Euler Hermes Economic Research

Country Report

Ethiopia

The spectre of drought re-emerges

General Information

GDP	USD54.798bn (World ranking 81, World Bank 2014)
Population	96.51mn (World ranking 13, World Bank 2014)
Form of state	Federal Republic
Head of government	HAILEMARIAM Desalegn
Next elections	2019, presidential

Strengths

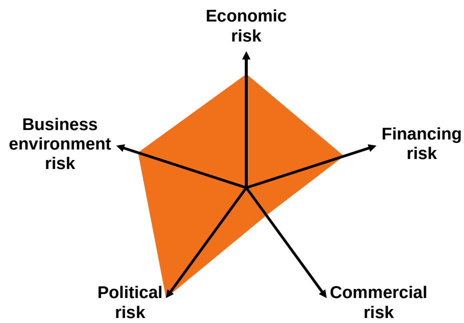
- Political stability (relative) is likely in the short term, with associated continuity in policy implementation.
- The political transition following the death in office of long-serving Prime Minister Meles Zenawi in August 2012 was smooth and without development of a power vacuum.
- The international community is generally supportive, particularly in times of drought-induced famine.
- High GDP growth rates in recent years, with an annual average +10.5% in 2005-14.
- Large domestic market (population over 95mn).

Weaknesses

- International agencies periodically question the commitment on protection of human rights.
- The region (Horn of Africa) is high risk. Ethiopia has borders with Sudan, South Sudan, Eritrea and Somalia - all offering challenges.
- High dependence on rain-fed agricultural output but recurrent drought, locust infestations etc. Water rights are a source of potential conflict in the Nile area.
- Continuing aid dependence, despite significant external debt forgiveness and re-profiling.
- Fiscal and current account deficits and weak foreign exchange reserves that provide an import cover below the three-month international comfort benchmark.
- Weak structural business environment.

Country Rating

D3



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
China	11%	1	22%	China
Germany	11%	2	14%	Saudi Arabia
Somalia	9%	3	8%	India
Saudi Arabia	7%	4	6%	Kuwait
Switzerland	6%	5	5%	Italy

By product (% of total)

Exports		Rank		Imports
Coffee, tea, cocoa, spices, and manufactures thereof	32%	1	20%	Petroleum, petroleum products and related materials
Vegetables and fruits	17%	2	9%	Road vehicles
Oil seeds and oleaginous fruits	17%	3	9%	Specialised machinery
Crude animal and vegetable materials, n.e.s.	7%	4	7%	Iron and steel
Live animals other than animals of	6%	5	5%	Fertilizers other than group 272

Source: Chelem (2013)

EULER HERMES
Our knowledge serving your success

Economic Overview

General Overview

Ethiopia is the second most populous African country (after Nigeria) and is classified as ‘low income’. Despite recent economic advances, it is also one of the world’s poorest economies, with around 50% of the over 95mn population engaged in subsistence farming. Periodic famines remain a severe constraint on per capita GDP growth.

The World Bank estimates that Ethiopia has hydropower generation potential second only to DR Congo in Africa. The government has ambitious plans for the country to become the “water tower of Africa”. A 25-year programme to increase hydro-electric capacity to 37,000 MW by 2037 includes a 6,000 MW Grand Ethiopian Renaissance Dam on the Blue Nile (scheduled for completion in 2018). However, there are environmental concerns relating to dam building on major rivers and Egypt, in particular of neighbouring countries, is concerned about the control of Nile waters that will be exerted if these projects are completed.

Political Overview

The ruling EPRDF party and its allies won an overwhelming majority in legislative polls in May 2015 that African Union observers declared as “generally consistent with the AU guidelines on the conduct of elections”. The result was not a surprise, given the fractured nature of the opposition and recent economic successes. Policies are expected to remain relatively unchanged under PM Hailemariam Desalegn. Donor countries and international aid agencies remain broadly supportive, although they sometimes question the government’s commitment to personal freedoms. In addition to formal political opposition and potential challenges to authority from within the military, there are significant regional, tribal and ethnic divisions. In two of the largest provinces, Oromia and Ogaden, there are some secessionist groups. Ethiopia has been a recent beneficiary of China’s strategic interest in developing links with raw material producers in Africa and that Asian country is Ethiopia’s largest trade partner.

