Ethiopia
Country Brief

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AFREXIMBANK

Transforming Africa's Trade

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Ethiopia

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INTRODUCTION

Located in the horn of Africa, the Federal Democratic Republic of Ethiopia is the continent's tenth largest country, with an area of about 1.13 million square kilometers. The population in 2023 is estimated at 127 million, making it the second most populous country in Africa after Nigeria. Ethiopia is a landlocked country that borders Sudan to the west, Somalia and Djibouti to the east, Eritrea to the north, and Kenya to the south. Amharic is the official working language, while English is the most widely spoken foreign language.

The key sectors of Ethiopia's economy are services, agriculture, and mining. While coffee, oil seeds, legumes, gold, and cut flowers have traditionally been the main sources of foreign exchange, the growth of light manufacturing, especially in the textiles and leather sectors, is enabling the country to diversify its sources of growth and trade. Despite the confluence of the COVID-19 pandemic and the Ukraine conflict, Ethiopia's economy has remained resilient, supported largely by sustained investment and modernisation of infrastructure, positioning Ethiopia as one of the fastest-growing economies in the world in the last decade. Nevertheless, drought, internal conflicts, and debt vulnerability could undermine the country's prospects for growth in the medium term.

POLITICAL ENVIRONMENT

The Ethiopian People's Revolutionary Democratic Front (EPRDF), established in May 1991, emerged as the ruling party after 17 years of armed insurrection against the Marxist military government known as the Derg. The EPRDF coalition established a federally organised state and in 1994 adopted a new constitution establishing a parliamentary republic with a bicameral legislature and a judicial system. The EPRDF won the first multiparty election, held in May 1995. Its operating philosophy is to support broad-based modernisation intended to transform Ethiopia from a poor, rural, agricultural state to a middle-income, urban, and industrialised economy by 2025.

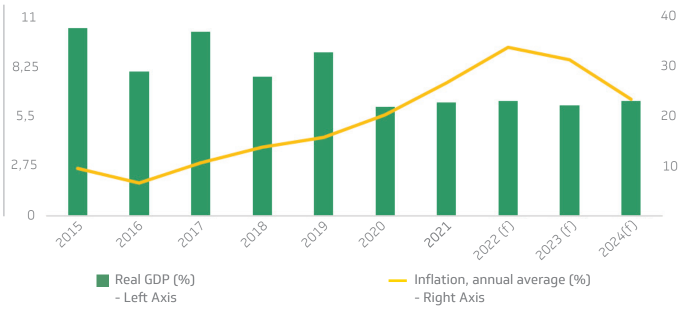
Following the death of Meles Zenawi, the first leader of the EPRDF, Hailemariam Desalegn assumed office as prime minister in 2012 and remained in office following the EPRDF victory in the 2015 elections. He announced his resignation in February 2018 amid nationwide protests. Abiy Ahmed, his successor, was sworn in as prime minister on 2 April 2018. In 2019, he dissolved the EPRDF and replaced it with the Prosperity Party, a coalition comprising all former members of the EPRDF except the Tigray People's Liberation Front (TPLF). Growing political tensions between the government and the TPFL culminated in the Tigray War in 2020. The parties signed a peace agreement in November 2022, ending two years of hostilities and gradually restoring stability. Ethiopia's next general election is scheduled for 2026.

ECONOMIC OVERVIEW

Gross Domestic Product

Despite the recurrence of shocks in the global and African economies, Ethiopia's economy has performed remarkably well in the last decade, with average annual GDP growth of 7.7 percent. Growth has been broad-based, driven by public investments in infrastructure and agriculture, foreign domestic investment (FDI) inflows, and expansion of the services and manufacturing sectors, particularly textiles, garments, leather, and shoe manufacturing, supported by low labour costs. At the height of the COVID-19 pandemic, Ethiopia was one of the few countries in the world to enjoy robust growth. Its 6.1 percent growth rate in 2020 reflected the country's resilience and its diversified sources of growth. GDP growth remained strong, increasing to 6.3 percent in 2021 and further to 6.4 percent in 2022, despite the Tigray war and fallout from the Ukraine conflict (figure 1).

Figure 1: Economic growth and inflation



Sources: Afreximbank Research, IMF World Economic Outlook 2023.

