QUARTERLY ECONOMIC BRIEF
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Overview

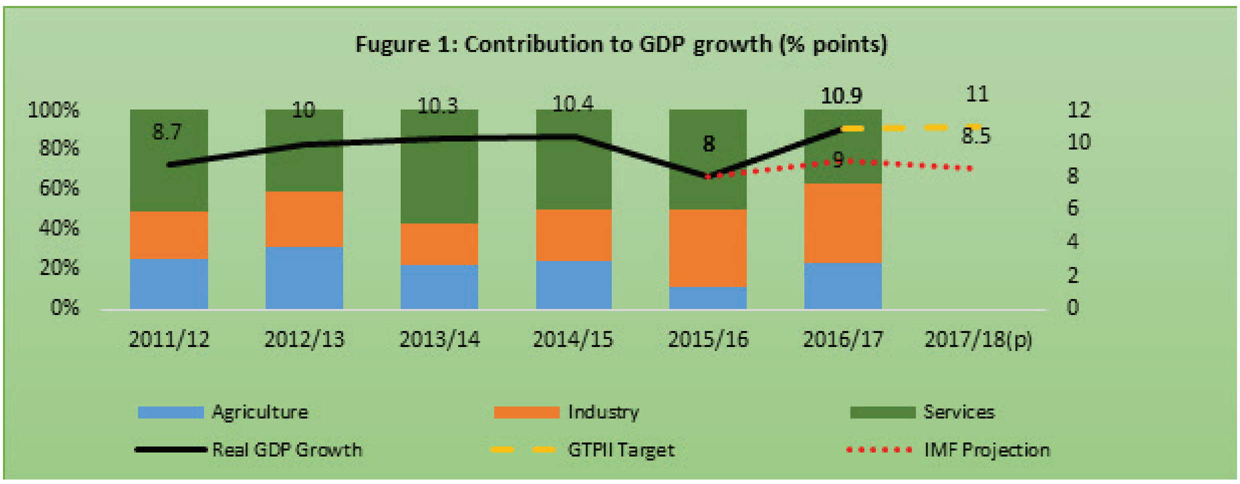
Economic growth recovered from the impact of drought in 2015/16 and registered 10.9 percent annual growth in 2016/17. There is an improvement in agricultural production in 2017/18 owing to adequate rain in highlands, however low rains persisted in pastoralist areas. The external sector continued to suffer from sluggish export performance which led to the country being classified in high risk of external debt distress. In order to support external competitiveness of the economy 15 percent devaluation of the Birr was undertaken in October 2017. The country is also looking in to partial privatization of major public enterprises as a part of long term solution to foreign exchange shortages, youth unemployment, private sector participation and corruption.

II. Macroeconomic Developments

2.1 Economic Growth

Gross Domestic product fully recovered from the drought impact. Real GDP growth was 10.9 percent in 2016/17 up from 8.0 percent in 2015/16, as agricultural value added grew by 14.7 percent. Industry has taken over the services as the major contributor to growth in 2016/17. Major contributor to the growth was industry sector contributing 4.4 percentage points, followed by services 4.0 and agriculture 2.5 percentage points. The contribution from the industry sector mainly came from construction sub-sector and that of services from wholesale and retail trade sub-sector.