Growth will dip because of drought but will remain strong

Annual real GDP growth averaged only +2.9% in 1991-2000 but +9% since that year. Relatively rapid growth in the latter period reflects a buoyant world economy in most years, inflows of donor aid and investment (particularly from the Gulf States and Asia, including China) and Ethiopia’s focus on agricultural-led industrialisation (including expansion of horticultural output), infrastructure projects and developments in the service sector.

After GDP growth of over +10% in 2013 and +8% in 2014, EH expects GDP growth will dip in 2015 and 2016 as a result of the worst drought in 30 years and the associated reduction in agricultural output and rural incomes. However, we expect annual growth will still be around +7%, spurred by public sector investment. This compares with a ten-year annual average up to end-2014 of +10.9%.

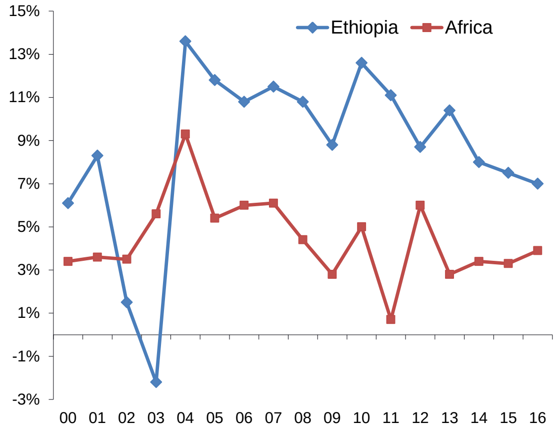
A longer-term outlook for growth is generally positive, although much depends on domestic and regional stability and on uncertain availability of water supplies. Expenditure on infrastructure will be a key growth driver, with a major dam project on the Nile and planned road construction and repair programmes but all these are subject to potential implementation delays and/or lack of finance.

Key economic forecasts

	2014	2015f	2016f	2017f
GDP growth (% change)	8.0	7.5	7.0	7.5
Inflation (%, end-year)	7.1	11.7	9.0	8.0
Fiscal balance (% of GDP)	-2.9	-3.3	-4.0	-3.5
Public debt (% of GDP)	23.7	24.0	24.5	26.0
Current account (% of GDP)	-9.6	-8.5	-8.0	-7.5
External debt (% of GDP)	32.0	34.5	38.0	41.0

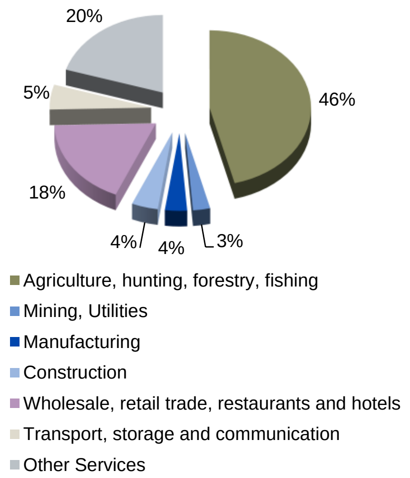
Sources: National sources, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

GDP breakdown (% of total)



Sources: National sources, IHS, Euler Hermes

Inflation and exchange rate

Inflationary pressures are a structural weakness of the economy and annual consumer price growth averaged almost 20% between 2007 and 2010, reflecting sharp increases in food and fuel prices but also government borrowing from the central bank because of limited alternative sources of domestic deficit financing. EH expects average inflation of around 10% in 2016 (almost 12% at end-2015 because of drought-related increases in food prices). Much also depends on uncertain commodity price movements. EH also expects the birr (ETB) will continue to depreciate against the USD, partly as a way of enhancing currently-weak export competitiveness.