Growth is projected to remain robust at 6.1 percent in 2023, despite the impact of the Tigray conflict and inflationary pressures. Growth is expected to increase to 6.4 percent in 2024 on the back of the International Monetary Fund (IMF)'s US$2 billion program to support the country's Homegrown Economic Reform Agenda (HGER II). Improving confidence and increasing foreign and private investments in key sectors such as telecoms, finance, and civil aviation, alongside growth in the export sector and increasing private consumption, will contribute significantly to the expansion of overall output. Ethiopian Airlines benefited from the uptick in tourism. Further support to output will come from major projects such as the Ethiopia-Djibouti gas pipeline, the expansion of the electricity grid, and railway and road construction. Political tensions and the possibility of a surge in instability remain the key downside risks to the positive outlook.

Inflation

Inflationary pressures have been high, with headline inflation reaching 33.9 percent in 2022, up from 26.8 percent in 2021, on account of the conflict in Tigray and consequent disruptions to supply chains and logistics, exacerbated by rising global fuel and food prices occasioned by the Ukraine conflict. Food inflation rose to 36.8 percent and reached an all-time high at about 44 percent in May 2022, up from about 25.1 percent in 2021. Non-food inflation also ticked higher to about 31.5 percent in 2022 from about 22.6 percent in 2021, reflecting significant increases in the price of fuel, transport, fertilizers, clothing and footwear, construction materials, furnishings and household goods, and services, as well as currency volatility. Inflation is projected to remain above 31 percent in 2023, as easing commodity prices are offset by the gradual lifting of government subsidies. It is expected to decelerate to about 18 percent in 2024, as the improving global and domestic environment eases supply chain and logistics challenges, reducing the price of oil and other commodities.

Exchange Rate

Ethiopia's currency is the Birr, and the country operates a managed floating exchange rate regime. In 2019, the National Bank of Ethiopia announced plans to transition to a fully flexible market-determined exchange rate regime in an effort to enhance price competitiveness and boost exports and FDI inflows. However, implementation has stalled due in part to inflationary pressures and limited foreign exchange, which has created volatility in the parallel market. The Birr traded at an average of Birr80:US$1 against Birr52:US$1 in the official market in 2022. Currently, the Birr is traded at an average rate of about Birr55:US$1 in the official market compared to birr108:US$1 in the parallel market. Nonetheless, improving external balances and confidence under the IMF programme and easing political tensions will support the currency and help stabilise the foreign exchange market.

Fiscal Balance

Government expenditure has remained elevated in the last few years largely on account of bold policies implemented by the government to help the population and businesses cope with the fallout from the COVID-19 pandemic and the ongoing Ukraine conflict. Other major expenditures include military outlays, conflict rehabilitation, and welfare spending to help the population cope with high inflation. Additional expenditures on mega-infrastructure projects, including the extension of the Addis Ababa International Airport and road developments, also increased public spending. As a result, the fiscal deficit widened to 5.1 percent of GDP in 2022, up from 3.1 percent in 2021. It is expected to trend downward in 2023 to about 5 percent of GDP and to about 4.3 percent of GDP in 2024, underpinned by revenue growth, a widening tax base, electricity and gas exports, and investments in mining, along with a vibrant aviation sector led by Ethiopian Airlines. The deficit will be financed by a combination of domestic loans and external concessional loans.

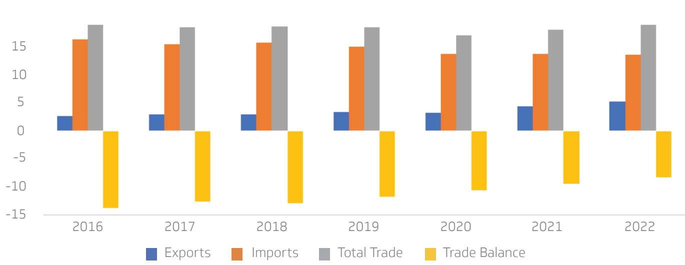
OVERVIEW OF TRADE, RESERVES, AND THE FINANCIAL SECTOR

Total Trade

Coffee, tea, maté and spices accounted for 49 percent of Ethiopia's total exports, while edible vegetables and certain roots accounted for 17 percent of the total. Their top destinations are the United States, Saudi Arabia, Somalia, Germany, the Netherlands, and the United Arab Emirates, which together accounted for 50 percent of the country's total exports in 2022.