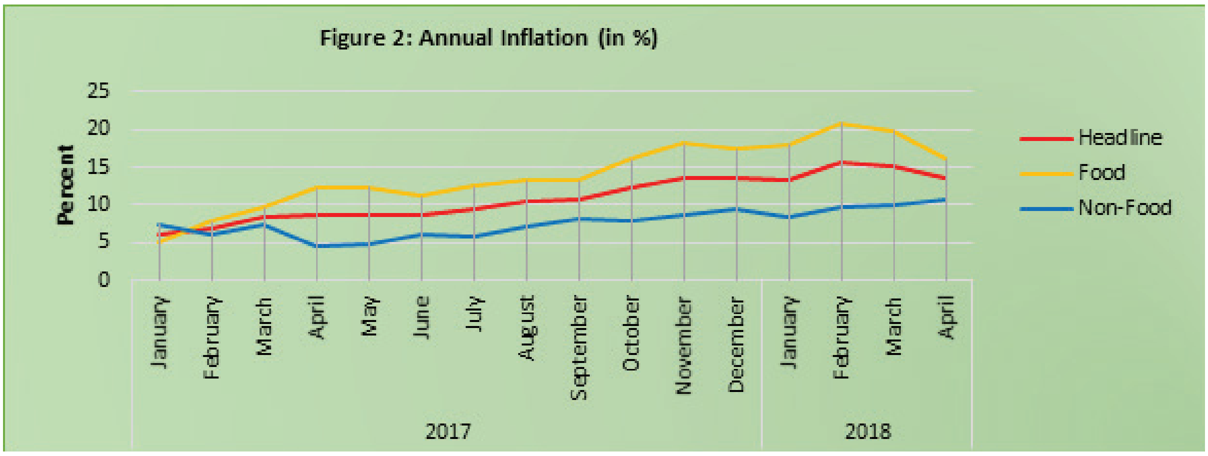
The contribution of the industry sector has significantly increased in the past four years, the major economic activity being the construction sector while the contribution of the manufacturing sector is still low. Gross Domestic Product (GDP) was US$ 80.0 Billion and per capita GDP was to US$ 863 in 2016/17. IMF's estimates the growth to be 8.5 percent for 2017/18.



Source: NPC, National accounts

2.2 Inflation

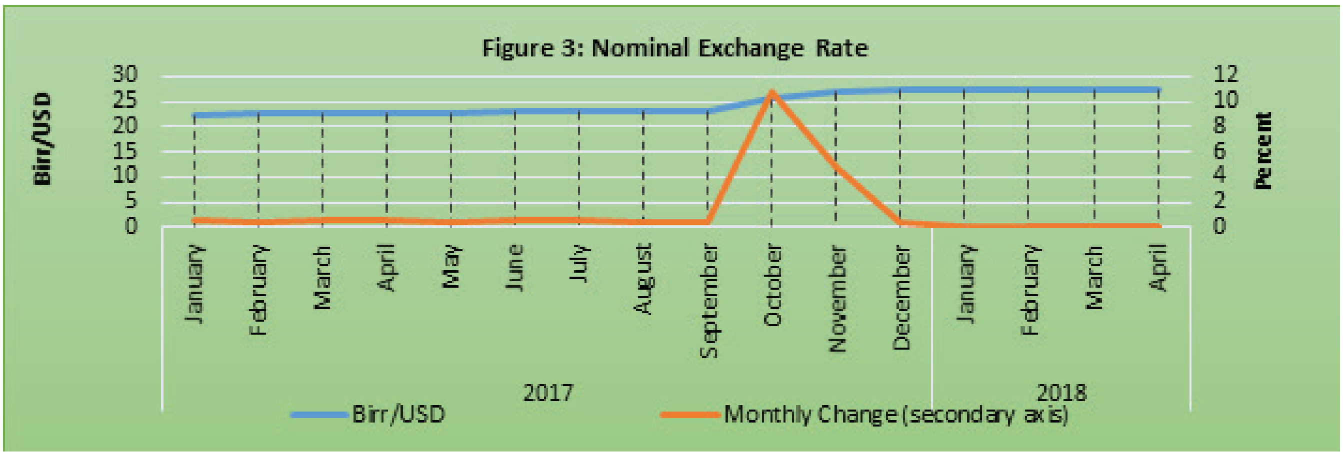
Inflation surpassed single digit since September 2017. In April 2018, annual general price level increased by 13.7 percent, food prices by 16.1 percent and prices of non-food items by 10.8 percent. Figure 2 depicts trends in general, food and nonfood inflation rates in 2017 and 2018. There is an obvious upward pressure on inflation after the devaluation of the birr by 15 percent in October 2017, but the magnitude was not very high which could be attributed to the monetary tightening that paralleled the devaluation.



