ETHIOPIA

DIFFICULT COMPROMISES

A breakthrough has recently been made in the process of restructuring the Ethiopian government's external debt. The peace agreement between the federal authorities and the Tigray rebel forces, signed in November 2022, ended two years of civil war and cleared the way for negotiations with international institutions to resume. Consequently, almost three years after requesting a debt restructuring under the G20 Common Framework, Ethiopia reached an agreement on an interim suspension of its bilateral debt service. However, this is only the first step on its journey, as the Ethiopian government must now reach agreements with all of its external creditors in order to fully restructure its debt. Before this, it must negotiate with the IMF in order to obtain its financial support, in exchange for undertaking tough reforms which will primarily set out to strengthen the country's external accounts. This is all happening against the backdrop of ongoing conflicts in the region, which are jeopardising the country's relations with its international partners.

A SLOW RESTRUCTURING PROCESS...

In February 2021, staring down the barrel of an increasingly likely default, the Ethiopian government requested a debt restructuring under the G20 Common Framework. At that time, external liquidity was falling to critically low levels. On top of the falling coffee prices (a third of Ethiopia's exports) over the past decade, the country had also been hit by the Covid-19 pandemic and the ongoing historic drought in the Horn of Africa since 2020.

However, the civil war that broke out in the country in November 2020 derailed the negotiation process and led to its relations with foreign donors being cut off. Official development assistance (ODA), on which the country has been historically dependent, shrank by 40% between 2020 and 2022, plummeting to USD 2.7 bn, a decade low. As a result, the foreign exchange shortage intensified and foreign exchange reserves gradually fell to USD 1 bn in June 2023, covering less than one month of imports.

The signing of the peace agreements between the federal government and the Tigray People's Liberation Front (TPLF) in November 2022 was a breakthrough moment in this situation. Ethiopia reached interim agreements on suspending its bilateral debt service for the 2023 and 2024 fiscal years, first in August 2023 with China, which holds 75% of its bilateral debt, and then last November with all of its other bilateral creditors. As a result, interest payments will be deferred until 2025, with the payment of the principal postponed until 2027, coming to a combined total of USD 2.5 bn.

Beyond the short-term external liquidity relief, these agreements enabled the Common Framework to be relaunched after a long spell of inactivity. In order to comply with this mechanism, two weeks after it signed the bilateral agreements, the Ethiopian government did not pay a USD 33 mn coupon owed on its outstanding Eurobond debt, in order to uphold the principle of comparability of treatment between creditors. As a result, S&P and Fitch downgraded the government rating to «default» last month. The country is the latest in a line of African governments that have defaulted on their external commercial debt since the Covid-19 pandemic, following in the footsteps of Zambia and Ghana.

However, unlike these other two countries, Ethiopia's default is the culmination of a temporary external liquidity crisis rather than a long-term insolvency issue. According to the Ethiopian Ministry of Finance, in September 2023, public debt was contained at 39% of GDP, compared to 88% in Ghana and 140% in Zambia when they defaulted, respectively. Furthermore, less than a quarter of the external debt was owed to private creditors. Therefore, the negotiations could be faster.

FORECASTS

	2021	2022	2023e	2024e	2025e
Real GDP growth (%)	6.3	6.3	6.1	6.2	6.4
Inflation (CPI, year average, %)	26.8	33.9	29.1	20.7	16.5
Government balance / GDP (%)	-2.8	-4.1	-2.7	-2.0	-2.5
Government debt / GDP (%)	53.8	46.4	37.9	31.2	28.9
Current account balance / GDP (%)	-3.2	-4.3	-2.4	-2.0	-1.2
External debt / GDP (%)	27.0	22.5	20.3	16.6	14.4
Forex reserves (USD bn)	2.9	1.5	1.1	1.3	1.5
Forex reserves, in months of imports	4.1	1.6	1.4	1.6	1.8

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

ETHIOPIA: EXTERNAL PUBLIC DEBT BY CREDITOR AS OF SEPTEMBER 2023

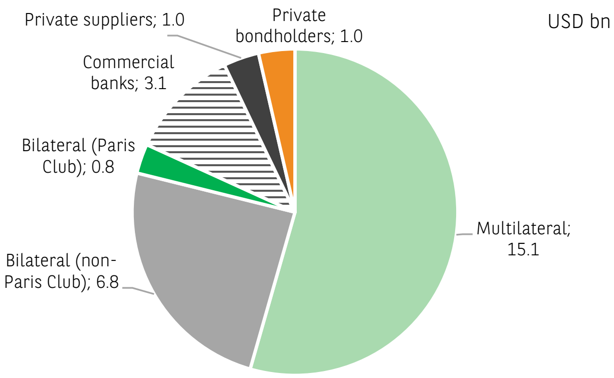

CHART 1

SOURCE: ETHIOPIAN MINISTRY OF FINANCE, BNP PARIBAS

Firstly, the scope of the restructuring will not include domestic debt, as was the case in Ghana. In addition, the restructuring is expected to be limited to extending maturities, with the aim of spreading repayments better over time and therefore reducing periods of liquidity pressure.

Any such agreement should be relatively easier to negotiate with bilateral creditors, especially with China, which has traditionally been reluctant to accept debt write-offs. However, as is often the case, Eurobond debt will be more difficult to restructure, as evidenced by the failure by the government and private bondholders to reach an initial agreement at the end of October. Fortunately, Ethiopia has issued only one Eurobond for an amount of USD 1 bn, i.e., only 11% of the scope of the debt to be restructured.