Ethiopia's top import products in 2022 included capital goods such as nuclear reactors, machinery and equipment, mechanical appliances, and vehicles, as well as cereals and fertilizers, which together accounted for 52 percent of total imports. The country's main sources of imports are China, India, and the United States, with a combined share of more than 50 percent of total imports. In 2022, the country's exports stood at US$5.4 billion, and its imports were estimated at US$13.6 billion - resulting in a trade deficit of US$8.3 billion, compared with US$9.4 billion and US$10.5 billion in 2021 and 2020, respectively (figure 2).

Figure 2: Ethiopia's total merchandise trade (US$ billion)



Sources: Afreximbank Research, IMF DOTS (2023).

Intra-African Trade

Ethiopia's total intra-African trade amounted to approximately US$2.48 billion in 2022, accounting for 12.64 percent of its total trade, which was below the regional average of 14 percent. Together, Djibouti, Kenya, Somalia, and Sudan were the destinations of over 89 percent of Ethiopia's exports to Africa, with Somalia alone accounting for more than 48 percent of Ethiopia's total exports to the continent in 2022. The main export products to Africa were edible vegetables and certain roots and tubers, coffee, tea, maté, and spices.

The countries providing the bulk of Ethiopia's imports in 2022 were Morocco, Egypt, and Djibouti, with a combined share of about 80 percent. The primary imports were fertilizers (58.8 percent), animal, vegetable, or microbial fats and oils (19.4 percent), mineral fuels, mineral oils, and bituminous substances (6.4 percent).

Reserves

Ethiopia's foreign reserves have trended downward in recent years, reaching US$1.02 billion in 2022, down from US$1.6 billion in 2021 after posting US$3.05 billion in 2020. The decline in reserves is attributable to factors such as the impact of the Tigray conflict and the COVID-19 pandemic, exacerbated by the fallout from the Ukraine conflict, as well as the country's ambitious infrastructure development agenda and high debt service in a context of rising interest rates. Nonetheless, the country's reserve position is expected to improve, with the stock of reserves projected to increase to US$1.4 billion in 2023 and an estimated US$2.03 billion in 2024, on the back of increasing output supported by the IMF programme, improving political stability, and rising FDI inflows.

Current Account Balance

After widening sharply to about 4.6 percent of GDP in 2021 from 2.8 percent in 2020, Ethiopia's current account deficit narrowed to 4.4 percent of GDP in 2022 as broad-based export growth, supported by increased export volumes in agriculture, horticulture, and light manufacturing products outpaced import growth. The downward trend of the current account deficit is expected to continue, with the deficit narrowing to 3.9 percent of GDP in 2023, as falling commodity prices reduce import bills while electricity and mining exports boost overall export revenues.

Financial Sector

Ethiopia's financial sector has expanded in recent years. As of March 2023, the country's financial sector was comprised of commercial banks, insurance companies, and microfinance institutions. Of the 30 banks operating in the country, 2 are state-owned and 28 are private. The insurance sector comprises 18 companies, with 17 being privately-owned and represented by 732 branches across the country. The microfinance sector is also significant, with 46 institutions and 1,074 branches.

Total capital of the financial sector was estimated at Birr262.8 billion[1] at end-March 2023. Of that total, commercial banks accounted for over 80 percent, followed by insurance companies (5.8 percent) and microfinance institutions (5.1 percent).

Two major public banks hold most of the capital in the banking sector - the Commercial Bank of Ethiopia holds 64 percent and the Development Bank of Ethiopia, 17 percent. Between March 2022 and March 2023, the banking sector performed well in terms of credit disbursement and deposits collection. Total loans grew by about 13 percent, with private banks and state-owned banks accounting for 60.4 percent and 39.6 percent of disbursed loans, respectively, during the period. The agriculture sector was the largest beneficiary, accounting for 25.7 percent of the loans, followed by international trade (15.6 percent), manufacturing (10.5 percent), building and construction (9.6 percent), and consumer and staff loans (9.5 percent). As a result, total credit outstanding stood at Birr1.9 trillion, representing a 27.7 percent increase during the period.

In recent years, the Central Bank of Ethiopia has undertaken a number of reforms in an effort to maintain a sound financial environment. In 2022, the shortage of foreign reserves led the Central Bank to restrict the issuance of foreign currencies to businesses importing goods including food, medicines, medical equipment, and raw materials. Instead, businesses were required to register with commercial banks to obtain foreign currency. Furthermore, the federal government is committed to promoting the sector's growth through reforms to attract foreign investors. In addition to addressing the liquidity constraint, these reforms are vital for the development and sustainability of Ethiopia's financial sector.

