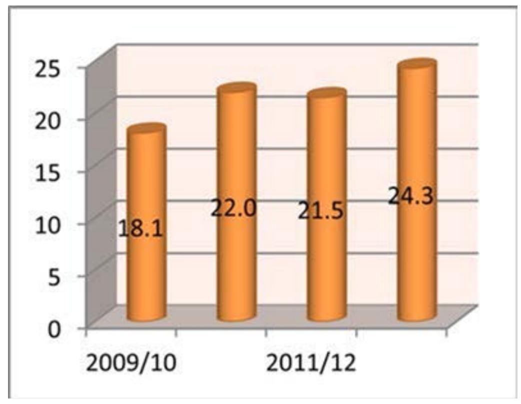
A recent debt sustainability analysis indicated that it remains sustainable but maintaining this low risk of debt distress will be a challenge.

Figure 8: Fiscal Deficit (% of GDP)



Source: MoFED

Figure 9: External Debt (% of GDP)



Source: MoFED

1.7 Developments in Social Sectors

Ethiopia has translated the rapid economic growth registered over the past years into declining incidence of poverty from 38.7 % in 2005 to 29.6 % in 20111 and it is estimated to further decline to 26 % in 2013.

Significant progress has also been achieved in the Millennium Development Goals (MDGs). Ethiopia was declared to have achieved MDG 4 on child mortality in 2013 two years ahead of schedule. According to a recent assessment, six of the MDGs are well on track to be achieved by 2015. Education is one of the sectors that have performed well. The country has achieved results beyond the target set for 2012/13 especially for indicators like the grade 1 intake rate and net primary school enrollment ratio. This is mainly a result of deliberate fiscal focus as the budget allocated to education increased from 17.5 % in 2009/10 to 25.2 % in 2012/13.

The country has also witnessed a significant improvement in food security as food grain production in 2012/13 grew by 13.2 % compared to the previous year. The country continues to make progress in human development and was one of the top movers of human development values as its Human Development Index (HDI) value increased by 44 % since 2000. Concerted efforts need to be exerted to accelerate progresses in MDG 3 on gender equality and women empowerment and MDG 5 on reducing maternal mortality rate, both of which are lagging behind.

A national consultation on post-2015 development agenda was held in 2012/13 with multiple stakeholders from government, civil society and the private sector to take on board lessons from the MDGs and build consensus on new goals.

II. Outlook for 2013/14

Now that Ethiopia has brought inflation down to a single digit, the focus of the country's policy would be towards maintaining it at that level while increasing the international reserves and maintaining the fiscal sustainability. Coordinated fiscal and monetary policy stance continue to be priority for Ethiopia. The country is also focusing on public investment in infrastructure and pro-poor spending through strengthening of domestic resource mobilization while reducing inflationary financing options such as central bank recourse.

Overall, the growth momentum is expected to be sustained in the medium term; this is counting on the recovery in the external demand that will support the export sector, continued efforts to improve productivity, diversification of the export base and the increasing share of industry in the GDP. Although economic growth is projected to remain robust, looking at the current trend and near future outlook, it will still be lower than the original GTP target of 11 %. Provided that there is a better enabling environment, including access to finance, private sector development is expected to play a key role in attaining the envisioned economic diversification and transformation in Ethiopia.

The progress made in the social sectors is expected to continue with a special focus on the sectors and indicators lagging behind, in line with the national sector specific plans and MDGs and assisted by increased budgetary allocation.

The pro-poor and infrastructure focused capital expenditures will continue to be given priority to sustain the current progress on MDGs and deepen the country's transformation process. In addition, the export sector is expected to benefit from the growing global demand. The current relatively expansionary monetary policy pursued by the central bank, that has further reduced the reserve requirement to 5 %, is expected to bear fruit in terms of increased credit to the economy. This will be very supportive in ensuring increased participation of the private sector. The government's attention is expected to continue in the areas of strengthening private small holder and commercial farms, micro and small enterprise development as well as the promotion of private sector participation in medium and large scale industrial development especially in textile, agro-industries, cement and sugar production.

Ethiopia's growth is expected to remain robust, however, the existing constraint on external financing for public infrastructure investment and slow recovery in the global demand could make the country fall short of the original target set in the Growth and Transformation Plan.