… WHICH WILL HINGE ON TOUGH REFORMS…

Nevertheless, any further progress under the G20 Common Framework is still dependent on securing a USD 3.5 bn IMF funding programme, which would unlock a similar amount from the World Bank. The Ethiopian government does not have much room for manoeuvre in negotiating the conditions for this funding: without an agreement with the IMF by the end of the first quarter of 2024, bilateral creditors reserve the right to cancel their debt service suspension. Yet, the IMF will demand tough reforms from the Ethiopian authorities, which the government has delayed for many years.

The main sticking point in the negotiations is the gradual devaluation of the exchange rate, a reform launched under the previous IMF programme in 2019, but ultimately abandoned in 2021. For decades, the National Bank of Ethiopia (NBE) has been managing the exchange rate and the Birr has been largely overvalued. Due to the foreign exchange shortage, the disparity between the official rate and the parallel market rate has gradually widened to nearly 100% at present.

Devaluation with the aim of bringing the official and parallel rates back together will be needed for the NBE to end the restricted access to the dollar (at least 35% of currency transactions are thought to be carried out on the parallel market) and liberalise the foreign exchange regime. The scale of the devaluation is being discussed by the Ethiopian government and the IMF, as a full correction of the overvaluation would obviously have a significant impact on inflation, which is already very high, with the year-on-year rise in consumer prices exceeding 25% since June 2021.

Therefore, if the foreign exchange market were to be liberalised, this would need to go hand in hand with a reform of monetary policy in order to better control inflation via the interest rate channel. At the present time, the NBE's main measures to tackle inflation involve capping bank credit growth at 14% for the current fiscal year and reducing the NBE's direct advances to the government, i.e. reducing the monetisation of the fiscal deficit. However, the end of direct advances will be difficult, in view of the government's substantial short-term financing needs and its struggles to find revenue. According to the IMF, the Ethiopian government's fiscal revenue gradually declined from 15.6% of GDP in 2016 to 8.5% in 2022, one of the lowest ratios in sub-Saharan Africa. Over the same period, spending contracted at a slower pace, so much so that the budget deficit widened to 4.1% of GDP in 2022. In order to get public finances on a more sustainable footing and show goodwill to the IMF, the government will therefore have to propose fiscal reforms aiming to structurally increase revenue while drastically reducing subsidies and social transfers, which accounted for more than half of budgetary expenditure in 2020.

Further reforms will be needed in order to durably attract foreign investment and strengthen external accounts. Other actions that may be required to secure the IMF financing include developing and liberalising the financial sector, continuing the programme to privatise public companies and improving the business environment.

ETHIOPIA: STRONG INFLATIONARY PRESSURES

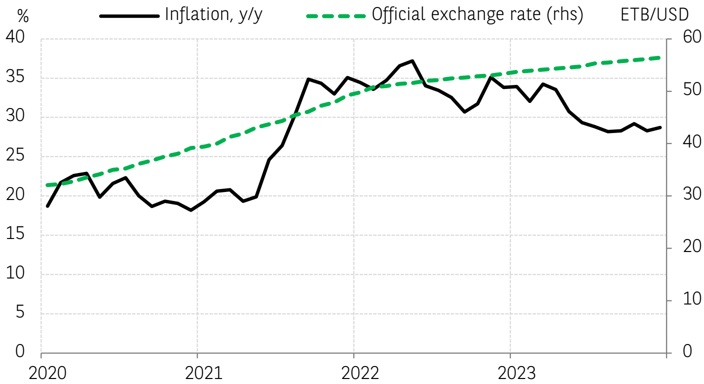

CHART 2

SOURCE: NBE, COMMERCIAL BANK OF ETHIOPIA, BNP PARIBAS

… AND BE THREATENED BY ONGOING CONFLICTS IN THE REGION

Despite its estimated death toll of 600,000 people, which has made the Ethiopian civil war the deadliest conflict in the last twenty years, the signing of the peace agreements between the federal government and the TPLF has not halted the ethno-political conflicts that are tearing the country apart. While the situation is still tense in Tigray, the insurgent movements in the neighbouring regions of Oromia and Amhara have grown in recent months, against the backdrop of territorial disputes and calls for self-determination. The United States and the European Union, which announced the resumption of ODA to Ethiopia in H2 2023, expressed their concern about the escalation of violence and reiterated that their financial assistance programmes remained conditional on the peace agreements being honoured. The resurgence of conflicts could also hold up the debt restructuring process.

On the external side, tensions between Ethiopia and its neighbours have also intensified in recent months. In December 2023, the trilateral negotiations with Egypt and Sudan around the Grand Ethiopian Renaissance Dam once again failed. Ethiopia, which expects the dam to produce 6,000 MW of electricity in the future, has refused to negotiate an agreement on sharing water resources, which Egypt has described as a violation of the 2015 Declaration of Principles. In addition, at the start of January, the Ethiopian government signed an agreement with the self-declared Republic of Somaliland to recognise its sovereignty in exchange for a port access on the Red Sea and a military base on the coast. Ethiopia, which has been a landlocked country since the secession of Eritrea in 1993, sees 95% of its trade transit through Djibouti for an annual payment of USD 1.5 bn. Somalia, supported by Egypt, immediately denounced the violation of its sovereignty, as Somaliland's sovereignty claim has no international recognition. There is no certainty as to whether anything concrete will come from this arrangement with Somaliland, but if it does, it will add fuel to the fire in an already fragile region.

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