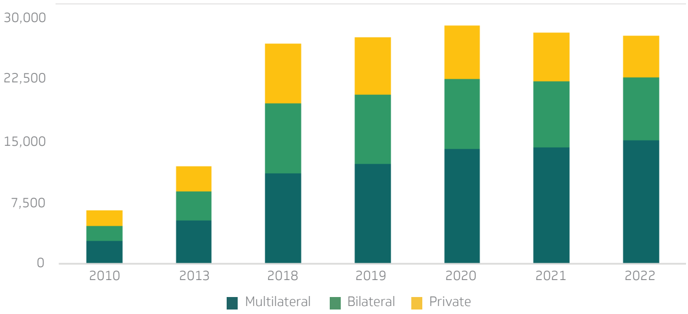
Debt Sustainability

Ethiopia's public debt has remained elevated in recent years, increasing by 4.5 percent to US$55.82 billion in 2022 from US$53.40 billion in 2021. Growth in the country's debt stock has been driven mainly by rising expenditures associated

[1] This only includes commercial banks, insurance companies and microfinance companies.

with the COVID-19 pandemic, exacerbated by the eruption of the Tigray conflict in the Northern part of the country and the Ukraine conflict. Significant borrowing to finance large infrastructure projects in support of growth also raised Ethiopia's debt. A US$1 billion sovereign Eurobond with a 10-year maturity was issued in 2014 to finance infrastructure, including roads, energy, industrial parks, and the expansion of sugar factories. While the government is currently negotiating a US$2 billion IMF programme to support implementation of HGER II and stabilise the macroeconomic environment, approval of the program will further increase the country's debt burden. The trend in Ethiopia's debt, driven largely by multilateral debt is illustrated in figure 3.

Figure 3: Evolution of Ethiopia's external debt composition, in US$ millions



Sources: Afreximbank Research, International Debt Statistics (DSSI), Ethiopian Ministry of Finance (MOF).

i. PV of external debt/GDP

The present value (PV) of external public debt stood at 21.8 percent of GDP as of 2022 and is projected to expand by 20.7 percent in 2023 and maintain the downward trend to 18.6 percent in 2024. These figures fall below the prudent Country Policy and Institutional Assessment (CPIA) threshold of 40 percent, indicating the country's capacity to sustain external debt, especially as China allowed Ethiopia to suspend payments on maturing debt in the 2023/24 fiscal year.

ii. Debt service/Revenue

External debt service-to-revenue increased to 24 percent in 2022, from 18 percent (within the prudent threshold) in 2021, as the confluence of crises, especially the COVID-19 pandemic and the local Tigray conflict, hindered revenue collection. At the same time, fallout from the Ukraine conflict constrained export receipts, increasing pressure on overall revenue. However, the ratio is expected to improve following reforms aimed at improving domestic resource mobilisation through taxes and improving public financial management and expenditure efficiency.

iii. External debt/exports

External public debt in terms of exports has been declining gradually to 264.9 percent in 2022 from 301.7 percent in 2021 and is expected to decline further to 252.6 percent in 2023 and 240.9 percent in 2024. However, it remains well above the prudent threshold of 180 percent, in part reflecting the low export base of the country and the ambitious national infrastructure development programme.

iv. External debt service/exports

The external debt service-to-exports ratio stood at 14.6 percent in 2022, down from 17.5 percent in 2021, and remaining marginally below the sustainable threshold of 15 percent, despite the US$2.1 billion in external debt service repayments and over US$1.7 billion in principal repayments. The ratio is expected to trend upward, with principal repayments estimated at around US$3 billion with payment for US$1 billion sovereign Eurobond falling due in 2024. However, the suspension of debt repayment falling due in 2023/24 to China will reduce pressure on the debt service.

An assessment of Ethiopia's debt based on the debt sustainability indicators suggests that the country is at high risk of external debt distress, with two debt sustainability analysis indicators breaching the prudent CPIA thresholds. Domestic resource mobilisation and national savings have been too low to meet the country's investment needs. This, combined with a small export base, has forced the country to resort to significant external loans, increasing debt in an environment of tightening global financing and high inflation. The situation has been aggravated by rising expenditures related to the military and management of the fallout from the Ukraine conflict, heightening the vulnerability of the country's debt position. Approval of the IMF's US$2 billion programme and donor support, along with implementation of reforms to improve domestic resource mobilisation and overall macroeconomic management, remain critical to help the country mitigate the risk of debt crisis.