Source: Central Statistical Agency

2.3 Exchange rate

Ethiopia devalued its currency by 15 percent in October 2017 as a policy measure to increase its competiveness of the external sector. One USD was exchanged for Birr 27.24 in April 2018. The exchange rate depreciation has stabilized back to small monthly changes, the change since the devaluation averaged 0.5 percent. Inflation has also been increasing in the period after the devaluation suggesting some level of a pass-through effect.



Source: National Bank of Ethiopia

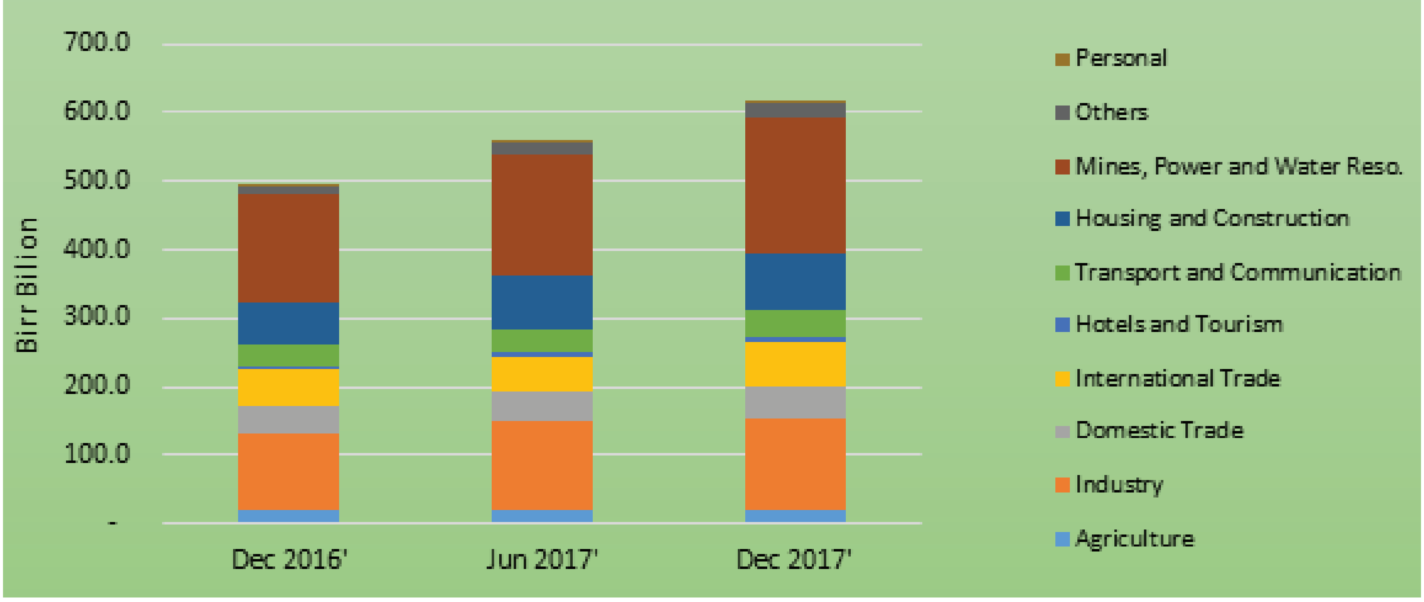
2.4 Financial Sector

Tighter monetary policy was followed to lessen the impact of devaluation on inflation. The policy measures included raising of the minimum deposit rate and introduction of credit ceiling. The minimum saving deposit rate was set at 7 percent since October from 5 percent. As a result, the average deposit interest rate increased from 5.4 percent to 8 percent and average lending rate from 12.75 percent to 14.25 percent.

Accordingly relatively less growth in credit and money supply is expected. In the first quarter of 2017/18, before the policy measures were undertaken, Money supply grew by 29.9 percent on annual basis and reached Birr 602.3 billion, growth in credit (30 percent), was the main driver of monetary expansion. On the other hand, the nominal GDP growth rate was 17.9 percent in 2016/17 which also called for monetary tightening.

