IMF Country Report No. 20/29

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

January 2020

2019 ARTICLE IV CONSULTATION AND REQUESTS FOR THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND AN ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—PRESS RELEASE AND STAFF REPORT

In the context of the 2019 Article IV Consultation and Requests for Three-Year Arrangements Under the Extended Credit Facility and the Extended Fund Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** for the 2019 Article IV Consultation and Requests for Three-Year Arrangements under the Extended Credit Facility and the Extended Fund Facility prepared by a staff team of the IMF for the Executive Board's consideration on December 20, 2019, following discussions that ended on November 8, 2019, with the officials of The Federal Democratic Republic of Ethiopia on economic developments and policies underpinning the IMF arrangement under the 2019 Article IV Consultation and the Extended Credit Facility and the Extended Fund Facility Programs. Based on information available at the time of these discussions, the staff report was completed on December 11, 2019.
- A **Debt Sustainability Analysis** prepared by the International Monetary Fund (IMF) and the International Development Association (IDA) staffs.
- An **Informational Annex** prepared by the IMF staff.

The documents listed below have been or will be separately released:

Letter of Intent sent to the IMF by the authorities of The Federal Democratic Republic of Ethiopia *
Memorandum of Economic and Financial Policies by the authorities of The Federal Democratic Republic of Ethiopia *
Technical Memorandum of Understanding*

*Also included in Staff Report

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org;
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 20/19
FOR IMMEDIATE RELEASE
January 28, 2020

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2019 Article IV Consultation with The Federal Democratic Republic of Ethiopia

On December 20, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation[1] with The Federal Democratic Republic of Ethiopia. At the same time, the Board approved three-year arrangements under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) for Ethiopia; a press release on this was issued separately.

Ethiopia has sustained high economic growth over the last decade. Substantial progress on reducing poverty and improving social indicators has also been noteworthy. In 2018/19, real gross domestic product (GDP) is estimated to have grown by 9 percent, driven by manufacturing and services. However, performance of goods exports remained weak and foreign exchange shortages persist. Policies appropriately targeted at containing public investment and debt contributed to a further narrowing of the current account deficit to 4.5 percent of GDP and a reduction in public and publicly-guaranteed debt to 57 percent of GDP. Inflation remained elevated in double digits, largely due to higher food prices, though non-food inflation has also been trending upward. While revenues came in below target, cuts in expenditure contained the fiscal deficit to 2.5 percent of GDP, below budget.

The authorities have announced a Homegrown Economic Reform Plan, consisting of a mix of macroeconomic, structural and sectoral policies, to address vulnerabilities and tackle structural bottlenecks inhibiting private sector activity. The macroeconomic policy measures envisaged under the Plan to address external imbalances, debt vulnerabilities, and inflation are expected to contribute to a slower growth in real GDP of 6.2 percent in 2019/20. Public expenditure restraint and tighter monetary policy are expected to contribute to a gradual reduction in inflation. Reserves are expected to improve to around US$4 billion by end

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

2019/20, sufficient to cover 2 months of prospective imports, due to higher external financing flows, including from the Fund.

Over the medium term, macroeconomic and structural reforms announced by the authorities are expected to lead to a reduction in public debt, lower external vulnerabilities, and stronger growth, investment and exports. This outlook is subject to downside risks, in particular from domestic opposition to reforms ahead of the upcoming elections, rising protectionism worldwide, weaker-than-expected global growth, and climate-related shocks.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They noted that Ethiopia's growth model, driven by public investment, had supported rapid growth and remarkably improved living standards over the past decade. At the same time, it has led to a build-up of debt and external vulnerabilities. Directors highlighted the urgency of fundamental reforms to correct macroeconomic imbalances, ease structural bottlenecks, and lay the foundation for sustainable, inclusive growth led by the private sector.

To this end, Directors welcomed the ambitious Homegrown Economic Reform Plan, which is appropriately built around macroeconomic, structural, and sectoral reforms. They considered that the plan, together with the authorities' strong ownership and commitment, deserves Fund support, which would help catalyze private investment and donor financing. Noting high implementation risks amid external vulnerabilities and political uncertainty, Directors underscored that steadfast determination, strong communication, and social protection would be key to obtain a broad-based public buy in. They also urged the authorities to seek additional debt reprofiling from external creditors to improve debt dynamics.

Directors supported a comprehensive approach to addressing the exchange rate overvaluation and foreign exchange shortages. They agreed with the priority placed on increasing exchange rate flexibility, reducing inflation, strengthening competitiveness, and rebuilding international reserves. They recommended a reform roadmap to transition to a market clearing exchange rate regime. Directors also supported monetary tightening, complemented by spending restraint by state owned enterprises (SOEs) and the phasing out of central bank financing of the government and the Development Bank of Ethiopia (DBE). Continued efforts are needed to modernize the monetary policy framework and further develop financial markets to deepen inclusion.

Directors stressed the need to reform SOEs to reduce public debt vulnerabilities and improve governance and transparency. In this context, it would be important to reduce SOEs'

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

borrowing, strengthen their financial positions, and prioritize investment activities. Immediate priorities also include an asset quality review of the Commercial Bank of Ethiopia, and a strategy to address the DBE's non-performing loans and develop a sustainable financing model.

Directors agreed that reforms are urgently needed to reverse the recent decline in domestic revenue mobilization and to meet Ethiopia's social and infrastructure needs. They welcomed the planned extension of the value added tax coverage. Directors also emphasized the need to protect high quality social assistance programs, rationalize subsidies, and improve expenditure efficiency more broadly.

Directors called on the authorities to build on progress made in improving the AML/CFT framework, and further strengthen data quality.

It is expected that the next Article IV consultation with the Federal Democratic Republic of Ethiopia will be held in accordance with the Executive Board decision on consultation cycles for members with Fund arrangements.

The Federal Democratic Republic of Ethiopia: Selected Economic Indicators

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Actual	Prel.		Program		IMF Staff Projections	
	(Annual percentage change, unless otherwise indicated)						
National income and prices							
GDP at constant prices (at factor cost)	7.7	9.0	6.2	6.1	7.0	7.5	8.0
GDP deflator	12.4	13.2	19.4	12.3	8.8	8.1	8.1
Consumer prices (period average)	14.5	12.6	19.4	11.1	8.1	8.0	8.0
Consumer prices (end period)	16.8	15.3	18.1	9.4	8.0	8.0	8.0
External Sector							
Exports of goods and services (U.S. dollars, f.o.b.)	13.1	7.9	12.8	12.7	14.0	12.4	9.7
Imports of goods and services (U.S. dollars, c.i.f.)	0.2	4.1	11.3	9.4	8.5	6.6	5.1
Terms of trade (goods, deterioration –)	-9.6	-1.9	4.1	5.6	3.2	1.5	1.4
Nominal effective exchange rate (end of period)	-16.3	-1.8	…	…	…	…	…
Real effective exchange rate (end of period)	-5.1	6.4	…	…	…	…	…
Money and Credit							
Change in net foreign assets	3.5	-63.2	83.9	222.1	95.2	71.7	42.5
Change in net domestic assets (including other items, net)	31.0	24.4	16.9	13.9	14.4	15.2	18.1
Broad money	29.2	19.7	18.0	19.2	19.9	21.6	22.0
Base money	19.1	15.3	12.5	13.0	13.0	13.5	13.5
Velocity (GDP/broad money)	2.97	3.04	3.24	3.28	3.23	3.10	2.97
	(Percent of GDP, unless otherwise indicated)						
Financial balances[1]							
Gross domestic savings	24.1	22.3	25.2	25.0	26.7	29.5	31.8
Public savings	2.1	1.7	2.6	3.6	4.7	4.9	5.0
Private savings	22.0	20.6	22.6	21.4	22.0	24.6	26.8
Gross domestic investment	34.2	35.2	34.3	36.3	38.1	38.6	40.8
Public investment	12.6	11.0	10.0	10.3	10.3	9.4	9.7
Private investment	21.6	24.2	24.3	26.0	27.8	29.2	31.1
Resource gap	-10.1	-12.9	-9.1	-11.4	-11.4	-9.1	-9.0
External current account balance, including official transfers	-6.2	-4.5	-5.5	-4.6	-4.6	-4.0	-3.4
Government finances							
Revenue	12.3	11.5	11.7	13.0	14.2	14.5	14.7
Tax revenue	10.7	10.0	10.1	11.5	12.7	13.0	13.3
Nontax revenue	1.6	1.6	1.5	1.5	1.5	1.5	1.5
External grants	0.8	1.2	0.9	0.8	0.6	0.7	0.7
Expenditure and net lending	16.1	15.3	15.0	16.0	16.8	17.1	17.4
Fiscal balance, excluding grants (cash basis)	-3.8	-3.8	-3.4	-3.0	-2.6	-2.6	-2.6
Fiscal balance, including grants (cash basis)	-3.0	-2.5	-2.5	-2.2	-1.9	-1.9	-1.9
Total financing (including residuals)	3.0	2.5	2.5	2.2	1.9	1.9	1.9
External financing	1.3	1.3	1.2	1.0	1.7	1.5	0.7
Domestic financing (including privatization)	2.7	1.3	1.3	1.2	0.3	0.4	1.2
Public debt[2]	59.5	56.8	53.4	52.7	52.0	47.5	43.3
Domestic debt	29.2	28.6	25.4	22.6	19.1	16.6	15.5
External debt (including to the IMF)	30.4	28.2	28.0	30.1	32.8	30.9	27.9
Overall balance of payments (in millions of U.S. dollars)	-202	58	-346	22	-547	184	1,692
Gross official reserves (in millions of U.S. dollars)	2,848	3,415	4,031	5,661	7,441	9,551	11,232
(months of imports of goods and nonfactor services of the following year)	1.7	1.8	2.0	2.6	3.2	3.9	4.3
GDP at current market prices (billions of birr)	2,200	2,696	3,391	4,094	4,828	5,630	6,594

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] Based on data from Central Statistical Agency (CSA), except for the current account balance, which is based on BOP data from National Bank of Ethiopia (NBE).

[2] Public and publicly-guaranteed debt, including the National Bank of Ethiopia and Ethio Telecom.

INTERNATIONAL MONETARY FUND

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

December 11, 2019

2019 ARTICLE IV CONSULTATION AND REQUESTS FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND AN ARRANGEMENT UNDER THE EXTENDED FUND FACILITY

KEY ISSUES

Context. In the last decade, rapid growth, the fastest in Sub-Saharan Africa, and strong policies to address poverty have yielded a remarkable improvement in living standards. But the debt-financed public investment-led development model has reached its limits, amid a buildup in external vulnerabilities, as illustrated by severe foreign exchange shortages and high premia on the parallel market, as well as debt and likely financial sector vulnerabilities. Recognizing these vulnerabilities, the authorities have prepared a "Homegrown Economic Reform Plan". Their reform agenda is appropriately ambitious and wide-ranging, encompassing macroeconomic reforms, structural reforms to ease institutional and structural bottlenecks to productivity and job growth, and sectoral reforms.

Arrangements under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF). The authorities have requested three-year arrangements under the ECF and EFF, with Fund financing of SDR 2.1 billion (around 700 percent of quota from a blend of PRGT and GRA resources). The Fund-supported program will build on their Homegrown Plan and aim to durably address the FX shortage, a key constraint on private sector growth; reduce debt vulnerabilities; gradually lift financial repression and harden SOE budget constraints to improve private sector access to credit; improve domestic revenue mobilization and strengthen public financial management to ensure that adequate resources are devoted to pro-poor spending; and address vulnerabilities in the financial sector and gradually expand government debt markets to encourage financial sector development.

Risks. The risks to the outlook are tilted to the downside. Domestic opposition to reforms ahead of the upcoming elections could increase investor uncertainty and weigh on investment and growth. External risks stem from rising protectionism and weaker-than-expected global growth as well as climate-related shocks.

Approved By
Zeine Zeidane (AFR) and Seán Nolan (SPR)

Discussions were held in Addis Ababa, from October 29 to November 8, 2019. The mission comprised Sonali Jain-Chandra (head), Narayanan Raman, Maria Coelho, Aminata Touré (all AFR), Souvik Gupta (SPR), Itaru Yamamoto (MCM), and Jules Leichter (Resident Representative in Addis Ababa) and Zenegnaw Abiy Hailu (local economist). The team met with Prime Minister Abiy Ahmed Ali, Finance Minister Ahmed Shide, Governor Yinager Dessie, and other senior officials. Mr. Mahlinza and Ms. Gasasira-Manzi (OED) joined the official meetings. M. Hasegawa, T. Gursoy, F. Nyankiye, C. Hreib, and J. Kiggundu provided research and administrative support from headquarters

CONTENTS

BOXES

FIGURES

TABLES

ANNEXES

APPENDIX

CONTEXT: A TRANSFORMATIVE MOMENT

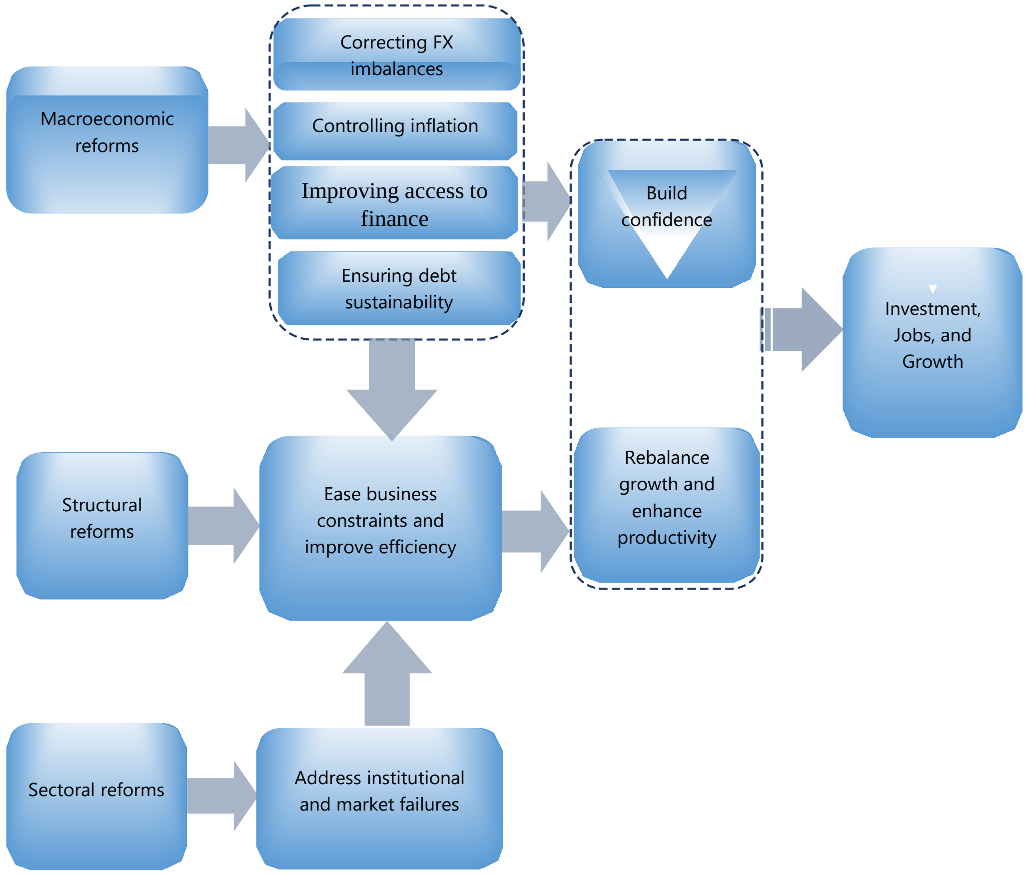
1. Ethiopia has enjoyed strong growth for over a decade, which has reduced poverty and raised living standards. Since 1990, per capita income in Ethiopia has increased by about 200 percent, while other development indicators saw remarkable improvement: life expectancy rose by about 10 years in a decade while infant mortality was halved. Importantly, Ethiopia made these strides while maintaining a relatively equitable income distribution.

2. However, the public investment-driven growth model has reached its limits. The model, driven by external borrowing by state-owned enterprises and diversion of resources towards infrastructure investment, has resulted in large imbalances. External vulnerabilities have risen amid a rapid buildup in public debt over the past few years, especially from the public enterprises; significant exchange rate overvaluation, in part due to inadequate adjustments in macroeconomic policy settings; and persistent and widespread shortages of foreign exchange as imports for public investment remained high and goods exports disappointed while external debt servicing needs went up. Foreign exchange reserves cover less than 2 months of prospective imports despite significant FX rationing. External debt vulnerabilities remain elevated, notwithstanding reprofiling of some bilateral external loans.

3. To tackle these vulnerabilities, the authorities have recently unveiled an ambitious "Homegrown Economic Reform Plan", for which they are seeking Fund financial support. The Plan, which takes a comprehensive approach to addressing imbalances and rebalancing growth, has three pillars: (i) macroeconomic and financial sector reforms to correct FX imbalances, control inflation, safeguard financial stability while promoting intermediation, and ensure debt sustainability; (ii) structural reforms to ease institutional and structural bottlenecks to productivity and job growth, and (iii) sectoral reforms to address institutional and market failures in key strategic sectors (Figure 1). The Plan builds on previously-announced reforms such as measures to privatize key SOEs and open up previously closed sectors of the economy to private sector participation. Key reforms envisaged by the Plan already in train include the decision to open up the telecommunications and sugar sectors to the private sector, strengthening the business and investment climate and phasing out measures of financial repression.

4. The economic reform drive is taking place against the backdrop of significant political uncertainty and heightened tensions. The government headed by Prime Minister Abiy Ahmed took office in April 2018 and embarked on a program of political reforms: it signed peace agreements with armed separatist groups, freed political prisoners, opened the space for political dissent and made peace with neighboring Eritrea. However, these changes have been followed by an increase in inter-regional and inter-ethnic tensions, and violence. High-profile assassinations took place in June 2019 and millions of people remain internally displaced. Elections are scheduled to take place in the first half of 2020, which may have implications for domestic security.

Figure 1. Ethiopia: The Pillars of the Authorities' Homegrown Economic Reform Plan



Source: Ethiopian authorities
Note: Macroeconomic reforms also encompass financial sector reforms.

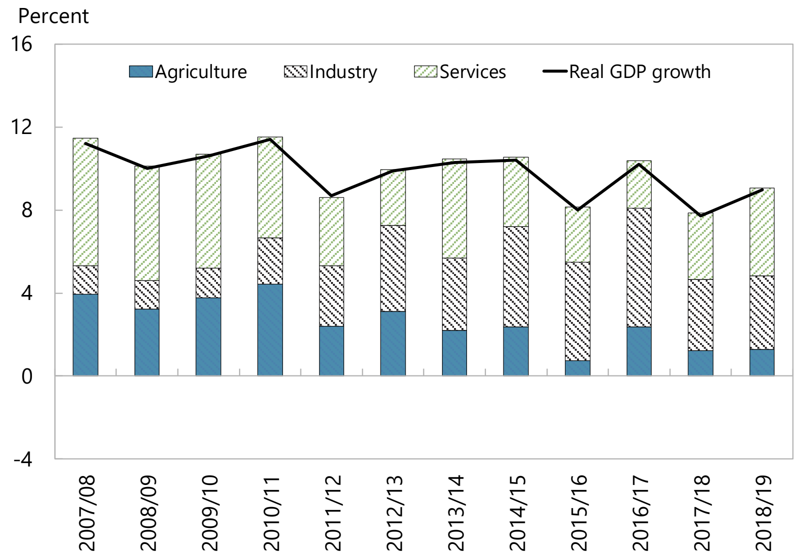
RECENT DEVELOPMENTS: SLOWING ACTIVITY AMID EXTERNAL IMBALANCES AND ELEVATED DEBT RISKS

5. Official data showed robust growth, notwithstanding slower public investment and continuing FX shortages (Figure 2 and Table 1)[1]. Real GDP grew by 9 percent in 2018/19, largely driven by the acceleration in the services sector. However, other indicators point to a more mixed picture: public investment was subdued, given government actions to control SOE debt accumulation and to limit budgetary capital outlays in the face of revenue shortfalls; merchandise exports and imports both declined in volume terms; electricity output rose by less than 1 percent, as disappointing rainfall levels impaired hydro output, resulting in interruptions in electricity supply that weighed on industrial activity; output of cement products declined by 2.5 percent, although production of iron and steel rose by 11 percent. This divergence between the evolution of many

[1] The fiscal year runs July-June.

high-frequency indicators and of headline GDP growth illustrates long-standing concerns about the quality of the national accounts data in Ethiopia.[2]

Figure 2. Ethiopia: Real GDP Growth and Contribution by Sector



Sources: Ethiopian authorities; and IMF staff calculations

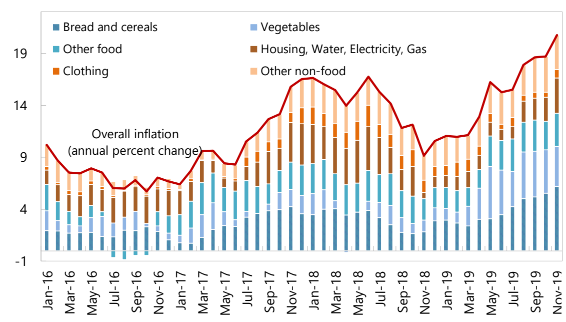
6. **Inflation has been elevated and above the authorities' single-digit objective for over 2 years, notwithstanding slower growth in monetary aggregates (Figure 3 and Table 3).** Inflation started to trend upward in 2017, driven by an accommodative monetary stance, exacerbated by the October 2017 devaluation. The NBE only began tightening the monetary stance in 2018. Due to transmission lags, credit and broader monetary aggregates continued to expand strongly into late-2018. Since then, credit and base money growth have slowed appreciably, marked by a welcome compositional shift in borrowing, with lower growth in public sector borrowing offset by strong private sector credit growth. Inflation rose to 20.8 percent in November 2019. This recent uptick in inflation has been largely driven by food price inflation, which in part has been affected by interruptions to logistics networks and higher transportation costs. Non-food inflation also exceeded 10 percent for the last two years.

[2] The quality of GDP measurement continues to be affected by source data issues, as flagged by earlier Fund technical assistance. National accounts statistics (especially from the expenditure side) remain a work in progress, and data on economic growth, savings, and investment are subject to considerable uncertainty. From the production side, the compilers have recently compiled updated Sources and Uses Tables (SUTs), with external technical support. The new SUTs would allow for the derivation of GDP both on production and expenditure basis; they are still being evaluated and have not yet been used in data compilation.

Figure 3. Ethiopia: Inflation and Monetary Developments

Headline inflation exceeds NBE's target, largely driven by food inflation…

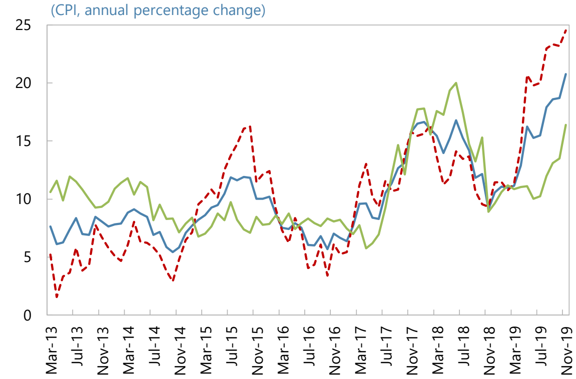
Contribution to Inflation
(percentage points, unless otherwise specified)



Source: Central Statistical Agency, Ethiopia

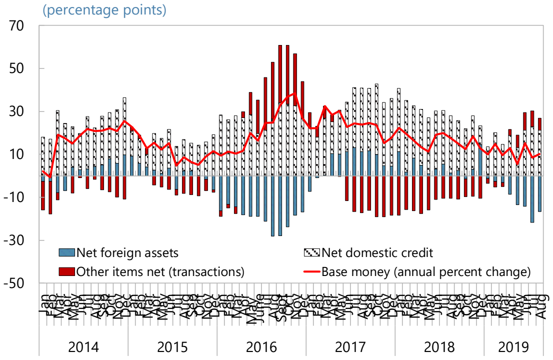
…though elevated non-food inflation is becoming more persistent

Inflation
(CPI, annual percentage change)



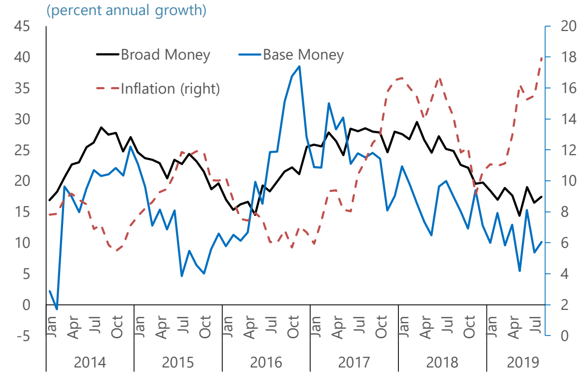
Base money growth has slowed due to a decline in NFA…

Contribution to Base Money Growth
(percentage points)



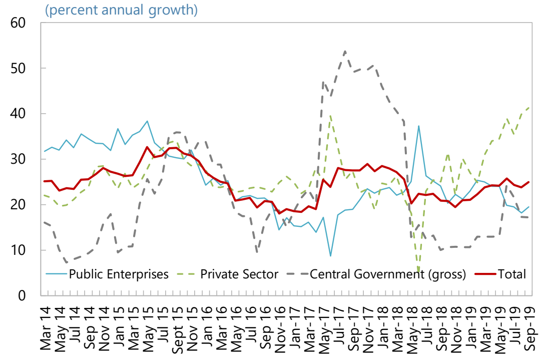
…which is translating into slower growth in broad money

Monetary Aggregates and Inflation
(percent annual growth)



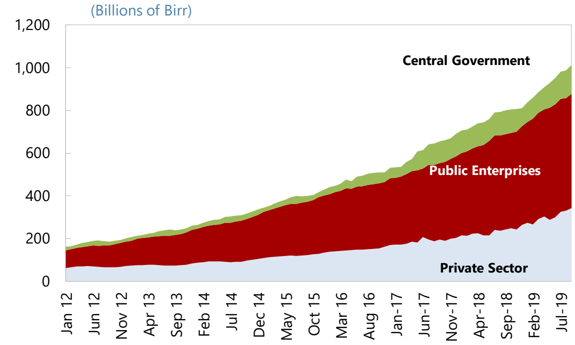
Private sector credit is expanding rapidly…

Credit to the Economy
(percent annual growth)



… but SOEs account for bulk of credit outstanding

Credit to the Economy
(Billions of Birr)



Sources: Ethiopian authorities; and IMF staff calculations.

Source: Ethiopian authorities.

7. The general government deficit in 2018/19 was well below budget as the authorities curtailed expenditure in the face of continuing revenue shortfalls (Table 2). As a result, the general government deficit narrowed from 3 percent of GDP in 2017/18 to 2.5 percent in 2018/19. Tax collection declined to 10 percent of GDP, underperforming the nominal budget target by 7 percent. In particular, import duties and taxes contracted by 0.4 pp of GDP due to import compression. Additional drivers of this decline include: (1) a shift in GDP composition since 2014/15 to sectors that are traditionally more prone to weak tax compliance (such as construction) and (2) some temporary impact of political unrest hindering revenue collection. The revenue shortfall was attenuated somewhat by the US$600 million in grants from the World Bank. Nonetheless, the deficit came in below the budget target as a result of cuts in current expenditure, including poverty-targeted expenditure. Capital expenditure remained constant in real terms.

8. The current account deficit narrowed to 4.5 percent of GDP in 2018/19, with financial support from development partners contributing to a modest improvement in reserves (Table 4). The trade balance improved as a decline in goods imports, for the third year in a row, more than compensated for the fall in goods exports. Goods imports fell on strict control of public investment and FX shortages, which affected private imports. Weak commodity prices weighed on merchandise exports, although manufacturing exports continued to grow fast from a small base. The surplus in the services balance was lower, while private transfers grew at a slower pace than a year ago. Additionally, higher-than-usual grant disbursements in the last quarter of 2018/19, a temporary factor, contributed to the smallest quarterly deficit in more than five years. International reserves rose to US$3.4 billion at end-June 2019 (1.8 months of prospective imports) from US$2.8 billion in 2017/18, although remained below both model-based and rule-of-thumb adequacy metrics (Annex II). In the first quarter of FY 2019/20, merchandise exports grew at 15 percent y/y, supported by coffee, flower, and textile exports. However, lower-than-expected financing flows and payments for fuel imports resulted in a decline in reserves to US$2.6 billion by September 2019.

9. The birr depreciated year on year by about 6.1 percent against the US dollar by end 2018/19, in line with past policy of maintaining a stable and predictable depreciation path against the dollar. Inflation differentials with trading partners and US dollar strength have resulted in a real appreciation of about 11½ percent as of October 2019 relative to end-FY2017/18.[3] Staff estimates suggest that real overvaluation widened to about 25 percent in the last fiscal year (from 12–18 percent estimated during the 2018 Article IV consultation), consistent with a gap between the observed current account and the norm based on fundamentals and desired policy settings of close to –2½ percent of GDP. The authorities agreed with the presence of overvaluation and external imbalances. The spread between the official and parallel market rate averaged 27 percent during 2018/19, though it has widened to 35 percent during the first half of

[3] This appreciation has more than offset the real depreciation that was achieved after the October 2017 devaluation.

November 2019.[4] Consequently, Ethiopia's external position is assessed to be weaker than warranted by medium-term fundamentals and desired policies (Annex II).

10. Efforts at containing external borrowing are bearing fruit and the authorities intend to do more to reduce external debt risks.

- The Debt Sustainability Assessment (DSA) concludes that Ethiopia continues to remain at high risk of external and overall debt distress.[5] During the last fiscal year, the authorities concluded debt reprofiling negotiations with China, reducing Ethiopia's medium-term debt service burden on these loans. The savings mainly arise from reprofiling of the US$2.5 billion loan for the Addis Ababa-Djibouti railway. In addition, efforts to prioritize SOE investment projects and contain SOE borrowing are bearing fruit: public and publicly-guaranteed debt declined to 57 percent of GDP at end-June 2019 from 59.5 percent in 2017/18, driven by lower SOE external borrowing.[6] Although public and publicly-guaranteed debt are expected to remain on a downward trajectory, the near- to medium-term debt servicing needs are elevated, especially relative to exports, with two of the indicators breaching the threshold in the near term under the program baseline.
- The authorities are cognizant of the risks and are seeking assurance on additional relief on external debt service from bilateral creditors with an aim to reduce the risk of external debt distress to "moderate" with some space before the end of the Fund-supported program. The authorities are expected to obtain firm commitments on some of these debt operations by the time of the approval of the arrangements. While the specific terms of the debt operations have to be determined following consultations with creditors, the debt operation would be guided by the following program objectives under the DSA baseline: the first phase of reprofiling would seek prospective saving of about US$1.65 billion in total debt service, primarily from deferment of debt service obligations, over 2019/20–2022/23 without increasing the present value (PV) of the reprofiled loans and avoiding any bunching of debt service obligations within a few years from the end of the Fund-supported program. The authorities are also seeking additional relief from other bilateral creditors in a second phase of reprofiling to help create buffers against adverse shocks and strengthen debt sustainability, on which firm commitments are expected by the first review of the arrangements. The additional reprofiling of debt service totaling approximately US$400 million would help Ethiopia reach "moderate" risk of external debt distress before the end of the program and create some space to absorb shocks.

[4] The parallel market is an illegal FX market, which is not tolerated by the authorities and subject to periodic crackdowns. Notwithstanding this, the NBE periodically surveys prices in the market as part of its surveillance of market conditions.

[5] Ethiopia owes arrears to Libya, Bulgaria, Russia, and former Yugoslavia, totaling about US$538 million as of June 2019, which are deemed away under the policy on arrears to official bilateral creditors, as the underlying Paris Club agreement is adequately representative, and the authorities are making best efforts to resolve the arrears. Furthermore, there are about US$8.2 million worth of external arrears (principal and interest payments combined) to commercial creditors, all pre-dating the1990s, from former Czechoslovakia, India, Italy, and former Yugoslavia. The authorities are continuing to make a good faith effort to reach a collaborative agreement with these creditors.

[6] Excludes Ethiopian airlines but includes long-term foreign currency liabilities of the central bank.

11. While financial stability indicators suggest that commercial banks are well-capitalized, with strong asset quality (Table 5), vulnerabilities in the financial system have increased. The state-owned Commercial Bank of Ethiopia (CBE) has experienced tighter liquidity conditions, while asset quality in the Development Bank of Ethiopia (DBE) remains weak.

- *System-wide indicators.* The financial system is dominated by banks, with the CBE accounting for about two-thirds of banking sector assets. Total capital to risk-weighted assets for the commercial banks stood at 19.2 percent in June 2019, while the non-performing loans (NPLs) to total loans and advances ratio was 2.3 percent, below the statutory ceiling of 5 percent. Liquidity conditions in the commercial banks appear to be adequate with the liquid assets-to-total deposits ratio at 16.9 percent, above the statutory minimum of 15 percent.
- *Commercial Bank of Ethiopia.* The CBE's liquidity ratio dropped in 2018/19 due to a persistent asset-liability mismatch: the CBE has been prioritizing the financing of long-term projects undertaken by SOEs by investing in SOE bonds and extending loans, drawing on its deposit base. Credit to the SOEs has expanded in line with significant growth in SOE investment in recent years, which tightened liquidity conditions of the CBE and exacerbated the maturity mismatch. The CBE's credit exposure to the SOEs is also highly concentrated in the energy sector, accounting for about 40 percent of its total asset portfolio. The repayment of SOE loans, which are guaranteed by the government, may also be lagging, exacerbating the CBE's liquidity position. The CBE also has large exposure to foreign exchange risks as the bank plays central role in foreign exchange transactions.
- *Development Bank of Ethiopia*. The development finance institution, the DBE, which is not a commercial bank, continues to report declining but still-high NPLs: the bank's NPL ratio declined from 39 percent in June 2018 to 34 percent in June 2019.

Authorities' Views

12. Based on GDP data, the authorities saw evidence of stronger private sector activity to offset the prudent public sector stance in 2018/19. Credit growth to the private sector also increased sharply during the year, supporting this view. They did note that there were some weaknesses: interruptions to the supply and logistics chains led to localized shortages of food and other necessities and contributed to the elevated inflation levels. Actions to address these interruptions have already been taken, which, together with the tighter monetary policy stance, should bring inflation down in the coming months.

13. The authorities argued for a more nuanced assessment of Ethiopia's debt vulnerabilities. They believed that the DSA framework did not adequately reflect the realities on the ground and saw scope for use of staff judgment in the risk rating. Additionally, the authorities viewed staff's exports projections as conservative, thereby biasing the relevant debt ratios upward. Finally, the authorities argued in favor of excluding Ethio-Telecom from the DSA on grounds of its financial position and the fact that they do not need government guarantees for external borrowing.

OUTLOOK AND RISKS: POSITIVE OUTLOOK WITH CONCERTED REFORMS

14. Concerted reforms, as set out in the Fund-supported program, should result in an improved medium-term outlook. Growth in 2019/20—2020/21 is likely to slow to about 6 percent, significantly below recent years, amid tighter monetary policy, a tighter fiscal stance and stronger control over SOE activities. These factors will contribute to a more rapid correction of external imbalances but reduce near-term growth (see policies section below). Inflation is expected to remain elevated as the tighter monetary policy will only have an impact with a lag. Over the medium term, as the exchange rate becomes more competitive, credit and FX are directed to the private sector and structural reforms begin to pay off, activity and exports are expected to pick up. Without the ambitious reforms envisaged under the program, external vulnerabilities and inflation are projected to remain elevated with low reserves of around 2 months of imports and slower adjustment in addressing debt vulnerabilities. The continuing drag from the import compression as a result of the FX shortage is also expected to impinge on investment and exports, thereby causing growth to slow over the medium term.

15. The risks to the outlook are tilted to the downside. Ethiopia will continue to be vulnerable to external shocks, even under a program scenario. As external vulnerabilities (Annex II) are expected to only improve gradually, shocks in the near term could have adverse effects on growth and stability. Reserves will only rise gradually, while FX rationing is only expected to recede later in the program period as the supply of FX strengthens. In particular, potential shocks due to rising protectionism and weaker-than-expected global growth could negatively affect exports, further exacerbating FX and debt vulnerabilities (Annex I). In addition, climate-related shocks would affect agriculture and hydro-power generation with adverse implications on growth, exports, and inflation. Domestic opposition to reforms could increase investor uncertainty and weigh on investment and growth. However, with determined program implementation over the medium term, vulnerabilities are expected to recede gradually even as economic conditions improve. There is, however, a substantial upside risk that envisaged reforms, if implemented faster than expected, would strengthen competitiveness, and spur investment and exports growth. Absent the implementation of reforms, Ethiopia's external vulnerabilities will remain significant even over the medium term.

Authorities' Views

16. While agreeing that macroeconomic projections for the program should be prudently set, the authorities have a more optimistic view of the near-term growth outlook. They argue that efforts of finalize ongoing public sector projects and more rapid pick-up in private sector activity should ensure higher growth. They cited the potential for higher proceeds from privatization of SOEs, which would provide additional financing to address debt vulnerabilities, support investment and more rapidly alleviate the FX shortage. Finally, they also pointed to the potential of a Fund-supported program to deliver a strong signal to investors that macroeconomic reforms are underway, further setting the stage for sustained growth.

PROGRAM DISCUSSIONS: SUPPORTING THE AUTHORITIES' REFORMS AND LAYING THE FOUNDATIONS FOR SUSTAINABLE AND INCLUSIVE GROWTH

17. The Fund-supported program, building on the authorities' Homegrown Economic Reform Plan, is tailored to meeting critical challenges. The main objectives of the program are to address external imbalances, including the elimination of the real exchange rate overvaluation, reduce debt vulnerabilities by undertaking consolidation of the broader public sector while increasing social spending, tighten monetary conditions to reduce inflation, and implement structural reforms to encourage private sector-led growth. The priorities for the program are to:

- durably address the FX shortage by eliminating the real overvaluation over the program period, while transitioning to a more flexible exchange rate regime;
- gradually increase the scale of the government's market-based domestic financing, which will support wider development of the financial sector and private investment;
- address risks in systemic state-owned banks, while strengthening the supervisory framework and financial safety nets;
- harden SOE budget constraints and strengthen oversight and management of SOEs to address debt vulnerabilities, improve SOE efficiency and support the authorities' privatization program; and
- strengthen domestic revenue mobilization and expenditure efficiency to ensure adequate fiscal space for poverty-reducing and needed infrastructure spending.