OPPORTUNITIES FOR BANK SUPPORT

Ethiopia's development aspirations are set forth in its ten-year development plan, *A Homegrown Economic Reform Agenda: A Pathway to Prosperity (2021–2030)*, a comprehensive and ambitious development plan aimed at safeguarding macro-financial stability and rebalancing and sustaining economic growth. The plan seeks to sustain growth by creating an economic environment that supports higher private investment and structural transformation of the economy. It rests on three key strategic pillars at the macro-financial, structural, and sectoral levels. It will be implemented through several strategies, including promoting investment in agriculture and manufacturing, improving logistics infrastructure to boost trade, and promoting tourism and the creative arts. This will create enormous opportunities for the African Export–Import Bank (Afreximbank) to enhance its presence in the country. Supporting the implementation of Ethiopia's development strategy through various programmes and facilities will further enhance the Bank's relevance.

In the manufacturing sector, Afreximbank financing could scale up the capacity of Ethiopia's light manufacturing and agro-processing industries by expanding output in the sector and enabling it to become a key driver of economic growth and transformation. Closing the infrastructure deficit—particularly transport, electricity, communications, and logistics infrastructure—and the Bank's support in developing industrial parks and special economic zones will be vital for crowding in private investment to boost value-added products and accelerate the process of structural transformation.

The tourism sector also presents opportunities for the Bank's CONTOUR programme, especially given Ethiopia's rich history and cultural heritage. The government is committed to promoting the sector and repositioning it as one of the drivers of growth and a major source of employment.

Appendix: Ethiopia Selected Macroeconomic and Financial Indicators

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Real GDP, %	10.3	10.4	8.0	10.2	7.7	9.0	6.1	6.3	6.4	6.1	6.4
Inflation, annual average, %	7.4	9.6	6.6	10.7	13.8	15.8	20.4	26.8	33.9	31.4	23.48
Exports of goods and services, % y/y	8.6	1.4	7.0	4.0	14.9	8.6	-8.1	3.1	11.0	-2.4	18.08
Current account, % of GDP	-7.9	-11.5	-10.9	-8.5	-6.5	-5.3	-4.6	-3.192	-4.263	-3.387	-2.603
Total reserves, US$ millions	3,525	3,835	3,031	3,046	3,987	2,993	3,046	1,631	1,015	1,394	2,032
Gross reserves, months of imports	2.30	2.28	1.78	1.84	2.35	1.81	2.05	0.9	0.5	0.6	0.8

Sources: Afreximbank Research, World Bank, IMF, EIU.

Headquarters
72B El-Maahad El-Eshteraky Street
Roxy, Heliopolis, Cairo 11341, Egypt
info@afreximbank.com
T +(202) 2456 4100/1/2/3/4

Abidjan Branch
3ème Etage, Immeuble CRRAE-UMOA,
Angle Boulevard Botreau Roussel –
Rue Privée CRRAE-UMOA Abidjan,
Côte d'Ivoire
abidjan@afreximbank.com
T +(225) 2030 7300

Caribbean Office
African Export-Import Bank
Banque Africaine d'Import-Export
Trident Insurance Financial center
Hastings, Christ Church,
Highway 7, Bridgetown,
Barbados BB5156

Abuja Branch
No. 2 Gnassingbe Eyadema Street
Off Yakubu Gowon Crescent
Asokoro, Abuja, Nigeria PMB 601
Garki, Abuja, Nigeria
abuja@afreximbank.com
T +(234) 9 460 3160

Harare Branch
Eastgate Building, 3rd Floor
(North Wing), Sam Nujoma Street
Harare, Zimbabwe P.O. Box CY 1600
Causeway, Harare, Zimbabwe
harare@afreximbank.com
T +(263) 4 700 904 / 941

Kampala Branch
Rwenzori Towers, 3rd Floor, Wing A,
Plot 6 Nakasero P.O. Box 28412
Kampala, Uganda
kampala@afreximbank.com
T +(256) 417 892 700
+(256) 312 423 700

Yaoundé Branch
National Social Insurance
Fund (NSIF) Headquarters Building,
Town Hall, Independence Square
P.O. Box 405, Yaoundé, Cameroon
yaoundebranch@afreximbank.com

afreximbank.com