ETHIOPIA

A NO LONGER ROARING TIGER

In Ethiopia, the coronavirus pandemic triggered an economic crisis that has jeopardised the country's development model of the past decade. Belated reforms, major logistics costs and a shortage of foreign currency have sharply slowed economic modernisation. Civil war in the Tigray region also threatens the country's political stability and worsens the humanitarian crisis. With no resources, Ethiopia lacks the means to face up to the pandemic's economic fallout, and is still highly dependent on international aid. The ratio of foreign currency debt to export receipts has become excessively high. The country has requested foreign debt treatment as part of the G20s' common framework for debt restructuring. Yet the diplomatic crisis with international partners is currently delaying its implementation.

A VERY FRAGILE DEVELOPMENT MODEL

Despite a decade of economic modernisation based on an industrialisation strategy, Ethiopia has failed to withstand the shock of the pandemic. The government's development model promoted the creation of industrial parks managed by the State that offered low taxation and very low labour costs. In reality, the tax-exempt zones presented major logistical problems (such as hooking up to water and power networks), a very high employee turn rate, and poor productivity.

According to central bank data, real GDP growth slowed to 6.1% in 2020, from 9% the previous year, despite the support of public spending (see chart 1). On the supply side, agriculture was the only sector that increased its contribution to growth (1.4%, vs. 0.9% in 2019) thanks to bumper harvests. Already hampered by the irregular supply of electrical power, industrial production and construction activity had to be suspended. No lockdown was officially imposed due to the pandemic, but travel restrictions enforced as part of the state of emergency clobbered the commercial sector. Transport and tourism were hit hardest after flights were suspended.

The recessionary impact of the pandemic will continue to be felt in 2021, with growth estimated at only 2%. Although the state of emergency was lifted in September 2020 after lasting five months, household consumption will remain depressed due to persistently high inflation pressures. Despite the decline in exports, the current account deficit will continue to narrow due to sluggish imports. At the same time, however, direct investments will continue to contract. The fiscal deficit is bound to widen with another increase in healthcare spending. The Minister of Health just confirmed the presence of the Delta variant in Ethiopia, which is spreading rapidly due to the low vaccination coverage. Uncertainty caused by the pandemic is straining growth prospects. Efforts to fight poverty are likely to be brought to a halt. In particular, food risks have been exacerbated by disruptions in the agricultural sector due to a massive invasion of crickets.

FORECASTS

	2019	2020	2021e	2022e
Real GDP growth (%)	9.0	6.1	2.0	8.7
Inflation (CPI, year average, %)	15.8	20.4	21.7	19.0
Government balance / GDP (%)	-2.5	-2.8	-3.3	-3.0
Government debt / GDP (%)	57.7	59.7	61.7	60.4
Current account balance / GDP (%)	-5.3	-4.6	-3.6	-3.9
External debt / GDP (%)	30.5	31.6	35.6	37.9
Forex reserves (USD bn)	3.0	3.0	3.2	3.4
Forex reserves, in months of imports	1.7	1.9	1.7	1.8

TABLE 1 e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

CONTRIBUTIONS TO GROWTH

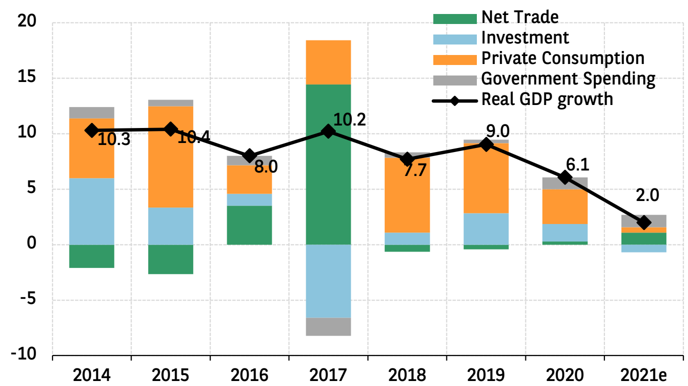

CHART 1 SOURCE: NATIONAL BANK OF ETHIOPIA

RISK OF DEBT DISTRESS

Exports of textiles and horticultural products were hard hit by the pandemic. Delays in privatisation projects reduced foreign direct investment (to 2.6% of GDP in 2020, compared to about 5% before the pandemic). As a result, foreign reserves have tended to dwindle since 2019. Pressures have increased on the local currency (the birr), and low foreign reserves have left the country highly dependent on international aid. The ratio of foreign public debt to GDP was 35% in 2021, but nearly 200% relative to export receipts. External debt servicing rose to 26% of export receipts (compared to 17% in 2015) after concessional loans expired. Today the country is mired in an excessive debt situation.