A. Fiscal Policy Reforms

18. Fiscal policies under the program aim to address debt vulnerabilities while bolstering poverty-targeted spending and financing the lifting of financial repression. The fiscal program aims to appropriately balance the need to meaningfully contain debt vulnerabilities while maintaining development spending and improving its inclusiveness. The program aims for a lower overall general government deficit of 0.6 percent of GDP over the program period relative to the outturn of 2.5 percent of GDP in FY 2018/19 (lower than the budgeted 3 percent of GDP). Also, a rise in the interest bill as a result of gradual increase in market financing delivers some additional primary consolidation. Finally, the fiscal program recognizes that debt vulnerabilities arise from large borrowing by SOEs in recent years rather than by the general government. The program builds on recent progress made by the authorities on reining in SOE borrowing (an adjustment of 8 pp of GDP over the last 4 years, Figure 4) by hardening SOE budget constraints further and other SOE reforms, including improving SOE governance and disclosure.

19. The program will target a non-financial public sector consolidation of 3.2 pp of GDP, which will include consolidation at the general government level and lower SOE borrowing needs. Specifically, reforms will focus on: MEFP ¶24- ¶25

- *Reducing the overall general government deficit* from 2.5 to 1.9 percent of GDP, while improving the composition of expenditure. Under the assumption of gradual market financing of the deficit, the primary deficit is projected to decline by 0.7 percent of GDP over the program (QPC).
- *Strengthening domestic revenue mobilization* through a combination of (i) tax policy and administration reforms; and (ii) a review of tax expenditures with a view to eliminating the most distortive measures and containing the granting of new ones. The recent introduction of a directive banning net new tax expenditures is a positive step in this direction (PA). The aim is to raise the tax revenue-to-GDP ratio by 2¾ pp over the course of the program to create space for increased social and investment spending. In the immediate term, the authorities are planning to strengthen tax policy by extending VAT coverage to some currently exempt goods and services, and raising excise taxes on tobacco and beer. Additional measures will be needed to achieve the revenue yields envisaged by the program. In particular, staff have identified key measures that could deliver the needed improvement (see Table below). The authorities, with staff's inputs, have committed to implementing tax policy and administration reforms to deliver an increase in revenues by 1 percentage point of GDP during 2020/21, that will be included in the budget for FY 2020/21 (SB).
- Improving expenditure efficiency by undertaking a review of explicit and implicit subsidies (SB)[7] and rationalizing them, simultaneously with poverty-impact mitigation measures to be determined at that stage. Electricity tariffs should continue to be raised to eventually ensure cost recovery, in line with the reform schedule agreed under the World Bank DPF triggers. Furthermore, over the course of the program, recommendations from the authorities' requested public investment management assessment will inform on the state of institutional strength and effectiveness of their public investment management cycle and will aim at improving efficiency.

[7] Estimates suggest that energy (electricity and fuel) prices are over 2¼ percent of GDP lower than implied by an ideal benchmark derived from global prices. This would be an upper-bound for an estimate of subsidies as it may include not only traditional subsidies as transfers, but other factors that may be country-specific to Ethiopia and not captured in a cross-country analysis (including the marginal cost of electricity generation). As such, the program will refrain from making specific recommendations until a review is undertaken by authorities.

Text Table. Ethiopia: Estimated Yields from Tax Policy and Administration Reforms
(All figures in percent of GDP)

Measures	Estimated Yield
Rationalizing tax expenditures	
VAT waivers on imported goods	0.10
Excise exemptions applied to imported goods	0.40
Reduce VAT expenditures on other goods and services, including fuels, water and electricity	0.65
Reduce VAT expenditures on foodstuffs	1.25
Other tax policy revenue sources	
PIT schedule reform	-0.09
Passive income witholding and inheritance tax reform	0.22
Loss from WTO accession/tariff regime simplification	-0.20
VAT broadening to air and rail transport	0.01
Excise system reform (fuel, tobacco)	2.05
Chat excise alignment with social cost	0.10
Motor vehicle circulation tax	0.16
Property tax reform	0.50
Alternative Minimum Corporate Income Tax	0.43
Revenue administration sources	
Bringing back compliance (primarily assessment) gap in VAT to 2013 levels	0.80
Total potential gain from policy and admin reforms	**6.38**

- *Expansion of social assistance spending in real terms* will ensure protection of the most vulnerable in a transitional contractionary environment. Emphasis will be given to the government's direct contribution to cash transfers under the rural and urban Productive Safety Net Programs, which is set to increase over the program, due both to increased ownership of the programs by the government, and to the recovery of real purchasing power of these transfers (IT, see Box 2).

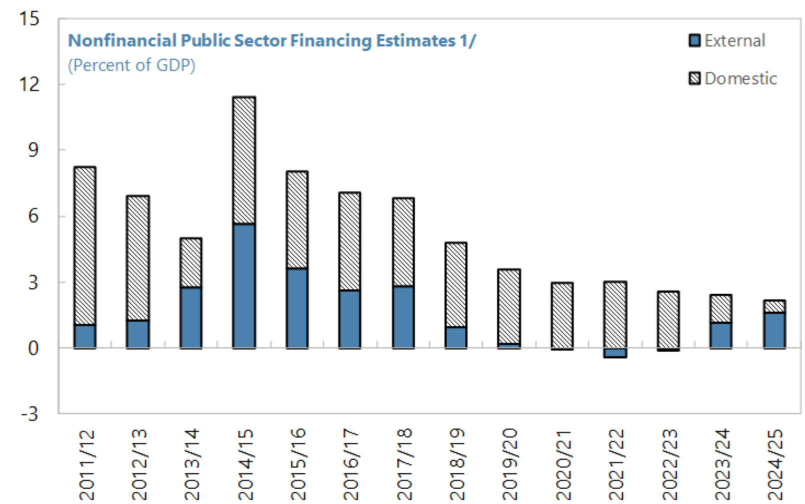
20. The program will aim to materially reduce debt vulnerabilities stemming from SOE borrowing and deepen other SOE reforms aimed to improve SOE governance and disclosure. With improvements in disclosure and financial reporting in the future (see below and Box 2), the program will include additional SOE reforms, which will be developed in collaboration with the World Bank.

- *Reducing SOEs' net borrowing requirement by 2.5 pp of GDP over the period of the program,* thus containing net accumulation of debt, both external and domestic, by SOEs (QPCs and ITs) while strengthening their oversight and transparency, including by requiring the publication of consolidated financial performance report based on audited accounts (SB). The proposed SOE consolidation over the program period is underpinned by: (i) an increase of electricity tariffs yielding around 0.4 percentage points of GDP this year, which would be followed by subsequent adjustments to reach cost recovery in 2021, and (ii) a further slowdown of public investment projects, which will primarily be done by strictly controlling the domestic and external borrowing of SOEs. The authorities have presented to staff investment and borrowing plans for the largest SOEs consistent with lower SOE borrowing requirements by 2.5 pp of GDP (see paragraph 12 of the DSA and associated table). In addition to the authorities' established borrowing limit framework introduced in 2017, the program will monitor public sector borrowing by setting domestic borrowing limits on public enterprises (IT), a zero limit on non-concessional debt and limits on concessional debt for the government (QPC and IT). Taken together, SOE reforms will translate into further streamlining SOE investment projects, expenditure controls and revenue measures (such as increased tariffs), and outright divestment of assets to the private sector, all of which should lower SOE debt vulnerabilities.

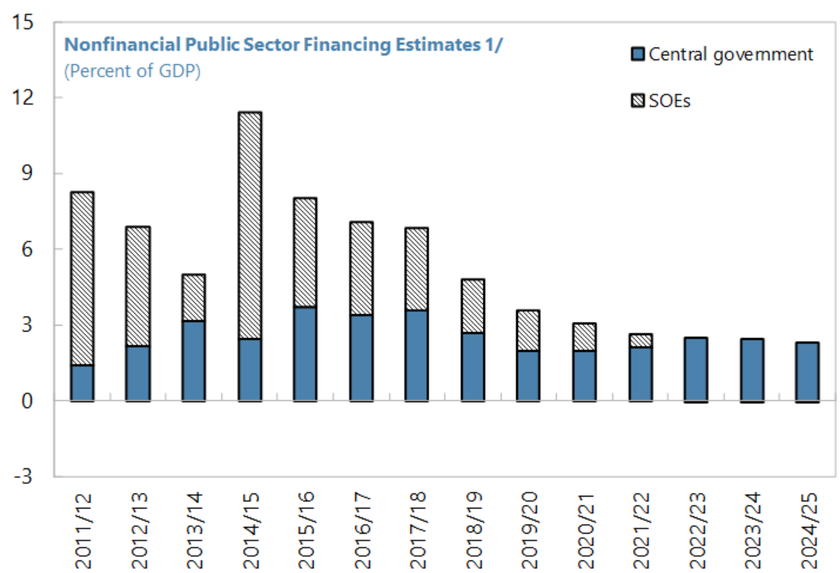
- *Recognizing losses arising from non-performing SOE loans* and devising a strategy for dealing with them. Some loans to SOEs from the CBE (already included in the public debt statistics)[8] are likely to be non-performing, raising the prospects of future budgetary costs for the government (though they will not lead to an increase in public debt). These would include bringing past SOE debts on to the government's balance sheet, taking over debt service payments for the SOEs. An AQR of the CBE (SB) can provide this information, informing future strategy and related costs.
- *Deepening SOE reforms* by phasing out financial repression measures in their favor, improving their transparency and financial reporting, and strengthening their efficiency. Setting a ceiling to SOEs domestic borrowing and the recent elimination of the "27-percent rule" should support greater availability of credit for private sector development and growth. The publication of consolidated performance and financial reports starting with the 2017/18 audited accounts of the largest SOEs (SB) will enhance transparency and financial reporting. Strengthening the oversight and management of SOEs by the Public Enterprise Holding and Administration Agency (PEHAA), and the planned parliament approval of the revised Public Enterprise Law will strengthen SOEs' performance management, and address oversight and governance gaps.
- *Cushioning any negative effects*. While some short-term contractionary effect of these reforms on output and employment are possible, in the medium-term increased competition and efficiency in reformed sectors should bolster productivity and output. Furthermore, the government is contemplating measures to mitigate these possible short-term effects.

[8] Ethiopia's public debt statistics are comprehensive, covering the entire non-financial public sector, including SOEs (see ¶1 of the DSA). In particular, domestic borrowing by SOEs from public sector financial institutions is fully included in historical debt data. Contingent liabilities are limited to the activities of the DBE (see discussion on financial sector issues below).

Figure 4. Ethiopia: Net Financing of the Public Sector



1/ Average exchange rate was used on change in debt stock reported in U.S. dollars. Excludes Ethiopian airlines. IMF staff projections 2019/20 onward.



1/ Excludes Ethiopian airlines. IMF staff projectons 2019/20 onward.

Box 1. Reforming State-Owned Enterprises

As strategically important providers of public goods and services, state-owned enterprises (SOEs) in Ethiopia have played a central role in driving the high investment and GDP growth rates over the past decade. The role of SOEs is far-reaching; these companies are active in key sectors such as industry, construction, finance, telecommunication, trade logistics, transportation, and energy. In particular, a large share of infrastructure investment such as building transport links, telecommunications facilities and energy generation infrastructure, was undertaken by the SOEs. SOEs also play a key role in providing necessary public services, often as under-funded mandates (e.g., tariff and fee levels set at below cost levels or investment in socially-important but less economically-viable projects). The authorities have often paired these responsibilities with certain advantages including legally-binding monopoly privileges and easy access to credit and FX.

As a result, SOEs have contributed to the buildup of macro-imbalances and have become a source of fiscal, financial and external risks. Subsidized credit coupled with mandates to undertake less viable investments or provide services below cost has resulted in significant growth in SOE investment and debt in recent years. In particular,

- SOEs are responsible for the bulk of the increase in public debt (roughly 15 of the 17-percentage point increase in the debt-to-GDP ratio between 2009/10—2018/19), two-thirds of which has been domestic debt.
- Of the total debt stock of SOEs at the end of 2018/19, which amounted to 26 percent of GDP, 14 percentage points is held by the CBE in the form of corporate bonds and loans.
- SOE borrowing from commercial banks amounted to 60 percent of total credit extended (Figure 3), restricting the private sector from accessing the financial resources it needs to expand.
- The bulk of SOE borrowing—both domestic and external—carries a government guarantee, exposing the government to contingent liabilities if the SOEs are unable to service their debts.

Similarly, easier access to FX, coupled with an overvalued exchange rate resulted in SOE imports (the flipside of their investment activities) rising sharply and contributing to external imbalances.

There is insufficient financial performance data on SOEs. The lack of published and consolidated operational and financial data for SOEs complicates efforts to assess their performance and risks. In addition, past financial reports did not conform to internationally accepted standards, though this is now being addressed with the ongoing transition to IFRS-compliant reporting for the major SOEs. While some SOEs are considered by the government to be meeting the objectives set by their mandates, the increased debt vulnerabilities and contingent liabilities for SOEs as a group signals that there are system-wide weaknesses in generating the necessary returns on investment to justify their debt levels and suggests there may be financial losses in a number of companies. The PEHAA is addressing this shortcoming by improving the compilation of financial performance data (see para 20) and is to publish a consolidated financial performance report by February 2020 (SB).

Mindful of these vulnerabilities, the authorities have started reforming the sector to curb debt levels, limit fiscal risks, improve transparency and oversight, and where appropriate, embark on privatizing these enterprises. In particular, the authorities have:

- *Tightened controls on new debt.* To limit debt accumulation and control fiscal risks, the Ministry of Finance introduced the 2017 Public Debt Management and Guarantee Issuance Directive to tighten controls over the contracting of new debt and limit government guarantees. Further, the authorities instituted a policy of zero new external non-concessional borrowing and have sought debt reprofiling on external debt with official bilateral creditors. These efforts have successfully allowed them to rein in borrowing and bring down the public debt-to-GDP ratio.
- *Privatization.* The authorities have embarked on an ambitious privatization program starting with the telecom and sugar sectors, including opening them to competition. Their broader plan is to transform and partially privatize strategic SOEs, fully divest non-strategic SOEs and improve the regulatory environment for SOEs. The partial privatization of Ethio-Telecom and expected issuance of additional licenses are expected to enhance efficiency and improve telecom services.
- *Strengthen governance and management of key SOEs.* In support of the SOE reform, authorities have revised the Public Enterprise Proclamation and established a supervisory authority, PEHAA. The new law will establish SOE governance structures and policies, financing, debt management, performance management, transparency and disclosure requirements will be submitted to Parliament.

B. Exchange Rate and Monetary Policy Reforms

MEFP ¶31

21. Monetary policy under the program aims to address elevated domestic inflation while complementing efforts to address FX shortages and reduce real overvaluation. In the immediate term, the authorities intend to tighten monetary policy by restricting the growth of reserve money, their main operational tool, to 12.5 percent (well below nominal GDP growth) over the course of 2019/20. This monetary tightening will be facilitated by the scaling back of NBE financing of the government and the DBE (next paragraph), and supported over time by the use of indirect instruments as the volume of market-based T-bills increases over the course of the program; staff also recommended the use of deposit auctions to mop up liquidity at market-determined interest rates. The monetary tightening will be supported by the control of domestic borrowing for SOEs envisaged under the program will complement the tighter monetary stance. Notwithstanding the tighter policies, projections suggest private sector credit is likely to benefit from the gradual retrenchment of the public sector over the course of the program. The NBE, with Fund TA, intends to strengthen its monetary policy framework over the medium-term.

22. The NBE is to gradually scale back its extension of new credit to the government (quantitative IT) and end its financing of the DBE (SB, June 2020). These reforms will give the NBE greater control over its balance sheet, facilitating the task of controlling reserve money growth. As a corollary, reduced access to NBE advances will require the central government to expand its use of market instruments to meet its domestic financing needs, thereby promoting the development of domestic bond markets. This shift in the form of fiscal financing will, over time, boost budgetary interest outlays, albeit while also strengthening the NBE's income position.

MEFP ¶32-33

23. The authorities have undertaken steps to develop financial markets and reduce financial repression. Most notably, the NBE recently eliminated the "27-percent rule", or the requirement for private banks to purchase 5-year NBE bonds equivalent to 27 percent of gross credit extended. This should allow private banks more room in their balance sheets to purchase assets or lend to their customers. The recent start of competitive market-based T-bill auctions (PA) should pave the way for an increase in nominal interest rates and a strengthening of the compositional shift in credit allocation towards the private sector, which is already underway. Indeed, a combination of public sector restraint and less financial repression could see credit more actively allocated to the private sector even as tighter monetary policy takes hold.

MEFP ¶39

MEFP ¶34

24. Exchange rate policy over the program will aim to eliminate the real overvaluation and durably address FX shortages. There was broad agreement with staff that the exchange rate overvaluation represents an important factor behind the shortage, and that real depreciation was needed over time to support efforts to bolster external competitiveness. However, the NBE is of the view that exchange rate adjustment and system reforms need to be approached carefully: rapid depreciation without improving FX availability will likely exacerbate shortages in the short term and stoke inflation. Integral to containing a possible surge in FX demand would be to boost reserves, so that market participants are reassured of FX availability on an ongoing basis. The FX rationing system would also likely have to remain in place in the short term until demand conditions stabilize. Going forward, faster depreciation – supported by tighter policies to address inflation that could undo the intended real depreciation – should reduce demand for FX while improving supply due to improved external competitiveness, setting the stage for the transition to a market-clearing exchange rate. On reserves, the authorities are aiming to build up reserves, bolstered by expected inflows from donors, privatization receipts and an improvement in export- and FDI-related flows, thereby easing the shortages. The authorities intend to raise reserves from US$3.4 billion (equivalent to 1.8 months of prospective imports of goods and services) in June 2019 to US$4 billion by June 2020 (2 months of imports). By the end of the program in December 2022, reserves are projected to be above 3 months of imports, close to the assessed level of reserve adequacy (Annex II).

25. The transition to a market-clearing exchange rate regime will be complemented by needed structural reforms and liberalization of administrative policies to create a functioning FX market. As a first step, the authorities are reviewing existing FX regulations with a view to consider their eventual consolidation as the exchange rate become more flexible. Their intention is to use this review to underpin the development, with Fund TA, of a roadmap towards a market-determined exchange rate underpinned by a deep and well-functioning FX market (SB for April 2020).

MEFP ¶35

26. Ethiopia continues to maintain exchange restrictions inconsistent with its obligations under Articles VIII, Section 2(a) of the IMF's Articles of Agreement.[9] The authorities' view is that all existing restrictions affect exclusively the capital account, and that there are no exchange restrictions on current account payments; consequently, they do not intend to request their approval.

C. Financial Sector Reforms

27. The authorities' financial sector reform program aims to strengthen financial stability, while re-orienting banks' activities to support the transition to a private sector-led economy. Reforms to the monetary management framework such as the recent welcome elimination of the "27-percent rule" and modernizing the monetary operations framework will also support the development of the financial sector, allowing it to cater more to the private sector. This will be complemented by steps to strengthen financial stability over the course of the program. There is work ongoing to review the CBE's exposure to the energy

MEFP ¶37-38

[9] Specifically, the IMF's Executive Board has determined that four measures, namely (i) the tax certification requirement for repatriation of dividend and other investment income; (ii) restrictions on repayment of legal external loans and suppliers of foreign partners credits; (iii) the prioritization and rationing of foreign exchange to certain imports of goods and services, debt payments and invisibles, and (iv) the requirement to provide a clearance certificate from the NBE to obtain import permits, represent exchange restrictions inconsistent with Article VIII, Section 2(a), of the IMF's Articles of Agreement and remain unapproved.

sector. Furthermore, the authorities intend to undertake a more comprehensive asset quality review (AQR) of the CBE in light of the concerns on increased exposure to the SOEs (SB).

28. The recent elimination of the 27-percent rule and the phasing-out of NBE financing of the DBE by June 2020 has implications for the funding model of the DBE. The authorities are reviewing the DBE's financing and business model to address high NPLs and to set it on a sound financial footing to ensure its long-term sustainability. However, they contend that the DBE has existing commitments to support viable private sector projects that should not be withdrawn immediately, though recognizing that alternative financing sources will need to be developed. In addition, the DBE's long-term viability will require a more stringent examination of the its business model and may require restructuring: the DBE currently lends to long-term private sector projects in priority sectors identified by the government, with capped interest rates, suggesting the term and credit risks in the DBE are inadequately priced into its lending rates.

MEFP ¶38

29. Continued efforts are needed to strengthen financial stability. A draft deposit insurance regulation, which sets out the establishment and operation of a deposit insurance scheme, is currently awaiting approval from the Council of Ministers, expected by June 2020. Operational regulations on the scheme are expected to be prepared in the next fiscal year. This should be supplemented by putting in place an emergency liquidity assistance framework with a crisis management framework and strengthened bank resolution framework. The authorities have requested Fund TA for these reforms. There is also a need to upgrade regulatory and supervisory standards, and strengthen financial reporting and disclosure. In this regard, the authorities are making steady progress on transitioning to Basel II, with the support of Fund TA. Reporting is also improving: banks have started a process of compiling and reporting its financial data using IFRS and expect to transition to IFRS 9 in the preparation of their 2018/19 financials. Ethiopia was removed from the FATF gray list due to solid improvements in the AML/CFT framework in October 2019 stemming from the authorities' significant progress in implementing its National Action Plan to address weaknesses in this area. Going forward, the authorities intend to work with the FATF-style regional body, ESAAMLG, to further strengthen the framework. These efforts should help Ethiopian banks continue to maintain correspondent banking relationships, after losses in recent years, as discussed in the last two staff reports.

MEFP ¶39-40

30. Strengthening financial inclusion is a key policy imperative for the authorities. Ethiopia has relied on expansion of bank branches to strengthen financial inclusion in the last decade, which has proven to be successful. However, recognizing the need to explore other means to improving inclusion, the authorities are pushing ahead with utilizing technology in driving their inclusion agenda. In particular, mobile banking offers particular benefits for a country as large as Ethiopia given that there are synergies between reforms in the telecommunications sector and progress in financial services. Strengthening network reliability and introducing telecom competition, including through the sale of licenses, could have positive spillovers to financial inclusion. Although the banking sector dominates

MEFP ¶41

Ethiopia's financial system, financial inclusion efforts have led to growth in microfinance companies and savings and credit cooperatives, which have become an important avenue to bringing in previously unbanked sectors into the formal financial system. To further enhance access to finance, the NBE has issued directives for the establishment and operations of a credit reference bureau. Other segments of the financial sector such as leasing and insurance remain under-developed. To address this and meet the needs of the economy, the NBE has granted a license to a foreign-owned entity to operate a leasing company.

D. Structural Reforms

MEFP ¶42

31. The authorities have placed high priority on improving the business climate. A high-level committee, chaired by the Prime Minister, has been set up to improve the business climate and address impediments to private sector development and is monitoring reform efforts. Early work is focused on addressing low access to credit and streamlining licensing and other requirements. Draft legislation to expand the range of eligible collateral to include moveable assets like machinery, transport equipment and livestock was approved in March. These efforts to improve the business climate should be stepped up. Other needed reforms should focus on unlocking potential growth in the service sector, improvement of local supply chains to enable value-added and transformation in the agriculture sector for both exports and import substitution, and the integration into educational programs of skill training to address the skills mismatch. Sector-specific reform to unlock bottlenecks to private investment in areas like tourism could support private investment while boosting FX inflows. Additional work will be undertaken under the program to identify possible reforms to strengthen productivity and competitiveness, which will support efforts to reduce the external imbalance.

MFFP ¶44

32. The program will support cash transfers under the Productive Safety Net Programme (PSNP). Both the rural and urban arms of the flagship PSNP, the largest social protection system in Sub-Saharan Africa, are highly regarded. The PSNP was chosen for its effectiveness in reducing poverty, particularly rural poverty (Box 2), efficiency and because the data on the government's contribution is both timely and monitorable. Over the course of the program, the targets set will enable the augmentation in the real value of benefits and set the stage for increasing the government's contribution to the PSNP from 18 percent to 38 percent, in line with recommendations made by the World Bank.[10,11]

---

[10] In particular, the targets under the program were set with the following considerations: (i) a recognition that the real value of benefits have eroded over time, and (ii) there is a need to dedicate more budget resources in anticipation of a gradual decline in donor participation in funding this program.

[11] Spending on other areas of pro-poor spending (primary healthcare, primary and secondary education) could not be incorporated into the social spending target at this stage as these are executed by the regions and are reported to the center with long- and variable-time lags. Consideration can be given to expanding the definition of social spending in future reviews, contingent on better data availability, which in turn will require a stronger reporting and coordination mechanism.

Box 2. Social Spending to Address Poverty in Ethiopia

Ethiopia has made significant headway in improving living standards in recent years. By 2016, Ethiopia had met 6 out of 8 of its Millennium Development Goals (MDGs). The proportion of people in Ethiopia below the poverty line has been halved; the prevalence of hunger and undernourishment has been reduced; access to education has expanded; the gap in enrolment between boys and girls has narrowed; under-five mortality has been reduced by two-thirds; and progress was recorded in reducing HIV/AIDs. Even on the two lagging MDGs—ensuring gender equality and improving maternal health—significant progress has been made. Ethiopia is aiming to become a middle-income carbon-neutral economy by 2025.

Rapid macroeconomic growth in Ethiopia has translated into fast consumption growth, which has been mainly concentrated in urban areas. The differential distribution of the gains from growth has had an impact on poverty alleviation: according to the latest World Bank assessment[1], the bulk of poverty reduction between 2011 and 2016 has occurred in urban areas. However, as poverty is concentrated in rural areas, this has led to a divergence in progress between urban and rural areas. In some regions, the poor have experienced negative consumption growth.

Poverty rates are equally distributed across regions, but the highest rates, depth and severity of poverty are in drought-prone lowlands. Less populous but drought-prone lowlands experience weaker coverage of those in extreme poverty, exacerbating inequality between regions.

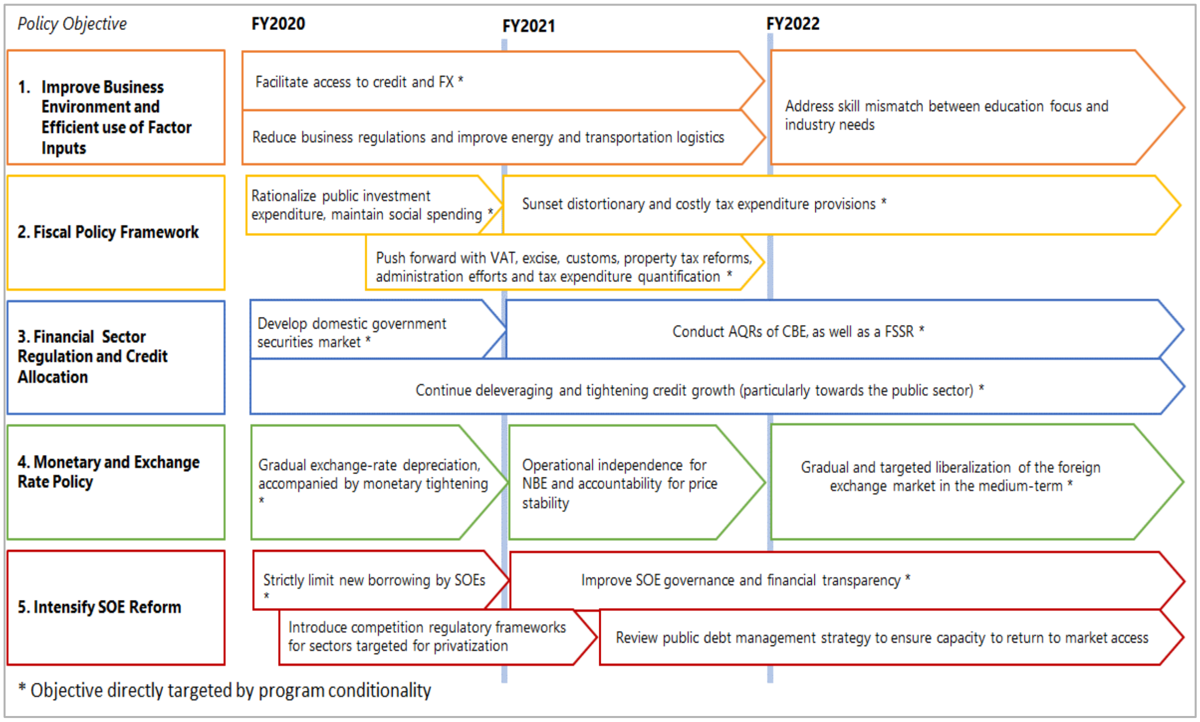
The authorities have traditionally defined "poverty-related spending" very broadly and even by this measure, spending has been declining. All spending on health, education, agriculture, roads, and water at any level is considered as "pro-poor". Even using this broad metric, spending on these five sectors, which amounted to about 12 percent of GDP between 2011/12 and 2015/16, decreased to 9.3 percent in 2018/19.

The broad envelope for social assistance programs is expected to remain stable in the medium-term, but enhancements to the efficiency of the programs, restoring the real value of benefits and expanding regional coverage would bring significant benefits. The rural PSNP provides conditional (on work) or unconditional cash or food transfers to targeted poor rural households during the lean season and is overall well targeted. However, only 13 percent of Ethiopia's poor are covered by the PSNP in 2016 and there would be significant benefits to substantially upscale the program to allow for a more universal regional coverage. Also, benefits are benchmarked on the results of local wage surveys, which have not been carried out in nearly 4 years. As a result, the real value of benefits are estimated to have been eroded by 30 percent on average in light of the high inflation. Similarly, the next stage of the UPSNP is to expand it to more cities targeting 1 million beneficiaries, and the government intends to increase its share of funding for both programs in the next 5 years.

---

[1] World Bank (2015) Ethiopia Poverty Assessment

Figure 5. Ethiopia: Reform Complementarities in Program Design and Sequencing



MEFP ¶48

33. Efforts to improve data quality to strengthen economic policy making are ongoing. A welcome recent development was the authorities' participation in the Fund's eGDDS initiative starting in August 2019, which will improve the timeliness and availability of data for the public. In the meantime, there is an ongoing work program to strengthen data compilation and reporting in external sector statistics, government finance data, monetary and finance statistics, price data and the national accounts though in the past, Fund TA recommendations have not always been uniformly implemented (Annex IV).

PROGRAM MODALITIES AND RISKS

34. The proposed program, which unlocks financing from the PRGT and GRA, is expected to fill around one-third of the financing gap, with donor support and privatization expected to fill the remainder. The financing gap is estimated at around US$8.4 billion over three years (Table 6), based on projected external financing flows, an estimate of the FX backlog, and the need to build adequate reserve buffers. The program proposes to draw on PRGT resources to the tune of SDR 1.2 billion (400 percent of Ethiopia's quota—SDR 300.7 million) in an Extended Credit Facility (ECF) arrangement and access GRA resources of about SDR 0.9 billion (300 percent of quota) via an Extended Fund Facility (EFF) arrangement, bringing total financial assistance to SDR 2.1 billion (700 percent of quota). This will substantially help address the estimated financing gap and would result in an average interest rate on the entire package of around 0.5 percent, consistent with relatively concessional financing. Development partners, including the World Bank, have also provided financing assurances. Privatization receipts will contribute to financing. With firm commitments for the first phase of debt reprofiling, the program will be fully financed for the next 12 months and there are good prospects of financing for the remainder of the program.

35. The exceptional access criteria under the PRGT, which need to be met for access above 300 percent of quota under the PRGT, are considered to be met:

- **Criterion 1: "an exceptionally large balance of payments need that cannot be met within the normal limits (e.g.: very large external shocks, very low levels of reserves)".** Ethiopia is experiencing acute BOP pressures, stemming from a highly overvalued exchange rate, weaker-than-expected export performance in recent years, and elevated external debt servicing needs. As a result, Ethiopia is experiencing an intensification of its persistent FX shortages and a large FX backlog, resulting in continued rationing of hard currency.[12] International reserves are very low, and have remained well below adequate levels, as a result of macroeconomic imbalances that have persisted for a significant period of time. Such low level of reserves significantly raises Ethiopia's external sector vulnerabilities and undermines confidence. The need for exceptional access stems from the need to restore international reserves to an adequate level to durably eliminate the FX shortages and create conditions for a successful transition toward market-determined exchange rate regime.
- **Criterion 2: "have a comparatively strong adjustment program and ability to repay the Fund".** The program entails ambitious reforms and adjustment, including high-quality fiscal consolidation (of the broader public sector), decisively reducing debt vulnerabilities, eliminating exchange rate overvaluation and FX shortages while building foreign reserve levels, and a fundamental reform of the financial system, moving it from state-allocated credit to a market-driven system. The program also includes debt operations aimed at reducing debt service to levels that would support a DSA risk rating of moderate before the end of the program, thereby strengthening Ethiopia's debt sustainability and the safeguards for the Fund (see para 10). Thus, Ethiopia's capacity to repay the Fund appears adequate (see para 36 and Table 8).
- **Criterion 3: "do not have sustained past and prospective access to capital markets and have income at or below the prevailing operational cutoff for assistance from IDA".** Ethiopia's GNI per capita is 67 percent of the IDA operational cutoff, less than the threshold levels of 80 percent (above which market access must be assessed) and 100 percent (the income criterion).

36. A modestly backloaded disbursement schedule is appropriate for Ethiopia, in view of the need to balance the delivery of significant financing with implementation risks amid political uncertainty and the graduated pace of some key reforms (Table 9). The program includes a semi-annual disbursement schedule, consistent with normal practice for arrangements

[12] An accurate measure of the FX backlog is not available due to data limitations and difficulty in timely verification of all FX demand.

under the PRGT. The proposed disbursement schedule will ensure the annual and cumulative disbursements will deliver sufficient financial support while respecting disbursement limits set out in the PRGT instrument and GRA financing. The backloaded disbursement schedule also mitigates program risks and incentivizes the authorities to deliver on difficult, but necessary reforms.

37. Ethiopia's capacity to repay the Fund appears adequate (Table 8). Under the program baseline, debt service to the Fund will peak at 0.31 percent of GDP, 2.8 percent of exports of goods and services and 2.1 percent of revenues in 2027/28. This compares favorably with other high access programs in recent years. Debt vulnerabilities will also significantly decline by the end of the program.

38. The program will be monitored via a set of quantitative targets and structural benchmarks. Proposed quantitative performance criteria and indicative targets are set out in the MEFP and are consistent with the macroeconomic framework laid out in Tables 1–4. The quantitative targets under the Fund-supported program are based on a prudent and realistic macroeconomic framework, particularly with relation to real GDP growth and exports, taking account of the data quality concerns outlined in paragraph 5. Prior actions and structural benchmarks are set out in the MEFP and are drawn from past surveillance and TA recommendations to support achievement of the program's objectives. The semi-annual reviews will be aligned with June and December test dates, consistent with the authorities' budget cycle.

MEFP Tables 1- 2

39. An updated safeguards assessment on the NBE will be required. The NBE last underwent a safeguards assessment in 2009. Outstanding recommendations include strengthening oversight of risks and controls, improving transparency and the external audit process, and legal amendments to address governance and independence weaknesses in the Central Bank Law. The NBE has not yet submitted 2017/18 Financial Statements and Management Letter as required by the Safeguards Policy, due to ongoing work to transition to IFRS-compliant financial reporting standards. The report for 2017/18 is currently being audited before finalization, after which the NBE intends to start work on the 2018/19 statements. The authorities have committed to concluding the updated assessment by the time of the first review.

MEFP ¶50

40. The risks to the program are high due to external vulnerabilities and political uncertainty. The gradual approach to addressing the exchange rate overvaluation—on balance the most appropriate policy—would still render the birr overvalued in the near term. Risks from public debt, which have built up over time, will be addressed via additional debt operations on bilateral external debt with an aim to improve Ethiopia's external debt distress rating to "moderate" with some space to absorb shocks before the end of the program. Such buffers will also help mitigate uncertainties surrounding the authorities' efforts at addressing the exchange rate overvaluation and any shortfall in exports. Addressing the low reserve levels forcefully should strengthen investor confidence and resilience. Reforms may also spark a backlash from entrenched elements in the government and public sector, including the SOEs. The unsettled political situation may also test the government's resolve to stick with necessary but difficult reforms, though the authorities have shown admirable resolve in a number of areas, notably in reining in public borrowing, expediting privatization and taking important steps on financial sector reform such as eliminating the 27 percent rule. In addition, Ethiopia is vulnerable to external and climate-related shocks that could impact program performance, if they materialize.

STAFF APPRAISAL

41. Ethiopia's public investment-driven growth and development model has reached its limit. The build-up of domestic and external imbalances has lent additional urgency to the authorities' efforts to engineer a smooth and durable transition. In this regard, the authorities have developed an ambitious economic reform plan that is appropriately calibrated to address these imbalances and spur private sector- and export-led growth.

42. While the general government stance should be tightened modestly, the low and falling revenue ratio, coupled with continued cuts to necessary capital spending, is a concern and needs to be reversed. In particular, there is an urgent need to implement strong tax policy measures, supplemented by efforts to improve tax administration, to halt and reverse the decline in the tax-to-GDP ratio, including by revisiting tax expenditures and reducing and eliminating exemptions, as identified by Fund TA. This, together with improved expenditure efficiency, would create fiscal space for increased development spending.

43. There has been significant progress in implementing SOE reform, but continued efforts are needed. The authorities should maintain their current policy of SOE consolidation to lower their debt burdens and ensure the success of the planned structural transformation towards a private sector-led growth model. To this end, the authorities should contain SOEs net borrowing by slowing the growth of their investments and, for the electricity sector, moving toward cost recovery. Furthermore, improvements in financial reporting, enhanced oversight and performance management, better regulatory environment to address oversight and governance gaps, and stringent investment and borrowing ceilings are essential to underpin the envisaged consolidation. Actions taken to strengthen SOE oversight and governance, particularly the ongoing work by PEHAA to compile a consolidated performance report for 2017/18 for 20 SOEs under its supervision, is welcome. This should be followed up with the compilation and publication of accounts for previous years, and work on the financial statements for 2018/19 should be expedited.