Appendix:

Table 1. Selected GTP Targets and Performance in 2011/12

Indicator	Baseline 2009/10	2011/12	2012/13	Plan Target 2014/15
Real GDP growth rate (%)	11	8.8	9.7	11.2
Per capita GDP at current market prices(USD)	401	510	550	698
Total consumption expenditure (PFCE) as % of GDP	90.6	85.0	82.3	85.0
Gross domestic saving as % of GDP	9.4	15	17.7	15.0
Gross domestic capital formation as % of GDP	23.7	33.1	33.0	30
Export of goods and non-factor services as % of GDP	10.5	13.9	12.7	31.2
Imports of goods and non-factor services as % of GDP	27.3	32.0	28.0	45.7
Resource balance as % of GDP	16.8	18.1	15.3	14.5
Domestic revenue and grants as % of GDP	16.8	15.7	16.1	19.7
Domestic revenue as % of GDP	12.9	13.9	14.6	17.3
Tax revenue as % of GDP	9.7	11.6	12.5	15.3
Total poverty-oriented expenditure as % of GDP	12.5	11.8	13.4	15.7
Capital expenditure as % of GDP	10	9.9	7.4	13.0
Recurrent expenditure as % of GDP	8.5	7.0	10.7	8.6
Overall balance including grants as % of GDP	1.6	1.2	2.0	2.0
External (net) as % of GDP	0.8	0.9	2.0	0.6
Domestic (net) as % of GDP	0.7	0.5	0.2	1.3

Source: MoFED

Table 2: Key Economic Indicators

Key Economic Indicators			
	2010/11	2011/2012	2012/13
GDP (US$ million at current prices)	31,406.6	42,206.0	46,597.8
Consumer price inflation (%, annual), CSA	38.1	20.5	7.4
External debt (US$ millions)	7,807.6	8,888.6	11,117.2
Official development assistance (ODA, US$ millions)	1,246.7	1,540.0	1,905.8

Source: MoFED

Table 3: Human development Indicators

Key Human Development Indicators	(latest year, in brackets next to the data)
Population (millions) GHDR	86.5 (2012) (GDHR)
Population living below absolute Poverty line CSA	27.8% (2012)
Gini coefficient CSA	0.298 (2010/11)
Unemployment rate (%, urban) CSA	17.5% (2012)
Literacy rate (%, adults) MoFED (Development and Poverty in Ethiopia), June 2013	46.7% (2011)
Life expectancy at birth (years) GHDR	59.7 years (GHDR, 2012)

Source: Human Development Report

Table 4: Millennium Development Goals (MDGs) indicators

MDGs Indicators (latest year, in brackets next to the data)	
Poverty rate (US$1.25 PPP per day) MDG1, indicator	30.7% (2011)
Proportion of population below minimum level of dietary energy consumption; MDG1, indicator 1.9 UN MDGs data	37.1% (2012)
Net enrolment ratio in primary education MDG2, indicator 2.1 UN MDGs data	80.2% (2012)
Proportion of seats held by women in national parliament MDG 3, indicator 3.3 UN MDGs data	27.8% (2013)
Under-five mortality (per 1,000 live births) MDG 4, indicator 4.1 UN MDGs data	68/1,000 (2012) (MDG database)
Maternal mortality rate (per 100,000 live births) MDG 5, indicator 5.1 UN MDGs data	350/100,000 (2010) (MDG database)
HIV prevalence among population aged 15-49 years MDG 6A, indicator 6.1 UN MDGs data	0.6% (2011)
Proportion of population using an improved drinking water source MDG 7, indicator 7.8 UN MDGs data	49% (2011) (MDG database)
Proportion of population using an improved sanitation facility MDG 7, indicator 7.9 UN MDGs data	21% (2011)

Source: MDGR

Table 5: Governance Indicators

Key Governance Indicators (latest year, in brackets next to the data)	
Corruption perceptions index (value and ranking) Transparency International	33 and ranked 111(2013)
Ease of Doing Business (value and ranking); World Bank	Ranked 127/185 (2013)
Democracy Index Economist Intelligence Unit	3.72 and ranked 123 (2012)
Country Policy and Institutional Assessment (CPIA, rating) World Bank	3.0 (2012)

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