Outstanding credit by the banking system including bond holdings reached Birr 618.6 billion by end of 2017 showing 25 percent annual growth. Most of the credit financed mines, power and water resources (financed mostly by bonds), followed by industry, hotels and tourism, and international trade (see fig 4). Stock of deposits mobilized by the banking sector reached Birr 639.5 billion by the end of 2017, posting 29.6 percent annual increase. In terms of access to banking services, by end of the first quarter of 2017/18, number of bank branches increased to 4, 461from 3,647 a year ago. As a result, bank to population ratio improved to 1 branch to 21,651 from 27,255.4 in the same period.

Figure 4: Outstanding Credit by Sector

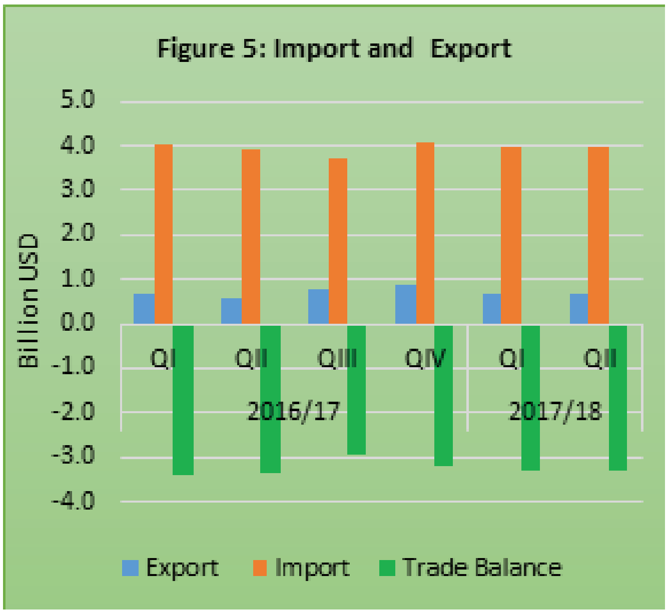


Source: National Bank of Ethiopia

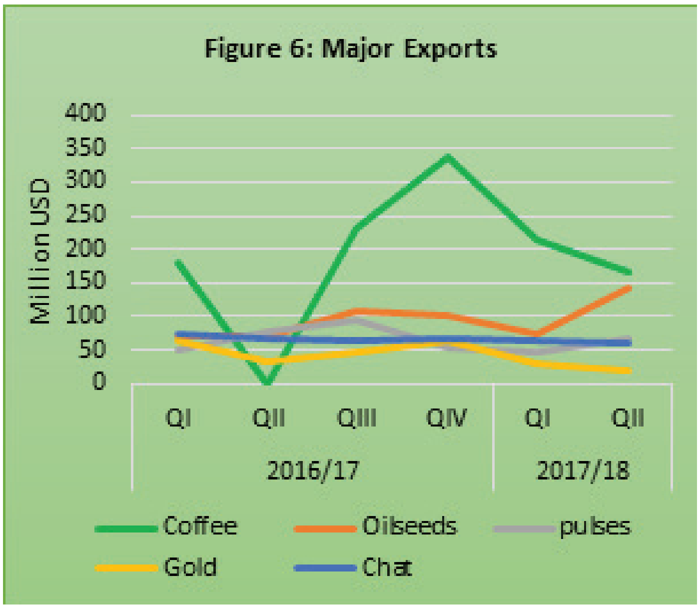
2.5 External Sector

No impact of the devaluation was observed in the following three months, the trade balance stayed the same between the first quarter and second quarter of 2017/18. Trade deficit in the in the first six months of 2017/18 was $6.6 Billion, no significant change on quarterly basis. Value of merchandize exports was $1.3 billion in the first six months of 2017/18 registering 9 percent growth compared to same period of the previous year. The growth was driven by increase in volume of some of the major exports and increase in price for the others.

There was a significant decline in earnings from gold export owing to both volume and price declines. Major exports included coffee (28 percent), oil seeds (16.2percent), chat (9.3 percent), pulses (8.5pecent), cut flower (7.7 percent), and leather (5 percent). Imports were $7.9 billion in the first six months of 2017/18, only marginal increase of $1.7 million compared to first six months of 2015/16. There was a decline in imports of major goods including capital goods (1.6 percent) and consumer goods (9.5 percent) while import of fuel increased by 29 percent.