44. Debt dynamics are expected to improve during the program period resulting from the reforms and the authorities' efforts at containing debt vulnerabilities. Recent efforts to contain SOE borrowing and reprofiling of some bilateral loans have helped improve the debt dynamics somewhat. However, near- to medium-term debt servicing needs remain elevated relative to exports, thereby leading to staff assessment of Ethiopia's "high" risk of external and overall debt distress. The authorities recognize the risks and intend to undertake further debt operations to bring down near- to medium-term debt servicing needs on bilateral loans with an aim of achieving a debt distress rating of "moderate" with some space over the course of the program. Such debt operations will strengthen Ethiopia's debt sustainability, provide financing necessary for the program, and help safeguard Fund resources.

45. Monetary reforms are being undertaken, with a welcome focus on addressing FX shortages, containing inflation, and strengthening the monetary policy framework. The decisions to phase out NBE financing of the government and the DBE, eliminate the 27-percent rule, and the recent issuance of market-based T-bills are welcome. Going forward, the authorities will need to build on these positive developments by ramping up the issuance of market-based securities and strengthening the NBE liquidity management framework. On exchange rate policy, the authorities' plan to eliminate the overvaluation during the program period will be essential for addressing external imbalances on a sustained basis. In preparation for the transition to a market-clearing exchange rate regime, the authorities will need to undertake preparatory work, including reviewing existing rules and regulations, develop a roadmap to guide the transition and build the market infrastructure necessary to support the move to a market-clearing exchange rate. In the meantime, the FX shortages will improve gradually, with FX rationing likely to remain a feature of the system in the near term.

46. A more comprehensive assessment of systemically-important institutions is critical to identify possible financial stability concerns and to map out the extent of potential contingent fiscal liabilities. The planned AQR of the CBE will help guide future policy, including developing necessary plans to address potential weaknesses in asset quality. The CBE's high credit exposure in the energy sector also warrants a strategy to reduce this concentration over the medium term. On the DBE, with the decision to phase out NBE financing of the bank, the ongoing work to identify a sustainable business and funding model going forward is welcome. This should be coupled with a comprehensive strategy to deal with its elevated NPL levels, including intervention to carve out problem loans as needed. The DBE's long-term viability will require stringent examination of its business model and may require restructuring. Other key reforms such as strengthening the financial safety net and the resolution framework and putting in place a crisis management framework should be expedited as they are important for underpinning financial stability. Progress in strengthening the AML/CFT framework and the plan to work with FATF and ESAAMLG in undertaking further improvements is welcome.

47. Further structural reforms to strengthen the business and investment climate are needed. The authorities' strong emphasis on addressing pressing constraints on the business climate is welcome. Efforts to upgrade data quality, including the authorities' participation in eGDDS, are welcome in supporting policy formulation and communicating with stakeholders. Addressing remaining weaknesses in data quality and improving disclosure and timeliness standards would strengthen policy formulation and improve the capacity to communicate with stakeholders.

48. The risks to the Fund-supported program are high, mitigated by measures taken to strengthen safeguards and contribute to its eventual success. Given the initial conditions and vulnerabilities in the Ethiopian economy, the near-term risks are significant; constraints stemming from the electoral timetable limit policy space in the coming months. To mitigate these, the authorities have adjusted policies, including by instituting and maintaining strict control of public borrowing and reaching out to creditors to reprofile debt and reduce risks. The program envisages significant reforms and requires strong policy actions from the authorities. The authorities will also need to strengthen their implementation capacity, with technical support from the Fund and other development partners, over the course of the program.

49. Ethiopia maintains exchange restrictions inconsistent with its obligations under Article VIII, Section 2(a) of the Fund's Articles of Agreement and staff does not propose their approval.

50. Staff supports the authorities' request for 3-year arrangements under the ECF and EFF. Further, staff proposes that the next Article IV consultation be conducted on a 24-month cycle, consistent with the normal practice for members with Fund arrangements.

Table 1. Ethiopia Selected Economic and Financial Indicators, 2015/16–2023/24

Social Indicators

GDP		**Poverty indicators in 2015/16 (national definitions)**	
Nominal GDP (2018, billions of U.S. dollars)	84.3	Poverty headcount ratio (percent of population)	23.5
GNI per capita, Atlas method (2018, current US$)	790	Food poverty (percent of population)	24.8
Population characteristics		**Income distribution, 2015**	
Total (2018, million)	94.1	Income shared by highest 10 percent of population	28.5
Urban population (2015)	19.5	Income shared by lowest 20 percent of population	7.3
Life expectancy at birth (2017, years)	65.9	GINI index	35.0

Economic Indicators

	2015/16 Act.	2016/17 Act.	2017/18 Act.	2018/19 Prel.	2019/20 Program	2020/21 Program	2021/22 Program	2022/23 IMF Staff Proj.	2023/24 IMF Staff Proj.
	(Annual percentage change)								
National income and prices									
GDP at constant prices (at factor cost)	8.0	10.2	7.7	9.0	6.2	6.1	7.0	7.5	8.0
GDP deflator	10.4	8.5	12.4	13.2	19.4	12.3	8.8	8.1	8.1
Consumer prices (period average) [1]	9.7	6.9	14.5	12.6	19.4	11.1	8.1	8.0	8.0
Consumer prices (end period) [1]	7.5	8.0	16.8	15.3	18.1	9.4	8.0	8.0	8.0
External sector									
Exports of goods and services (U.S. dollars, f.o.b.)	0.3	2.9	13.1	7.9	12.8	12.7	14.0	12.4	9.7
Imports of goods and services (U.S. dollars, c.i.f.)	3.1	-4.8	0.2	4.1	11.3	9.4	8.5	6.6	5.1
Terms of trade (goods, deterioration –)	0.8	3.9	-9.6	-1.9	4.1	5.6	3.2	1.5	1.4
Nominal effective exchange rate (end of period)	-2.2	-3.7	-16.3	-1.8	…	…	…	…	…
Real effective exchange rate (end of period)	1.4	2.1	-5.1	6.4	…	…	…	…	…
	(Annual percentage change, unless otherwise indicated)								
Money and credit									
Change in net foreign assets	-37.4	66.8	3.5	-63.2	83.9	222.1	95.2	71.7	42.5
Change in net domestic assets (including other items net)	26.2	26.7	31.0	24.4	16.9	13.9	14.4	15.2	18.1
Broad money	19.9	28.8	29.2	19.7	18.0	19.2	19.9	21.6	22.0
Base money	16.3	22.7	19.1	15.3	12.5	13.0	13.0	13.5	13.5
Velocity (GDP/broad money)	3.46	3.20	2.97	3.04	3.24	3.28	3.23	3.10	2.97
	(Percent of GDP, unless otherwise indicated)								
Financial balances[2]									
Gross domestic savings	21.0	22.4	24.1	22.3	25.2	25.0	26.7	29.5	31.8
Public savings	3.8	1.6	2.1	1.7	2.6	3.6	4.7	4.9	5.0
Private savings	17.2	20.8	22.0	20.6	22.6	21.4	22.0	24.6	26.8
Gross domestic investment	38.0	38.4	34.2	35.2	34.3	36.3	38.1	38.6	40.8
Public investment	17.1	14.4	12.6	11.0	10.0	10.3	10.3	9.4	9.7
Private investment	20.9	24.1	21.6	24.2	24.3	26.0	27.8	29.2	31.1
Resource gap	-17.0	-16.1	-10.1	-12.9	-9.1	-11.4	-11.4	-9.1	-9.0
External current account balance, including official transfers	-9.1	-8.0	-6.2	-4.5	-5.5	-4.6	-4.6	-4.0	-3.4
Government finances									
Revenue	15.0	14.1	12.3	11.5	11.7	13.0	14.2	14.5	14.7
Tax revenue	12.4	11.5	10.7	10.0	10.1	11.5	12.7	13.0	13.3
Nontax revenue	2.7	2.6	1.6	1.6	1.5	1.5	1.5	1.5	1.5
External grants	0.8	0.7	0.8	1.2	0.9	0.8	0.6	0.7	0.7
Expenditure and net lending	18.2	18.0	16.1	15.3	15.0	16.0	16.8	17.1	17.4
Fiscal balance, excluding grants (cash basis)	-3.2	-3.9	-3.8	-3.8	-3.4	-3.0	-2.6	-2.6	-2.6
Fiscal balance, including grants (cash basis)	-2.3	-3.2	-3.0	-2.5	-2.5	-2.2	-1.9	-1.9	-1.9
Total financing (including residuals)	2.3	3.2	3.0	2.5	2.5	2.2	1.9	1.9	1.9
External financing	1.7	1.6	1.3	1.3	1.2	1.0	1.7	1.5	0.7
Domestic financing (incl. privatization)	2.0	1.8	2.7	1.3	1.3	1.2	0.3	0.4	1.2
Public debt [3]	54.3	56.5	59.5	56.8	53.4	52.7	52.0	47.5	43.3
Domestic debt	25.6	28.3	29.2	28.6	25.4	22.6	19.1	16.6	15.5
External debt (including to the IMF)	28.7	28.2	30.4	28.2	28.0	30.1	32.8	30.9	27.9
Overall balance of payments (in millions of U.S. dollars)	169	659	-202	58	-346	22	-547	184	1,692
Gross official reserves (in millions of U.S. dollars)	3,402	3,197	2,848	3,415	4,031	5,661	7,441	9,551	11,232
(months of imports of goods and nonfactor services of following year)	2.1	2.0	1.7	1.8	2.0	2.6	3.2	3.9	4.3
GDP at current market prices (billions of birr)	1,541	1,833	2,200	2,696	3,391	4,094	4,828	5,630	6,594

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] For 2015/16 and earlier, based on December 2011 base; for all subsequent data and projections, the base is December 2016.

[2] Based on data from Central Statistical Agency (CSA), except for the current account balance, which is based on BOP data from National Bank of Ethiopia (NBE).

[3] Public and publicly-guaranteed external debt. Includes long-term foreign liabilities of the NBE and external debt of Ethio-Telecom.

Table 2a. Ethiopia: General Government Operations, 2015/16–2023/24[1]

(Millions of Birr)

	2015/16 Act.	2016/17 Act.	2017/18 Act.	2018/19 Prel.	2019/20 Program	2020/21 Program	2021/22 Program	2022/23 IMF Staff Proj.	2023/24 IMF Staff Proj.
Total revenue and grants	244,819	270,214	287,562	344,937	425,265	566,159	718,448	855,107	1,017,205
Revenue	231,805	257,737	269,648	311,318	395,067	532,115	687,367	816,802	972,342
Tax revenue	190,520	210,173	235,229	268,458	343,513	470,475	615,392	733,688	875,952
Direct taxes	71,844	81,417	97,646	115,858	147,438	179,569	213,356	250,582	295,633
Indirect taxes	118,676	128,755	137,583	152,600	196,075	290,906	402,036	483,105	580,319
Domestic indirect taxes	55,953	62,553	67,172	77,774	97,802	159,045	235,824	305,122	392,949
Import duties and taxes	62,723	66,202	70,411	74,826	98,273	131,861	166,212	177,984	187,370
Nontax revenue	41,285	47,565	34,419	42,860	51,554	61,640	71,975	83,114	96,390
Grants	13,014	12,477	17,914	33,619	30,198	34,044	31,081	38,305	44,864
Program grants	291	588	3,746	17,646	11,056	10,710	3,062	5,630	6,594
Project grants	12,724	11,889	14,168	15,973	19,142	23,334	28,019	32,675	38,269
Total expenditure and net lending (cash basis)	280,893	329,658	354,209	413,105	509,794	655,898	812,562	964,859	1,145,749
Recurrent expenditure [2]	136,709	176,635	210,474	238,156	290,093	360,239	430,210	507,644	626,801
Defense spending	9,498	11,940	12,814	15,605	15,605	19,602	23,115	26,956	38,166
Poverty-reducing expenditure [3]	71,690	89,918	104,070	120,140	152,103	190,517	230,805	275,342	330,381
Interest payments	7,232	8,248	11,571	13,526	17,408	23,355	29,307	39,467	63,973
Domestic interest and charges	3,639	4,126	6,181	7,436	9,351	13,239	16,501	25,392	48,555
External interest payments [4]	3,593	4,122	5,390	6,090	8,057	10,116	12,806	14,075	15,418
Other recurrent expenditure	48,289	66,529	82,019	88,885	104,977	126,766	146,984	165,879	194,281
Capital expenditure	144,184	153,023	143,735	174,949	219,701	295,659	382,352	457,215	518,948
Central treasury	109,236	115,772	108,673	142,739	169,468	238,288	290,118	354,906	433,830
External project grants	12,724	11,889	14,168	15,973	19,142	23,334	28,019	32,675	38,269
External project loans	22,225	25,362	20,895	16,237	31,091	34,037	64,215	69,634	46,849
Overall balance									
Including grants	-36,073	-59,444	-66,647	-68,168	-84,529	-89,739	-94,113	-109,752	-128,544
Excluding grants	-49,088	-71,921	-84,561	-101,787	-114,727	-123,783	-125,195	-148,057	-173,408
Financing	57,937	73,140	87,930	71,726	84,529	89,739	94,113	109,752	128,544
Net external financing	26,034	28,953	28,135	35,401	40,936	40,158	81,805	86,100	47,543
Gross borrowing [5]	28,223	31,621	32,450	40,973	48,285	52,860	99,727	108,142	72,756
Project loans	22,225	25,362	20,895	16,237	31,091	34,037	64,215	69,634	46,849
Protection of Basic Services (PBS)	5,999	6,259	11,555	24,736	17,194	18,823	35,512	38,508	25,908
Amortization	-2,190	-2,669	-4,315	-5,572	-7,349	-12,701	-17,922	-22,042	-25,213
Domestic (net)	31,403	33,304	50,447	36,325	25,571	28,204	-7,645	23,652	81,001
Net acquisition of financial assets [6]	500	10,883	9,349	0	18,021	21,376	19,953	0	0
Memorandum items:									
Total poverty-reducing expenditure	184,576	204,284	210,898	245,490	309,528	377,947	448,914	528,992	626,748
Primary fiscal balance, including grants	-28,842	-51,196	-55,076	-54,642	-67,121	-66,384	-64,807	-70,285	-64,571

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] Government financial statistics are reported by the authorities based on GFSM 1986.

[2] Excluding special programs (demobilization and reconstruction).

[3] Poverty-reducing spending is defined to include total spending on health, education, agriculture, roads, and food security.

[4] External interest and amortization are presented after HIPC debt relief from the World Bank and the African Development Bank.

[5] Includes prospective donor financing to close the financing gap.

[6] Reflects privatization receipts net of financial investments or recapitalization on SOEs.

Table 2b. Ethiopia: General Government Operations, 2015/16–2023/24[1]

(Percent of GDP)

	2015/16 Act.	2016/17 Act.	2017/18 Act.	2018/19 Prel.	2019/20 Program	2020/21 Program	2021/22 Program	2022/23 IMF Staff Proj.	2023/24 IMF Staff Proj.
Total revenue and grants	15.9	14.7	13.1	12.8	12.5	13.8	14.9	15.2	15.4
Revenue	15.0	14.1	12.3	11.5	11.7	13.0	14.2	14.5	14.7
Tax revenue	12.4	11.5	10.7	10.0	10.1	11.5	12.7	13.0	13.3
Direct taxes	4.7	4.4	4.4	4.3	4.3	4.4	4.4	4.5	4.5
Indirect taxes	7.7	7.0	6.3	5.7	5.8	7.1	8.3	8.6	8.8
Domestic indirect taxes	3.6	3.4	3.1	2.9	2.9	3.9	4.9	5.4	6.0
Import duties and taxes	4.1	3.6	3.2	2.8	2.9	3.2	3.4	3.2	2.8
Nontax revenue	2.7	2.6	1.6	1.6	1.5	1.5	1.5	1.5	1.5
Grants	0.8	0.7	0.8	1.2	0.9	0.8	0.6	0.7	0.7
Program grants	0.0	0.0	0.2	0.7	0.3	0.3	0.1	0.1	0.1
Project grants	0.8	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Total expenditure and net lending (cash basis)	18.2	18.0	16.1	15.3	15.0	16.0	16.8	17.1	17.4
Recurrent expenditure [2]	8.9	9.6	9.6	8.8	8.6	8.8	8.9	9.0	9.5
Defense spending	0.6	0.7	0.6	0.6	0.5	0.5	0.5	0.5	0.6
Poverty-reducing expenditure [3]	4.7	4.9	4.7	4.5	4.5	4.7	4.8	4.9	5.0
Interest payments	0.5	0.5	0.5	0.5	0.5	0.6	0.6	0.7	1.0
Domestic interest and charges	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.5	0.7
External interest payments [4]	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.2
Other recurrent expenditure	3.1	3.6	3.7	3.3	3.1	3.1	3.0	2.9	2.9
Capital expenditure	9.4	8.3	6.5	6.5	6.5	7.2	7.9	8.1	7.9
Central treasury	7.1	6.3	4.9	5.3	5.0	5.8	6.0	6.3	6.6
External project grants	0.8	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
External project loans	1.4	1.4	0.9	0.6	0.9	0.8	1.3	1.2	0.7
Overall balance									
Including grants	-2.3	-3.2	-3.0	-2.5	-2.5	-2.2	-1.9	-1.9	-1.9
Excluding grants	-3.2	-3.9	-3.8	-3.8	-3.4	-3.0	-2.6	-2.6	-2.6
Financing	3.8	4.0	4.0	2.7	2.5	2.2	1.9	1.9	1.9
Net external financing	1.7	1.6	1.3	1.3	1.2	1.0	1.7	1.5	0.7
Gross borrowing [5]	1.8	1.7	1.5	1.5	1.4	1.3	2.1	1.9	1.1
Project loans	1.4	1.4	0.9	0.6	0.9	0.8	1.3	1.2	0.7
Protection of Basic Services (PBS)	0.4	0.3	0.5	0.9	0.5	0.5	0.7	0.7	0.4
Amortization	-0.1	-0.1	-0.2	-0.2	-0.2	-0.3	-0.4	-0.4	-0.4
Domestic (net)	2.0	1.8	2.3	1.3	0.8	0.7	-0.2	0.4	1.2
Net acquisition of financial assets [6]	0.0	0.6	0.4	0.0	0.5	0.5	0.4	0.0	0.0
Float/unidentified financing	-1.4	-0.8	-1.0	-0.1	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Poverty-reducing expenditure	12.0	11.1	9.6	9.1	9.1	9.2	9.3	9.4	9.5
Primary fiscal balance, including grants	-1.9	-2.8	-2.5	-2.0	-2.0	-1.6	-1.3	-1.2	-1.0

Sources: Ethiopian authorities and IMF staff estimates and projections. The Ethiopian fiscal year ends July 7.

[1] Government financial statistics are reported by the authorities based on GFSM 1986.

[2] Excluding special programs (demobilization and reconstruction).

[3] Poverty-reducing spending is defined to include total spending on health, education, agriculture, roads, and food security.

[4] External interest and amortization are presented after HIPC debt relief from the World Bank and the African Development Bank.

[5] Includes prospective donor financing to close the financing gap.

[6] Reflects privatization receipts net of financial investments or recapitalization on SOEs.

Table 3. Ethiopia: Monetary Survey and Central Bank Accounts, 2015/16–2023/24

	2015/16 Act.	2016/17 Act.	2017/18 Act.	2018/19 Act.	2019/20 Program	2020/21 Program	2021/22 Program	2022/23 IMF Staff Proj.	2023/24 IMF Staff Proj.
	(Millions of birr, unless otherwise indicated)								
Monetary survey									
Net foreign assets	22,800	38,035	39,376	14,505	26,681	85,945	167,722	287,970	410,264
Central bank	10,506	23,977	28,759	3,968	14,246	70,575	149,215	268,507	389,807
Commercial banks	12,293	14,058	10,617	10,537	12,434	15,370	18,507	19,463	20,457
Net domestic assets	422,467	535,349	701,241	872,152	1,019,875	1,161,424	1,328,350	1,530,626	1,808,424
Domestic credit	464,623	603,867	784,622	978,092	1,125,451	1,292,249	1,463,230	1,698,762	2,067,097
Claims on government (net) [1]	47,524	85,442	102,003	124,191	131,814	146,358	142,535	151,999	181,989
Claims on nongovernment	417,099	518,425	682,619	853,901	993,636	1,145,891	1,320,695	1,546,762	1,885,108
Public enterprises	270,068	321,482	441,297	528,780	608,941	667,266	703,893	725,426	758,306
Private sector	147,031	196,943	241,322	325,121	384,695	478,625	616,802	821,336	1,126,802
Broad money	445,266	573,384	740,617	886,657	1,046,556	1,247,369	1,496,072	1,818,597	2,218,687
Money	178,610	216,770	281,155	308,505	354,932	417,417	492,390	587,540	705,032
Currency outside banks	66,686	73,918	86,417	92,017	95,956	106,643	118,457	131,212	146,791
Demand deposits	111,924	142,852	194,737	216,488	258,977	310,774	373,933	456,328	558,242
Quasi money	266,657	356,614	459,462	578,152	691,623	829,953	1,003,682	1,231,057	1,513,655
Savings deposits	217,034	293,432	382,564	487,544	582,281	697,601	842,468	1,031,905	1,267,049
Time deposits	49,622	63,183	76,899	90,608	109,342	132,352	161,215	199,152	246,606
Central bank									
Net foreign assets	10,506	23,977	28,759	3,968	14,246	70,575	149,215	268,507	389,807
Foreign assets	74,157	73,874	77,617	98,727	137,531	238,731	377,846	510,024	630,436
Foreign liabilities	63,650	49,897	48,858	94,759	123,285	168,157	228,631	241,518	240,629
Net domestic assets	108,658	122,281	145,416	196,782	211,597	184,700	139,279	59,002	-18,101
Domestic credit	120,645	148,117	187,500	224,314	249,764	260,206	260,206	260,206	260,206
Government (net)	95,038	120,891	140,207	172,171	191,622	202,063	202,063	202,063	202,063
Other items (net)	-11,987	-25,836	-42,083	-27,533	-38,168	-75,505	-120,926	-201,204	-278,307
Reserve money	119,165	146,258	174,175	200,749	225,843	255,275	288,494	327,509	371,705
Currency outside banks	66,686	73,918	86,417	92,017	95,956	106,643	118,457	131,212	146,791
Commercial bank reserves	52,479	72,340	87,758	108,732	129,887	148,632	170,038	196,297	224,915
Cash in vault	15,907	20,328	26,494	29,783	31,681	31,794	31,272	36,101	41,364
Reserve deposit	36,572	52,012	61,264	78,949	98,206	116,838	138,766	160,196	183,550
	(Annual percentage change, unless otherwise indicated)								
Monetary survey									
Net foreign assets	-37.4	66.8	3.5	-63.2	83.9	222.1	95.2	71.7	42.5
Net domestic assets	26.2	26.7	31.0	24.4	16.9	13.9	14.4	15.2	18.1
Domestic credit	25.6	30.0	29.9	24.7	15.1	14.8	13.2	16.1	21.7
Claims on government (net) [1]	54.7	79.8	19.4	21.8	6.1	11.0	-2.6	6.6	19.7
Claims on nongovernment	22.9	24.3	31.7	25.1	16.4	15.3	15.3	17.1	21.9
Public enterprises	22.9	19.0	37.3	19.8	15.2	9.6	5.5	3.1	4.5
Private sector	22.9	33.9	22.5	34.7	18.3	24.4	28.9	33.2	37.2
Broad money	19.9	28.8	29.2	19.7	18.0	19.2	19.9	21.6	22.0
Money	15.5	21.4	29.7	9.7	15.0	17.6	18.0	19.3	20.0
Quasi money	23.1	33.7	28.8	25.8	19.6	20.0	20.9	22.7	23.0
Memorandum items:									
Base money growth	16.3	22.7	19.1	15.3	12.5	13.0	13.0	13.5	13.5
Nominal GDP growth	18.7	18.9	20.0	22.5	25.8	20.8	17.9	16.6	17.1
Excess reserve deposit (billions of birr)	11,416	25,456	22,654	40,813	46,693	55,819	65,901	71,843	75,972
Percent of deposits	3.0	5.1	3.5	5.1	4.9	4.9	4.8	4.3	3.7
Money multiplier (broad money/reserve money)	3.74	3.92	4.25	4.42	4.63	4.89	5.19	5.55	5.97
Velocity (GDP/broad money)	3.46	3.20	2.97	3.04	3.24	3.28	3.23	3.10	2.97
Currency-deposit ratio	0.176	0.148	0.132	0.116	0.101	0.093	0.086	0.078	0.071
Birr per U.S. dollar (end of period)	21.8	23.1	27.3	28.9	…	…	…	…	…
Nominal GDP (millions of birr)	1,541,277	1,832,786	2,200,121	2,696,223	3,390,554	4,094,284	4,827,955	5,630,222	6,594,246

Sources: NBE and IMF staff estimates and projections.

[1] Claims on the general government by the banking system less deposits of the general government with the banking system.

Table 4a. Ethiopia: Balance of Payments, 2015/16–2023/24

(Millions of U.S. dollars)

	2015/16 Act.	2016/17 Act.	2017/18 Act.	2018/19 Act.	2019/20 Program	2020/21 Program	2021/22 Program	2022/23 IMF Staff Proj.	2023/24 IMF Staff Proj.
	(Millions of U.S. dollars, unless otherwise indicated)								
Current account balance	-6,660	-6,539	-5,231	-4,304	-5,962	-4,810	-4,742	-4,547	-4,341
Excl. official transfers	-8051	-7967	-6483	-6431	-7336	-6088	-5903	-5877	-5823
Trade balance	-13,858	-12,895	-12,417	-12,447	-13,460	-14,848	-15,876	-16,532	-16,947
Exports of goods	2,868	2,908	2,836	2,665	2,937	3,240	3,653	4,059	4,477
Coffee	723	883	839	764	860	1,008	1,124	1,190	1,257
Oil seeds	477	351	424	388	388	412	427	447	468
Gold	291	209	100	28	33	52	83	177	282
Other	1,377	1,464	1,473	1,485	1,656	1,768	2,018	2,245	2,470
Imports of goods	-16,725	-15,803	-15,253	-15,112	-16,397	-18,088	-19,529	-20,591	-21,424
Services (net)	-246	-61	237	42	-234	155	471	759	932
Exports	3,196	3,331	4,220	4,945	5,647	6,432	7,376	8,337	9,123
Imports	-3,442	-3,392	-3,982	-4,903	-5,882	-6,277	-6,905	-7,578	-8,191
Income (net)	-376	-496	-377	-467	-672	-674	-672	-663	-608
Private transfers (net)	6,429	5,485	6,075	6,442	7,030	9,279	10,174	10,559	10,800
Official transfers (net)	1,391	1,428	1,252	2,127	1,374	1,278	1,161	1,330	1,482
Capital account balance	7,578	6,895	6,397	5,836	5,617	4,832	4,195	4,731	6,032
Foreign direct investment (net)	3,269	4,171	3,723	3,015	4,665	4,495	4,127	4,703	5,400
Other investment (net)	4,309	2,724	2,674	2,820	952	338	68	28	632
Federal government	1,631	1,418	1,631	1,158	1,118	1,074	1,061	944	947
Disbursements	1,734	1,535	1,795	1,537	1,331	1,375	1,414	1,357	1,396
Amortization	-102	-117	-163	-379	-213	-301	-353	-413	-449
Other public sector [1]	2,117	674	937	1,326	-166	-736	-993	-916	-315
Disbursements	2,779	1,389	1,689	2,302	1,078	776	444	530	982
Amortization	-663	-715	-752	-977	-1,244	-1,512	-1,437	-1,446	-1,297
SOEs (incl EAL)	-663	-715	-752	-977	-994	-1,087	-962	-971	-1,072
NBE	0	0	0	0	-250	-425	-475	-475	-225
Private sector borrowing (net)	451	503	251	264	0	0	0	0	0
Other (net)	110	130	-145	72	0	0	0	0	0
Errors and omissions	-749	303	-1,368	-1,473	0	0	0	0	0
Overall balance	169	659	-202	58	-346	22	-547	184	1,692
Excl. financing gap	…	…	…	…	*-1,919*	*-2,137*	*-3,298*	*-1,742*	*1,692*
Financing	-169	-659	202	-58	-30	-831	-790	-1,615	-1,692
Central bank (net; increase –)	-24	-556	-17	-83	-30	-831	-790	-1,615	-1,692
Reserves (increase –)	-153	205	350	-568	-617	-1,630	-1,780	-2,110	-1,681
Of which: prospective donor financing (increase –)	…	…	…	…	-220	-175	-700	-825	0
debt service reprofiling (increase –)	…	…	…	…	-156	-634	-637	-606	-178
first phase of reprofiling					*-156*	*-479*	*-514*	*-497*	*-114*
second phase of reprofiling					*0*	*-155*	*-124*	*-108*	*-64*
Liabilities (increase +)	128	-760	-367	485	586	799	990	495	-11
Fund credit (net)	-47	-52	-52	-52	586	799	990	495	-11
Commercial banks (net; increase –)	-145	-103	219	25	0	0	0	0	0
	(Annual percentage change, unless otherwise indicated)								
Memorandum items:									
Exports of goods	-5.0	1.4	-2.5	-6.0	10.2	10.3	12.7	11.1	10.3
Imports of goods	1.6	-5.5	-3.5	-0.9	8.5	10.3	8.0	5.4	4.0
Services exports	5.5	4.2	26.7	17.2	14.2	13.9	14.7	13.0	9.4
Services imports	10.8	-1.4	17.4	23.1	20.0	6.7	10.0	9.7	8.1
Exports of goods and services (percent of GDP)	8.3	7.6	8.4	7.9	7.9	9.2	10.8	10.9	10.7
Imports of goods and services (percent of GDP)	-27.6	-23.5	-22.8	-20.8	-20.5	-23.3	-25.8	-24.8	-23.4
Trade balance (percent of GDP)	-19.0	-15.8	-14.7	-12.9	-12.4	-14.2	-15.5	-14.6	-13.4
Private transfers (net, percent of GDP)	8.8	6.7	7.2	6.7	6.5	8.9	9.9	9.3	8.5
Gross official reserves (millions U.S. dollars)	3,402	3,197	2,848	3,415	4,031	5,661	7,441	9,551	11,232
(Months of following year imports of goods and services)	2.1	2.0	1.7	1.8	2.0	2.6	3.2	3.9	4.3
(Months of imports -- authorities' definition) [2]	2.9	2.7	2.3	2.3	2.4	3.1	3.8	4.7	5.2

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] Includes net borrowing by state-owned enterprises and NBE time deposits.

[2] The NBE definition for import coverage excludes food-aid and franco-valuta imports.

Table 4b. Ethiopia: Balance of Payments, 2015/16–2023/24

(Percent of GDP)

	2015/16 Act.	2016/17 Act.	2017/18 Act.	2018/19 Act.	2019/20 Program	2020/21 Program	2021/22 Program	2022/23 IMF Staff Proj.	2023/24 IMF Staff Proj.
Current account balance	-9.1	-8.0	-6.2	-4.5	-5.5	-4.6	-4.6	-4.0	-3.4
Current account balance, excl. official transfers	-11.0	-9.7	-7.7	-6.7	-6.7	-5.8	-5.8	-5.2	-4.6
Trade balance	-19.0	-15.8	-14.7	-12.9	-12.4	-14.2	-15.5	-14.6	-13.4
Exports of goods	3.9	3.6	3.4	2.8	2.7	3.1	3.6	3.6	3.5
Coffee	1.0	1.1	1.0	0.8	0.8	1.0	1.1	1.0	1.0
Oil seeds	0.7	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Gold	0.4	0.3	0.1	0.0	0.0	0.0	0.1	0.2	0.2
Other	1.9	1.8	1.7	1.5	1.5	1.7	2.0	2.0	2.0
Imports of goods	-22.9	-19.3	-18.1	-15.7	-15.1	-17.3	-19.1	-18.1	-16.9
Services (net)	-0.3	-0.1	0.3	0.0	-0.2	0.1	0.5	0.7	0.7
Exports	4.4	4.1	5.0	5.1	5.2	6.2	7.2	7.3	7.2
Imports	-4.7	-4.1	-4.7	-5.1	-5.4	-6.0	-6.7	-6.7	-6.5
Income (net)	-0.5	-0.6	-0.4	-0.5	-0.6	-0.6	-0.7	-0.6	-0.5
Private transfers (net)	8.8	6.7	7.2	6.7	6.5	8.9	9.9	9.3	8.5
Official transfers (net)	1.9	1.7	1.5	2.2	1.3	1.2	1.1	1.2	1.2
Capital account balance	10.4	8.4	7.6	6.1	5.2	4.6	4.1	4.2	4.8
Foreign direct investment (net)	4.5	5.1	4.4	3.1	4.3	4.3	4.0	4.1	4.3
Other investment (net)	5.9	3.3	3.2	2.9	0.9	0.3	0.1	0.0	0.5
Federal government	2.2	1.7	1.9	1.2	1.0	1.0	1.0	0.8	0.7
Disbursements	2.4	1.9	2.1	1.6	1.2	1.3	1.4	1.2	1.1
Amortization	-0.1	-0.1	-0.2	-0.4	-0.2	-0.3	-0.3	-0.4	-0.4
Other public sector [1]	2.9	0.8	1.1	1.4	-0.2	-0.7	-1.0	-0.8	-0.2
Disbursements	3.8	1.6	1.8	2.1	1.0	0.8	0.4	0.4	0.7
Amortization	-0.9	-0.8	-0.8	-0.9	-1.2	-1.5	-1.3	-1.1	-1.0
SOEs (incl EAL)	-0.9	-0.8	-0.8	-0.9	-1.0	-1.1	-0.8	-0.8	-0.8
NBE	0.0	0.0	0.0	0.0	-0.2	-0.4	-0.4	-0.4	-0.2
Private sector borrowing (net)	0.6	0.6	0.3	0.3	0.0	0.0	0.0	0.0	0.0
Other (net)	0.2	0.2	-0.2	0.1	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-1.0	0.4	-1.6	-1.5	0.0	0.0	0.0	0.0	0.0
Overall balance	0.2	0.8	-0.2	0.1	-0.3	0.0	-0.5	0.2	1.3
Excl. financing gap	...	...	...	...	*-1.8*	*-2.0*	*-3.2*	*-1.5*	*1.3*
Financing	-0.2	-0.8	0.2	-0.1	0.0	-0.8	-0.8	-1.4	-1.3
Central bank (net; increase –)	0.0	-0.7	0.0	-0.1	0.0	-0.8	-0.8	-1.4	-1.3
Reserves (increase –)	-0.2	0.3	0.4	-0.6	-0.6	-1.6	-1.7	-1.9	-1.3
Of which: prospective donor financing (increase –)	...	...	...	...	-0.2	-0.2	-0.7	-0.7	0.0
debt service reprofiling (increase –)	...	...	...	...	-0.1	-0.6	-0.6	-0.5	-0.1
first phase of reprofiling	...	...	...	...	*-0.1*	*-0.5*	*-0.5*	*-0.4*	*-0.1*
second phase of reprofiling	...	...	...	...	*0.0*	*-0.1*	*-0.1*	*-0.1*	*-0.1*
Liabilities (increase +)	0.2	-0.9	-0.4	0.5	0.5	0.8	1.0	0.4	0.0
Fund credit (net)	-0.1	-0.1	-0.1	-0.1	0.5	0.8	1.0	0.4	0.0
Commercial banks (net; increase –)	-0.2	-0.1	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Gross official reserves	4.7	3.9	3.4	3.6	3.7	5.4	7.3	8.4	8.9

Sources: Ethiopian authorities and IMF staff estimates and projections.

[1] Includes net borrowing by state-owned enterprises and NBE time deposits

Table 5. Ethiopia: Financial Stability Indicators, 2011/12—2018/19

	Jun-12	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17	Jun-18	Jun-19
Capital adequacy								
Capital to Risk-Weighted Assets	13.4	17.9	17.4	16.4	14.7	21.8	22.3	19.2
Regulatory Capital Tier I to Risk-Weighted Assets	13.4	17.9	17.4	16.4	14.7	21.8	22.3	19.2
Capital to Assets	6.7	7.2	7.0	6.6	6.5	8.8	8.3	7.8
Asset quality								
NPLs to Total Loans	1.4	2.5	2.0	2.1	2.9	2.6	3.0	2.3
NPLs Net of Provisions to Capital	-5.6	-0.5	-2.3	-1.1	2.9	2.1	0.8	n.a.
Earning and profitability								
Return on Assets	3.9	3.2	3.1	3.1	2.7	1.9	1.7	1.9
Return on Equity[1]	55.7	48.0	44.9	47.4	43.0	29.7	20.2	23.8
Gross Interest Income to Total Income[2]	56.8	64.9	62.8	67.9	73.9	74.9	84.2	79.6
Interest Margin to Gross Income	39.1	45.1	42.3	46.1	49.9	48.4	34.4	n.a.
Non-interest Expenses to Gross Income[3]	22.9	26.9	32.7	32.1	33.1	34.2	36.2	n.a.
Personnel Expenses to Non-interest Expenses	42.2	43.3	43.7	47.4	48.2	51.3	55.4	n.a.
Liquidity								
Liquid Assets to Total Assets	20.6	23.2	16.2	11.7	11.9	12.5	12.4	14.5
Liquid Assets to Short-term liabilities	26.7	30.1	20.8	14.8	15.6	17.7	16.5	16.9
Total Loans and Bonds to Total Deposits[4]	94.0	93.9	100.6	105.0	107.2	106.5	101.0	108.2

Sources: National Bank of Ethiopia, provided to IMF staff during the mission.

[1]The average capital used to calculate the ROE execludes retained earning and profit & loss.

[2] Total income comprises gross interest income and gross non-interest income.

[3]Gross income comprises net interest income and total non-interest income.

[4]Customer deposit includes time, current and saving deposits.