External deficits and low import cover

Another structural weakness is the annual current account deficit, which averaged almost -7.5% of GDP between 2007 and 2010, financing of which requires international assistance. EH expects the current account deficit will be -8% of GDP, or over, in 2015 and 2016. Partly as a result of the weak external sector, including competitiveness pressures on the ETB, FX reserves are low. At USD3.3bn billion at end-2014 reserves provided only just over two months of import cover, compared with the internationally-acknowledged "safe" minimum of three months. FX reserves may increase to almost USD4 billion by end-2017, subject to some recovery in export revenues from coffee and gold. Even so, import cover will remain below the comfort threshold.

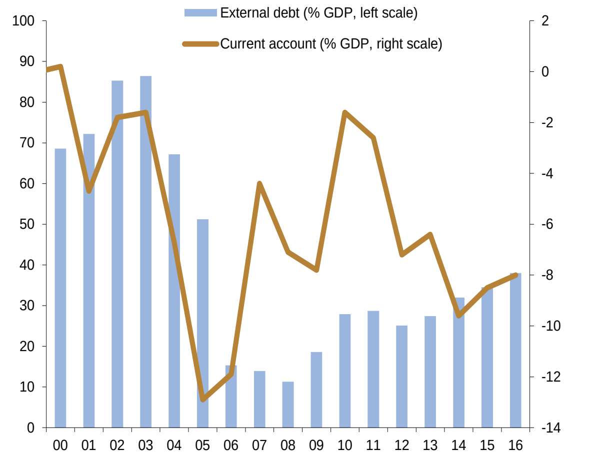
External debt is again rising

External debt ratios remain challenging (debt to GDP 32% in 2014 and debt to export revenues 117%) but servicing obligations on that debt is unlikely to cause any short-term problems, following implementation of international debt relief schemes. The debt service ratio (repayments/total export revenues) is now around 5%.

IMF & World Bank support

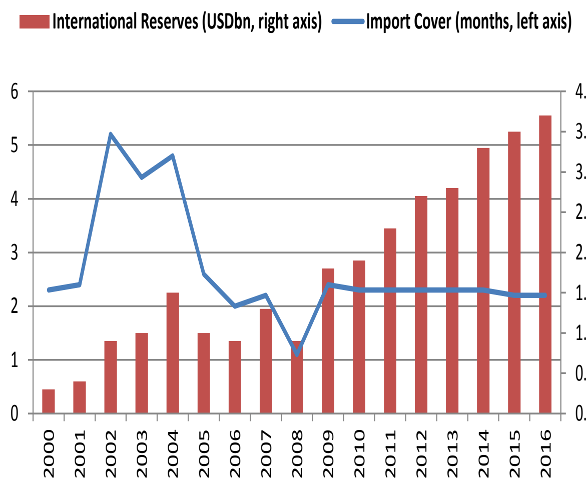
Ethiopia does not have an IMF financial facility currently in place (a fully-drawn ESF expired in November 2010) but tries to follow a Fund-style policy programme in order to maintain support from the wider donor community. Ethiopia completed its programme under the HIPC initiative in April 2004 thereby signifying an effective exit from the debt relief process and allowing the country to access an approximate USD300mn in additional annual concessional financing. The IMF and World Bank granted full debt relief of USD1.3bn, as well as USD707mn in 'topping up'. The challenge for the government is to maintain debt at manageable levels. In any event, Ethiopia will remain highly aid-dependent.

Current account and external debt (% of GDP)



Sources: National sources, IHS, Euler Hermes

Foreign exchange reserves and import cover



Sources: National sources, IHS, Euler Hermes

Last review: 2015-12-17
Country Risk Analyst:
Andrew Atkinson
andrew.atkinson@eulerhermes.com