Source: National Bank of Ethiopia



Source: National Bank of Ethiopia

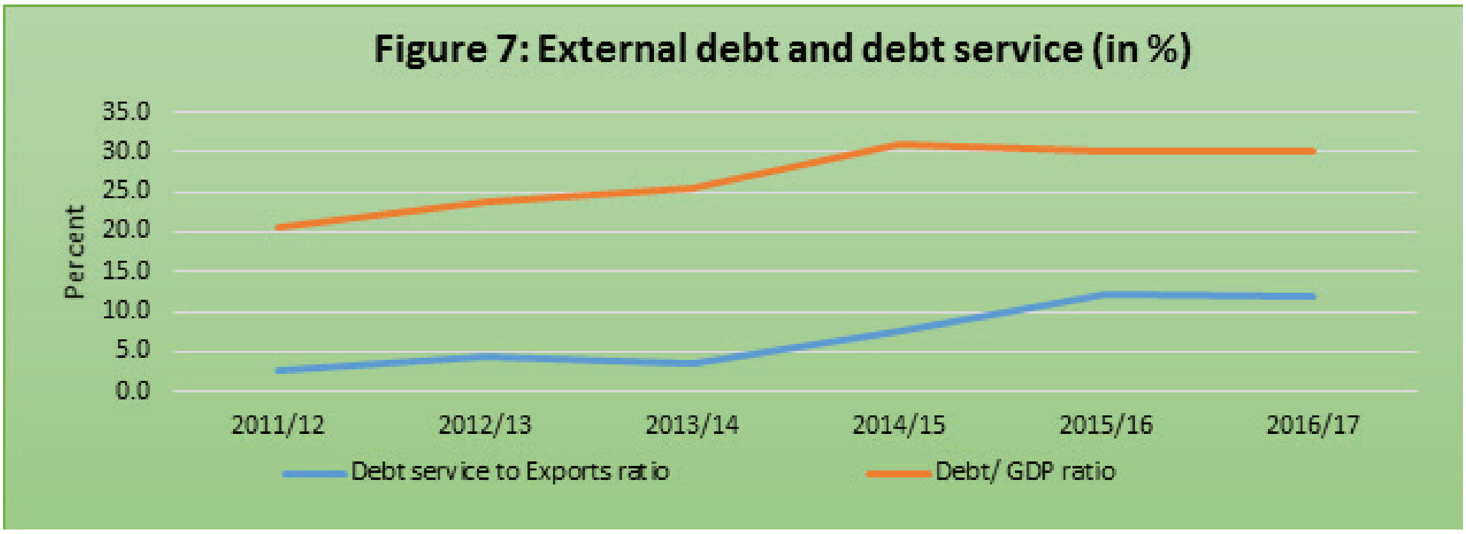
Enhancing exports remains to be the key challenge of the Ethiopian economy. External sector performance is being supported by the inflow of private transfers, public transfers and capital inflows. For example, in the first quarter of 2017/18 private transfers totaled $1.7 billion ($1.3 billion remittances), capital inflow, mostly in the form of and foreign direct investment and long-term borrowing, was $ 1.2 billion and official transfers were $ 1.1 billion. Services sector registered a net surplus of $126.9 million in the period recovering from deficit in the past nine consecutive quarters.

Export diversification is still very low as agricultural commodities dominate at around 70 percent of value of total merchandise exports, the share of manufactured exports remained low at 5 percent electricity export contributed 2.6 percent. Efforts to diversify exports toward more processed and value added goods such as leather and textile need to be enhanced. In addition, the stagnant export sector coupled with ever increasing demand for imports has put pressure on external reserves, which among others, motivated the recent policy direction of partial privatization of state owned enterprises.

2.6 External Debt

The International Monetary fund (IMF), in its most recent Debt sustainability analysis revised Ethiopia's risk of debt distress from moderate to high. Even though, the total external debt to GDP ratio remained around 30 percent, another major of debt sustainability, which is debt service to exports ratio has been increasing to reach 12 percent because of low exports. The stock of public external debt reached $24.2 billion, in September 2017, showing 12 percent annual growth.