Table 6. Ethiopia: Gross Financing Needs

(Millions of U.S. dollars)

	2019/20 Program	2020/21 Program	2021/22 Program	2022/23 IMF Staff Proj.	2023/24 IMF Staff Proj.
External financing requirement	**9,442**	**9,537**	**9,473**	**9,845**	**9,260**
Current account deficit, excl. official transfers	7,336	6,088	5,903	5,877	5,823
Federal government amortization	213	301	353	413	449
Other public sector amortization 1/	1,244	1,512	1,437	1,446	1,297
Repayments to Fund	32	6	0	0	10
Change in gross reserves (+ = increase)	617	1,630	1,780	2,110	1,681
Change in commercial bank reserves (+ = increase)	0	0	0	0	0
External financing sources	**6,495**	**6,099**	**5,562**	**6,589**	**7,779**
Foreign direct investment, excl. privatization	4,086	3,949	3,704	4,703	5,400
External loans to Federal government	1,331	1,375	1,414	1,357	1,396
Other public sector external borrowing	1,078	776	444	530	982
Other (net)	0	0	0	0	0
Financing gap (+ = need for financing)	**2,947**	**3,437**	**3,911**	**3,256**	**1,482**
Expected financing					
Official transfers	1,374	1,278	1,161	1,330	1,482
Residual gap	**1,573**	**2,159**	**2,750**	**1,926**	**0**
IMF	619	804	990	495	0
Privatization proceeds	579	546	423	0	0
Debt service reprofiling 2/ 3/ 4/	156	634	637	606	178
First phase of reprofiling	*156*	*479*	*514*	*497*	*114*
Second phase of reprofiling	*0*	*155*	*124*	*108*	*64*
Prospective donor financing	220	175	700	825	0

Source: IMF staff estimates.

1/ Includes guaranteed and non-guaranteed SOE loans and long-term debt of National Bank of Ethiopia (NBE).

2/ Represents reprofiling that could yield moderate risk of external debt distress with some space to absorb shocks during the program. Firm commitment for the second phase of debt reprofiling is expected to be obtained by the first review of the arrangements.

3/ Frontloaded privatization proceeds in 2020/21 would help compensate for the amount from the second phase of reprofiling that will fall due inside the first 12 months after the program approval.

4/ In 2023/24, savings from debt reprofiling, which are reflected above the line in the balance of payments, are shown for completeness of information.

Table 7. Ethiopia: Proposed Schedule of Disbursements Under the ECF and EFF

Date of availability	Condition for disbursement	Amount (millions of SDR)				Percent of quota 1/		
		Total	Percent share of	ECF	EFF	Total	ECF	EFF
December 18, 2019	Executive Board approval of the ECF/EFF arrangements	223.85	10.6	133.64	90.21	74.44	44.44	30.00
April 15, 2020	Observance of continuous performance criteria (PCs) and PCs for end-December 2019 and completion of the first review	223.85	10.6	133.64	90.21	74.44	44.44	30.00
October 15, 2020	Observance of continuous PCs and PCs for end-June 2020 and completion of the second review	223.85	10.6	133.64	90.21	74.44	44.44	30.00
April 15, 2021	Observance of continuous PCs and PCs for end-December 2020 and completion of the third review	358.33	17.0	200.47	157.87	119.17	66.67	52.50
October 15, 2021	Observance of continuous PCs and PCs for end-June 2021 and completion of the fourth review	358.33	17.0	200.47	157.87	119.17	66.67	52.50
April 15, 2022	Observance of continuous PCs and PCs for end-December 2021 and completion of the fifth review	358.33	17.0	200.47	157.87	119.17	66.67	52.50
October 17, 2022	Observance of continuous PCs and PCs for end-June 2022 and completion of the sixth review	358.33	17.0	200.47	157.86	119.17	66.67	52.50
	Total	**2,104.90**	**100.00**	**1,202.80**	**902.10**	**700.00**	**400.00**	**300.00**

Source: IMF staff caculations.
1/ Ethiopia's quota is SDR 300.7 million.

Table 8. Ethiopia: Capacity to Repay the Fund, 2019/20—2034/35 1/

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	2032/33	2033/34
Fund obligations based on existing credit															
(In millions of SDR)															
Principal	23.4	4.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	1.1	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Fund obligations based on existing and prospective credit 2/															
(In millions of SDR)	25.1	9.1	10.6	21.1	31.4	74.2	173.5	296.9	383.4	399.7	376.2	290.2	167.9	34.2	0.9
Principal	23.4	4.0	0.0	0.0	7.5	51.0	151.4	277.5	370.9	390.9	370.0	286.5	166.0	33.2	0.0
ECF	*23.4*	*4.0*	*0.0*	*0.0*	*0.0*	*13.4*	*66.8*	*140.3*	*220.5*	*240.6*	*227.2*	*173.7*	*100.2*	*20.1*	*0.0*
EFF	*0.0*	*0.0*	*0.0*	*0.0*	*7.5*	*37.6*	*84.6*	*137.2*	*150.4*	*150.4*	*142.8*	*112.8*	*65.8*	*13.2*	*0.0*
Charges and interest	1.7	5.1	10.6	21.1	23.9	23.3	22.1	19.4	12.6	8.8	6.2	3.7	1.9	1.0	0.9
Total obligations based on existing and prospective credit 2/															
In millions of SDRs	25.1	9.1	10.6	21.1	31.4	74.2	173.5	296.9	383.4	399.7	376.2	290.2	167.9	34.2	0.9
In millions of U.S. dollars	34.6	12.7	14.8	29.5	44.1	104.2	243.7	417.0	538.6	561.5	528.4	407.6	235.9	48.1	1.3
In percent of general government revenue	0.27	0.09	0.10	0.18	0.24	0.53	1.14	1.79	2.13	2.03	1.75	1.24	0.66	0.12	0.00
In percent of exports of goods and services	0.40	0.13	0.13	0.24	0.32	0.70	1.50	2.34	2.76	2.62	2.25	1.59	0.84	0.16	0.00
In percent of GDP	0.03	0.01	0.01	0.03	0.03	0.08	0.17	0.26	0.31	0.30	0.25	0.18	0.10	0.02	0.00
In percent of quota	8.35	3.04	3.53	7.01	10.44	24.68	57.71	98.73	127.52	132.93	125.10	96.51	55.85	11.38	0.30
Outstanding Fund credit (end of period)	0.7	4.2	9.7	20.2	23.0	22.3	21.2	18.4	11.7	7.9	5.3	2.8	1.0	0.1	0.0
In millions of SDRs	451.7	1,029.9	1,746.6	2,104.9	2,097.4	2,046.4	1,895.0	1,617.5	1,246.7	855.7	485.7	199.2	33.2	0.0	0.0
In millions of U.S. dollars	622.2	1,425.7	2,429.6	2,941.0	2,946.0	2,874.4	2,661.8	2,272.0	1,751.1	1,202.0	682.2	279.8	46.6	0.0	0.0
In percent of general government revenue	5.4	11.3	17.9	19.2	17.0	15.0	12.8	10.0	7.1	4.5	2.3	0.9	0.1	0.0	0.0
In percent of exports of goods and services	7.2	14.7	22.0	23.7	21.7	19.4	16.4	12.8	9.0	5.6	2.9	1.1	0.2	0.0	0.0
In percent of GDP	0.57	1.36	2.37	2.59	2.33	2.17	1.83	1.43	1.01	0.63	0.33	0.12	0.02	0.00	0.00
In percent of quota	150.2	342.5	580.8	700.0	697.5	680.6	630.2	537.9	414.6	284.6	161.5	66.3	11.0	0.0	0.0
ECF	*90.2*	*200.0*	*333.3*	*400.0*	*400.0*	*395.6*	*373.3*	*326.7*	*253.3*	*173.3*	*97.8*	*40.0*	*6.7*	*0.0*	*0.0*
EFF	*60.0*	*142.5*	*247.5*	*300.0*	*297.5*	*285.0*	*256.9*	*211.3*	*161.3*	*111.3*	*63.8*	*26.3*	*4.4*	*0.0*	*0.0*
Net use of Fund credit (millions of SDR)	424.3	578.2	716.7	358.3	-7.5	-51.0	-151.4	-277.5	-370.9	-390.9	-370.0	-286.5	-166.0	-33.2	0.0
Disbursements	447.7	582.2	716.7	358.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	23.4	4.0	0.0	0.0	7.5	51.0	151.4	277.5	370.9	390.9	370.0	286.5	166.0	33.2	0.0
Memorandum items:															
General government revenue (billions of birr)	395.1	532.1	687.4	816.8	972.3	1,127.0	1,293.6	1,480.1	1,693.8	1,938.3	2,225.5	2,549.1	2,907.3	3,323.8	3,809.0
Exports of goods and services (billions of U.S. dollars)	8.6	9.7	11.0	12.4	13.6	14.9	16.3	17.8	19.5	21.4	23.5	25.7	28.1	30.8	33.5
Gross international reserves (billions of U.S. dollars)	4.0	5.7	7.4	9.6	11.2	11.6	13.0	14.5	15.8	17.2	18.2	19.5	21.3	23.5	25.3
In months of prospective imports	2.0	2.6	3.2	3.9	4.3	4.1	4.3	4.5	4.6	4.6	4.6	4.6	4.6	4.7	4.7
Nominal GDP (billions of U.S. dollars)	108.9	104.6	102.4	113.6	126.6	132.7	145.4	158.9	173.7	189.7	207.4	226.7	246.7	268.5	292.3
SDR per U.S. dollar (period average)	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Quota (millions of SDR)	300.7	300.7	300.7	300.7	300.7	300.7	300.7	300.7	300.7	300.7	300.7	300.7	300.7	300.7	300.7

Source: IMF staff estimates.

1/ Year ending in June.

2/ Including the proposed disbursements under the new ECF/EFF.

Annex I. Risk Assessment Matrix

Source of Risk	Relative Likelihood	Impact if Realized	Policy Response
Domestic Risks			
An intensification of political uncertainty and instability, which impacts policy implementation and growth	**M/H**	H. An intensification of political instability, especially ahead of the upcoming elections could adversely impact growth and inflation, and fuel demand for FX, further exacerbating vulnerabilities and fueling further instability. The capacity to implement policies could be adversely affected, with the potential rollback of necessary reforms.	Strengthen communication and dialogue to build the case for policies address grievances. Open up dialogue on implementation and sequencing of reforms to all stakeholders, including development partners, to ensure robust buy in and reduce the risk of poor implementation. Devote additional resources to social safety net and pro-poor programs to defuse opposition to reforms.
Domestic opposition to necessary reforms. Or policy choice to postpone adjustment for political reasons. Reforms and export competitiveness stall.	**M/H**	H. Necessary reforms are delayed or rolled back—including export-oriented as well as domestic initiatives. Investor uncertainty would increase, slowing the flow of FDI and domestic private sector development. Adverse growth impact. Weaker debt sustainability. Banks exposed to deteriorating balance sheets of their customers, higher NPLs. Substantial upside risk over the medium term if comprehensive reform agenda is implemented now. These reforms would expand fiscal space (tax system reforms, SOE reform, privatization and PPPs, etc.) and crowd in private investment and activity.	Maintain the reform momentum while expanding dialogue. Open up dialogue on implementation and sequencing of reforms to all stakeholders, including development partners, to ensure robust buy in and reduce the risk of poor implementation. Accelerate tax administration and tax policy reforms to strengthen fiscal revenues. Develop and share transparent metrics to show how and when policies are working to strengthen the coalition for reform. Protect pro-poor and social safety net programs.
Climate change. Increased frequency of drought conditions and flooding.	**M**	H. Food price shock leading to a higher food inflation. Adverse social impact, and stalled progress on poverty reduction. Lower agricultural exports, higher social spending, higher spending on remedial measures (food and fertilizer imports, animal feed, etc.). Underperformance in hydro-power generation leading to lower supply for domestic consumption and lower exports.	Increase food assistance. Tighten monetary policy if second-round effects are significant. Slow SOE imports and increase fiscal expenditure for social and medical protection. Develop medium-term strategies to diversify energy mix.

Source of Risk	Relative Likelihood	Impact if Realized	Policy Response
External Risks[1]			
Weaker-than-expected global growth: China: Intensification of trade tensions and/or a housing market downturn prompt a slowdown (high likelihood).	**M/H**	H. Lower demand for Ethiopia's main exports leading to widening trade deficit and weaker debt sustainability. Financing from a major bilateral partner affected adversely.	Accelerate reforms enhancing export competitiveness. Adopt a market-clearing exchange rate policy.
Rising protectionism and retreat from multilateralism.	**H**	H. Lower demand for Ethiopia's main exports leading to widening trade deficit and weaker debt sustainability. Reduction in remittances from diaspora.	Accelerate reforms enhancing export competitiveness. Adopt a more flexible exchange rate policy.
Intensification of security risks in the region, causing regional socio-economic and political disruptions.	**H**	L. Intensification of the flow of refugees/displaced peoples into Ethiopia, already host to the second largest refugee population in SSA, as a result of instability in neighboring countries.	Mitigated by experience, political consensus and well-established policy framework for dealing with refugees.
Reduced financial services by correspondent banks ("de-risking").	**M**	H. Reduction in availability of foreign exchange to private banks, increase in cost of cross-border transactions, including remittances. Higher current account deficit and lower growth. Lower capacity of banks to finance economic activity.	Swiftly address AML/CFT deficiencies and avoid further action by the FATF. Closely monitor status of CBR and effectively communicate respondent banks' AML/CFT compliance efforts to correspondent banks. Explore opportunities for banking sector consolidation.

[1] Based on the August 2019 update of the Global Risk Assessment Matrix.

Annex II. External Sector Assessment

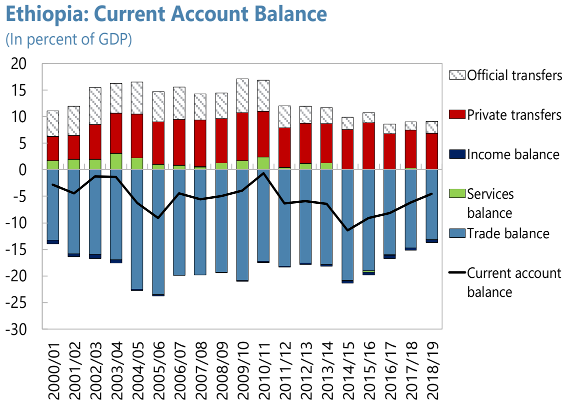
Ethiopia's external position is assessed to be weaker than suggested by medium-term fundamentals and desired macroeconomic policies. Macroeconomic imbalances would need to be addressed via appropriate policy adjustment, including more exchange rate flexibility, and structural reforms. Policy tightening by both the monetary authority and the broader public sector would help lower inflation, which will also contribute to eliminating the real exchange rate overvaluation. Over the medium term, the exchange rate should become more market determined and flexible.

A. The Current Account

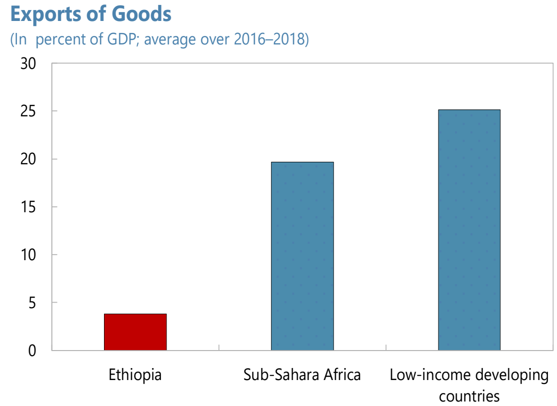
Background

1. Ethiopia's current account (CA) deficit is driven by a large goods trade deficit, that is partly offset by services trade, private remittances, and official transfers. The large trade deficit (10-year average of nearly 18 percent of GDP) reflects low and declining exports and a public-sector driven growth model that in recent years relied on debt-financed infrastructure development and fueled imports, which were supported by an overvalued exchange rate.

- In 2018/19, *goods exports* declined by 6 percent from a year ago, marking the fourth year of annual decline in the last five years. As a result, share of goods exports to GDP has more than halved since 2013/14 to slightly below 3 percent of GDP. Ethiopia's goods exports/GDP ratio is very low compared to the average for Sub-Saharan Africa or for low-income developing countries.
- However, *services exports* have performed well in recent years, growing at an average rate of nearly 22 percent per annum for the last two years. At about 5 percent of GDP, services exports are nearly twice as large as good exports, thanks in part to the expansion of Ethiopia's civil aviation sector.
- *Imports* have slowed rapidly in the last 2-3 years, with goods imports declining for three years in a row, resulting from reining in of external borrowing by the state-owned enterprises and a prioritization of public investment projects, as well as FX shortages which have curtailed private sector imports.
- The trade deficit/GDP ratio has improved to 12.9 percent in 2018/19 from about 21 percent in 2014/15 on declining imports as a much higher goods imports base more than offset the negative contribution from declining goods exports.



Sources: Ethiopian authorities; and IMF staff calculation and estimates.



Source: IMF, *World Economic Outlook* database.

2. **Ethiopia's weak export performance results from structural impediments that have impacted the private sector. Agricultural products, primarily coffee and oil seeds, account for a bulk of goods exports.** The agricultural sector is plagued by low labor productivity and is vulnerable to natural disasters, such as drought and flooding. Thus, a large share of Ethiopia's export basket is exposed to supply shocks, coming from domestic production and/or global prices. Manufacturing exports have grown at a fast clip in recent years, but from a very low base, and now account for about 12½ percent of goods exports. Insufficient and unreliable access to foreign exchange, credit, imported intermediate inputs, and unreliable electricity supply are often cited as the major constraints of doing business in Ethiopia. Being a land-locked country, Ethiopia needs to significantly improve its trade and border logistics. In this context, the rail link to Djibouti could be better used to realize its full potential. Finally, an overvalued exchange rate may have also hampered prospects for manufacturing exports.

3. **Recently, the external imbalances have begun to be tackled.** The CA deficit narrowed to an average of about 5¼ percent of GDP in the last two years from an average of about 8 percent of GDP in the preceding five years (peak deficit was 11½ percent of GDP in FY2014/15). The improvement in the CA balance was mainly because of a lower trade deficit, a result of lower public investment and an increase in private saving. In 2018/19, the CA deficit was about 4½ percent of GDP, with a measurable improvement in the CA balance observed in the last quarter of the fiscal year because of higher-than-usual donor support.

Assessment

4. **Staff assessment, based on the refined EBA-lite model, shows that in 2018/19 the CA balance was weaker than medium-term fundamentals and desired policies.** The model-identified CA gap is about –2.4 percent of GDP (+/-1 percent of GDP). The cyclically-adjusted and

multilaterally-consistent CA norm is close to –2.8 percent of GDP[1] While the 2018/19 CA deficit recorded an improvement from a year ago, in staff's estimates the larger-than-usual donor support in the fourth quarter of the fiscal year temporarily contributed to about 1 percentage point of GDP improvement in the CA deficit, for which staff adjustment is applied. It is also possible that the model does not capture some country-specific factors. One such factor could be import compression arising from limited access to foreign exchange. Although staff is not proposing any ad-hoc adjustment to the model results, such a distortion implies that the underlying current account imbalance could be potentially larger.[2] Model-estimated policy gaps contribute about –1.5 percent of GDP to the CA gap.[3] The policy gaps come mainly from domestic sources, notably, a larger-than-desired fiscal deficit for the nonfinancial public sector, a need to build reserves to reach adequate levels, and low productivity levels.[4]

Table 1. Ethiopia: Assessment of the Current Account Balance
(In percent of GDP)

	Norm 1/	Underlying 2/	Gap
EBA-lite revised current account (CA) regression model	–2.8	–5.2	–2.4
Of which: contributions from identified policy gaps			–1.5
unexplained residual based on observed CA			0.3
natural disasters and conflicts			2.0

Source: IMF staff estimates.
1/ Adjusted for cyclical factors and multilateral consistency.
2/ Adjusted for cyclical factors (the output gap and the terms-of-trade gap). Includes staff adjustment for temporary factor (about 1 percent of GDP)

5. Measures to boost productivity and improve the business climate are needed to durably reduce the external imbalance. While fiscal consolidation at the broader public sector level, including the state-owned enterprises, over the medium term would help support an improvement in the CA balance, measures are needed to increase productivity and lower private

[1] The CA norm is estimated to have improved by about 3 percent of GDP since the last Article IV consultation. This mainly reflects refinements in the EBA-lite regression methodology and an update to the estimation period. The methodological revisions were aimed at (i) clarifying the roles of remittances and aid in external balance; (ii) recognition of the impact of natural disasters and militarized conflicts, where applicable; (iii) incorporation of social insurance and financial policies; and (iv) reflecting the changes made in the updated 2018 EBA methodology, for example, modeling of demographics.

[2] Cross-country evidence shows that Ethiopia's average import/GDP ratio over the past three years was among the lowest in its income group, lower by about 10 percentage points from the average of the comparator countries. However, staff notes that availability of foreign exchange would have helped exporters as well by allowing them better access to imported inputs and more free usage of export proceeds. Thus, the estimated impact of foreign exchange rationing would be smaller than 10 percent of GDP but would be significant. Additionally, in such a counterfactual world, FX reserves would have likely been much lower, resulting in a higher policy gap.

[3] The EBA-lite model considers the actual policy (P) and its desired level (P*) in the country under study relative to its trading partners. Thus, policy gap is defined as $(P – P_{world}) – (P^* – P^*_{world})$. The overall policy gap, as a share of GDP, comprises: fiscal policy 0.02 percent; public health expenditure 0.39 percent; changes in reserves –0.44 percent; private credit level 0.01 percent; private credit growth 0.06 percent; and capital controls when combined with relative productivity and global risk aversion -1.58 percent.

[4] The external sustainability approach is not reported due to non-availability of official statistics on international investment positions (IIP). Given persistent CA deficits, Ethiopia is considered to be a net borrower economy.

precautionary saving, including via policies that will support greater inclusion (these include higher spending on social protection and public healthcare) but increased access to finance will likely boost financial saving. A comprehensive effort at improving the business environment, accompanied by reforms, should be considered to boost export competitiveness. FX reserves will need to be built up to adequate levels to create buffers against external vulnerabilities (see Section D).

B. Capital and Financial Flows

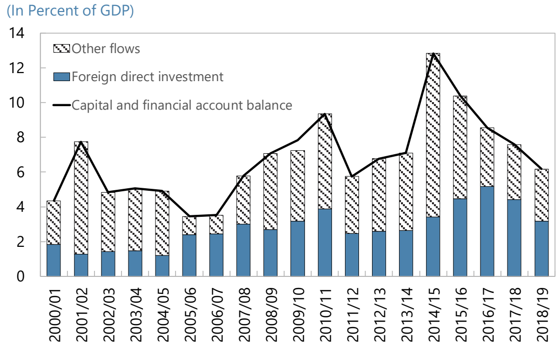
Background

6. The capital and financial accounts are dominated by official flows to the public sector and foreign direct investment (FDI).[5] In 2014, Ethiopia issued its first and only (10-year) Eurobond of US$1 billion. In 2018/19, Ethiopia is recorded a surplus of 6 percent of GDP, its lowest in five years as debt flows have decelerated. FDI/GDP ratio declined to 3.1 percent last year, but the average over the last three years represents an increase from the average witnessed during the preceding 5–10 years. Net FDI inflows in Ethiopia are significantly higher than the average for the region or for the low-income developing countries. In 2019/20, financial account flows, as a share of GDP, are expected slightly higher than a year ago as lower as public debt-creating flows are offset by higher inflows on FDI, including from staff's projection on privatization proceeds.

Assessment

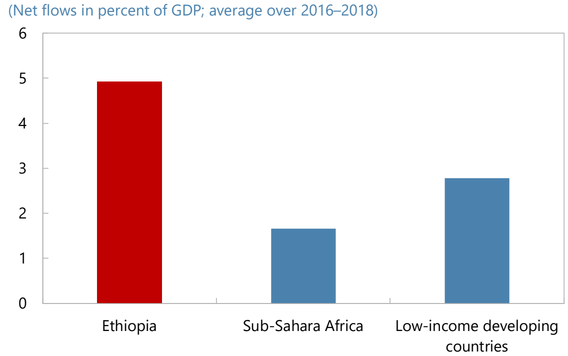
7. Over the medium term, the capital and financial account is expected to remain in surplus, supported primarily by FDI as external debt financing for public investment projects will slow down further. Such a compositional shift would also help mitigate Ethiopia's external vulnerabilities. However, although these flows will be adequate to finance the projected CA deficit, they are not sufficient to meet the country's external gross financing needs.

Ethiopia: Capital and Financial Account Balance
(In Percent of GDP)



Sources: Ethiopian authorities; and IMF staff calculation and estimates.

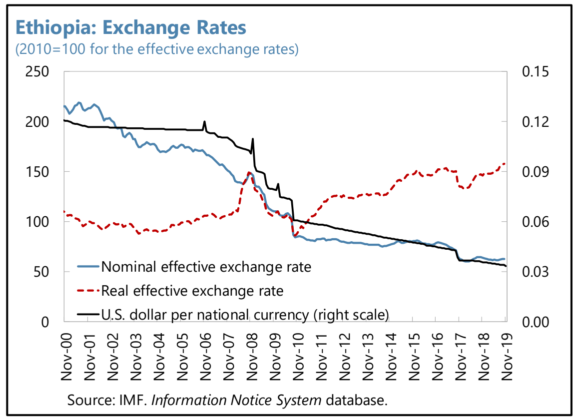
Foreign Direct Investment
(Net flows in percent of GDP; average over 2016–2018)



Source: IMF, *World Economic Outlook* database.

[5] Ethiopia maintains certain exchange controls and potentially capital flow management measures.

C. Real Exchange Rate



Background

8. The real effective exchange rate (REER) has remained on a trend appreciation path for some years now, as higher inflation differentials have more than offset a trend depreciation in the nominal effective exchange rate (NEER). Periodic devaluations (latest in October 2017) and a steadily managed depreciation of the currency has led to a cumulative 37 percent weaker NEER relative to 2010 average. However, this depreciation was not sufficient to offset the inflation differential with the trading partners (average domestic inflation since 2010 has been close to 14 percent y/y as compared to, for example, a 6 percent nominal depreciation against the U.S. dollar in FY2018/19), resulting in a cumulative 58 percent appreciation of the REER from its 2010 average. Between end-2017/18 and October 2019, the REER was estimated to have appreciated by about 11½ percent, thereby offsetting the real depreciation that was achieved after the October 2017 devaluation.

Assessment

9. The EBA-lite REER model estimates the REER gap at about 25 percent in FY2018/19, but has large unexplained model residuals, suggesting that the model has a poor fit to Ethiopian data. Thus, based on the estimated CA gap, staff assesses the REER to be overvalued by 23.4 percent (+/-10 percent) in 2018/19 (given an estimated semi-elasticity of –0.10 for the CA balance to changes in REER). The average parallel market premia was about 27 percent in 2018/19, a proxy for exchange rate misalignment in this context. However, with inflation accelerating since mid– 2019 and staying elevated (October 2019: 18.6 percent y/y, relative to 12.9 percent y/y in April 2019), this overvaluation has likely widened further. The parallel market premia had risen to 37 percent in June 2019 from 28 percent in December 2018.

Table 2. Ethiopia: Assessment of the Real Exchange Rate
(In percent)

	Gap
EBA-lite REER index model	25.2
Of which: contributions from identified policy gaps	–0.1
contributions from natural disasters and conflicts	–1.6
unexplained residual	26.9
Staff estimate using the CA-REER semi-elasticity 1/	23.4

Source: IMF staff estimates.
1/ The estimated semi-elasticity of the current account balance with respect to real effective exchange rate is –0.10.

10. Increased exchange rate flexibility, combined with appropriately tight macroeconomic policies and a shift to a modern monetary policy framework to durably lower inflation, should

support an orderly correction in the overvaluation over the next 2–3 years. A rapid correction via a step devaluation may get undone due to exchange rate passthrough to prices. As the spread between the official and parallel rates closes, measures to transition to a market-clearing exchange rate such as the introduction of a progressively increasing band around the official rate and removal of restrictions inhibiting participation in the interbank FX market, should be considered.

D. FX Reserves

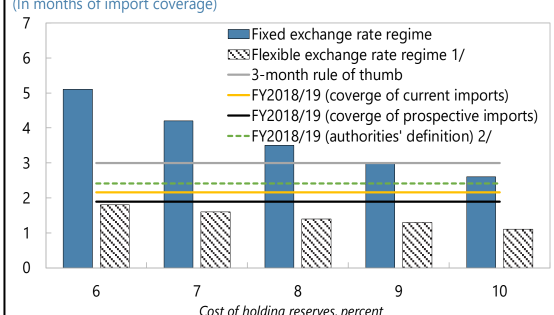
Background

11. As of end-FY2018/19, gross FX reserves at the central bank were estimated to have reached US$3.4 billion, helped in part by external assistance during the year. Outstanding gross reserves are equivalent to about 12 percent of GDP, 48 percent of exports of goods and services, or 1.8 months of next year's projected imports of goods and services (staff estimate).[6] Ethiopia's *de jure* exchange rate regime is floating, but *de facto* regime is classified as "crawl-like". However, in the first three months of the current fiscal year, FX reserves had declined on import payments to US$2.6 billion.

Assessment

12. Ethiopia's FX reserves are significantly below the commonly-applied threshold of 3 months of prospective imports coverage. Historically, reserves have stayed low, averaging around 2 months of prospective import coverage over the past decade. The IMF's reserve adequacy estimate for low-income economies suggests that about 3½–5 months of import coverage of reserves would be adequate given Ethiopia's current *de facto* exchange rate regime and a 6–8 percent range for the opportunity cost of holding reserves.[7] At 1.8 months of prospective import coverage (or, 2.2 months of current import coverage), gross reserves for 2018/19 are assessed to be inadequate under the current assumptions. Staff's baseline projects a rise in reserves over the medium term, supported by domestic adjustments and reforms and from increased external assistance, to above 4 months of import coverage. Higher reserves would serve as an important buffer against shocks, but they are not substitute for needed policy adjustments and structural reforms.

Ethiopia: Optimal Level of Holding Reserves
(In months of import coverage)



Source: IMF staff estimates.
1/ Includes floating or freely floating *de jure* regimes.
2/ Excludes food aid and franco-valuta imports.

---

[6] Following authorities' definition, which excludes food aid and franco-valuta imports, import coverage of gross reserves would have been 2.4 months.

[7] These estimates consider the current *de facto* exchange rate regime, and assume (i) risk neutrality, (ii) opportunity cost of holding reserves, proxied by the movement of yields on Ethiopia's 2024 Euro bond; and (iii) an unconditional probability of a large shock at 30 percent. For more discussions, see IMF, 2016, *Guidance Note on the Assessment of Reserve Adequacy and Related Considerations*, June 2016.

Annex III. Authorities' Response to Past IMF Policy Recommendations

Fiscal

1. **Intensify reforms to enhance domestic revenue mobilization.** In the face of the declining tax-to-GDP ratio, staff recommended stepping up domestic resource mobilization efforts. The authorities—with support from the Fund and other development partners—have made progress on numerous tax policy amendments and tax administration measures. These include preparation of directives on VAT, excise, and trade taxes and further work in strengthening tax administration. The authorities are also making preparations to institute a property tax: work to build up a fiscal cadaster is ongoing. Consistent with staff advice to streamline tax incentive, a measure to reduce the number of institutions able to grant tax incentives was taken to control growing tax expenditures. Despite these efforts, the tax revenue performance has not been encouraging, and efforts should be further intensified.

2. **Tackling debt vulnerabilities, enhancing the governance of SOEs, and improving fiscal transparency.** Staff also recommended tackling debt vulnerabilities, which has been driven in large part by the SOEs. The authorities' efforts to restrict SOEs from non-concessional borrowing for new projects has borne fruit and contributed to improved debt dynamics. On SOE reform, the authorities have announced an ambitious privatization program and announced their intention to strengthen governance and management of key SOEs. Of particular note is the legislation to open up the telecom sector to competition and facilitate the partial privatization of Ethio-Telecom which will enhance efficiency and improve telecom services. However, lack of progress on preparing financial statements consistent with IFRS and making them available to the public has held back broader efforts to reform SOEs. There has also been a lack of progress on fiscal transparency, as the draft budget, medium-term budget framework, and financial statements are not published.

Monetary and Financial

3. **Supporting external competitiveness through more flexible exchange rate and reforming NBE bills.** The 2018 Article IV found the real exchange rate to be overvalued by 12–18 percent, and staff advocated addressing the overvaluation and allowing greater exchange rate flexibility. The authorities have recently allowed for greater exchange rate flexibility. On monetary operations, the NBE has announced the elimination of the "27-percent rule", phasing out of NBE financing of the DBE and government, and conducted the first auction for market-based T-bills. The authorities intend to strengthen the financial safety net and crisis management frameworks, with support from Fund TA.

Structural

4. **Undertaking structural reforms to improve business environment.** Progress has been in this area. A high-level committee led by the Prime Minister has focused on improving the doing

business index. The ten key indicators identified, include starting a business, construction permits, registering property, getting electricity, getting credit, paying taxes, trading across borders, resolving insolvency, protecting minority rights, and enforcing contracts. Progress is reviewed on a monthly basis. An example of a concrete step taken to address private sector access to finance is the NBE issuance of legislation to expand the range of eligible collateral to include moveable assets such as machinery, transport equipment and livestock. After nearly seven years of discontinued negotiations, Ethiopia has initiated the accession process to join the WTO and the AfCFTA has been ratified.

5. Addressing gaps in the quality and timeliness of economic statistics. The authorities took an important step in improving data reporting by launching e-GDDS in August 2019, supported by STA TA. Fund TA to improve data quality, especially for the compilation of the national accounts and balance of payments, has intensified, and progress has been made on developing quarterly GDP data on the expenditure side. There has been little progress on migrating to more recent GFSM fiscal reporting standards, and summary consolidated accounts of the public enterprises are not produced. The authorities have requested Fund TA, including to develop a Public Sector Balance Sheet.

Annex IV. Capacity Development Strategy for FY20–22

1. **Ethiopia is undertaking major economic reforms as it transitions from a public to private sector-led growth model.** Rapid growth over the past decade has resulted in impressive poverty reduction and improvement in social indicators, but macroeconomic imbalances have emerged, and the public investment-driven model has reached its limits. Recognizing the need to open space for the private sector to sustain high growth over the medium term, the authorities have announced a 3-year *Homegrown Economic Reform Program* (Plan). The Plan aims to implement reforms to (i) increase revenues and improve the efficiency of spending. (ii) strengthen the monetary policy framework, (iii) develop the financial sector to support credit to the private sector, and (iv) improve the business environment. The government led by Prime Minister Abiy, who took office in April 2018, has intensified its engagement with the Fund through a more regular policy dialogue and increased requests for TA. With the announcement of an ambitious and comprehensive reform plan which covers many core macroeconomic areas of Fund expertise, including fiscal, monetary, financial sector and statistics, the collaboration is expected to strengthen further.

2. **TA intensity has picked up significantly and is delivered from both HQ and the regional center in East Africa (AFE).** In FY 2019, Ethiopia received 39 TA missions. Ongoing and planned TA financed in part by the Revenue Mobilization Thematic Fund (RMTS) focuses on tax policy and administration, with delivery coming from both HQ and AFE, PFM and budget transparency, including gender budgeting, PFRAM and fiscal risks, improvements in statistics, financial sector development and central bank operations are also on the agenda. A planned mission to develop a public sector balance sheet would contribute to the broad strategy of SOE reform. An LTX funded by DFID started in early November 2019 and will work closely with the NBE on the development of a market for government securities and strengthening monetary operations. STA has been providing support via TA missions and training on external sector and monetary and financial statistics.

3. **Diagnostic assessments in key reform areas and TA coordination could inform specific areas of Fund focus, increasing the efficiency of delivery.** While ongoing TA work in the areas of revenue policy and reforms has identified core issues to be addressed, an FAD-led Medium-Term Revenue Strategy (MTRS) initiative could provide a clear and comprehensive roadmap for future efforts coordinated with partners. A Public Investment Management Assessment (PIMA) would align well with the authorities' objective of increasing investment efficiency and a Fiscal Transparency Evaluation (FTE) would identify potential measures to increase fiscal transparency, an area of continued weakness. A Financial Sector Stability Review (FSSR) could be beneficial in mapping technical assistance needs in the financial development and prudential supervision areas. Ongoing dialogue with development partners will be key both pre and post diagnostic TA efforts.

4. In support of these policy priorities, the proposed strategy for IMF TA FY20–22 is as follows:

Priorities	Objectives
Domestic Revenue Mobilization: Tax policy and revenue administration	Increase tax revenue to GDP ratio.
Improving the monetary policy transmission mechanism	Developing a market for government securities with market-based interest rates, a more flexible exchange rate, and an active management of liquidity.
Strengthening the financial stability framework and mapping financial development needs	Address gaps in supervisory and regulatory processes, assess the financial stability framework. Map financial development next steps through an FSSR.
PFM and budget transparency	Strengthen the public finance management framework and account for fiscal risks from the broader public sector
Data quality and statistics	Enhance the reliability, coverage, timeliness, and integrity of economic statistics, including national accounts, BOP and monetary statistics.

5. To achieve these objectives, it is expected that FAD, MCM, and STA will provide TA, supported by AFRITAC East. While delivery of TA is largely done though short-term missions focusing on policy recommendations, there is a component of training, including in the context of LTX work in the financial sector and fiscal TA on tax registration, audit and preparation of a fiscal risk statement. Ongoing TA in some areas is, at times, supported through ad hoc contacts via video conference, including STA efforts to support the August 2019 launch of e-GDDS.

6. The main risks to the impact of the TA in FY20 are capacity constraints in an environment with multiple donors and a large reform agenda. These include challenges in managing technical issues associated with an upgrade of policy frameworks, and considerable TA work done by multiple development partners in overlapping policy areas. These risks could be mitigated by aligning TA closely with government reform priorities, earmarking and training dedicated staff in government agencies to implement the reforms, and a further strengthening of coordination among development partners, supported by the IMF Resident Representative who took the post in March 2019.

Authorities' Views

7. The authorities concurred with the thrust of the Capacity Development Strategy and found it broadly consistent with their objectives.

Appendix I. Letter of Intent

Addis Ababa, December 11, 2019

Madame Kristalina Georgieva
Managing Director
International Monetary Fund
Washington DC

Dear Madame Managing Director:

We request the IMF's support for our economic reform program to address macroeconomic imbalances and place Ethiopia on a sustainable path of high economic growth over the medium term.

Ethiopia has experienced an extended period of rapid economic growth, significant poverty reduction and notable improvement in social indicators. While the public sector-driven model has delivered good results, it has also resulted in a buildup of public debt and external imbalances that could undermine continued progress towards our goal of achieving middle income status by 2025. Now is the time for reforms that address structural bottlenecks and create room for the private sector to take the lead in creating high quality, inclusive growth.