Ethiopia has officially requested debt restructuring from the G20 countries as part of the common framework for debt treatment[1]. The World Bank and IMF concluded that Ethiopia's debt was sustainable but that rescheduling its foreign debt payments would reduce the risk of

1 In November 2020, the G20 countries adopted a common framework to manage any debt restructuring needed by the world's 73 poorest countries. After a debt sustainability analysis conducted by the International Monetary Fund (IMF) and the World Bank (WB), negotiations will initially be held with the G20 member countries and any other creditor countries that want to join the initiative. During a second phase, under IMF supervision, the country must negotiate with all other creditors using terms at least as favourable as those obtained with the G20 countries.

an excessive debt situation at the end of the current IMF programmes. Ethiopia is currently benefiting from two IMF facilities, an expanded concessional credit facility that expired in September 2021, and an expanded non-concessional credit mechanism that is still operational. The committee of creditors met on 16 September to examine the debt restructuring request, but negotiations have bogged down over the question of the comparable treatment of private creditors. The country has a Eurobond issue outstanding with a nominal value of USD 1 bn, but its value has plummeted since the announcement that Ethiopia would participate in the common framework[2].

VERY HIGH POLITICAL RISKS

General elections on 21 June 2021 confirmed the victory of the Prosperity Party, the new political arm of the incumbent Prime Minister, Abiy Ahmed. He took power in April 2018 as part of a four-party coalition that brought together regional ethnic groups but was dominated by a minority party, the Tigray People's Liberation Front (TPLF). At the end of 2019, Abiy Ahmed ended the coalition and replaced it with a single party dominated by the Amharas. Actually, three out of ten regions were unable to participate in the elections due to the civil war in the northern part of the country.

The ethnic conflict started in the Tigray in November 2020 and spread rapidly to the neighbouring states of Afar and Amhara. The conflict now threatens the stability of the entire region.

The extent of the violence can be attributed to the frustrations of the Oromo, the ethnic group of Prime Minister Abiy Ahmed, who were expecting improved living conditions and greater inclusion in political life. Recent military cooperation between Ethiopia's two main insurrection movements[3] are putting pressure on the federal government.

On 23 May 2021, the United States placed economic sanctions on the country (visa restrictions, partial suspension of aid and pressure on the IMF and the World Bank to freeze future pay-outs). The US is alarmed by chronic insecurity in the region, which is hampering humanitarian operations. It is waiting for the results of a UN Security Council investigation concerning accusations of human rights violations that may constitute war crimes. Meanwhile Abiy Ahmed has lashed out against American interference, which makes no distinction between its treatment of the government and the insurgents, who are now listed as terrorist organisations.

Bolstered by his solid electoral victory, the Ethiopian prime minister is now seeking to strengthen his diplomatic relations elsewhere, notably with the African Union and Turkey, which whom it recently signed military and economic cooperation agreements.

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Sara CONFALONIERI
sara.confalonieri@bnpparibas.com

FOREIGN RESERVES AND EXCHANGE RATE ARE UNDER PRESSURE

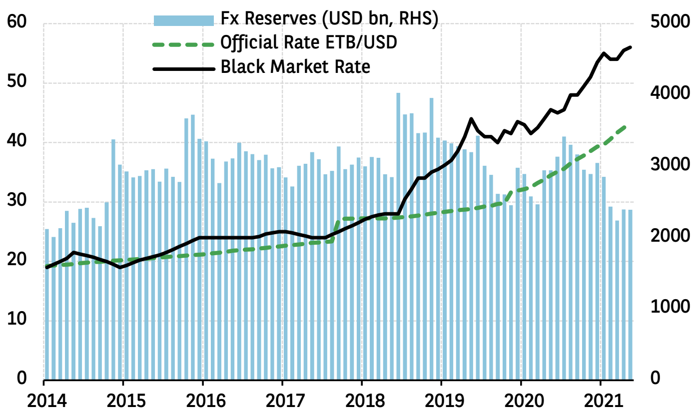

CHART 2

SOURCE: NATIONAL BANK OF ETHIOPIA, IMF

2 The spread with the JPMorgan Emerging Market Bond Index Global (EMBIG) widened to 1000 basis points in early September.
3 Tigray People's Liberation Front (TPLF) and the Oromo Liberation Front (OLF)