Fifty six percent of the debt is owed by central government and the balance by public enterprises of which 52 percent is government guaranteed. Fifty five percent of the debt stock is owed by the central government and the balance by public enterprises of which 66 percent is government-guaranteed. In terms creditors 50 percent of the external debt owed by public enterprises is sourced from private creditors, particularly suppliers followed by bilateral (45 percent).



Source: MoFEC, Debt Statistics

2.7 Government Finance

Government tax collection falls below target. In the first nine months of 2017/18, the federal government collected Birr 140 billion in revenues and grants, which was 59 percent of the budget. Expenditure was Birr 211 billion in the same period, 67.3 percent of the budget and 21.4 percent higher compared to the same period of last year.

In his speech to the parliament, the Minister of finance recognized a weakness in the tax collection compared to the previous years and the government will not be able to collect around Birr 50 billion this year. The tax revenue as percent of GDP have also further decreased to 11.6 percent in 2016/17 compared to 12.7 percent two years ago. The ministry proposed the budget for 2018/19 to be Birr 254.8 billion, a 5.2 percent increment over the previous years' budget.

III. Agricultural Production and Impact of Climate Change

The Central Statistical Agency (CSA) agricultural sample survey for Meher (the main harvest season) indicates an increment in agricultural production, in 2017/18 owing to increase area of cropped land and yield per hectare implying improvement in productivity. Most importantly, there was relatively normal and adequate rainfall in some part of the country. Compared to 2016/17, area cultivated increased by 0.83 percent and production in quintals by 5.4 percent.

However, according to the 2018 Humanitarian and Disaster Resilience Plan in southern and south-eastern Ethiopia, two previous years of consecutive drought, compounded with weak rains at the end of 2017 left hundreds of thousands destitute. Poor pasture regeneration and limited water source replenishment for livestock, in those areas, have resulted in acute humanitarian needs. According to the plan, 7.9 million people are currently in need of emergency food assistance mostly in the pastoralist areas. The food security situation in the lowland agro-pastoral areas is not expected to improve significantly in 2018 while the good harvest in highland areas, is expected to reduce large scale needs in the northern highlands.

IV. Policy Reforms

Ethiopia is introducing and economic reform and set a policy direction to fully and/or partially liberalize privatize state owned enterprises. Accordingly, the Government will sell to both local and foreign investor minority shares in Ethio-Telecom, Ethiopian Airlines, Ethiopian Electric Power and Ethiopian Shipping and Logistics Services Enterprise while retaining majority shares. Ethiopia will also sell full or partial shares of industrial parks, railway, sugar factories, hotels as well as other manufacturing enterprises to domestic and foreign investors.

According to statements by the Prime Minister, the government expects to solve challenges related to foreign exchange shortages, the youth unemployment, corruption and inefficiencies in the public sector. From the economic point of view, this policy move will have both direct and indirect impacts on the economy. The direct impact is that the government will able to mobilize both foreign currency and domestic resources to address immediate challenges in balance of payments and budget deficits. The indirect impacts are more in terms of encouraging the private sector by spurring confidence in the policy and business environment and help efficient use of resources.

- Partial ownership of the private sector in these companies will open a room for more accountable practices and reduce corruption.
- Through encouraging efficiency and full capacity utilization, the partial privatization will also contribute to higher employment and pave the way for the private sector as a lead employer.
- Increased efficiency will also translate in to enhancing competiveness and better services to consumers.
- This could also help the government, in some way, to focus on very key economic and social sectors that cannot be handled by the private sector.
- This policy direction will also help to stabilize expectations such as in the parallel foreign exchange market.

In general, the policy reform is expected to open the way for a market-oriented approach to the economic management that could see a revitalization of the role of the private sector in the financial and telecommunication sectors. In addition, this could address the lingering challenge of foreign exchange shortage in the short-to-medium term and potentially enhance the competitiveness of the external sector. The next step for the government is to work on the policy, legal and regulatory frameworks for the implementation.

Acknowledgements:

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