The authorities have identified four key policy challenges: (i) foreign exchange imbalances, (ii) high inflation, (iii) high external debt burden, and (iv) limited private sector access to finance. To address these challenges, we have recently announced a 3-year *Homegrown Economic Reform Program* which has three components: (i) macroeconomic reforms, (ii) structural reforms, and (iii) sectoral reforms. Our goal is to address external imbalances through a combination of structural reforms to promote exports and FDI, implementation of an ambitious privatization program and a move to greater exchange rate flexibility. This will be supported by reforming state-owned enterprises, consolidating the public sector deficit and revenue reforms to create fiscal room needed to finance infrastructure and social needs in a sustainable way. Financial sector reforms will facilitate private sector access to credit and support a modern monetary policy framework to bring inflation down to the central bank's single digit objective.

Steadfast implementation of the authorities' reform plan will reduce debt vulnerabilities and create an economic environment supportive of higher private investment and structural transformation.

The upgrading of policy frameworks will increase efficiency and transparency and support strong, sustainable growth and poverty reduction, while maintaining stability.

We request the Fund's financial support for our program through new three-year arrangements under the Extended Credit Facility and Extended Fund Facility in the amount of SDR 2104.9 million or the equivalent of 700 percent of our quota share, to be disbursed in seven tranches. The Fund's support will be instrumental in effective implementation of our economic reform program through providing balance of payments assistance, catalyzing other concessional resources, and monitoring reform implementation. Our program will be monitored through semiannual reviews (the first on or after April 15, 2020 and the second on or after October 15, 2020) with quantitative criteria and structural benchmarks as described in the attached Memorandum of Economic and Financial Policies (MEFP) and defined in the attached Technical Memorandum of Understanding (TMU). The authorities will provide the IMF with all the data and information required to monitor implementation of the measures and achievement of the objectives as detailed in the TMU.

The Ethiopian authorities believe that the policies described in the MEFP are appropriate to achieve the program objectives, but they will take any additional measures that become necessary for this purpose. The authorities will consult the IMF on the adoption of such measures, and prior to any revision of the policies set forth in the MEFP, in accordance with the Fund's policies on such consultations. The authorities consent to the publication of this letter and its attachments, and the related staff report.

Very truly yours,

/s/

H. E. Mr. Ahmed Shide
Minister of Finance
The Federal Democratic Republic of Ethiopia

/s/

H. E. Dr. Yinager Dessie
Governor, National Bank of Ethiopia
The Federal Democratic Republic of Ethiopia

Attachments (2)

I. Memorandum of Economic and Financial Policies (MEFP)
II. Technical Memorandum of Understanding (TMU)

Attachment I. Memorandum of Economic and Financial Policies

Addis Ababa, December 11, 2019

I. INTRODUCTION

1. **Over the past two decades, the Ethiopian economy has expanded rapidly, leading to a six-fold rise in per capita incomes and sizeable gains in human development indicators.** Since 2003, per capita income in Ethiopia rose by about 650 percent, while other development indicators saw remarkable improvement. Growth was pro-poor as reflected in significant reduction in poverty and improvements in access to health and education. The key driver of past growth was public investment aimed to building critically needed human and physical capital.

2. **Notwithstanding this progress, the economy is now facing significant challenges and macroeconomic imbalances.** Immediate macroeconomic challenges are pressing: high inflation, persistent external imbalances, including severe FX shortages and international reserves below adequate levels, and elevated risk of debt distress. Over the medium term, the main challenges are related to putting in place the building blocks for a sustainable and non-disruptive transition from public sector-led to private sector-led growth, supported by improved policy frameworks to ensure that imbalances do not re-emerge. This includes developing a modern financial system which will also improve the effectiveness of monetary policy. Work is also needed to strengthen fiscal management by reversing the decline in domestic revenue mobilization, which would also support the prudent debt strategy going forward and improving budget execution to ensure the maximum return from past investment in public projects.

3. **The government has embarked on a strategic approach to formulating and executing these reforms in our Homegrown Economic Reform Plan (HERP).** The reform plan aims to ensure a smooth transition from a public sector-led to private sector-led growth. The reform agenda in the Plan is comprehensive and well-coordinated, with three pillars: (i) macroeconomic and financial sector reforms to correct FX imbalances, control inflation, safeguard financial stability while promoting intermediation, and ensure debt sustainability; (ii) structural reforms to ease institutional and structural bottlenecks to productivity and job growth, and (iii) sectoral reforms to address institutional and market failures in key strategic sectors.

4. **The economic program discussed in this memorandum is built on the HERP, recognizing the centrality of strong ownership and commitment to its eventual success.** Our program is intended to deliver tangible and measurable gains in living standards by undertaking reforms to address long-standing structural bottlenecks to ensure that high growth is sustainable over the long term and will enable Ethiopia to reach lower middle-income level by 2025. Critical to this will be the strengthening of institutions and the upgrading of macroeconomic policy frameworks. Therefore, the focus of the program is to durably reduce and eliminate FX shortages over the course of the program; gradually lift financial repression and improve private sector access to credit; strengthen domestic revenue mobilization and public financial management to ensure

adequate resources are devoted to pro-poor spending; and assess and address vulnerabilities in the financial sector while encouraging financial sector development.

II. BUILDING ON PAST ACHIEVEMENTS OF RAPID GROWTH AND POVERTY REDUCTION

5. **For the past two decades Ethiopia has successfully pursued an agriculture-led industrial policy with the goals of supporting industrialization, urbanization, development and poverty reduction.** The government's strong commitment to reducing poverty is reflected in the significant proportion of public resources invested in pro-poor sectors. Indeed, the annual government budget allocates more than 60 percent of general government expenditure to pro-poor infrastructure and services in agriculture, education, health, water and roads.

6. **The implementation of pro-poor polices has led to a significant expansion in access to social services, with concrete improvements in access to education and health outcomes.** Ethiopia achieved universal lower-primary education (Grades 1 to 4) by 2015. The number of students enrolled expanded from 17.3 million in 2007/2008 to close to 28 million in 2017/2018, an average increase of 1 million new students a year. Similarly, there has been a rapid growth in the number of teachers and schools. Ethiopia has also made notable strides in overall child survival, with a reduction in the under-five mortality rate, from 123 per 1,000 live births in 2005 to 55 per 1,000 live births in 2019. Similar declines have occurred in the infant mortality rate, from 77 per 1,000 in 2005 to 43 per 1,000 in 2019. But there remains an unfinished agenda with respect to maximizing the coverage and quality of high-impact maternal and neo-natal health interventions.

7. **The government also focused on promoting equity and across regions to narrow spatial inequality.** There is growing momentum and political will for tailored strategies and approaches to address vulnerabilities and build resilience in those regions, particularly in lowland areas, Ethiopia's poorest agro-ecological zone. With the support of its development partners, the Ethiopian government has developed a lowland livelihood resilience project that aims to improve livelihood resilience of pastoral and agro-pastoral communities in Ethiopia. As part of its HERP, the government plans to fundamentally shift the center-periphery approach, by bringing lowland areas at the center of the economic transformation.

8. **This robust economic performance and expansion of social services has resulted in a dramatic reduction in the level of poverty.** The incidence of poverty markedly declined from 45.5 percent in 2000 to 23.5 percent in 2016. According to the recent Household Consumption Expenditure Survey report, between 2010/11 and 2015/16 about 5.3 million people were lifted out of poverty. Poverty gap and poverty severity indices, which are measures of the distance between the income of the poor in the population from the poverty line, have declined from 10.1 percent and 3.9 percent in 2000 to 3.7 percent and 1.4 percent in 2016 respectively. Notwithstanding these achievements, the poverty rate, at 23.5 percent, remains high, and the government is committed to further reducing it by half.

9. Addressing poverty and continuing to invest in critical social services remains the touchstones of the government's economic program going forward. As the Second Growth and Transformation Plan (GTP II) draws to a close in 2019/20, the government is formulating our 10-year Perspective Plan for 2020/21—2029/30, building on the HERP, which outlines macroeconomic, structural and sectoral reforms that will pave the way for job creation, further poverty reduction, and ensuring inclusive growth.

III. RECENT ECONOMIC DEVELOPMENTS

10. Real GDP growth remained robust at 9 percent in 2018/19, supported by still-strong private sector activity as the public sector remained on a prudent footing. In particular, the government maintained tight control over fiscal expenditure and public sector borrowing, including by the SOEs, in order to address macroeconomic imbalances and reduce debt vulnerabilities. However, real GDP growth remained robust supported by strong activity in the industry, which grew at 12.6 percent, and services, which grew at 11 percent, sectors. Inflation continues to exceed the NBE's single-digit objective, averaging 12.6 percent in 2018/19, and reaching 18.6 percent in October 2019. The elevated inflation was largely driven by higher food prices, which were affected by interruptions to the transport and logistics network, below-average-rainfall in selected areas and delays in delivering inputs such as fertilizer to some areas.

11. The current account deficit in the balance of payments narrowed to 4.5 percent of GDP in 2018/19. The improvement in the current account was supported by a lower trade deficit-to-GDP ratio and an increase in official transfers, particularly in the last quarter of the year. Exports of goods were below expectations, declining by 6 percent, but non-factor services exports showed strong growth to rise by 17.2 percent, driven by the continued expansion in air transportation services. As a result, overall exports of goods and non-factor services rose by 7.9 percent, faster than the growth in imports of goods and non-factor services (4.1 percent). This moderate import growth was driven by a small decline in the imports of goods (-0.9 percent) due to lower imports of capital and consumption goods. Net transfers rose by 17 percent driven by one of the strongest annual increases in official transfers. Private transfers also grew, but at a slower pace than the year before. The steady growth in private transfers is an early indication of measures taken by the government over the year to invite the participation of the diaspora in the future growth of Ethiopia. As these measures take root, and new reforms are implemented, the volume of funds remitted by Ethiopians abroad is expected to respond strongly.

12. FX reserves are inadequate and there is an urgent need to increase reserves which will also help strengthen the credibility of our reform agenda. Gross official reserves rose from $2.8 billion in FY 2017/18 to $3.4 billion in FY 2018/19. This small increase in reserves was supported by inflows from donors and bilateral loans to the National Bank of Ethiopia (NBE), while the policy of FX rationing remained effective amid growing FX shortages. At only 1.8 months of prospective imports, our FX reserves are significantly below our targets. As of September 2019, gross reserves had declined to US$2.6 billion due to a significant decline in external disbursements to the public sector, larger debt service payments by the SOEs and payments for fuel imports.

13. Strong efforts were undertaken to reduce debt vulnerabilities. In 2018/19, the government did not undertake any new non-concessional external borrowing, while the use of non-concessional financing by SOEs (excluding Ethiopian Airlines) was limited to previously contracted loans. To complement the strong control of external borrowing that has been in place for the last couple of years now, the government also proactively undertook operations to reprofile some of the external bilateral debt held by SOEs. These efforts, which involved a combination of lengthening grace periods and loan maturities, and, in some cases, lowering interest rates, is expected to see a reduction in debt service payments over the immediate term. The total savings in debt service over the three-year period to June 2022 is expected to be close to US$ 950 million, which improves debt dynamics, preserves scarce FX and reduces vulnerabilities. As a result, debt of the non-financial public sector declined from 61 percent of GDP in June 2018 and to 59.5 percent in June 2019, driven by a 1.8-percentage point of GDP decline in external debt, while domestic debt remained largely stable.

14. The exchange rate depreciated by 6.1 percent against the U.S. dollar in the fiscal year ending June 2019, in line with the NBE's policy of maintaining a stable and predictable depreciation path for the birr. The nominal effective exchange rate, however, depreciated more modestly, reflecting the strength of U.S. dollar against trading partner currencies. However, the widening inflation differentials with trading partners led to a real effective exchange rate (REER) appreciation during the year, bringing the REER back to its pre-October 2017 level when a 15-percent nominal devaluation was announced. The spread between the official and parallel market exchange rate initially narrowed to 10.5 percent above the official rate in July 2018 but rose in subsequent months. By June 2019, the spread stood at 36.7 percent. Transactions in the parallel market remain illegal and the government will continue to enforce the relevant laws and regulations to deter operators in the market.

15. Notwithstanding the policy of gradual depreciation against the US dollar, foreign exchange shortages continued to be the key challenge for the Ethiopian economy in 2018/19. The NBE has maintained its policy of rules-based exchange rate rationing whereby scarce foreign currency is allocated to priority sectors. In this regard, policies have not changed from those described in the staff report for the 2018 IMF Article IV consultation with Ethiopia. Repayment of external debt and foreign currency for the purchase of necessities—medicines and fuel—continue to be afforded the highest priority. Banks are required to also allocate FX to priority imports, particularly inputs used by exporters, for infrastructure projects and agricultural inputs. Notwithstanding these pressures, the NBE has not changed its policy on the surrender of FX since the last Article IV consultation.

16. The financial system continues to be sound, underpinned by a well-capitalized, profitable and liquid commercial banking system. Commercial banks reported a risk-weighted capital ratio (RWCR) of 19.2 percent in June 2019, well above the statutory minimum of 8 percent. The Commercial Bank of Ethiopia (CBE) in particular, had an RWCR of 34.7 percent, and private banks reported capital levels well in excess of the regulatory minimum. Asset quality also remains good: non-performing loans (NPLs) to total loans were below 3 percent – under the statutory 5-

percent ceiling – and have been largely stable throughout the year. The CBE's NPL ratio, in particular, was 1.78 percent in June 2019. Private banks remained liquid: the liquid assets-to-deposits ratio remained high at 18.7 percent, above the statutory minimum of 15 percent. The CBE, however, experienced tighter liquidity conditions due to its support for critical national projects that have not yet started generating revenues during the year. In response, the government has adjusted the pace of implementation of projects to reduce pressures.

17. Economic policies in 2018/19 were aimed at restoring macroeconomic stability and reducing risks, while supporting a transition to sustainable growth. In particular, the lower-than-budgeted deficit recorded by the general government and the strong control of the accumulation of external debt by the public sector saw the ratio of total debt of the non-financial public sector to GDP decline by about 2 percentage points during the year to 59 percent. Monetary policy was also tightened to address inflation. We intend to continue these prudent policy settings, which should help contain inflation and further reduce risks and vulnerabilities during the program.

18. The general government fiscal deficit stood at 2.5 percent of GDP, lower than the budget target of 3.2 percent. Revenue performance (including grants) was stable in 2018/19: the government was able to meet 93 percent of its tax collection target and overall general government revenues increased slightly to 3.2 percent of GDP. While import duties and indirect taxes underperformed, direct taxes were slightly above budget. On the expenditure front, the tighter fiscal stance was driven by a contraction of other recurrent expenditures by 0.3 percent of GDP, largely realized through targeted cost saving interventions introduced by the MoF in the form of optimizing administrative and travel costs as well as spending on goods and services by federal Ministries.

19. The government made further strides in SOE reforms to improve oversight, financial reporting, and is moving forward in implementing its privatization strategy. In addition to controlling SOEs' borrowing, the government has made significant efforts in upgrading the management of SOEs. Efforts to strengthen oversight have been undertaken by the Ministry of Finance (MOF) and the Public Enterprise Holding and Administration Agency (PEHAA, formerly the Ministry of Public Enterprises). PEHAA in particular, has been working to improve financial reporting and transparency, including overseeing the adoption of, and transition to, internationally-accepted financial reporting standards, with priority being given to SOEs that will be privatized in the near future. Efforts to privatize SOEs in the telecommunications and sugar are at an advanced stage. In telecommunications, the government is finalizing the process of appointing an external privatization advisor and expects to complete the partial sale of Ethio-Telecom before the end of the current fiscal year. Interest has also been expressed by foreign investors to take stakes in sugar refineries and the logistics sector.

20. Monetary policy in 2018/19 was aimed at addressing inflation while supporting the transition to private sector-driven growth. The growth of reserve money—the NBE's main operational instrument——was reduced from 19.1 percent in June 2018 to 15.3 percent by June 2019. As a result, broad money growth slowed sharply from 29.2 percent to 19.7 percent over the same period. However, these headline figures mask a welcome underlying compositional shift from the public to the private sector. In particular, credit to public enterprises slowed from 22.8 percent in

June 2018 to 21 percent in June 2019 while for the private sector, credit growth accelerated from 22.5 percent to 34.7 percent. As a result, the share of private sector credit to total credit to the non-government sector rose from 38 percent in 2017/18 to 40.6 percent in 2018/19. In part, this was supported by efforts to focus the activities of SOEs on critical projects, freeing up space for the private sector to avail itself of financial resources.

21. The government continues to make strides in developing the financial system. Branch expansion continues to be strong, which has mobilized deposits and improved financial inclusion in Ethiopia. Other efforts to modernize the financial system in 2018/19 include the approval of a new law to allow the use of moveable capital as collateral in accessing credit and ongoing efforts to modernize financial markets. Financial disclosure practices were also strengthened during the year. The government has also eased regulations to allow the Ethiopian diaspora to invest in the financial sector, which had previously been closed to non-residents. The first non-Ethiopian financial firm, a leasing company, also started operations in August, which will enable the importation of critical capital equipment without necessarily having to use scarce FX resources. The company will use its foreign capital to purchase and bring in equipment for long-term leases, which can then be settled in local currency. Policy measures have been taken to allow establishment of interest-free banks and banks that will focus on providing residential and commercial mortgages.

22. Ethiopia continued to implement measures to attract foreign investment during the year. Foreign direct investment remained substantial at around US$3 billion during the year. As part of efforts to improve the business climate, a number of measures aimed at attracting foreign capital, were introduced during the year. In July, the parliament approved legislation to allow for the issuance of two new telecommunication licenses for interested investors, including foreign investors. This initiative has attracted widespread interest among possible entrants and work is now ongoing to finalize the process to award the new permits. The revision of the Investment Law which will transition from a "positive" to a "negative" list signals the government's commitment to an open investment environment in support of private sector-led growth. Aside from addressing structural bottlenecks, broader measures to tackle macroeconomic imbalances are also key to creating an environment conducive to attracting private investment.

IV. THE ECONOMIC PROGRAM AND POLICIES FOR 2019–2022

A. Fiscal Policy and Reforms

23. Our program recognizes the need to find a balance between continued public sector support for critical development goals while mitigating risks and making room for private sector development. The central feature of fiscal policy will be to ensure SOEs' activities are focused on completing critical projects that have significant positive spillovers on growth and development, leading to a decline in the borrowing requirements of SOEs over the program period. On the side of the general government, there is a strong focus on strengthening revenue mobilization and prudent expenditure execution. Altogether, the program targets a 3.2 percentage points of GDP consolidation in the borrowing requirement of the public sector over the program period, excluding interest payments of the general government.

24. The program envisages a consolidation of the overall balance of the general government. Specifically, we intend to:

- Target a gradually declining path in the primary balance of the general government, measured using total financing of the budget less interest payments (quantitative performance criterion, QPC), consistent with consolidation of the overall deficit to 1.9 percent of GDP. The decline in the primary balance, estimated to be around 0.7 percentage point of GDP over the program period, also reflects the gradual lifting of financial repression.
- Increase tax revenues (indicative target, IT), which will help ensure that poverty-targeted expenditure will rise as subsidies are pared back. Our goal is to reverse the declining trend in the tax to GDP ratio, currently near 10 percent, the lowest among many of our regional peers. We attribute this mainly to weaknesses in both tax administration and policy, which we aim to improve. According to a recent IMF tax policy diagnostic study, the potential tax capacity for Ethiopia could be as high as 20 percent of GDP. In order to increase our tax effort, both policy and administration reforms will be critically important. In particular, we plan to undertake the following tax policy measures:
    - To introduce a new excise tax regime from the middle of FY 2019/20, changing the base for ad-valorem taxes to ex-factory price, adding a specific rate on tobacco to bring it closer externality correcting levels, increasing the applicable excise rate on beer, and introducing an environmental tax on imported used vehicles, which is expected to result in an additional excise tax revenue of ETB 2.5 billion in FY 2019/20 and at least ETB 8.5 billion in FY 2020/21; we intend to further revise excise rates as deemed appropriate each year thereafter, especially in light of new information on the social cost of consumption goods not covered by the current draft legislation, as well as the double dividend associated with corrective fuel taxation under a conducive inflationary environment and political economy context. We will also evaluate the possibility of introducing an annual motor vehicle circulation tax, which we expect could raise as much as Br 5 billion.
    - To complete reforms related to the value-added tax (VAT) and aim to begin its implementation in FY 2020/21, particularly by removing exemptions which should result in an additional Br 30 billion that year, according to some estimates;
    - To pursue tariff amendments, including the removal of VAT and excise waivers on imported goods, subject to customs duty exemptions (including intermediate capital goods), and eliminate the Second Schedule of the customs tariff by a third, which is expected to yield about Br 7 billion in new revenues in FY 2019/20 and at least Br 16 billion in 2020/21;
    - To introduce a property tax in FY 2020/21 (with yield to be determined following the completion of the fiscal cadaster);

  - To initiate income tax reforms in FY 2020/21, with implementation slated to take place in FY 2021/22. The envisaged reforms, which include increasing the bottom personal income tax threshold and increasing final withholding taxes on interest income, while expected to be revenue neutral, will directly address income inequality and investment distortions. In addition, the government will consider the possibility of introducing new taxes on inheritances (estate tax) and gifts; and
  - To ensure tax incentives are granted and monitored based on a transparent and clearly-defined process, we will undertake a tax expenditure assessment quantifying revenue forgone for each type of tax incentive in existence in the country and assessing the effectiveness of any expected benefits associated with those incentives relative to alternative policies supporting similar objectives. This report will be published alongside the draft budget for FY 2020/21. In the interim, we have issued a directive banning issuance of new tax incentives, unless accompanied by the reduction of existing incentives that have an equal or larger cost in terms of revenue forgone.
  - In addition to the above, we plan to identify revenue measures which will deliver 1 percentage point of GDP for FY 2020/21, to be included in the FY 2020/21 budget.

- Improve expenditure efficiency, starting with undertaking a review of explicit and implicit subsidies (SB) and rationalizing them over the course of the program. In addition, the planned increase in electricity tariffs by 60 percent (while protecting the poor) will bring tariffs to cost recovery and improve the financial position of the publicly-owned generation utility, Ethiopian Electric Power.

- We also plan to ensure the adequacy and sustainability of our expenditure on social protection (particularly through the PSNP) (IT), primary education and public healthcare. We will endeavor to assess potential improvements in the efficiency of all of these components with support from the broader reform agenda encompassed in the program and aim to improve the capacity of the federal government to support expenditure execution and reporting in these areas at the sub-national level.

25. A significant portion of the public sector adjustment will come from rebalancing away from State-Owned Enterprises (SOEs). As part of the envisaged SOE reforms, we aim to continue to reduce the SOE debt build up and limit its contribution to public debt vulnerabilities. As such, net borrowing by SOEs will be reduced by 2.5 percentage points of GDP over the course of the program, thus containing net accumulation of debt, both external and domestic, by SOEs (QPCs and ITs). In 2019/20, a 0.7-percentage point reduction in net borrowing is expected to be delivered through the electricity tariff increase discussed above and limiting borrowing by SOEs. To achieve the full target over the program period, we have taken steps to set stringent investment and borrowing limits on all SOEs in our 3-year investment plan. The Public Debt and Guarantee Issuance Directive (No. 46/2017), which was shared with the IMF, ensures that the MoF issues guarantees only if the proceeds of the loan in respect of which guarantee is sought are used for projects implemented by public enterprises to which priority is given in the development plan of the government approved by the House of Peoples' Representatives. The directive also requires that public enterprises shall, before entering in to a works contract with any contractor for the implementation of a project expected to be financed by external loan, be required to obtain a letter of clearance from the Ministry confirming that negotiations to conclude the financing agreement can proceed and a Government guarantee can be issued for the loan. The investment plan reiterates our commitment to avoid contracting debt to execute new projects and identifies projects to be deferred. The MoF has issued a directive to SOEs, instructing them to adhere to the approved 3-year investment plan. In addition, the draft Public Enterprise Law, to be ratified in 2020, introduces new requirements defining each SOE's social and revenues objectives, enforcing performance management, setting provisions for indebtedness limits, and addressing oversight and governance gaps.

26. The government will strengthen governance and oversight of the SOEs. A major focus of the program will be to build on recent improvements in SOE transparency, performance and oversight. Reforms are undertaken both at the sector and enterprise levels. The government will strengthen financial reporting of SOEs by ensuring the publication of audited financial statements for SOEs that are in compliance with internationally-recognized standards. Further, PEHAA will publish consolidated financials of the 20 SOEs under its supervision, using the latest available accounts, starting with the 2017/18 statements (SB for February 2020). These efforts will not only deliver better governance and oversight over these companies in support of privatization efforts but will also contribute to more efficient public investment consistent with meeting infrastructure gaps without undermining debt sustainability.

27. The government is making good progress in implementing the SOE reform and privatization strategy. The government has revised the Public Enterprise Proclamation and established a supervisory authority, PEHAA, to facilitate the reform of public enterprises including to enhance management efficiency and undertake privatization. Reforms are being undertaken in six sectors: telecommunications, logistics and railway, industrial parks, sugar, and energy. Sectoral assessments—which were launched for all sectors—are pending for the industrial parks and completed for the other sectors. The sectoral assessments will set the stage for developing the privatization strategy in each sector. Currently, the privatization process is most advanced in telecommunications and sugar, which are expected to be completed by mid-2020. In the medium term, the privatization of export-oriented/enhancing industries such as sugar, and energy will boost the efficiency and competitiveness of these sectors to realize the country's export potential. More generally, these reforms will enhance the competitiveness of SOEs, encourage private sector participation in key sectors of the economy and increase the availability of capital for expansion and investment. The expected efficiency gains from the reforms and private sector participation in critical support services such as logistics, telecommunications and energy will also help address critical bottlenecks, enhancing the overall competitiveness of the Ethiopian economy.

28. The government recognizes the proceeds from the privatization will need to be managed prudently. The main priority for the use of these funds is to close the identified external financing gap and contribute to the efforts to bolster international reserves, with the support of financing from development partners. A secondary priority would be to strengthen the financial position of public entities to ensure their long-term financial viability. The proceeds are not intended to start new public investment projects over the program period. Indeed, the government is aware that launching new investment projects would likely unwind recent progress in kickstarting private sector development and again increase the demand for FX. Further, increasing reserves is an integral part of the strategy to permanently address the FX shortages, which in turn will allow past investments in infrastructure to pay off as private sector activity, FDI and exports take off.

29. Strengthening public investment management will be a critical priority for our program. Notwithstanding the need to maintain prudence in relation to future investment projects over the program period, and the large scale of investment in recent years, Ethiopia's infrastructure gap remains significant and will need to be met to sustain growth. This does not, however, mean that the public sector will need to shoulder the entire burden. Innovative modalities to crowd-in private sector involvement in public projects, such as public-private partnerships (PPPs) are envisaged to have significant potential but also carry risks. Even projects where the public sector is best placed to execute will require careful evaluation at the selection stage, and strong oversight in their execution. As such, it will be critical to upgrade the capacity to choose, manage and review public expenditure on infrastructure and manage fiscal risks. As a first step, the government intends to produce a fiscal risk statement to accompany the budget for 2020/21, supported by IMF TA. To further strengthen public expenditure management and understand the overall public sector balance sheet, as already requested, the government plans to plans to develop Public Sector Balance Sheet (PSBS) and undertake a Public Investment Management Assessment to be conducted by the IMF, to begin after April 2020.

30. While recent measures and debt reprofiling have helped, we intend to seek additional reprofiling to help lower Ethiopia's external debt vulnerability. With the strong support of our development partners, the government has already taken significant steps in optimizing existing debt and thereby improving debt dynamics. However, significant as these efforts have been, the government is cognizant that Ethiopia has large external debt servicing needs in the near- to medium-term, especially when measured relative to projected exports under the program baseline. In order to consolidate recent gains and improve upon them, the government has taken proactive steps, including initiation of discussions with bilateral creditors to seek additional relief on debt servicing with an aim to reduce Ethiopia's risk of external debt distress rating, as defined in the Bank–Fund Debt Sustainability Analysis, to "moderate" before the end of the program. We are also cognizant of the need to avoid any increase in the present value of the reprofiled loans and bunching of repayment under the new terms within a few years after the program ends. We expect to seek firm commitment on part of this additional relief before the approval of the arrangements and to receive firm commitments on the remaining reprofiling by the first review of the arrangements. In addition, we believe that the recent initiatives in improving business climate and the ongoing reforms to boost private sector activity, including addressing the issues of exchange rate overvaluation, FX shortages, availability of credit, and reliability of supply of electricity and other inputs, will help boost Ethiopia's exports, particularly in the agro-processing, tourism, mining, and manufacturing sectors. This will bolster our future ability to service debt and reduce our reliance on external financing over time. In this context, a successful accession to the World Trade Organization, on which the current government has resumed discussions, should also support expansion of market access for Ethiopia's exports.

B. Monetary Policy and Developing Financial Markets

31. Monetary policy will continue to be oriented to bringing inflation down to single digits. Accordingly, the growth in reserve money will be limited to 12.5 percent year-on-year by June 2020 (QPC), which will be well below the projected growth rate for nominal GDP. This is projected to reduce the growth of broad money to 18 percent over the same period. In the immediate term, the NBE will need to rely on direct instruments to achieve its operational target. Accordingly, a gradually declining limit will be set on direct advances by the NBE to the government (IT) with the aim of eliminating them by the end of the program, while new advances to the DBE will be gradually reduced and eliminated after June 2020. These measures will help ensure lower reserve money growth, in line with our target. Notwithstanding this slowdown in the monetary aggregates, the constraints on SOE domestic borrowing will create the space to sustain growth in private sector credit, consistent with the government's policy to rebalance activity towards the private sector.

32. The NBE will take a comprehensive approach to developing financial markets, lifting financial repression and transitioning to a more modern monetary management framework. The starting point is the establishment of a well-functioning government securities market, beginning with the issuance of market-based Treasury bills (T-bills) over the program period. The government has completed an assessment of sufficiency of legal and regulatory framework for introduction of primary auctions, and the first successful auction took place on December 4, 2019. These issuances are aimed to increase gradually until it meets the full domestic financing needs by the end of the program period. The increasingly larger pool of T-bills (at market-determined interest rates) will also provide the NBE with the tools needed to conduct open market operations, and over time, help transition to an interest rate-based monetary policy framework. The NBE appreciates the placement of an IMF long-term resident expert at the central bank to provide real-time, on-the-ground advice as these reforms are implemented.

33. The NBE has eliminated the requirement on private banks to purchase NBE bills equivalent to 27 percent of loans extended. The elimination of the NBE bill, which took place in November 2019, will gradually open a gap in the NBE's liquidity management toolkit, which will be filled by new instruments such as term deposits and certificates of deposits, and when the volume of T-bills in the system becomes large enough, marketable securities. Additional reforms to modernize the existing liquidity windows at the NBE will proceed in parallel. Specifically, there is a need to consider the terms of accessing the overnight liquidity facility to ensure its availability and usefulness, including cost and range of eligible collateral. The NBE requests additional IMF TA to complement the work of the resident long-term expert to assist in this area.

C. Exchange Rate Reforms

34. The government is committed to reducing and eventually eliminating the overvaluation of the exchange rate and the associated FX shortages. Going forward, the NBE will modulate the pace of adjustment, taking into account economic developments, with the goal of steadily moving towards the alignment of the real exchange rate with economic fundamentals and elimination of the gap with the parallel market over the program period. As the gap with the parallel market closes, the exchange rate will transition to becoming more market-determined. The NBE will target an increase in reserves to build buffers and strengthen credibility. This will set the stage for the NBE to end the FX rationing and move to a market-determined exchange rate. The target on net international reserves (NIR) envisaged under the program (QPC) aims to increase gross reserves to US$4 billion by June 2020 (2 months of prospective imports), eventually aiming to reach about US$7.4 billion (3.2 months) by June 2023, close to the assessed level of reserve adequacy.

35. Greater exchange rate flexibility and higher reserves will be complemented with an appropriate macroeconomic stance and structural measures to create a functioning FX market. The tighter monetary policy stance noted above is integral to the strategy to reduce and eventually eliminate FX shortages. Indeed, increased flexibility in the exchange rate alone is not a sufficient condition to durably address the FX shortage: analytical work by both the NBE and the IMF have shown that absent monetary measures to achieve inflation objectives, external imbalances and misalignment of the real exchange rate will persist. Further, to move towards a market-determined exchange rate, reforms to create a well-functioning and deep FX market will be needed. As a first step toward that transition, the NBE will undertake a review of all existing FX regulations and restrictions and adopt a roadmap to develop the FX market and guide the move towards a more market-clearing exchange rate system by the end of the program (SB for April 2020). We seek IMF technical assistance to develop the FX reform roadmap. The NBE recognizes that as markets develop, there will be a greater need to have an integrated communications strategy and framework to support monetary and FX operations. A transition plan will have to also incorporate building these capacities in the NBE ahead of the eventual transition.

36. The government undertakes to not introduce any new measures that are inconsistent with Article VIII of the IMF Articles of Agreement. As the FX shortage eases, measures currently in place could be reviewed with a view to their eventual relaxation as conditions permit over the course of the program. The government will provide, in a timely manner, any data required from time to time to assess the status of exchange restrictions as well as possible multiple currency practices, and compliance with continuous PCs in this area and with the Articles of Agreement (for details please refer to the attached Technical Memorandum of Understanding).

D. Financial Stability and Financial Sector Development

37. The government's financial development agenda is focused on ensuring stability while supporting the development of a modern financial system capable of supporting private sector-led growth. The agenda on financial market development and gradually lifting financial repression discussed earlier is an integral part of the strategy. In addition, the government recognizes the urgent need to upgrade regulatory and supervisory standards, strengthen and reform state-owned financial institutions, develop a financial safety net and build on the notable progress made in strengthening Ethiopia's AML/CFT framework.

38. The government is committed to implementing measures to strengthen the liquidity position and solvency of public banks. The government will implement the needed reforms to address vulnerabilities of the state-owned banks, the DBE and the CBE. The government is committed to addressing identified weaknesses and improve the governance structure of the public banks. Specifically:

- The government has instituted a task force to review the issue of the CBE's exposure to the energy sector, encompassing both the legacy of past lending and to ensure the sustainability of future financing arrangements. This will be complemented by a comprehensive asset quality review, to be undertaken by an appropriately qualified international audit firm, in order to address any remaining vulnerabilities. The government will share the final reports on the review and the necessary plans to address vulnerabilities of the CBE with the IMF staff by April 2021 (SB).
- The DBE's financing model, which relies on financing from the NBE, which in turn is funded by the proceeds from the sale of NBE bills, will need to be changed as the issuance of these bills has been eliminated. The NBE will cease new financing of the DBE from the start of FY 2020/21. The government is working on a comprehensive plan to address long-standing issues in the DBE, most notably its high NPL ratio, which stood at 33.9 percent in June 2019. Nevertheless, the DBE's commitment to support ongoing projects that are profitable and viable requires it maintain its operations. Therefore, government is working to identify sustainable funding model for the DBE and will provide the necessary support during the transition.

39. In order to support the transition to a private sector-led economy and support the development of the financial sector, the government is making progress towards putting in place a financial safety net. Regulation governing the establishment and operations of a deposit insurance system have been drafted and have been submitted for review the Council of Ministers. This is expected to be approved by the end of 2019/20, following which, operational regulations will be drafted. In addition, the government will review regulatory framework and strengthen them in line with international best practices. In particular, there is a need to put in place a bank resolution and liquidation framework, emergency liquidity assistance framework, and a crisis management framework. Also, the NBE is working toward transitioning to the Basel II framework. These large-scale and important reforms require greater attention to strengthening capacity at the NBE. The NBE sees the need for intensified TA support from the development partners.

40. Ethiopia has made significant improvements in addressing concerns regarding its AML/CFT framework. In their October 2019 statement, the Financial Action Task Force (FATF) removed Ethiopia from the list of jurisdictions being monitored for weakness in their AML/CFT framework. In their statement, the FATF recognized that Ethiopia "has strengthened the effectiveness of its AML/CFT regime and addressed related technical deficiencies to meet the commitments in its action plan regarding the strategic deficiencies that the FATF identified in February 2017." The government, through its relevant agencies tasked with addressing AML/CFT issues, will continue to work with the FATF-style regional body, ESAAMLG, to further strengthen our framework.

41. Efforts are being exerted to further strengthen financial inclusion. For instance, a proclamation on movable collateral registry was ratified in June 2019. Retail payments such as government-to-person (G2P) and person-to-government (P2G) are also expected to go digital and draft financial consumer protection framework and financial education strategy are being finalized. In addition, the government is studying the possibility of setting up risk-sharing schemes such as SME and agricultural finance guarantee funds. A financial education strategy is expected to be launched by end of December 2019. A dedicated unit at the NBE tasked with coordinating, monitoring and evaluating the implementation of this strategy is being set up. A directive for banks to offer no-frills accounts (including simplified KYC) to bring under-served parts of the population into the banking system has also been drafted. These initiatives are expected to increase access to finance by the adult population from 35 percent in 2017 to 60 percent by 2020.

E. Structural Reforms to Ensure Sustainable and Inclusive Growth

42. The government continues to place a high priority on improving the business climate in Ethiopia. A high-level committee, chaired by the Prime Minister, has been set up to address impediments to private sector development and is monitoring reform efforts. Early results from this work include new legislation to expand the range of eligible collateral to include moveable assets, which was approved this fiscal year, and efforts to address impediments to the registration and operations of business, including obtaining licenses and construction permits. In addition to addressing FX shortages and access to finance problems through eliminating the financial repression, the reform agenda will ease other constraints to doing business and enhance productivity. As laid out in our HERP, we intend to tackle the institutional and structural bottlenecks to productivity and job creation and implement sectoral reforms in key strategic sectors. We plan to expedite ongoing efforts to allow privatization in key sectors; create a secure and predictable market access to exports, including by expediting accession to the World Trade Organization (WTO); and improve the efficiency of domestic markets for goods and services by removing barriers to entry, enforcing the Competition Law, and improving the efficiency of the commodity market supply chain.

43. The government has developed a comprehensive job creation strategy. With about 2 million new entrants into the workforce each year, high youth unemployment and rapid urbanization, job creation is a top priority for the government. Our *Plan of Action for Job Creation* aims to foster the business environment and conditions necessary to create 14 million jobs by 2025. The Plan of Action has 6 strategic objectives: (i) adopting job rich macro policies; (ii) building a vibrant local private sector; (iii) developing human capital to meet the changing needs of the labor market; (iv) strengthening labor market intermediation and linkages; (v) improving the inclusiveness of the labor market; and (vi) realizing the job-creation potential of prospective high yield sectors. This strategy is fully integrated with the broader reforms of the HERP which envisions a shift from public sector-led to private sector-led growth. Policies will aim to improve working conditions and social protection in the labor market and study the possibility of introducing a minimum wage and unemployment insurance and other social safety net programs. The strategy will also address the structural challenges the youth and women face in the labor market through targeted support, including by promoting off-farm activities, developing child care services and expanding village and community-based programs for women.

44. The authorities' program supports Ethiopia's efforts to meet key commitments under the Sustainable Development Goals (SDGs), with a particular focus on protecting the poor. Under the program, the government commits to ensuring sufficient resources for vital social safety net programs, particularly the Productive Safety Net Programme (PSNP) and the version targeted at the urban poor and vulnerable, the U-PSNP. The PSNP is highly regarded by the international community and the adequacy of its financing is covered by the target on poverty-related spending (IT), which programs a rising resource envelope over the course of the program. In order to protect the continued adequacy of the cash transfers to existing beneficiaries in real purchasing power terms and enable the financial sustainability of the program over the medium-term, we intend to revise the current PSNP wage rate by 30 percent over the next three years to recover lost real value, and from now on adjust the wage rate every year using annual bread and cereals CPI calculated by the CSA at the regional level. Furthermore, given a projected retrenchment of donor contributions to the PSNP over the medium-term, we are committed to increase the government's direct contribution, in coordination with the World Bank. In line with objectives of reducing inequity across regions, we are also committed to reviewing the design of the program in order to expand to a larger number of regions, while improving targeting in regions currently covered.

45. The program's goals of achieving rapid but sustainable growth over the long term, coupled with reforms to strengthen resource allocation is the platform to make further inroads in reducing poverty and lifting living standards. The expected take off in growth by the end of the program, which will be both rapid and more sustainable, will support efforts to broaden the availability and accessibility of quality social services and economic opportunities. This, in turn, will be important reducing poverty and improve the living standards of our citizens through the generation of well-remunerated jobs. In addition to the poverty-reducing impact of growth and job creation, the government intends to continue investing in areas that directly support poverty reduction such as education, health, agriculture, water and sanitation, and road infrastructure.

46. The program will work to strengthen gender equality and upgrade women's status in the economy. Ethiopia has shown a firm political commitment to the advancement of gender equality, women's rights and women's economic empowerment. The Ethiopian Women, Development and Change Strategy, developed in 2017/18, aims to increase women's economic empowerment by addressing high rates of unemployment and informality and ensuring urban job creation and food security for women. In 2016, the Financial Administration proclamation was revised to mainstream gender issues in the budget preparation process. Recent technical assistance from the IMF on gender responsive budgeting will help us improve the allocation of public resources towards gender equality policies. Our political commitment is also reflected in the recent appointment of a gender-balanced cabinet and the first female president in Ethiopian history. In addition, the government has signed up to the Sustainable Development Goals (SDGs), which includes ending violence against women and girls by 2030 (SDG goal 5). Future policies will focus on increasing the productivity of female farmers, female education opportunities in rural areas, strengthening efforts to change discriminatory cultural beliefs and attitudes, and providing rehabilitative services and support to women and children who have been victims of violence or harmful practices.

47. The program's contributions to macroeconomic stability also supports Ethiopia's climate resilience objectives under the SDGs. Climate change resilience objectives are fully integrated into our medium-term growth and transformation plans—both through the achievement of SDGs (in particular, SDG 13 to take action to combat climate change and its impacts), and Ethiopia's nationally-determined contribution to reduction of greenhouse gases under the Paris Agreement. Our *Climate Resilient Green Economy Strategy* sets out the policies aimed at meeting these ambitious commitments. Ethiopia has been at the forefront of several successful adaptation measures in Sub-Saharan Africa, including the usage of weather index insurance by smallholder farmers. In addition, the program's emphasis on the improved efficiency and continued funding of essential infrastructure projects (including in sustainable energy generation and distribution, irrigation systems, and water reservoirs to ensure water security) is expected to improve the capacity for adaptation of the economy to climate change.

48. The government is committed to strengthening the collection and provision of data to aid decision making and support communication with investors and the public. Ethiopia has expended significant resources to upgrade the quality of economic data, with the support of development partners, including the IMF. The main priority is the adoption and eventual transition to more current data reporting and collation standards for the national accounts, government finance statistics, monetary and financial statistics and external sector data. Ethiopia has announced its participation in the IMF's Enhanced General Data Dissemination Standards (eGDDS) initiative in August 2019 and is working toward meeting its commitments under the initiative.

V. PROGRAM MONITORING

49. Program implementation will be evaluated semiannually by the IMF's Executive Board based on performance criteria and quantitative indicators and structural benchmarks (Tables 1 and 2). The next review of the program will be completed on or after April 15, 2020 based on the performance criteria and quantitative indicators at end-December 2019 (Table 1) and relevant structural benchmarks (Table 2). Those criteria and quantitative benchmarks are defined in the Technical Memorandum of Understanding (TMU), as well as adjusters in case of contingencies.

50. The government has established a committee, chaired by the Minister of Finance, and comprising the Governor of the National Bank of Ethiopia, two macroeconomic advisors of the Prime Minister and a designated State Minister at the Ministry of Finance and Chief Economist and Vice-Governor of the NBE to oversee program implementation and facilitate high-level communication with Fund staff. The committee will also act to solicit information and facilitate dialogue between Fund staff and other agencies, ministries and public sector bodies whose cooperation is required for the successful implementation of the program. At the technical level, the government has designated staff of the NBE to act as contacts with Fund staff with regard to regular provision of data, in compliance with the data calendar described in the TMU, as well as any other data that may be requested for the purposes of program monitoring by the Fund. In particular, the government undertakes to provide the necessary information and data required to successfully complete an updated IMF Safeguards Assessment by the time of the first review, as required under IMF policies on the use of Fund resources.

Table 1. Ethiopia: Quantitative Performance Criteria (QPC) and Indicative Targets (ITs), December 2019—December 2020

(Millions of Ethiopian Birr, unless otherwise specified)

	end-June 2019	end-Sep 2019	end-Dec 2019	end-March 2020	end-June 2020	end-Sep 2020	end-Dec 2020
	Initial level	Projected	Program target	Indicative target	Program target	Indicative target	Indicative target
Quantitative performance criteria							
Net financing of the general government primary balance (ceiling, cumulative change, includes grants and excludes interest payments) [1/, 2/, 3/]	54,642	16,780	33,561	50,341	67,121	16,596	33,192
Net international reserves (floor, cumulative change , US$ millions) [2/]	3,172 [7/]	-818	-636	-157	21	32	137
Reserve money outstanding (ceiling)	200,749 [7/]	186,801	199,815	212,829	225,843	233,937	242,031
Continuous performance criteria							
Contracting or guaranteeing of external non-concessional debt by the government or the NBE (ceiling, US$ millions) [4/]			0	0	0	0	0
Accumulation of external payment arrears by the government or the NBE (ceiling, US$ millions) [4/]			0	0	0	0	0
Indicative targets							
Claims on public enterprises by commercial banks (ceiling, cumulative change) [2/ 3/]	444,884 [7/]	610	25,127	49,644	74,161	14,581	29,162
Tax revenue collected by the federal government (floor, cumulative change) [2/]	194,265	54,387	81,589	163,178	244,792	56,358	112,750
Net claims on the general government by the NBE (ceiling, cumulative change) [2/]	143,620 [7/]	7,608	10,905	15,178	19,450	2,871	5,743
Contracting or guaranteeing of external concessional debt by the government (ceiling for the fiscal year ending June, US$ millions) [4/, 5/]			1,825	1,825	1,825	2,100	2,100
Productive Safety Net Programme cash transfers (floor, cumulative change) [2/, 6/]	3,646	606	2,330	6,365	11,082	1,601	3,593
Memorandum items:							
Official external grants disbursed to the government (US$ millions, cumulative) [2/]			485	728	970	217	435
Official external loans disbursed to the government (US$ millions, cumulative) [2/]			776	1,163	1,551	338	675

Sources: Ethiopian authorities and IMF staff estimates and projections.

1/ Excluding through on-lending from the general government.

2/ Cumulative change from July.

3/ Excludes commercial bank claims related to Addis Ababa Housing credit, as set out in paragraph 5 of the TMU.

4/ To take effect from program approval date.

5/ The limit is a continuous target (ceiling) on the contracting of concessional debt for the fiscal year by the government or the NBE.

6/ Excludes in-kind benefits. Includes cash transfers to beneficiaries under the rural Productive Safety Net Programme (PSNP) and Urban Productive Safety Net Programme (UPSNP).

7/ Outstanding as at end-June 2019.

Table 2. Ethiopia: Prior Actions and Structural Benchmarks

December 2019—December 2020

Measures	Target Date	Rationale	Status
Prior Actions			
1. Issue a directive to ban net new tax expenditures (not allowing new incentives unless incentives with equal or larger forgone revenue are revoked elsewhere) from the start of the program.		Tax revenue mobilization	Met
2. Conduct the first auction of marketable treasury securities.		Sustainability of government financing and reduction of financial repression	Met
Structural Benchmarks			
1. The Public Enterprises Holding and Administration Agency (PEHAA) to publish a consolidated financial performance report, including financial performance of the 20 SOEs under its supervision, using latest available audited accounts starting with 2017/18 accounts.	end-Feb 2020	Sustainability of public sector financing	
2. Submit a supplementary budget to the House of People's Representatives incorporating the program targets on primary net financing, tax revenues, and PSNP expenditure.	end-March 2020	Sustainability of general government financing	
3. Adopt a new excise tax regime that (i) replaces the current tobacco excise tax with an ad valorem excise tax of 30 percent on producer/importer declared retail sales price complemented by a specific excise tax of at least 5 ETB per cigarette pack; and (ii) changes the tax base for ad valorem excises from the cost of production to ex-factory price for all goods.	end-March 2020	Tax revenue mobilization	
4. Adopt a roadmap to deepen the FX market and guide the move towards a more flexible exchange rate by the end of the program.	end-April 2020	Liberalization of foreign exchange market	
5. Submit to Parliament a budget that includes revenue measures of 1 percent of GDP.	end-June 2020	Tax revenue mobilization	
6. Eliminate new NBE financing of DBE.	end-June 2020	Strengthen monetary policy implementation	
7. Complete and publish an assessment of tax expenditures.	end-June 2020	Tax revenue mobilization	

Table 2. Ethiopia: Prior Actions and Structural Benchmarks (concluded)

December 2019—December 2020

Measures	Target Date	Rationale	Status
8. Publish audited financial statements for the CBE and DBE up to fiscal year 2018/19.	end-June 2020	Financial sector stability	
9. Complete a review of all subsidies on energy products (including fuels – petroleum products, coal and gas – and electricity), quantifying the value of such subsidies in 2018/19 and 2019/20.	end-September 2020	Rationalizing expenditure	
10. Complete an audit, to be undertaken by the Auditor General, to assess the extent of payment arrears by the Federal Government to suppliers, domestic contractors and other entities providing goods or services to the general government.	end-December 2020	Sustainability of public sector financing	
11. Complete an Asset Quality Review of the Commercial Bank of Ethiopia.	end-April 2021	Financial sector stability	

Attachment II. Technical Memorandum of Understanding

Addis Ababa, December 2, 2019

1. This Technical Memorandum of Understanding (TMU) describes the quantitative and structural assessment criteria established by the Ethiopian authorities and the staff of the International Monetary Fund (IMF) to monitor the program supported by the Fund's Extended Credit Facility (ECF) and Extended Fund Facility (EFF) and described in the Memorandum of Economic and Financial Policies (MEFP), Tables 1 and 2. It also specifies the content, the periodicity, and deadlines for the transmission of data to Fund staff for program monitoring purposes.

2. The quantitative targets are defined as ceilings and floors set on cumulative changes between the reference periods described in Table 1 of the MEFP and the end of the month covered, unless otherwise indicated. Structural benchmarks are presented in Table 2.

A. Institutional Definitions

3. Unless otherwise specified, the government is defined in this TMU as the general government of Ethiopia and the public enterprises exclusively.

4. The general government is defined for program monitoring purposes as the budgetary central government plus state governments and woredas, excluding state-owned enterprises and existing extra-budgetary funds. The definition of the general government includes any new funds, or other special budgetary or extra-budgetary entities that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's Manual on Government Finance Statistics 2014. The authorities will inform IMF staff on the creation of any such entities without delay.

5. Unless otherwise specified, public enterprises refer to those entities under the term of "public enterprises" in the monetary survey provided by the National Bank of Ethiopia—excluding Addis Ababa Housing or other credit facilitators. These include Ethiopian Electric Power, Sugar Corporation, Metals and Engineering Corporation, Ethiopian Railway Corporation, Ethiopian Construction Works Corporation, and Yayu Fertilizer Complex which are the public enterprises benefiting from government guarantees on domestic borrowing.

B. Definitions of Quantitative Targets

6. The following quantitative targets will be monitored and evaluated under the program. The quantitative targets are defined as ceilings or floors set on cumulative changes between the reference periods as described below, unless otherwise indicated. Some of the targets will have the provisions for adjustments as described in section C below.

Performance criteria (PC):

Periodic PCs that are evaluated as of each test date (see section D):

- Net financing of the general government primary balance (ceiling, cumulative change)
- Net international reserves of the NBE (floor, cumulative change)
- Reserve money of the NBE (ceiling, outstanding balance)

Continuous PCs that are evaluated on a continuous basis starting from program approval:

- Contracting of external non-concessional borrowing by the government or the NBE and provision of government guarantees on external non-concessional borrowing (zero ceiling)
- Accumulation of external payment arrears by the government (zero ceiling)

In addition to the above-mentioned quantitative targets, the following continuous conditionality will also apply (i) non-imposition or intensification of restrictions on the making of payments and transfers for current international transactions; (ii) non-introduction or modification of multiple currency practices, excluding the introduction or modification of a multiple price auction system developed in consultation with Fund staff; (iii) prohibition of entering into bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement; and (iv) non-imposition or intensification of import restrictions for balance of payments reasons.

Indicative Targets (IT):

Indicative Targets that are evaluated as of each test date:

- Claims on public enterprises by commercial banks (ceiling, cumulative change)
- Tax revenue collected by the federal government (floor, cumulative change)
- Net claims on the general government by the NBE (ceiling, cumulative change)
- Productive Safety Net Programme cash transfers (floor, cumulative change)

Indicative Target that is evaluated on a continuous basis during a fiscal year, starting from program approval:

- Contracting of external concessional borrowing by the government or the NBE (ceiling for the fiscal year ending June).

7. Program exchange rates. Reserve assets and liabilities will be converted into U.S. dollar terms at exchange rates and the gold price in effect on September 30, 2019 as follows:

Original Currency (1 unit, unless otherwise specified)	**Value in US$** (unless otherwise specified)
Special Drawing Right (SDR)/ African Development Bank Unit of Account	1.3633
Euro	1.0889
Japanese yen (per USD)	107.95
Pound sterling	1.2301
Chinese yuan (per USD)	7.1292
Canadian dollar (per USD)	1.3243
Norwegian krone (per USD)	9.0874
Swedish krona (per USD)	9.8047
UAE dhiram (per USD)	3.6725
South African rand (per USD)	15.20895
Gold (1 troy ounce)	1,467.50

Assets and liabilities denominated in other currencies will be evaluated based on their respective exchange rates with the U.S. dollar on September 30, 2019, as published in the IMF's *International Financial Statistics (IFS)* , except for gold, which will be valued at the closing price reported on the London Metal Exchange on September 30, 2019.. For the purpose of evaluating inflows of foreign grants and budget support loans and other direct financing of the general government, the program exchange rate used will be **1 U.S dollar = Birr 29.17**, which is the rate prevailing on September 30, 2019.

Definitions

8. Net international reserves (NIR) of the NBE are defined as the difference between the reserve assets of the NBE (i.e., the external assets that are readily available to, and controlled by, the NBE, as per the 5th edition of the IMF *Balance of Payments Manual*), minus the NBE's short term foreign exchange liabilities to residents and nonresidents, and Fund credit outstanding. Short-term liabilities refer to those that can be called immediately (e.g., FX demand deposits of banks, public enterprises or the private sector) or other liabilities with an original maturity of less than 1 year, including deposits, swaps and other arrangements. The following liabilities will be excluded when calculating NIR: all foreign currency deposits of the government with the NBE, all long-term foreign currency liabilities with original maturity of 1 year or longer, including term deposits in foreign exchange placed by residents or nonresidents. Gold holdings refer to holdings of monetary gold included in reserve assets as per the 5th edition of the IMF's *Balance of Payments Manual*. The performance criterion will be evaluated as the cumulative change in NIR between any specified test date and June 30 immediately prior to the test date in question (see Section D). Net international reserves as at June 30, 2019 was US$3,172 million, based on program exchange rates as set out in paragraph 7 of this memorandum (see Table next page).

US$ Million, Converted Using Program Exchange Rates	**Position as at End-June 2019**
Foreign assets of the NBE	3,384.0
Less foreign liabilities:	212.1
Of which:	
Fund credit outstanding	*37.4*
SDR allocation	*174.4*
Other short-term foreign liabilities	*0.3*
Net International Reserves	**3,171.9**
Source: National Bank of Ethiopia	

9. **Reserve money outstanding ceiling of the NBE** is defined as the sum of currency issued by the NBE (including the vault cash of commercial banks and currency outside banking system) and balances of commercial banks on accounts with the NBE. Reserve money outstanding on June 30, 2019 was Br 200,749 million.

10. **The net financing of the overall general government balance (including grants)** will be monitored quarterly under the cash balance of the general government balance, including grants, including the operations of sub-national (state and woreda) governments financed from local funds. It will be measured below the line and will include:

- **Net external financing**, excluding valuation gains and losses and changes to on-lending to public enterprises. This will be based on data prepared for the debt bulletin by the debt management directorate at the Ministry of Finance.
- **Change in net domestic credit from the banking system**, excluding valuation gains and losses from deposits denominated in foreign currency. These will be based on monetary survey data compiled by the NBE and include: (i) direct advances from the NBE to the general government, (ii) the stock of issued government securities (including bonds and Treasury bills) held by the banking system, (iii) net local currency deposits of the central and state and local governments at the NBE and commercial banks, (iv) foreign currency deposits of the central government at the NBE. As with net external financing, on-lending from domestic banks through the general government to public enterprises (if any) should also be excluded. For program monitoring purposes, any bonds issued by states or regional housing agencies for housing projects where the debt obligations will be transferred to the private owners of the housing units shall be excluded.
- **Change in the net domestic nonbank financing**, excluding valuation gains and losses. These include (i) domestic privatization receipts transferred from the privatization accounts to the budget, (ii) the stock of issued government securities held outside the general government and the banking system (including pension funds and extra-budgetary funds), net of valuation changes, (iii) any other government borrowing from domestic nonbank sources net of repayments, minus (v) government deposits with nonbank financial institutions, and (vi) changes in financial assets (either in the form of additional equity or loans) owned by the government with public enterprises as the counterparty (as a result of capital injections).

11. Net financing of the general government primary balance (including grants) is defined as the net financing of the overall general government balance (including grants) minus the consolidated interest bill of the federal and state budgets. The quantitative performance criterion will be a ceiling on this concept.

12. Total external grants to the federal and state governments are defined as the sum of project grants, cash external grants for budgetary support, capital grants reflecting the principal amounts of external debt cancellation or swaps, and other grants.

13. Claims on public enterprises by commercial banks is defined as the cumulative change in the stock of claims on public enterprises (as defined in paragraph 5 of this memorandum) by commercial banks, evaluated between any test date and June 30 immediately prior to the test date. Claims on public enterprises by commercial banks shall consist of all domestic commercial bank claims on public enterprises, including loans, bonds, and other liabilities issued by public enterprises.

14. Net claims on the general government by the NBE is defined as the stock of claims of the NBE on the general government, net of general government deposits with the NBE.

15. Floor on Productive Safety Net Programme cash transfers (PSNP)—Indicative Target. The floor will apply to the general government to the cash transfers spending by the sum of the rural and urban Productive Safety Net Programmes. It will be measured using total disbursements for both programs from Channel 1 and Channel 2 directorates in the Ministry of Finance.

16. Floor on Tax Revenues Collected by the Federal Government—Indicative Target. Total tax revenues collected are defined as the sum of revenues collected by the Ministry of Revenues from any of the following: (i) duties, taxes, and other charges on international trade; (ii) personal income tax of federal government employees (including on employment income, royalty income, dividends, interest, capital gains); (iii) profit (including repatriated profits) tax and sales (including value-added tax, and excises) taxes from enterprises assigned to the federal government (including sole proprietors subject to the turnover tax); (iv) taxes on gains from lotteries and gambling; (v) taxes from air, rail, and marine transport; (vi) taxes from rent of property assigned to the federal government; (vii) taxes and fees on licenses and federal services; (viii) stamp duties; (ix) personal income tax of staff of enterprises jointly assigned to the federal and regional governments; (x) profit tax, royalties, and rent from large scale mining, petroleum, and gas incorporated enterprises; (xi) any other excises not covered by the list thus far; (xii) all revenue assignments under the concurrent taxation powers of the federal and regional governments – namely, corporate income tax and dividend withholding tax on companies, profit and sales tax on enterprises jointly assigned to the federal and regional governments; (xii) unclassified tax revenues minus corresponding refunds. To the extent that revenue assignments change after the date of this Memorandum, and the federal government is entitled to levy and collect any other instruments not covered by the list above, revenue from such instruments should also be included from that moment. That may include taxes on private property and land use, as well as agricultural income tax and personal income tax of private employees. Total tax revenue collection will be defined, for each test date, as the cumulative sum of tax revenues collected since the beginning of the current year.

External debt definition

17. For program purposes, the definition of debt is set out in paragraph 8(a) of the Guidelines on Public Debt Conditionality in Fund Arrangements, attached to IMF Executive Board Decision No. 15688-(14/107) adopted on December 5, 2014.[20]

(a) For the purposes of these guidelines, the term "debt" is understood to mean a current (i.e., noncontingent) liability created by a contractual arrangement whereby a value is provided in the form of assets (including currency) or services, and under which the obligor undertakes to make one or more payments in the form of assets (including currency) or services at a future time, in accordance with a given schedule; these payments will discharge the obligor from its contracted principal and interest liabilities. Debt may take several forms, the primary ones being as follows:

i) Loans, that is, advances of money to the borrower by the lender on the basis of an undertaking that the borrower will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits), as well as temporary swaps of assets that are equivalent to fully collateralized loans, under which the borrower is required to repay the funds, and often pays interest, by repurchasing the collateral from the buyer in the future (repurchase agreements and official swap arrangements);

ii) Suppliers' credits, that is, contracts under which the supplier allows the borrower to defer payments until sometime after the date when the pertinent goods are delivered, or the services are provided; and

iii) Leases, that is, agreements governing the provision of property that the lessee has the right to use for one or more specified period(s), generally shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purposes of the guidelines, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, apart from payments related to the operation, repair, or maintenance of the property.

(b) According to the above-mentioned definition, debt includes arrears, penalties, and damages awarded by the courts in the event of a default on a contractual payment obligation that represents a debt. Failure to make payment on an obligation that is not considered a debt according to this definition (e.g., payment on delivery) does not give rise to a debt.

18. External payment arrears are defined as payments (principal and interest) on external debt contracted or guaranteed by the government or the NBE that are overdue (taking into account any contractually agreed grace periods). For the purposes of the program, the government and the NBE undertake not to accumulate any new external payments arrears on their debt.

[20] http://www.imf.org/external/pp/longres.aspx?id=4927.

19. External debt, in the assessment of the relevant criteria, is defined as any borrowing from or debt service payable to nonresidents. The relevant performance criteria are applicable to external debt contracted or guaranteed by the government, the NBE, and public enterprises (excluding the debt of Ethiopian Airlines not guaranteed by the government), or to any private debt for which the government and the NBE have provided a guarantee that would constitute a contingent liability. Guaranteed debt refers to any explicit legal obligation for the government or the NBE to repay a debt in the event of default by the debtor (whether payments are to be made in cash or in kind). For program purposes, this definition of external debt does not include routine commercial debt related to import operations and maturing in less than a year, rescheduling agreements, and IMF disbursements.

20. Medium- and long-term external debt contracted or guaranteed by the government, the NBE, and public enterprises corresponds, by definition, to borrowings from nonresidents originally maturing in one year or more. **Short-term debt** corresponds, by definition, to the stock of borrowings from nonresidents initially maturing in less than one year and contracted or guaranteed by the government, the NBE, and public enterprises.

21. External debt is deemed to have been contracted or guaranteed on the date of approval by the House of Peoples' Representatives as per proclamation no. 648/2009 that provides for the financial administration of the Federal government of Ethiopia. Contracting of credit lines with no predetermined disbursement schedules or with multiple disbursements will be also considered as contracting of debt. For program purposes, external debt denominated in currencies other than the U.S. dollar will be converted to U.S. dollars on the basis of exchange rate on the date of the approval as published by the U.S. Federal Reserve.[21]

22. For program purposes, a debt is deemed concessional if it contains a grant element representing at least 35 percent, calculated as follows: the grant element is the difference between the present value (PV) of the loan and its face value, expressed as a percentage of the loan's face value. The PV of a loan at the time of its signing date is calculated by discounting future principal and interest payments, on the basis of the unified discount rate of 5 percent set forth in Executive Board Decision No. 15248-(13/97). Concessionality will be assessed on the basis of all aspects of the loan agreement, including maturity, grace period, repayment schedule, front-end fees, and management fees. The calculation is performed by the authorities, using the IMF model,[22] and verified by IMF staff on the basis of data provided by the authorities. For loans with a grant component of zero or less, the PV is set at an amount equal to the face value.

23. In the case of debt with a variable interest rate represented by a reference interest rate plus a fixed margin, the grant element of the debt will be calculated on the basis of a program reference rate plus a fixed margin (in basis points) specified in the loan agreement. The program reference rate for variable interest rates will be based on the 10-year average projections made in the latest Fall edition of the Fund's *World Economic Outlook* until modified. The program reference

[21] https://www.federalreserve.gov/releases/h10/current/
[22] http://www.imf.org/external/np/spr/2015/conc/index.htm.

rate for these currencies are show below on a calendar year basis until modified. To convert to Ethiopian fiscal year, a simple average of two successive calendar years will be used (e.g., for 2019/20, simple average of 2019 and 2020 will be used). Where the variable rate is linked to a benchmark interest rate other than the six-month USD LIBOR, a spread reflecting the difference between the benchmark rate and the six-month USD LIBOR (rounded to the nearest 50 bps) will be added.

Assumptions for Variable Interest Rate Set Limits		
	10-year average six-month LIBOR (in percent)	**Spread (currency minus US$, in percent rounded to nearest 50 bps)**
U.S. dollars	2.42	0.0
Euro	-0.13	-2.50
Japanese yen	-0.06	-2.50
Pound sterling	0.83	-1.50
Other	1.05	-1.50

24. Performance criteria on the introduction or modification of multiple currency practices. The performance criteria on the introduction or modification of multiple currency practices (MCP) will exclude the contemplated implementation or modification of the multiple price foreign exchange auction system, developed in consultation with Fund staff, which gives rise to an MCP.

C. Adjustment Factors

25. The **floor on cumulative change in NIR** will be adjusted downward for any shortfall in the expected cumulative inflow of official grants and loans disbursed to the government from official development partners in foreign currency from the beginning of the fiscal year, up to a maximum of US$300 million at program exchange rates. The projected inflows of official grants and loans to the government are set out in the macroeconomic framework underpinning the program. This adjustor will only apply in the event that the actual outturn in NIR falls below the PC for NIR described above, and there are shortfalls in official grants and loans disbursed to the government (e.g., the adjustor would not apply if the performance of privatization of state assets exceeds expectations, irrespective of shortfalls in official grants and loans disbursed to the government, if any).

26. The ceiling on the net financing of the general government primary balance (including grants) will be adjusted:

- Upward by the amount of cumulative shortfall in external grants relative to the baseline projection up to US$150 million at program exchange rates.
- Upward by the cumulative excess in external project financing relative to the program projections evaluated in birr terms at actual exchange rates. External project financing is

defined as disbursements from bilateral and multilateral creditors to the general government for specific project expenditure.

- Downward for any shortfall in the targeted cash transfers (PSNP) and it will be adjusted upward for over performance in the PSNP spending up to ETB 10 billion in FY 2019/20 from their indicative targets.
- Downward by the full amount of any increase in the stock of budgetary arrears on social payments such as wages, pensions, social benefits accumulated since the beginning of the fiscal year.

D. Other Definitions

For the purposes of monitoring of structural benchmarks, the following definitions will be used:

- **Tax expenditure** is understood as any benefit under the tax code that deviates from the benchmark treatment of the code and whose benefit to the relevant taxpayers could be alternatively effected through government spending (such as through the provision of subsidies or other transfers to the relevant taxpayers).
- **Revocation of tax incentives** currently granted on a contractual, rather than legislative basis, entails grandfathering of existing incentives until the term of the original benefit (the case of corporate income tax holidays, for example). The revocation will therefore inhibit at a first stage, the granting of new tax exemptions based on the definition of tax incentives provided above.
- **Subsidies are understood to include both explicit and implicit subsidies.** The former are defined as current unrequited transfers that government units make to enterprises on the basis of the level of their production activities or the quantities or values of the goods or services they produce, sell, export, or import. In turn, implicit subsidies can include, but need not be limited to: an official system of multiple exchange rates, payable tax credits, and losses of government trading organizations whose function is to buy products and then sell them at lower prices to residents or nonresidents as a matter of deliberate government economic or social policy, the central bank accepting interest rates lower than the prevailing market rates. The complete definition is included in the Government Finance Statistics Manual 2014 (6.89 and 6.90).

Test Dates

27. Test dates for evaluating performance against PCs are December 31, 2019 and June 30, 2020, except for continuous PCs, which apply between program reviews without interruption. In addition, the program will evaluate all quantitative targets, except the continuous PCs, as ITs, based on performance as at March 31, 2020, September 30, 2020 and December 2020.

E. IMF Reporting Requirements

28. To effectively monitor the program performance and development of economic situation, the Ethiopian authorities will provide the IMF with the information listed below:

Information	Provider	Periodicity and due date
Gross international reserves and foreign liabilities of the National Bank of Ethiopia (NBE), reported by the amounts in the original currency of the assets and liabilities; and the weight (in oz.) of holdings of monetary gold. Breakdown between liquid and unencumbered reserves and reserves that are pledged, swapped or otherwise encumbered	NBE	Monthly within 30 days of the end of each month
Net domestic assets of the NBE	NBE	Monthly within six weeks of the end of each month
Reserve Money	NBE	Monthly within six weeks of the end of each month
Net claims on the general government	Ministry of Finance (MOF)/NBE	Monthly within six weeks of the end of each month
Regional government's fiscal data	MOF	Quarterly within twelve weeks of the end of each month
Domestic Arrears	MOF	Monthly within six weeks of the end of each month
External Arrears	MOF	Monthly within four weeks of the end of each month
Claims on public enterprises by commercial banks	NBE/MOF	Monthly within six weeks of the end of each month
Claims on public entities other than those described in paragraph 5 by commercial banks, including, but not limited to, Addis Ababa Housing and other credit facilitators	NBE/MOF	Monthly within six weeks of the end of each month
Federal Government Tax Revenue	MOF	Monthly within 60 days of the end of each month
Rural and Urban Productive Safety *Net Programme Cash* Transfers	MOF	Monthly within six weeks of the end of each month
Consumer Price Index	NBE	Monthly within six weeks of end of each month
National Accounts, annual	NDPC	Within three weeks of any revision or data release

Information	Provider	Periodicity and due date
Consolidated Budget Report of Federal and Regional Government	MOF	Quarterly within twelve weeks of end of each quarter
Monetary Survey	NBE	Monthly within six weeks of end of each month
NBE's outstanding credit to commercial banks (bank-by-bank) and DBE by type of credit	NBE	Monthly within six weeks of end of each month
Financial Soundness Indicators (aggregate and bank-by-bank)	NBE	Quarterly, within six weeks of the end of each quarter.
Bank-by-bank financial data of commercial banks and the DBE, including balance sheets, income statements, NPLs and liquidity positions broken down by currency by template provided by the IMF	NBE	Annually, within six weeks of the end of each year.
Bank-by-bank financial data of the CBE and DBE including balance sheets, income statements, NPLs and liquidity position, by template provided by the IMF	NBE	Quarterly, except for the end of the year, within six weeks of the end of each quarter.
Outstanding balance of Addis Ababa city administration house development loans from banks	NBE	Monthly within six weeks of end of each month
T-Bill auction details	NBE	Monthly within two weeks
Interbank exchange rate	NBE	Weekly within five business days
BoP data: exports, imports, services, private transfers, and capital account transactions	NBE	Quarterly within eight weeks of end of each quarter
Detailed international trade data on exports and imports by commodities	NBE	Monthly within six weeks of end of each month
Imports by type of institutions (e.g., state-owned enterprises or government and private sector)	NBE	Quarterly within eight weeks of end of each quarter
New external debt obligations contracted and/or guaranteed (concessional and non-concessional) by the government of Ethiopia or NBE, including details on the amounts, terms, and conditions of each new obligation	MOF/NBE	Monthly within four weeks of end of each month
Outstanding stock of external debt, disbursements/issuance, and debt service, by debtors, creditors, and type of debt	MOF/NBE	Monthly within six weeks of end of each month
Outstanding stock of domestic debt, disbursements/issuance, and debt service, by debtors, creditors, and type of debt	MOF/NBE	Monthly within six weeks of end of each month

INTERNATIONAL MONETARY FUND

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

December 11, 2019

STAFF REPORT FOR ARTICLE IV CONSULTATION AND REQUESTS FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND AN ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—DEBT SUSTAINABILITY ANALYSIS

Approved By
Zeine Zeidane (AFR), Seán Nolan (SPR), and Marcello Estevão (IDA)

Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)

Ethiopia: Joint Bank—Fund Debt Sustainability Analysis[1]	
Risk of external debt distress	*High*
Risk of overall debt distress	*High*
Granularity in the risk rating	*Sustainable*
Application of judgement	*None*

After rising rapidly in recent years, Ethiopia's external debt, as a share of GDP, has grown at a much slower pace. External sector vulnerabilities include an overvalued exchange rate and a small export base. The authorities have already taken steps by controlling SOE external borrowing and have reprofiled some of their loans. Nevertheless, two external debt indicators still breach their respective thresholds in the next few years. As a result, Ethiopia continues to be assessed at "high" risk of debt distress. Recognizing the challenges and to safeguard Ethiopia's debt sustainability, the authorities intend to undertake additional reprofiling of bilateral loans to reduce external debt servicing needs relative to exports with an aim to achieve a "moderate" risk of external debt distress rating and create some space to absorb shocks. This will underpin the strength of the program and safeguard Ethiopia's capacity to repay the Fund in line with the second exceptional access criterion under the Poverty Reduction and Growth Trust (PRGT). Further strengthening of debt management practices and continued improvement in debt reporting is recommended.

[1] This debt sustainability analysis was conducted using the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries (LIC-DSF) that was approved in 2017.

A. Debt Coverage

Text Table 1. Ethiopia: Coverage of Public and Publicly Guaranteed Debt and Parameters of Contingent Liability Shocks for the Tailored Stress Test

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	No

	Public debt coverage	Check box
1	Central government	X
2	State and local government	X
3	Other elements in the general government	X
4	o/w: Social security fund	X
5	o/w: Extra budgetary funds (EBFs)	X
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	X

1	The country's coverage of public debt	general government, SOEs (excl. Ethiopian airlines), and the central bank		
	Public debt coverage and the magnitude of the contingent liability tailored stress test	Default	Used for the analysis	Reasons for deviations from the default settings
2	Other elements of the general government not captured in 1.	0 percent of GDP	0	None
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	4	To account for potential liabilities, including from a policy bank.
4	PPP	0 percent of PPP stock	0	None
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5	None
	Total (2+3+4+5) (in percent of GDP)		9.0	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

1. **Coverage of debt statistics is comprehensive in Ethiopia (Text table 1).** The authorities publish debt statistics on a quarterly basis on domestic and external debt, including that of the state-owned enterprises (SOEs). The detailed information on external debt includes outstanding debt by contracting institution (Federal government, government-guaranteed borrowing by SOEs and non-guaranteed borrowing by SOEs),[2] types of creditors and currency composition, new debt commitments during the fiscal year, global average maturity and grant element for new commitments, disbursements during a fiscal year, debt service payments, and commitments and undisbursed amounts for all contracted debt. However, reporting of external debt statistics at the public enterprises may need to be strengthened further. In addition, staff has added debt owed by the central bank, but not reported in the above-mentioned debt statistics, to two bilateral lenders for an amount of US$2 billion, which the authorities view as monetary arrangements between the central banks and not public debt but which the authorities may be required to refinance. Domestic debt data similarly covers debt of the non-financial public sector (Federal government and SOEs) and covers debt outstanding by borrowing entity, instrument, lender (including lending by the central bank and public sector financial institutions) and debt service payments. Debt reporting continues to improve under the World Bank's Development Policy Operation (DPO) program with expanded

[2] The public debt data also includes data for Ethiopian Airlines (EAL). EAL meets the criteria for exclusion set out in the 2017 Staff Guidance Note on the Debt Sustainability Framework for Low-Income Countries (Appendix III) because it is run on commercial terms, has a sizeable profit margin (as reflected in audited accounts published annually), enjoys managerial independence, and borrows without government guarantee. On this basis, this DSA does not include the debt of EAL. The DSA, however, includes the debt stock of Ethio-Telecom, which are not guaranteed by the government. The authorities view Ethio-Telecom as meeting the criteria for exclusion from the DSA.

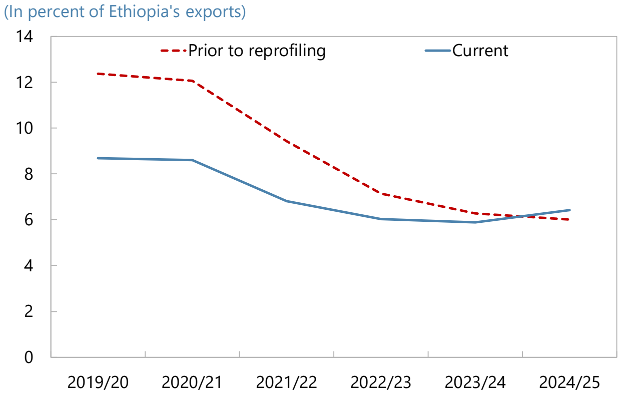
coverage of SOE domestic debt in the quarterly debt reports, public disclosure of an annual debt report, and going forward, public disclosure of audited annual statements of major SOEs. Notwithstanding the comprehensive coverage of historical debt data, staff assumes a larger contingent liability shock to account for potential liabilities, including those arising from the Development Bank of Ethiopia (DBE), which is a non-deposit taking financial institution that supports long-term private sector projects.

B. Recent Development

2. The pace of Ethiopia's external debt accumulation has decelerated in recent years on active measures. After rising by about 10 percentage points to 29.4 percent of GDP in the five-year period ending in 2014/15 (public and publicly guaranteed external debt accounted for about three-fourth of this increase), the pace of increase in the external debt stock has seen a welcome slowdown, in response to active measures taken by the authorities to contain SOEs' external borrowing, including an ongoing commitment under the World Bank's DPO program to a zero non-concessional debt policy for new loans. In 2018/19, public and publicly-guaranteed external debt/GDP ratio was about 28½ percent (including non-guaranteed public external debt, the ratio was 31.4 percent), lower by 2 percentage points from a year ago. At current level, Ethiopia's external debt/GDP ratio is below the average for low-income countries (about 40 percent of GDP), but above the median (about 26 percent of GDP).

3. The bulk of Ethiopia's external debt is official debt. Official creditors account for three-fourths of outstanding external debt, with the remaining one-fourth is attributable to private creditors, including the Eurobond issued in 2014. Among the official creditors, IDA and non-Paris club bilateral creditors account for the majority share. The entire external debt portfolio is long-term by original maturity and about two-thirds of these loans are on fixed interest rates. These external borrowings are primarily used for infrastructure investment: transport and communication; highway and railway transport infrastructure; electricity, gas, steam; and industry and tourism sectors together account for about two-third utilization of these loans. About 55 percent of these loans were outstanding with the Federal government, including those that were on-lent to SOEs, and about 13 percent was non-guaranteed external debt of SOEs, primarily for the airline and telecommunication companies. Guaranteed external debt for SOEs accounted for about 25 percent of total external debt stock as of end-June 2019.[3]

Ethiopia: External Debt Service Needs of Selected SOEs
(In percent of Ethiopia's exports)



Sources: Ethiopian authorities; and IMF staff calculation and projections.

[3] Ethiopia owes arrears to Libya, Bulgaria, Russia, and former Yugoslavia, totaling about US$538 million as of June 2019, which are deemed away under the policy on arrears to official bilateral creditors, as the underlying Paris Club agreement is adequately representative, and the authorities are making best efforts to resolve the arrears. Furthermore, there are about US$8.2 million worth of external arrears (principal and interest payments combined) to commercial creditors, all pre-dating the1990s, from former Czechoslovakia, India, Italy, and former Yugoslavia. The authorities are continuing to make a good faith effort to reach a collaborative agreement with these creditors.

4. The authorities concluded the debt reprofiling on some loans in 2018/19. While tighter control over external borrowing by public enterprises helped slow down debt accumulation, conclusion of debt reprofiling for some of the Chinese loans, including the US$2.5 billion loan for the Addis Ababa-Djibouti rail project, has also contributed to lowering of near-term debt servicing needs.

Ethiopia: External Public Sector Debt

	As at end-June 2018			As at end-June 2019		
	USD, million	Percent of Total	Percent of GDP	USD, million	Percent of Total	Percent of GDP
Total[1]	**26,773**	**100.0**	**33.2**	**29,039**	**100.0**	**31.4**
Official Creditors[1]	**20,018**	**74.8**	**24.8**	**22,104**	**76.1**	**23.9**
Multilaterals	**10,492**	**39.2**	**13.0**	**11,684**	**40.2**	**12.6**
IDA	7,754	29.0	9.6	8,877	30.6	9.6
IMF	91	0.3	0.1	38	0.1	0.0
AfDF/AfDB	2,053	7.7	2.5	2,130	7.3	2.3
Other multilateral	594	2.2	0.7	639	2.2	0.7
Bilaterals[1]	**9,527**	**35.6**	**11.8**	**10,420**	**35.9**	**11.3**
Paris Club	546	2.0	0.7	558	1.9	0.6
Non-Paris Club[1]	8,981	33.5	11.1	9,863	34.0	10.7
Private Creditors	**6,755**	**25.2**	**8.4**	**6,935**	**23.9**	**7.5**
Of which: Bond and Notes Holders	1,000	3.7	1.2	1,000	3.4	1.1

Sources: Ethiopian authorities and IMF staff calculations.

[1] Includes Ethiopian airlines and long-term external liabilities of the National Bank of Ethiopia.

5. The total public debt stock is nearly equally split between external and domestic debt. SOEs have a slightly more than 50 percent share of the public domestic debt. SOE corporate bonds account for three-fourths of their outstanding domestic debt, held by the largest public sector bank, the Commercial Bank of Ethiopia (CBE). For the Federal government, banks hold most of the domestic debt, primarily the National Bank of Ethiopia (NBE), the central banker, on account of its direct advances to the government. 91-dayTreasury bills accounted for 77 percent of outstanding T-bills and were held by non-bank financial institutions (e.g., the private organizations' employees' social security agency), albeit at a rate that is well-below prevailing and historical inflation. The reported debt stock includes guaranteed debt to public enterprises.

Ethiopia: Composition of Public Sector Debt

	As at end-June 2019		
	Billions of birr	Percent of total	Percent of GDP
Total [1]	**1618.5**	**100.0**	**60.0**
External [1]	**847.1**	**52.3**	**31.4**
Domestic	**771.4**	**47.7**	**28.6**
Central government	361.9	22.4	13.4
Banks	*254.7*	*15.7*	*9.4*
NBE	*194.7*	*12.0*	*7.2*
Other banks	*60.0*	*3.7*	*2.2*
Non-banks	*107.2*	*6.6*	*4.0*
SOEs	409.5	25.3	15.2

Source: Ethiopian authorities, IMF staff calculations.

[1] Includes Ethiopian airlines and long-term external liabilties of the National Bank of Ethiopia.

6. **Access to increased external borrowing supported a debt-financed growth model, but at the cost of increasing debt vulnerabilities.** Ethiopia was one of fastest growing economies in the world over the past decade, with growth averaging at close to 10 percent per annum. This was made possible by a ramp up in public investment in physical infrastructure, financed by external borrowing. Because of deteriorating debt service indicators, following weaknesses in exports and revenues, the 2017 DSA assessed Ethiopia at high risk of external debt distress. Ethiopia has one of lowest exports/GDP ratios among the low-income countries. Moreover, export performance, particularly that of merchandise exports, has been anemic since 2014/15, driven by weak global commodity prices and domestic supply shock (for example, flood) impacting agricultural production. Manufacturing exports have expanded at a fast pace, including garments exports, but from a small base. Services exports have done well in recent years, helped by expansion of operations by the Ethiopian Airlines. The present value (PV) of public and publicly guaranteed (PPG) external debt to exports ratio stood at slightly above 250 percent as of 2018/19. In response, the authorities have reined in borrowing by the SOEs and strengthened debt management. While this has slowed down accumulation of external debt, slower public investment has also put a brake on fast economic growth. Ethiopian Airlines' expansion in recent years has also contributed to its external debt, but at a much slower pace than the rest of the public sector. Its external debt, which are not guaranteed by the Ethiopian government and not included in the DSA, has stayed between 2.5 percent and 3 percent of GDP over the past four years.

C. Outlook and Key Assumptions

7. **Growth is expected to slow down further in the near term but strengthen over the medium term.** In 2019/20, under staff baseline, growth is expected at 6.2 percent, but will strengthen to about 8 percent by 2023/24 (see text table below). Under the reform plan, Ethiopia aspires to shift to a private-sector led growth model, an important departure from the current public-sector driven model. To facilitate the rebalancing process, the authorities will need to address the macroeconomic imbalances, including foreign exchange shortages; undertake structural reforms to ease the bottlenecks to productivity and job

growth; attract FDI notably through the opening of key sectors to foreign investors; strengthen macroeconomic policymaking; and undertake focused reforms in key strategic areas.

8. **The proposed Fund arrangement will help support the authorities' reform agenda and strengthen external buffers.** Under the program, central bank's gross reserves are expected to increase with support from external assistance to reach adequate levels over the medium term. Relative to the last Article IV DSA in 2018, the current account balance will improve over the medium term as businesses benefit from the authorities' efforts at addressing the external imbalances, including the overvaluation and severe shortage of foreign exchange. The general government balance, as a share of GDP, will improve to 1.9 percent over the medium term. Revenues which have been low and falling, will only improve with concerted tax administration and policy measures, but will remain below, as a share of GDP, the previously projected levels.

9. **Some of the key assumptions underlying the medium-term macroeconomic framework have changed since the last DSA.** These include: a slower growth path in the near term; higher gross external reserves; a lower revenue/GDP ratio for the general government to start with which only improves over the medium- and long-term; and finally, a consolidation of nonfinancial public sector balance that is expected to take place primarily at the public enterprises through limits on their borrowings. In addition, the current framework reflects updates to the global macroeconomic assumptions and official statistics from Ethiopia.

10. **The realism tool indicates that the assumed fiscal adjustments could have downside risks, while economic growth could have a modest upside risk (Figure 4).** As discussed in the main report, one of the objectives of the program is to address vulnerabilities arising from nonfinancial public sector balance sheets and there are implementation risks. However, the authorities have demonstrated in recent years that they are aware of external debt vulnerabilities and have reined in borrowing by public enterprises. On the growth projections, while cross-country historical experience of countries that transitioned out a public sector driven model could imply that growth forecasts could be optimistic, staff's current projection also considers Ethiopia's history of strong growth.

11. **This DSA makes the following assumptions on borrowing and debt servicing**:

a. Evolution of external debt reflects projection on debt service payments on outstanding debt and assumptions on disbursement of already committed, but not disbursed, loans, and new commitments by multilateral and/or Paris Club members. However, given the conditionality under the Fund-supported arrangements, no contracting or guaranteeing of new non-concessional external loans is assumed over the medium term.

b. Given Ethiopia's elevated debt vulnerabilities, the authorities' aim to reduce pressures arising from high external debt service needs (relative to exports) in the near- to medium-term. This will help strengthen debt sustainability and will be guided by their intention to reduce the risk of external debt distress to "moderate" during the program that would underpin the strength of the program and safeguard Ethiopia's capacity to repay the Fund in line with the second exceptional access criterion under the Poverty Reduction and Growth Trust (PRGT). This will also provide necessary financing during the Fund-supported program. The authorities have contacted some of their external bilateral creditors and are expected to obtain commitments from some of them by the time of the approval of the arrangements. Additional commitments from bilateral creditors are expected by the first review of the arrangements.

i. The DSA baseline reflects savings associated with the firm commitments expected at the time of the approval of the arrangements (about US$1.65 billion over 2019/20–2022/23). These savings come from deferred debt service that do not increase the present value (PV) of the reprofiled loans and avoid any bunching of debt service obligation within a few years after the end of the program. This will be consistent with bringing the debt-service to exports ratio below the relevant threshold within the program period.

ii. Reprofiling by some other bilateral lenders, for which firm commitments are expected by the first review of the arrangements, will help generate additional savings on approximately US$400 million debt service over 2020/21–2022/23. This will help create some additional space to absorb shocks relative to the debt-service to exports threshold within the program period.

c. The domestic debt stock reflects the borrowing needs under the fiscal framework. Staff's current baseline includes the authorities' decision to convert outstanding old debt stock of 91-day T-bills and central bank advances to the Federal government into 3-year and 25-year bonds respectively (latter with a 10-year grace period), and rolling over of domestic debt for the state-owned enterprises that together accounted for about 90 percent of SOE domestic debt in 2018/19 with a 3-year grace period and 10-year maturity. The DSA baseline assumes that the 3-year bond mentioned above will be paid off on maturity, while the new central bank advances will be rolled over for three years and thereafter converted to T-bills at the prevailing market rate.

d. The government's domestic borrowing will increasingly shift toward borrowing at a market-determined rate, with the real rate on domestic borrowing becoming positive toward the end of the medium term. This is consistent with the reforms to phase out financial repression. On December 4, 2019, the authorities conducted the first auctions of T-bills.

12. This DSA has also altered the borrowing profile of the public sector in line with the design of the Fund arrangement and the Bank DPO. Given the zero limit on non-concessional external debt, future debt contracts will be on concessional terms. For 2019/20, the program's indicative target on concessional debt include the authorities' current pipeline of expected commitments (text table). The identified projects reflect Ethiopia's traditional focus areas: agriculture, transport and communication, road and rail transport infrastructure etc. Future disbursements are predominantly from multilateral sources, especially over the longer horizon. As a result, the grant element of new debt is expected to be stronger than the last DSA.

Ethiopia: Public and Publicly Guaranteed External Debts

(Contracted and expected commitments for 2019/20)

	US$ million	Percent of total
By source	**1,895**	**100.0**
Concessional debt	1,895	100.0
Of which: contracted before program negotiations began	86	4.5
Multilateral	983	51.9
Of which: contracted before program negotiations began	0	0.0
Bilateral	915	48.3
Of which: contracted before program negotiations began	86	4.5
Non-concessional debt	0	0.0
Uses of debt financing	**1,895**	**100.0**
Budget financing	500	26.4
Project financing	1,395	73.6
Federal government	1,000	52.8
Public enterprises (to be on-lent by Federal government)	395	20.8

Source: Ethiopian authorities.

13. **Ethiopia's debt carrying capacity is assessed as "medium", unchanged from the last DSA.** The Composite Index (CI) that measures debt carrying capacity stands at 2.80, within the 2.69 and 3.05 range. As a result, the following thresholds to assess the risk of external debt distress applies to Ethiopia:

a. Present value of PPG external debt/GDP ratio: 40 percent.

b. Present value of PPG external debt/exports: 180 percent.

c. External debt service/exports: 15 percent.

d. External debt service/revenues: 18 percent.

Calculation of the CI Index

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.442	1.33	47%
Real growth rate (in percent)	2.719	8.278	0.23	8%
Import coverage of reserves (in percent)	4.052	20.072	0.81	29%
Import coverage of reserves^2 (in percent)	-3.990	4.029	-0.16	-6%
Remittances (in percent)	2.022	5.847	0.12	4%
World economic growth (in percent)	13.520	3.559	0.48	17%
CI Score			2.80	100%
CI rating			Medium	

Text Table 1. Ethiopia: Key Macroeconomic Assumptions—Comparison with the Previous Vintage of DSA

Fiscal year ending June	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2038/39
Grant Element of New External Borrowing									
2019DSA	...	35.6	36.8	40.2	44.6	49.6	53.1	52.9	50.9
2018DSA	51.5	44.6	45.9	48.8	47.6	47.6	47.7	48.1	32.3
Non-Concessional Debt Disbursements (billions of U.S. dollars)									
2019DSA	...	0.42	0.34	0.23	0.12	0.02	0.00	0.00	0.00
2018DSA	0.00	0.64	0.55	0.18	0.43	0.30	0.30	0.30	1.25
Real GDP Growth (annual percent change)									
2019DSA	9.0	6.2	6.1	7.0	7.5	8.0	7.0	6.6	4.6
2018DSA	8.5	7.6	7.1	7.0	7.0	6.5	7.0	6.6	4.5
Current Account Balance (percent of GDP)									
2019DSA	-4.5	-5.5	-4.6	-4.6	-4.0	-3.4	-3.6	-3.7	-3.6
2018DSA	-6.2	-5.8	-5.2	-4.2	-3.8	-4.2	-4.1	-3.8	-2.4
Exports of goods and services (percent of GDP)									
2019DSA	7.9	7.9	9.2	10.8	10.9	10.7	11.2	11.2	12.4
2018DSA	8.6	8.9	9.2	9.7	10.2	9.3	9.4	9.4	13.5
Exports of goods and services (annual percent change)									
2019DSA	7.9	12.8	12.7	14.0	12.4	9.7	9.2	9.4	10.5
2018DSA	12.7	12.6	12.6	13.6	14.3	10.0	9.2	8.5	9.8
Fiscal balance (percent of GDP)									
2019DSA	-2.5	-2.5	-2.2	-1.9	-1.9	-1.9	-1.8	-1.8	-1.8
2018DSA	-3.1	-3.0	-2.9	-2.8	-2.7	-3.0	-2.6	-2.5	-1.9
International reserves (billions of U.S. dollars)									
2019DSA	3.4	4.0	5.7	7.4	9.6	11.2	11.6	13.0	42.0
2018DSA	3.4	3.9	4.7	5.9	7.5	6.6	7.0	7.5	19.8
General government revenue (percent of GDP)									
2019DSA	11.5	11.7	13.0	14.2	14.5	14.7	14.8	14.7	14.6
2018DSA	13.0	13.1	13.3	13.5	13.9	12.9	13.0	13.2	22.9

Sources: Ethiopian authorities; IMF and World Bank staff estimates and projections.

D. External Debt Sustainability Analysis

Baseline

14. Under the baseline, external debt declines as a share of GDP (Figure 1). The present value (PV) to GDP ratio of external debt remains well within the threshold, while another indicator, PV of external debt to exports breaches the applicable threshold for the first four years. The breach of this indicator reflects two primary factors: (i) debt service needs from the large borrowings for public infrastructure investment projects in the last few years; and (ii) recent lackluster performance of exports of goods. Debt reprofiling by some bilateral creditors in the form of deferment of debt service payments are expected to bring the debt service/exports ratio slightly below its threshold by 2021/22. In the absence of such commitments, debt service/exports ratio would have remained about its threshold until 2022/23. The debt service to revenue ratio remains below its applicable threshold throughout the projection period. The profile of the two external debt service indicators also reflect the maturity of US$1 billion Euro bond in 2024/25, resulting in a one-off breach in the debt service/exports ratio in the post-program period. The baseline is consistent with Ethiopia reaching "moderate" risk of external debt distress (Figure 6).

Stress Tests

15. The standard stress tests show Ethiopia's vulnerabilities to export shocks. In the case of the two indicators that are currently breaching the applicable thresholds, such breaches become larger and persistent beyond the medium term under an export shock. In addition, the debt service-to-revenue ratio experiences a one-off breach under a real depreciation stress test. In this context, it should be noted that the baseline scenario already includes a profile of annual depreciation during the program that would help eliminate the estimated overvaluation existing as of 2018/19. These scenarios demonstrate Ethiopia's vulnerabilities to large shocks that impact external sector performance. Additionally, neither the public gross financing needs, which peaks at 6 percent of GDP in 2019/20, helped in part by recent conversion of pre-existing short-term debt into medium- and long-term bonds, nor the EMBI spread on Ethiopia's Euro bond (about 350 basis points as of mid-November 2019) breaches the threshold (14 percent of GDP and 570 basis points, respectively). Thus, Ethiopia's market financing risks are currently assessed to be low (Figure 5).

Alternative Scenario

16. An alternative scenario with additional debt reprofiling as described above will help Ethiopia create some additional space to absorb shocks (Figure 7). Under this scenario additional deferment of debt services (about US$400 million) are expected to take place over 2020/21–2022/23, for which commitments are expected by the first review of the arrangements. Under this scenario the debt service/export ratio goes below 13.2 percent during the last year of the program and stays at or below that level in the future except for a one-off breach in 2024/25 due to the maturing of the Euro bond. The PV of debt/export is largely similar to the baseline, while debt service/revenue ratio improves further.

E. Public Debt Sustainability Analysis

Baseline

17. Ethiopia's overall public debt has increased to about 57 percent of GDP, about half of which is external debt. Public enterprises account for a little more than 50 percent of outstanding domestic debt. Under staff's baseline, overall public debt declines steadily and stays well below the applicable threshold throughout the projection period. The PV of debt-to-revenue remains on a downward trend. However, the debt service to revenue ratio displays a nonlinear behavior, whereby it goes up in the longer term after declining over the next few years. This reflects a combination of maturing existing debt as their grace periods expire and higher real cost of new domestic borrowing. Amortization of outstanding domestic medium- to long-term debt, however, does not pose any rollover risks as these debts are held by the public sector financial institutions.

Stress tests

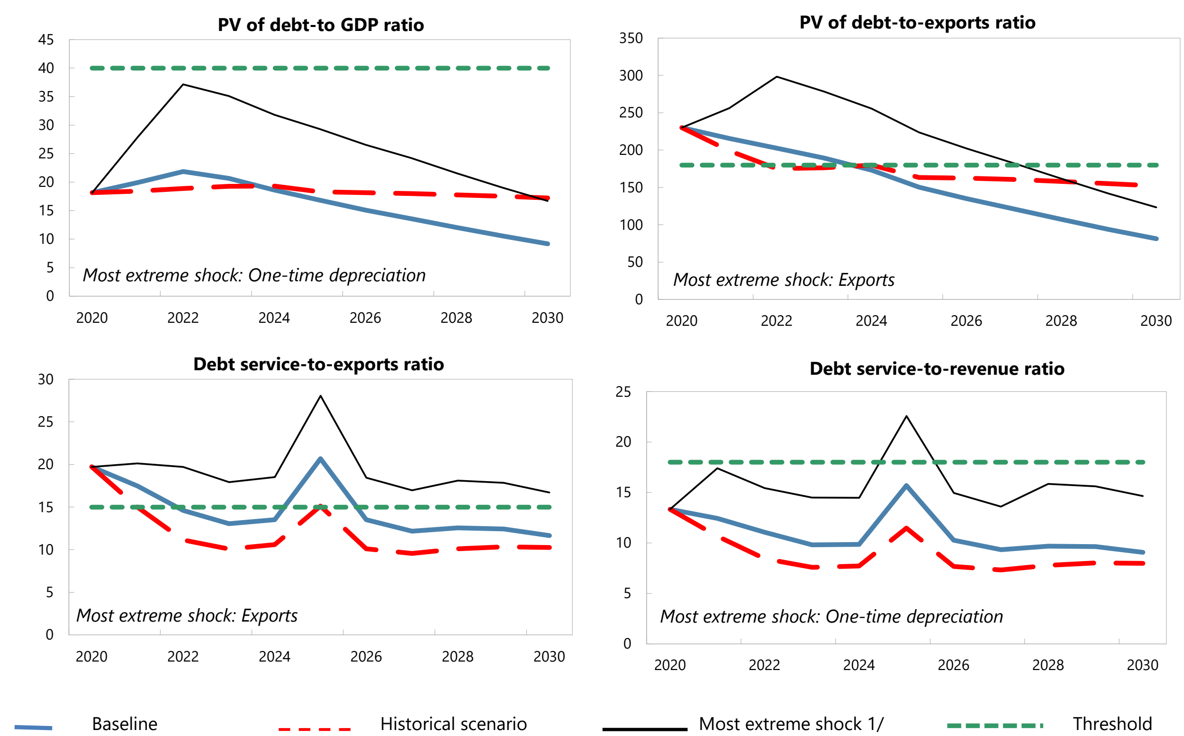
18. Stress tests demonstrate that the overall public debt is susceptible to the materialization of contingent liabilities. However, the overall debt/GDP ratio remain within the 55 percent threshold. Under the stress scenario, all public debt indicators worsen.

F. Assessment

19. Based on the analysis staff arrives at the following assessment:

- Public and publicly-guaranteed debt is sustainable. The DSA baseline includes the authorities' intention to obtain commitments for deferment of debt service obligations on some bilateral external loans by the time of the approval of the arrangements with an aim to improve the external debt distress risk rating to "moderate" during the course of the program. The debt operations are not expected to increase the PV of external debt and avoid any bunching of debt service obligation within a few years after the end of the Fund-supported program.
- Under the baseline, two external debt indicators (PV debt/GDP and debt service/revenues) and PV public debt/GDP remain below their respective thresholds. Two other indicators breach their respective thresholds in the first few years: the external debt service/exports ratio goes below its threshold within the program period, while the PV external debt/exports ratio goes below its threshold a year after the program ends. All debt indicators trend downward over the medium term except for a one-off spike in the external debt service indicators in 2024/25 due to the maturity of the US$ 1 billion Euro bond (debt service/exports breach its threshold in 2024/25). Liquidity risks are elevated for servicing external debt.
- Ethiopia is assessed at "high" risk of external debt distress because of the above-mentioned breaches in the PV of external debt/exports and external debt service/exports ratios.
- Recognizing the challenges, the authorities intend to undertake additional debt operations with external bilateral creditors and create some additional space during the course of the program, without increasing the PV of these reprofiled debt. The authorities are expected to secure these additional commitments from bilateral creditors by the first review of the arrangements.
- Ethiopia's overall public debt is assessed to be at "high" risk of debt distress because of its external debt vulnerabilities. Public debt service needs are also high relative to revenues although rollover risks of domestic debt are mitigated by the fact they are almost entirely held by the public financial institutions.
- The main external vulnerabilities arise from Ethiopia's narrow export base. Any adverse shock to exports would worsen the external debt indicators.
- On domestic debt, the vulnerabilities are related to realization of contingent liabilities.

Figure 1. Ethiopia: Indicators of Public and Publicly Guaranteed External Debt, 2020–30



Customization of Default Settings	Size	Interactions
Tailored Stress		
Combined CL	Yes	
Natural disaster	n.a.	n.a.
Commodity price	n.a.	n.a.
Market financing	No	No

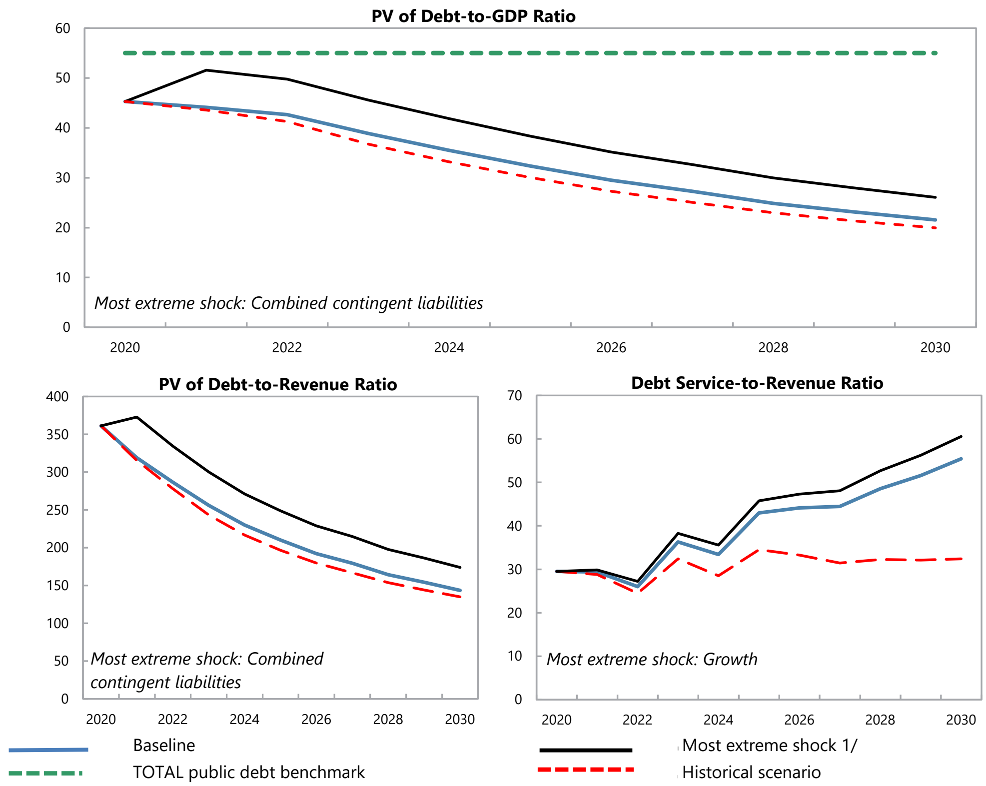
Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.0%	1.0%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	33	33
Avg. grace period	5	5

* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Figure 2. Ethiopia: Indicators of Public Debt, 2020–30

(In percent)



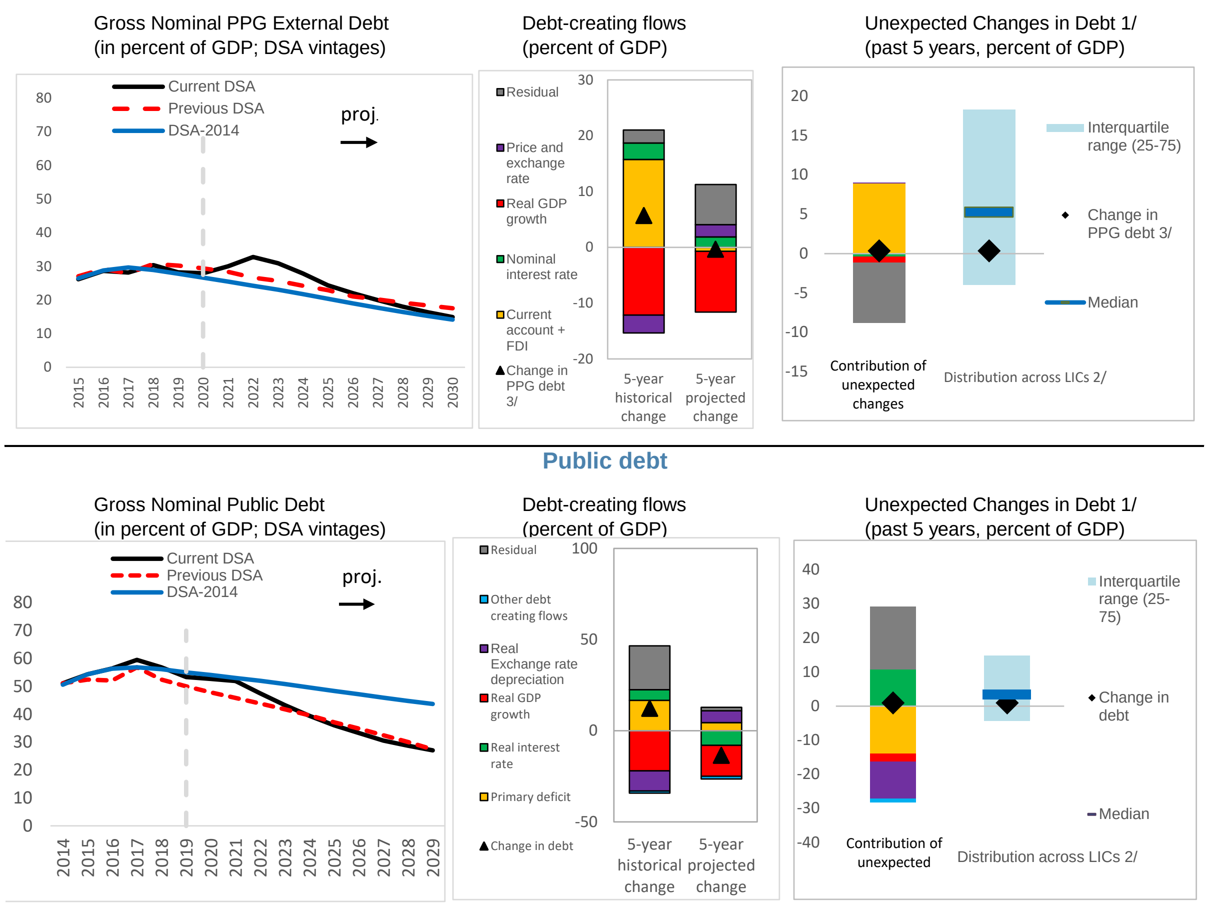
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	29%	34%
Domestic medium and long-term	20%	54%
Domestic short-term	51%	12%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.0%	1.0%
Avg. maturity (incl. grace period)	33	33
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	4.1%	4.1%
Avg. maturity (incl. grace period)	10	10
Avg. grace period	3	3
Domestic short-term debt		
Avg. real interest rate	1.4%	1.4%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2030. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 3. Ethiopia: Drivers of Debt Dynamics—External Debt



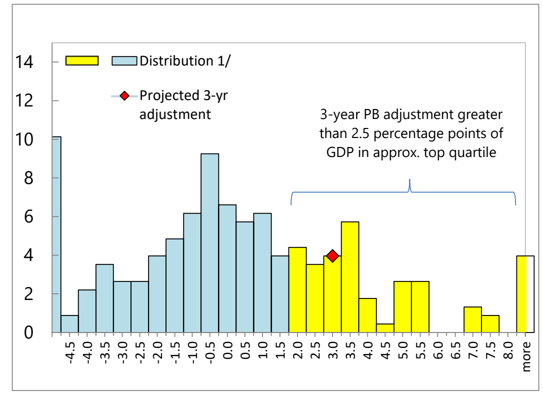
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

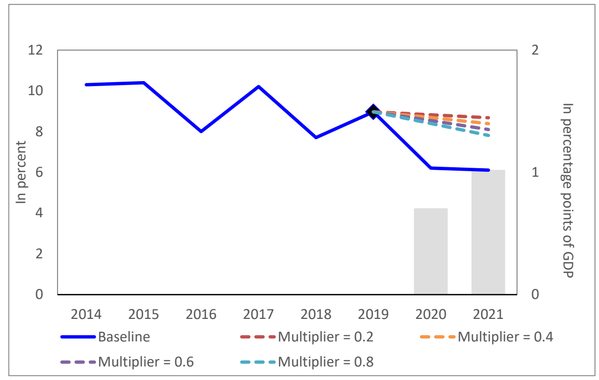
Figure 4. Ethiopia: Realism Tools

3-Year Adjustment in Primary Balance (Percentage points of GDP)



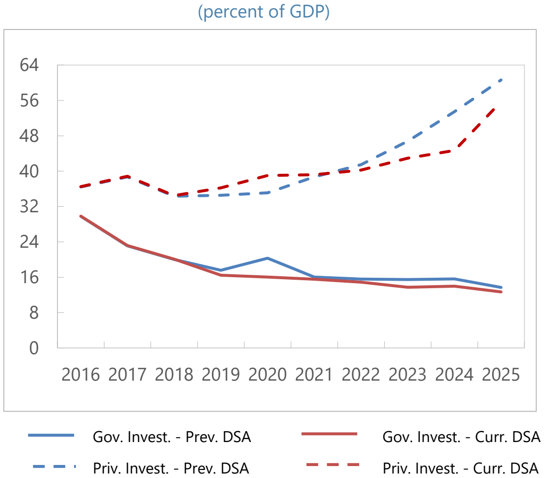
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(percent of GDP)



Contribution to Real GDP growth
(percent, 5-year average)

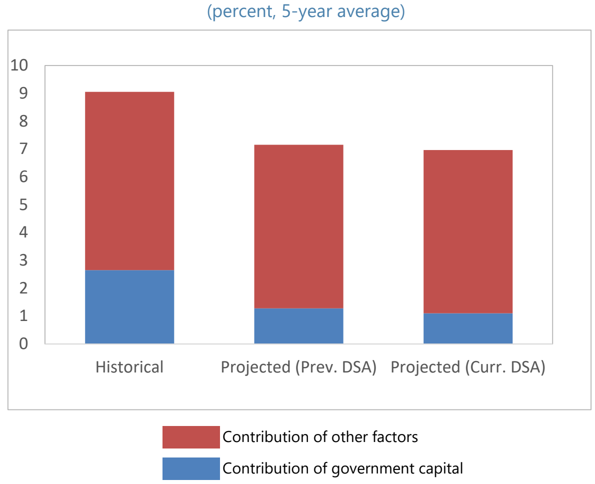
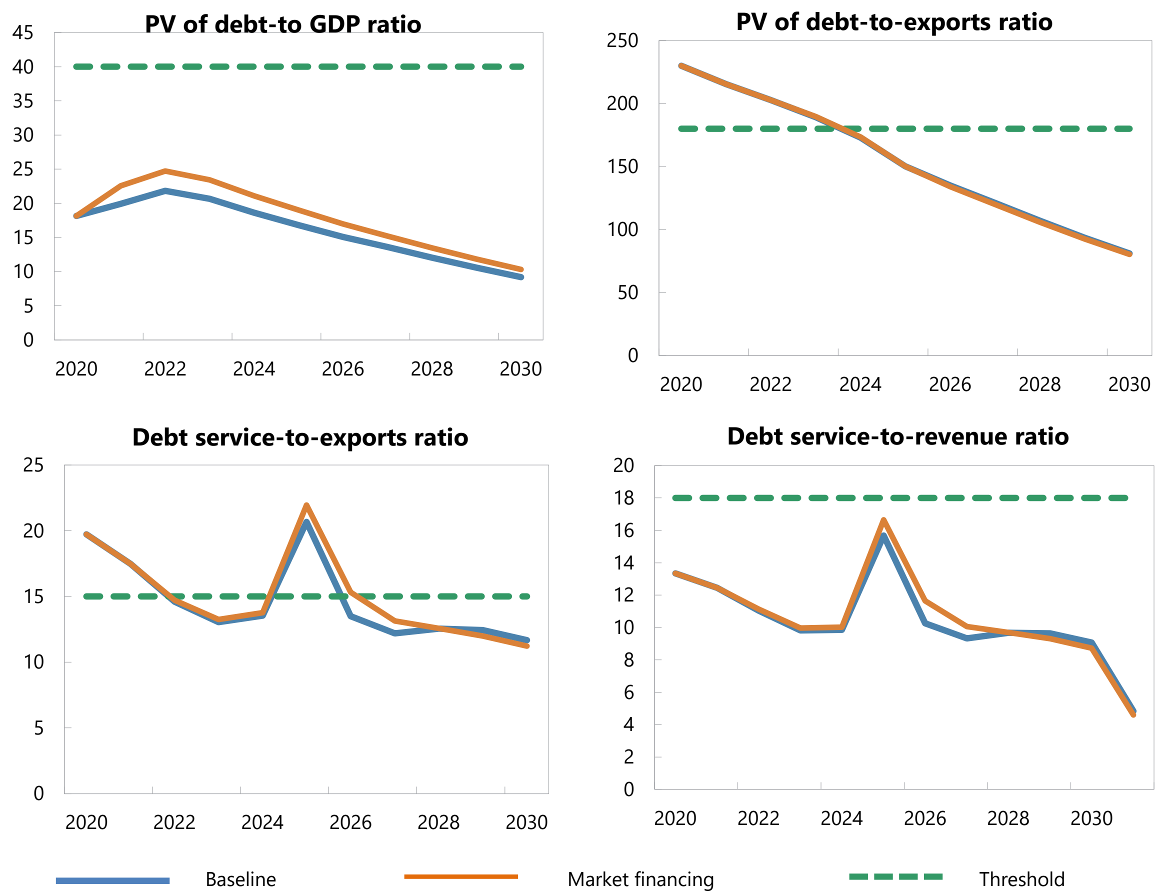


Figure 5. Ethiopia: Market-Financing Risk Indicators

	GFN 1/	EMBI 2/
Benchmarks	14	570
Values	6	351
Breach of benchmark	No	No
Potential heightened liquidity needs	Low	

1/ Maximum gross financing needs (GFN) over 3-year baseline projection horizon.
2/ EMBI spreads correspond as of November 14, 2019.



Sources: Country authorities; and staff estimates and projections.

Figure 6. Ethiopia: Qualification of Moderate Category (2020–30)[1/]

Sources: Country authorities; and staff estimates and projections.

1/ For the PV debt/GDP and PV debt/exports thresholds, x is 20 percent and y is 40 percent. For debt service/Exports and debt service/revenue thresholds, x is 12 percent and y is 35 percent.

Figure 7. Ethiopia: Qualification of Moderate Category, with Alternative Scenario (2020–30)[1/]

Sources: Country authorities; and staff estimates and projections.

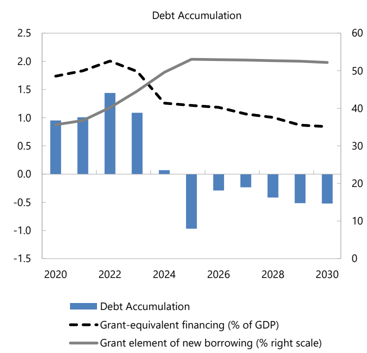
1/ For the PV debt/GDP and PV debt/exports thresholds, x is 20 percent and y is 40 percent. For debt service/Exports and debt service/revenue thresholds, x is 12 percent and y is 35 percent.

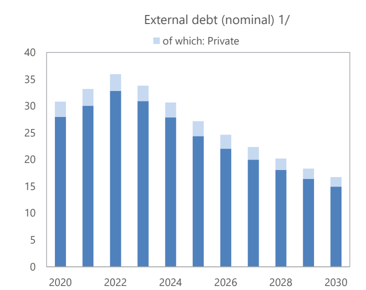
Table 1. Ethiopia: External Debt Sustainability Framework, 2017–39

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030	2039	Historical	Projections
External debt (nominal) 1/	30.6	33.1	31.1	30.8	33.2	36.0	33.8	30.7	27.2	16.7	10.7	27.2	26.7
of which: public and publicly guaranteed (PPG)	28.2	30.4	28.2	28.0	30.1	32.8	30.9	27.9	24.4	15.0	9.8	24.6	24.1
Change in external debt	-0.8	2.4	-2.0	-0.2	2.4	2.8	-2.2	-3.1	-3.5	-1.6	-0.3		
Identified net debt-creating flows	-0.5	0.9	-2.7	-0.5	-1.7	-1.8	-2.6	-3.3	-2.8	-1.4	-1.3	0.0	-2.0
Non-interest current account deficit	7.3	5.6	3.8	4.9	4.3	4.4	3.8	2.9	3.2	3.5	3.5	5.9	3.7
Deficit in balance of goods and services	-31.1	-31.2	-28.7	-28.3	-32.5	-36.6	-35.7	-34.1	-34.8	-32.9	-32.0	-38.7	-33.6
Exports	7.6	8.4	7.9	7.9	9.2	10.8	10.9	10.7	11.2	11.3	12.4		
Imports	-23.5	-22.8	-20.8	-20.5	-23.3	-25.8	-24.8	-23.4	-23.6	-21.6	-19.6		
Net current transfers (negative = inflow)	-8.5	-8.7	-8.9	-7.7	-10.1	-11.1	-10.5	-9.7	-9.3	-6.4	-3.5	-10.9	-8.7
of which: official	-1.7	-1.5	-2.2	-1.3	-1.2	-1.1	-1.2	-1.2	-1.0	-0.8	-0.6		
Other current account flows (negative = net inflow)	46.9	45.5	41.4	40.9	46.9	52.0	50.0	46.8	47.3	42.8	39.0	55.5	46.0
Net FDI (negative = inflow)	-5.1	-4.4	-3.1	-4.3	-4.3	-4.0	-4.1	-4.3	-4.4	-4.5	-4.5	-3.5	-4.3
Endogenous debt dynamics 2/	-2.7	-0.4	-3.4	-1.1	-1.6	-2.1	-2.3	-1.9	-1.6	-0.5	-0.4		
Contribution from nominal interest rate	0.7	0.6	0.7	0.6	0.3	0.3	0.2	0.5	0.4	0.6	0.1		
Contribution from real GDP growth	-2.9	-2.3	-2.6	-1.7	-2.0	-2.4	-2.4	-2.4	-2.0	-1.0	-0.5		
Contribution from price and exchange rate changes	-0.5	1.4	-1.5	...	...	...	...	...	...	...	...		
Residual 3/	-0.3	1.6	0.7	0.3	4.0	4.5	0.4	0.1	-0.7	-0.1	1.0	1.6	0.7
of which: exceptional financing	-0.1	-0.1	-0.1	0.9	1.4	2.2	1.6	0.1	-0.1	-0.3	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	19.6	18.1	19.9	21.8	20.7	18.6	16.8	9.2	5.8		
PV of PPG external debt-to-exports ratio	...	...	247.6	230.1	215.6	202.7	189.3	173.1	150.3	81.2	46.8		
PPG debt service-to-exports ratio	20.3	18.5	24.6	19.7	17.5	14.6	13.0	13.5	20.7	11.7	3.0		
PPG debt service-to-revenue ratio	11.0	12.6	16.8	13.3	12.4	11.0	9.8	9.9	15.7	9.1	2.6		
Gross external financing need (Million of U.S. dollars)	3366.7	2638.9	2811.9	2690.4	2048.4	2325.3	1705.6	632.7	2009.2	1266.2	-1848.1		
Key macroeconomic assumptions													
Real GDP growth (in percent)	10.2	7.7	9.0	6.2	6.1	7.0	7.5	8.0	7.0	6.2	4.6	9.6	6.7
GDP deflator in US dollar terms (change in percent)	1.7	-4.3	4.7	6.7	-9.5	-8.5	3.2	3.2	-2.0	2.9	3.1	2.1	0.7
Effective interest rate (percent) 4/	2.4	1.9	2.4	2.2	1.0	0.8	0.5	1.6	1.4	3.4	1.0	1.7	1.7
Growth of exports of G&S (US dollar terms, in percent)	2.9	13.1	7.9	12.8	12.7	14.0	12.4	9.7	9.2	9.6	10.5	8.9	10.8
Growth of imports of G&S (US dollar terms, in percent)	-4.8	0.2	4.1	11.3	9.4	8.5	6.6	5.1	5.9	8.3	7.1	8.6	7.6
Grant element of new public sector borrowing (in percent)	...	...	...	35.6	36.8	40.2	44.6	49.6	53.1	52.2	50.9	...	47.6
Government revenues (excluding grants, in percent of GDP)	14.1	12.3	11.5	11.7	13.0	14.2	14.5	14.7	14.8	14.5	14.6	13.7	14.2
Aid flows (in Million of US dollars) 5/	556.8	686.4	1198.8	2250.8	2284.5	2661.9	2822.3	2109.7	2242.4	2381.7	4064.1		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	1.7	1.8	2.0	1.8	1.3	1.2	0.8	0.6	...	1.3
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	53.2	51.6	49.8	56.2	68.2	70.8	70.2	62.9	...	63.8
Nominal GDP (Million of US dollars)	81,788	84,298	96,140	108,934	104,577	102,353	113,579	126,571	132,658	207,406	437,264		
Nominal dollar GDP growth	12.1	3.1	14.0	13.3	-4.0	-2.1	11.0	11.4	4.8	9.3	7.9	11.9	7.4
Memorandum items:													
PV of external debt 7/	...	...	22.4	21.0	23.1	25.0	23.6	21.4	19.6	11.0	6.7		
In percent of exports	...	...	283.1	266.1	249.3	231.8	215.8	199.0	175.4	97.0	53.7		
Total external debt service-to-exports ratio	24.9	22.7	28.7	23.9	21.3	17.9	16.6	17.1	24.1	13.8	4.1		
PV of PPG external debt (in Million of US dollars)			18837.9	19753.4	20851.4	22356.6	23469.0	23548.1	22322.7	19044.5	25444.6		
(PVt-PVt-1)/GDPt-1 (in percent)				1.0	1.0	1.4	1.1	0.1	-1.0	-0.5	0.3		
Non-interest current account deficit that stabilizes debt ratio	8.1	3.2	5.8	5.1	1.9	1.6	6.0	6.1	6.7	5.1	3.8		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**No**





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt. Presented on fiscal year basis (e.g., 2020 referes to fiscal year ending in June 2020).

2/ Derived as [r - g - ρ(1+g) + Ɛα (1+r)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ɛ=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

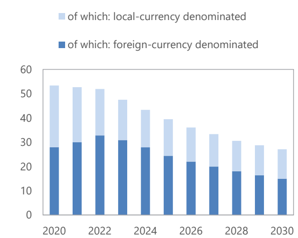
Table 2. Ethiopia: Public Sector Debt Sustainability Framework, 2017–39

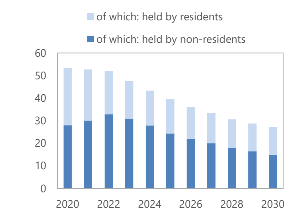
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030	2039	Historical	Projections
Public sector debt 1/	**56.5**	**59.5**	**56.8**	**53.4**	**52.7**	**52.0**	**47.5**	**43.3**	**39.5**	**27.1**	**12.1**	**49.2**	**40.4**
of which: external debt	**28.2**	**30.4**	**28.2**	**28.0**	**30.1**	**32.8**	**30.9**	**27.9**	**24.4**	**15.0**	**9.8**	**24.6**	**24.1**
Change in public sector debt	2.1	3.1	-2.7	-3.4	-0.7	-0.7	-4.4	-4.2	-3.8	-1.7	-1.5		
Identified debt-creating flows	**-1.5**	**0.2**	**-4.3**	**-6.6**	**-4.6**	**-3.4**	**-3.9**	**-3.4**	**-3.0**	**-1.0**	**-1.2**	**-3.7**	**-3.1**
Primary deficit	**4.5**	**4.0**	**3.3**	**2.6**	**1.6**	**0.4**	**0.0**	**-0.2**	**-0.7**	**-0.3**	**-0.8**	**2.4**	**0.1**
Revenue and grants	14.7	13.1	12.8	12.5	13.8	14.9	15.2	15.4	15.4	15.0	14.8	**15.2**	**14.8**
of which: grants	0.7	0.8	1.2	0.9	0.8	0.6	0.7	0.7	0.7	0.5	0.3		
Primary (noninterest) expenditure	19.2	17.0	16.1	15.1	15.4	15.3	15.2	15.2	14.7	14.7	14.0	**17.5**	**14.9**
Automatic debt dynamics	**-5.4**	**-3.4**	**-7.7**	**-8.7**	**-5.7**	**-3.4**	**-3.9**	**-3.3**	**-2.4**	**-0.8**	**-0.4**		
Contribution from interest rate/growth differential	-16.9	-11.0	4.3	-8.7	-5.7	-3.4	-3.9	-3.3	-2.4	-0.8	-0.4		
of which: contribution from average real interest rate	-11.9	-6.9	9.2	-5.4	-2.6	0.1	-0.3	0.3	0.5	0.9	0.2		
of which: contribution from real GDP growth	-5.0	-4.0	-4.9	-3.3	-3.1	-3.4	-3.6	-3.5	-2.8	-1.7	-0.6		
Contribution from real exchange rate depreciation	11.5	7.6	-12.0	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	**-0.6**	**-0.4**	**0.0**	**-0.5**	**-0.5**	**-0.4**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**-0.2**	**-0.1**
Privatization receipts (negative)	-0.6	-0.4	0.0	-0.5	-0.5	-0.4	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (liquid financial asset)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	**3.7**	**2.9**	**1.6**	**3.2**	**3.9**	**2.7**	**-0.5**	**-0.7**	**-0.8**	**-0.6**	**-0.3**	**6.4**	**0.4**
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	**...**	**...**	**48.8**	**45.3**	**44.1**	**42.7**	**38.9**	**35.5**	**32.4**	**21.5**	**8.2**		
PV of public debt-to-revenue and grants ratio	**...**	**...**	**381.5**	**361.2**	**319.0**	**286.6**	**255.9**	**230.2**	**210.1**	**143.7**	**55.3**		
Debt service-to-revenue and grants ratio 3/	**78.0**	**93.8**	**102.1**	**29.5**	**29.4**	**26.0**	**36.3**	**33.4**	**43.0**	**55.4**	**22.8**		
Gross financing need 4/	15.4	15.8	16.4	5.8	5.1	3.9	5.5	5.0	5.9	8.0	2.6		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	10.2	7.7	9.0	6.2	6.1	7.0	7.5	8.0	7.0	6.2	4.6	**9.6**	**6.7**
Average nominal interest rate on external debt (in percent)	2.5	1.8	2.3	2.2	0.8	0.6	0.3	1.6	1.3	3.5	0.8	**1.6**	**1.6**
Average real interest rate on domestic debt (in percent)	-2.4	-5.2	-6.7	-11.4	-7.2	-3.6	-1.8	-0.1	0.8	3.1	3.1	**-7.6**	**-1.0**
Real exchange rate depreciation (in percent, + indicates depreciation)	78.7	36.9	-30.8	...	...	...	...	...	...	...	...	**16.1**	**...**
Inflation rate (GDP deflator, in percent)	7.9	11.5	12.5	18.4	13.8	10.2	8.5	8.4	8.3	8.2	8.4	**12.6**	**9.8**
Growth of real primary spending (deflated by GDP deflator, in percent)	9.8	-4.6	3.1	-0.1	8.0	6.3	6.7	8.3	3.4	6.0	4.6	**9.5**	**5.8**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	2.3	0.9	6.0	6.1	2.3	1.2	4.5	4.0	3.2	1.4	0.7	**3.1**	**2.8**
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**No**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: general government, SOEs (excl. Ethiopian airlines), and the central bank . Definition of external debt is Residency-based. Presented on fiscal year basis (e.g., 2020 referes to fiscal year ending in June 2020).

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 3. Ethiopia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2020–30

(In percent)

	Projections 1/										
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
PV of debt-to GDP ratio											
Baseline	18	20	22	21	19	17	15	14	12	11	9
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	18	18	19	19	19	18	18	18	18	18	17
B. Bound Tests											
B1. Real GDP growth	18	20	23	21	19	17	16	14	13	11	10
B2. Primary balance	18	20	24	23	20	19	17	15	14	12	11
B3. Exports	18	21	24	23	21	19	17	15	14	12	10
B4. Other flows 3/	18	22	26	25	22	21	19	17	15	13	12
B5. Depreciation	18	28	37	35	32	29	27	24	22	19	17
B6. Combination of B1-B5	18	22	25	24	21	20	18	16	14	13	11
C. Tailored Tests											
C1. Combined contingent liabilities	18	22	24	23	21	19	17	16	14	13	11
C2. Natural disaster	...	...	...	...	...	...	...	...	...	...	...
C3. Commodity price	...	...	...	...	...	...	...	...	...	...	...
C4. Market Financing	18	23	25	23	21	19	17	15	13	12	10
Threshold	40	40	40	40	40	40	40	40	40	40	40
PV of debt-to-exports ratio											
Baseline	**230**	**216**	**203**	**189**	173	150	135	121	107	94	81
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	**230**	**199**	175	176	180	163	162	161	158	155	152
B. Bound Tests											
B1. Real GDP growth	**230**	**216**	**203**	**189**	173	150	135	121	107	94	81
B2. Primary balance	**230**	**220**	**221**	**207**	**190**	167	151	137	122	108	95
B3. Exports	**230**	**256**	**298**	**278**	**255**	**224**	**202**	**182**	162	142	123
B4. Other flows 3/	**230**	**239**	**242**	**226**	**208**	**183**	167	150	133	117	102
B5. Depreciation	**230**	**216**	**247**	**230**	**212**	**187**	170	155	137	121	106
B6. Combination of B1-B5	**230**	**255**	**230**	**258**	**237**	**208**	**189**	170	151	132	115
C. Tailored Tests											
C1. Combined contingent liabilities	**230**	**233**	**221**	**208**	**192**	169	154	141	127	114	101
C2. Natural disaster	...	...	...	...	...	...	...	...	...	...	...
C3. Commodity price	...	...	...	...	...	...	...	...	...	...	...
C4. Market Financing	**230**	**216**	**203**	**190**	174	150	134	120	106	93	80
Threshold	180	180	180	180	180	180	180	180	180	180	180

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

Table 3. Ethiopia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2020–30 (concluded)

(In percent)

	Projections 1/										
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Debt service-to-exports ratio											
Baseline	**19.7**	**17.5**	14.6	13.0	13.5	**20.7**	13.5	12.2	12.6	12.4	11.7
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	**20**	15	11	10	11	**15**	10	10	10	10	10
B. Bound Tests											
B1. Real GDP growth	**20**	**17**	15	13	14	**21**	14	12	13	12	12
B2. Primary balance	**20**	**17**	15	14	14	**21**	14	13	13	13	13
B3. Exports	**20**	**20**	**20**	**18**	**19**	**28**	**18**	**17**	**18**	**18**	**17**
B4. Other flows 3/	**20**	**17**	15	14	14	**21**	14	13	14	14	13
B5. Depreciation	**20**	**17**	15	14	14	**21**	14	13	15	14	13
B6. Combination of B1-B5	**20**	**19**	**18**	**16**	**17**	**25**	**17**	**16**	**17**	**16**	**15**
C. Tailored Tests											
C1. Combined contingent liabilities	**20**	**17**	15	13	14	**21**	14	12	13	13	12
C2. Natural disaster	...	...	...	...	...	...	...	...	...	...	...
C3. Commodity price	...	...	...	...	...	...	...	...	...	...	...
C4. Market Financing	**20**	**17**	15	13	14	**22**	**15**	13	13	12	11
Threshold	15	15	15	15	15	15	15	15	15	15	15
Debt service-to-revenue ratio											
Baseline	13	12	11	10	10	16	10	9	10	10	9
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	13	11	8	8	8	11	8	7	8	8	8
B. Bound Tests											
B1. Real GDP growth	13	13	11	10	10	16	11	10	10	10	9
B2. Primary balance	13	12	11	10	10	16	11	10	10	10	10
B3. Exports	13	12	11	10	10	16	10	10	10	10	10
B4. Other flows 3/	13	12	11	10	10	16	11	10	11	11	10
B5. Depreciation	13	17	15	14	14	**23**	15	14	16	16	15
B6. Combination of B1-B5	13	12	11	10	10	16	11	10	11	11	10
C. Tailored Tests											
C1. Combined contingent liabilities	13	12	11	10	10	16	10	10	10	10	9
C2. Natural disaster	...	...	...	...	...	...	...	...	...	...	...
C3. Commodity price	...	...	...	...	...	...	...	...	...	...	...
C4. Market Financing	13	12	11	10	10	17	12	10	10	9	9
Threshold	18	18	18	18	18	18	18	18	18	18	18

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

Table 4. Ethiopia: Sensitivity Analysis for Key Indicators of Public Debt, 2020–30
(In percent)

		Projections 1/									
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
PV of Debt-to-GDP Ratio											
Baseline	45	44	43	39	36	32	29	27	25	23	22
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	45	44	41	37	33	30	27	25	23	21	20
B. Bound Tests											
B1. Real GDP growth	45	45	45	41	38	35	33	31	29	27	26
B2. Primary balance	45	46	48	44	40	37	34	31	29	27	25
B3. Exports	45	45	45	41	38	34	31	29	26	25	23
B4. Other flows 3/	45	46	47	43	40	36	33	31	28	26	24
B5. Depreciation	45	45	43	38	34	30	27	24	21	19	17
B6. Combination of B1-B5	45	43	44	40	36	33	30	27	25	23	21
C. Tailored Tests											
C1. Combined contingent liabilities	45	52	50	46	42	38	35	33	30	28	26
C2. Natural disaster	...	...	...	...	...	...	...	...	...	...	...
C3. Commodity price	...	...	...	...	...	...	...	...	...	...	...
C4. Market Financing	45	44	43	39	36	32	29	27	25	23	21
TOTAL public debt benchmark	55	55	55	55	55	55	55	55	55	55	55
PV of Debt-to-Revenue Ratio											
Baseline	361	319	287	256	230	210	192	180	164	154	144
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	361	315	278	243	217	197	180	167	154	144	135
B. Bound Tests											
B1. Real GDP growth	361	326	301	272	247	229	213	202	188	180	171
B2. Primary balance	361	332	323	289	261	239	220	206	189	178	166
B3. Exports	361	324	302	270	243	223	204	191	174	164	152
B4. Other flows 3/	361	336	317	284	256	235	216	202	184	173	160
B5. Depreciation	361	326	289	253	223	198	176	159	141	127	113
B6. Combination of B1-B5	361	312	294	261	234	213	194	180	164	152	140
C. Tailored Tests											
C1. Combined contingent liabilities	361	373	335	300	271	249	229	215	198	186	174
C2. Natural disaster	...	...	...	...	...	...	...	...	...	...	...
C3. Commodity price	...	...	...	...	...	...	...	...	...	...	...
C4. Market Financing	361	319	287	256	230	210	192	179	163	154	143
Debt Service-to-Revenue Ratio											
Baseline	30	29	26	36	33	43	44	44	49	52	55
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2020-2030 2/	30	29	24	32	28	35	33	31	32	32	32
B. Bound Tests											
B1. Real GDP growth	30	30	27	38	36	46	47	48	53	56	61
B2. Primary balance	30	29	29	42	37	46	48	49	53	56	59
B3. Exports	30	29	26	37	34	43	44	45	49	52	56
B4. Other flows 3/	30	29	26	37	34	43	44	45	50	53	57
B5. Depreciation	30	28	26	36	33	43	43	42	46	49	52
B6. Combination of B1-B5	30	28	26	38	34	43	44	44	48	51	54
C. Tailored Tests											
C1. Combined contingent liabilities	30	29	37	41	37	49	50	50	54	57	60
C2. Natural disaster	...	...	...	...	...	...	...	...	...	...	...
C3. Commodity price	...	...	...	...	...	...	...	...	...	...	...
C4. Market Financing	30	29	26	36	34	44	45	45	49	51	55

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

INTERNATIONAL MONETARY FUND

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

2019 ARTICLE IV CONSULTATION AND REQUEST FOR THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND AN ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—INFORMATIONAL ANNEX

December 11, 2019

Prepared by The African Department
(In collaboration with other departments)

CONTENTS

RELATIONS WITH THE FUND

(As of October 31, 2019)

Membership Status: Joined: December 27, 1945 Article XIV

General Resources Account:	**SDR Million**	**% Quota**
Quota	300.70	100.00
IMF's holdings of currency (holdings rate)	293.26	97.53
Reserve Tranche Position	7.51	2.50

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	127.93	100.00
Holdings	3.95	3.09

Outstanding Purchases and Loans:	**SDR Million**	**% Quota**
ESF Arrangement	20.06	6.67

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ESF	Aug 26, 2009	Nov 22, 2010	153.76	153.76
ECF [1]	Mar 22, 2001	Oct 31, 2004	100.28	100.28
ECF [1]	Oct 11, 1996	Oct 22, 1999	88.47	29.49

Overdue Obligations and Projected Payments to Fund [2]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2019	2020	2021	2022	2023
Principal	8.02	12.03			
Charges/Interest	0.27	1.01	1.01	1.01	1.01
Total	8.29	13.04	1.01	1.01	1.01

Implementation of HIPC Initiative:	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	November 2001
Assistance committed	
by all creditors (US$ million)[3]	1,982.20
of which: IMF assistance (US$ million)	60.85

[1] Formerly PRGF

[2] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

[3] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence, these two amounts cannot be added.

(SDR equivalent in millions)	45.12
Completion point date	April 2004
Disbursement of IMF assistance (SDR million)	
Assistance disbursed to the member	45.12
Interim assistance	10.28
Completion point balance	34.84
Additional disbursement of interest income[4]	1.54
Total disbursements	46.66

Implementation of Multilateral Debt Relief Initiative (MDRI):

I.	MDRI-eligible debt (SDR million)[5]	112.07
	Financed by: MDRI Trust	79.66
	Remaining HIPC resources	32.41
II.	Debt Relief by Facility (SDR million)	

		Eligible Debt	
Delivery Date	**GRA**	**PRGT**	**Total**
January 2006	N/A	112.07	112.07

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

As of February 4, 2015, the post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

Exchange Rate Arrangement

Since July 2018 the birr followed a depreciating trend within a 2 percent band against the U.S. dollar. Accordingly, the de-facto exchange rate arrangement was reclassified as “crawl-like” from “stabilized” arrangement, effective July 27, 2018. The authorities describe their exchange rate regime as a managed float with no predetermined path for the exchange rate. The pace of depreciation of the nominal exchange rate, however, has recently increased. The NBE continues to supply foreign exchange to the interbank market based on plans prepared at the beginning of each fiscal year, which take into account estimates of supply and demand. The transaction-weighted average interbank market exchange rate as of November 19, 2019, is Br 29.8372 = US$1. Ethiopia maintains four restrictions on payments and transfers for current international transactions, which relate to: (i) the tax certification requirement for repatriation of dividend and other investment income; (ii) restrictions on repayment of legal external loans and suppliers of foreign partners credits; (iii) the prioritization and rationing of foreign exchange to certain imports of goods and services, debt payments and invisibles, and (iv) the requirement to provide a clearance certificate from the NBE to

[4] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

[5] The MDRI provided 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

obtain import permits. These restrictions are inconsistent with Article VIII, Section 2(a), of the IMF's Articles of Agreement and remain unapproved. In October 2017, the NBE introduced a requirement for all commercial banks to surrender 30 percent of their gross foreign exchange inflows to the central bank. The requirement is not assessed to give rise to an exchange restriction.

Safeguards Assessment

The National Bank of Ethiopia (NBE) was subject to an update safeguards assessment in 2009 (previous assessment was completed in 2001). The updated assessment found improved financial reporting and internal audit practices. Notwithstanding these developments, the assessment noted significant weaknesses. Recommendations focused on strengthening oversight of risks and controls, improving accounting records and the external audit process, and legal amendments to address safeguards weaknesses in the Central Bank Law. Since then, some progress has been reported on the outstanding safeguards recommendations, particularly the establishment of an audit committee, and capacity building for the internal audit function. Staff has recently received audited financial statements for the previous years together with the management letters issued by the NBE's external auditor up to fiscal year 2016/17. A full set of the finalized audited financial statements has now been published on the NBE's website. The finalization of the financial report for 2017/18 and the associated audit report has been delayed due to the adoption of IFRS-compliant reporting standards. The NBE expects to post these once the audit has been completed.

Article IV Consultation

Ethiopia is on the standard 12-month consultation cycle, in accordance with the Decision on Article IV Consultation Cycles (Decision No, 14747-(10/96), 9/28/2010). The last consultation was concluded on November 30, 2018.

Technical Assistance (FY2019–present)

Ethiopia is rated as a high intensity TA recipient, with most provided through the regional center in East Africa. In FY 2019 Ethiopia received 39 TA missions. Ongoing and planned HQ TA focuses on tax policy and administration, PFM, improvements in statistics, financial development and central bank operations. With respect to external sector statistics, Ethiopia is part of the 5-year UK DFID funded Enhanced Data Dissemination Initiative 2 (EDDI2) Project for balance of payments module 1, which ends in 2020. As part of this project by way of sustained TAs and regional workshops, the NBE has started improving the coverage and quality of external sector statistics.

Recently, a long-term resident expert (LTX), funded by DfID, was placed at the National Bank of Ethiopia (NBE) to [provide advice, training and strengthen capacity in modernizing central banking operations, and developing functioning foreign exchange and government securities markets.] The LTX's work is expected to be supplemented by targeted TA provided by short-term experts. At the authorities' request, the Fund continues to provide TA on tax policy and revenue administration reforms to support revenue mobilization efforts, including by streamlining tax expenditures. New TA will also be provided in calendar year 2020 on the development of a public sector balance sheet, and public investment management. Future TA could also address weaknesses in data reporting to the fund, with a particular focus on improving the reliability and comprehensiveness of national accounts, fiscal data, and monetary and financial statistics and enhance the transparent dissemination of key economic statistics.

Table 1. The Federal Democratic Republic of Ethiopia: Fund Technical Assistance

Department	Purpose	Time of Delivery
FAD	Cash Forecasting and Management	September 2018
FAD	Training on Fiscal Risk Identification and Drafting a Fiscal Risk Statement	March 2019; August 2019
FAD	Training on Tax Policy and Revenue Forecasting	July 2018
FAD	Revenue Administration: VAT Gap Assessment	October 2018; April 2019
FAD	Revenue Administration: Customs Administration	November 2018; July 2019; November 2019
FAD	Revenue Administration: Tax Audit	July 2019; November 2019; March 2020
FAD	Revenue Administration: Governance Structure	November 2019
FAD	Revenue Administration: IT Strategy	November 2019
FAD	Tax Policy: Review of Property and Trade Taxes	February 2019
FAD	Tax Policy: Diagnostic Tax Policy Assessment	September 2019
FAD	VAT reform and legal drafting	July 2019; October 2019
FAD	Gender Budgeting	September 2019
FAD	Public Financial Management: Public Sector Balance Sheet Development	March 2020
MCM	Implementing Risk-Based Supervision Integrating Bank Supervisory Systems	June 2018
MCM	Implementing Basel II	April 2019
MCM	Monetary Policy Implementation Framework, Foreign Exchange and Financial Market Issues	March 2019; May 2019; July 2019; September 2019
MCM	Money and Foreign Exchange Markets and Instruments	September 2018
MCM	Oversight Training for Payments and Settlements Systems	August 2018
STA	Balance of Payments Statistics and International Investment Position (EDDI2)	November 2018
STA	Developing methodology and data sources for compiling construction prices	June 2018
STA	e-GDDS (EDDI2)	February 2019
STA	Government Financial Statistics TA mission and training to support compilation of BCG data	November 2018; January 2019
STA	Monetary and Financial Statistics (FSSF)	January 2019
STA	Training (in-country): National Accounts/Developing quarterly GDP by expenditure	April 2019

Resident Representative: Jules Leichter was appointed as IMF Resident Representative to Ethiopia in March 2019.

JOINT MANAGEMENT ACTION PLAN, JULY 2019–JUNE 2020

(As of October 31, 2019)

Title	Products	Provisional and Actual Timing of Missions	Expected and Actual Delivery Date
	A. Mutual Information on Relevant Work Program		
The World Bank work program in the next 12 months	**Economic Policy Analysis and Advice**		
	• Public Expenditure and Financial Accountability Assessment	Ongoing	December 2019
	• Ethiopia Economic Update	Ongoing	June 2020
	• Public Procurement System Assessment	Ongoing	June 2020
	• Poverty, employment, and inclusion assessment	Ongoing	May 2020
	Technical Assistance		
	• Public Investment Management	November 2019	November 2020
	• Fiscal risks and contingent liabilities	December 2019	June 2020
	• Support to tariff reforms in preparation for WTO accession	February 2020	June 2022
	• Financial Deepening and Development Program	November 2019	March 2020
	• Government Bond Market Development	Ongoing	February 2020
	• Strengthening Accountability and Integrity in Ethiopia	Ongoing	May 2020
	• Managing Public Resources for Improved Service Delivery	Ongoing	June 2020
The Fund work program in the next 12 months	**Macroeconomic Policy Analysis and Advice**		
	• Article IV Consultation	October 2019	October 2019
	IMF Program		
	• ECF/EFF Negotiations	October/ November 2019	October/November 2019
	• ECF/EFF First Review	March 2020	March/April 2020

	Technical Assistance • Revenue Administration • Financial Market Development • Monetary and Financial Statistics • Government Finance Statistics • Financial Supervision: Basel II Implementation	 November 2019 September 2019 April 2020 May 2020 November 2019	 November 2019 October 2019 April 2020 May 2020 January 2020
B. Mutual Information on Relevant Work Program			
Fund request to Bank	• Periodic update on all TA activities • Macroeconomic and financial data to be shared regularly • Participating in reviews of key analytical work	Ongoing	Ongoing
Bank request to Fund	• Periodic update on all TA activities • Macroeconomic and financial data to be shared regularly • Letter of Assessment to support proposed lending operations	Ongoing December 2019	Ongoing December 2019
C. Agreement on Joint Products and Missions			
Joint products in the next 12 months	• Debt Sustainability Analysis (DSA)	November 2019	November 2019

STATISTICAL ISSUES

(As of November 19, 2019)

I. Assessment of Data Adequacy for Surveillance

General: Data provision is broadly adequate for surveillance. However, in 2018/19 some data reported to the Fund were subject to considerable delays and revisions. The existing data weaknesses reflect capacity constraints and the authorities are seeking to address them through technical assistance (TA).

National Accounts: Deficiencies in the source data and compilation practices affect the accuracy and reliability of the GDP statistics. Weaknesses are particularly evident in respect to the estimation of output in key sectors, including agricultural production, and in private consumption, saving, investment, and fixed capital formation. The statistical discrepancies between the expenditure categories and output remain significant. Information provided to the Fund is subject to discrepancies. Policymaking and surveillance would benefit from improving national accounts statistics.

The authorities have been receiving TA on national accounts through AFRITAC East. The last mission on April 2019 supported the development of quarterly GDP by expenditure. The annual GDP was recently rebased to 2015.

Government finance statistics: Despite some improvements, the general government operation data continue to be affected mainly by limited institutional coverage. Data for the general government are based on Government Finance Statistics Manual (GFSM) 1986 although some recent progress has been made to compile budgetary central government data that follows the GFSM 2014. Establishing a framework for compiling and disseminating Government Finance Statistics and public-sector debt statistics that meet GFSM 2014 has been initiated through support from AFRITAC East. Lack of consolidation of extra-budgetary funds into comprehensive fiscal reporting hinders proper assessment of the Government's fiscal stance, savings, and borrowing requirement. Current financial statements of public enterprises and other information on their operations is not available.

Monetary statistics: Monetary and financial statistics (MFS) have not been reported to STA since 2010. The authorities have not yet reported MFS using the Standardized Report Forms (SRFs) and existing MFS data are compiled with deviations from the recommended methodology, such as lack of detailed currency and sectoral breakdown of financial instruments. Data for Other Financial Corporations are not reported. Monetary survey data for both the central bank and commercial banks are subject to frequent delays in reporting for surveillance. Data from commercial banks is subject to significant revisions. Financial Access Survey data have not been reported since 2012.

Financial statistics: Aggregate set of Financial Soundness Indicators (FSIs) neglect many core indicators. In addition, information gaps, e.g.: commercial banks' income statements, information on distribution of non-performing loans (NPLs) by sector, NPL provisions, maturity of credit, net open position, have implications for conducting an assessment of financial sector risks.

Balance of payments: As part of the DFID funded EDDI2 Project, the National Bank of Ethiopia has been receiving continued TA. Steps have been taken towards enhancing source data and improving the quality of balance of payments estimates. However, progress is stalled by limited staff resources, high staff turnover, and financial constraints. In September 2017, the NBE launched a pilot direct investment survey. The second round of the survey was conducted in September 2018. However, due to low response rate and inadequate coverage, the survey results could not be integrated in the balance of payments. If the survey is implemented on a regular basis with a good coverage of key enterprises, the accuracy of external sector statistics could be improved significantly.

I. Data Standards and Quality

Ethiopia has implemented the enhanced General Data Dissemination System (e-GDDS) by launching a National Summary Data Page (NSDP) in August 2019. However, accompanying metadata have not been updated since 2008. No Report on the Observance of Standards and Codes has been completed.

Table 1. The Federal Democratic Republic of Ethiopia: Table of Common Indicators Required for Surveillance

(As of November 19, 2019)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange rates	12/6/2019	11/19/2019	D	D	D
International reserve assets and reserve liabilities of the monetary authorities [1/]	9/30/2019	11/4/2019	M	M	M
Reserve/base money	9/30/2019	11/4/2019	M	M	M
Broad money	9/30/2019	11/4/2019	M	M	M
Central bank balance sheet	9/30/2019	11/4/2019	M	M	M
Consolidated balance sheet of the banking system [2/]	9/30/2019	11/4/2019	M	M	Q
Interest rates [3/]	6/30/2019	9/13/2019	M	M	M
Consumer price index	10/31/2019	11/4/2019	M	M	M
Revenue, expenditure, balance, and composition of financing [4/] — central government	7/7/2019	10/29/2019	M	M	M
Revenue, expenditure, balance, and composition of financing [4/]— general government [5/]	7/7/2019	10/29/2019	Q	Q	Q
Stocks of central government and central government-guaranteed debt [6/]	6/30/2019	9/30/2019	Q	Q	Q
External current account balance	6/30/2019	11/4/2019	Q	Q	Q
Exports and imports of goods and services	6/30/2019	11/4/2019	M	M	M
GDP/GNP	6/30/2019	10/28/2019	A	A	A
Gross external debt	6/30/2019	9/30/2019	Q	Q	Q
International investment position [7/]	...	...	N/A	N/A	N/A

[1/] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2/] The authorities provide aggregate balance sheet items but not detailed enough for proper financial stability analysis.

[3/] Both market-based and officially determined, including discount rates, money market rates, and rates on treasury bills, notes, and bonds.

[4/] Foreign, domestic bank, and domestic nonbank financing.

[5/] The general government consists of the central government and local governments.

[6/] Including currency and maturity composition.

[7/] Reflecting capacity constraints which the authorities are addressing through technical assistance.