April 24, 2020
Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
700 19th St, NW
Washington, DC 20431
USA

Dear Managing Director:

Before the COVID-19 pandemic hit Ethiopia, our economy was healthy, and we had made good progress under the ECF-EFF arrangements with the IMF. When the shock materialized, the impact was felt well before our country’s first case was confirmed on March 13: export industries, including air travel, were under pressure, and demand for tourism and hospitality services plummeted. Our preliminary estimates suggest that projected growth rates could decline by around 3 percentage points during 2019/20. The impact for 2020/21 could be of a similar order of magnitude but would depend on how the pandemic evolves and corrective measures taken. While the impact on our largely rural and subsistence based agricultural sector should be limited, secondary and tertiary activities—especially tourism and hospitality services—are likely to be hit across the board. The risks to these projections are slanted heavily to the downside.

It is difficult at this stage to fully and accurately assess the impact of the pandemic on the budget. However, expenditures to directly fight COVID-19 in Ethiopia, as well as to support the economy and provide for affected households, are currently expected to entail additional spending of around 1.6 percent of GDP. These costs could rise if the crisis deepens. Specific measures include emergency food distribution ($635 million, 0.6 percent of GDP), health sector support ($430 million, 0.4 percent of GDP) and emergency shelter and non-food items ($282 million, 0.3 percent of GDP), with the remainder allocated to agricultural sector support, nutrition, the protection of vulnerable groups, additional education outlays, logistics, refugee support, and site management support.

The policies we are undertaking to address the crisis will make it necessary to delay our ambitious multi-year fiscal consolidation plan for the general government. We project that the fiscal deficit will rise by some 1.5 percent of GDP in 2019/20 and by 1.3 percent of GDP in 2020/21 relative to IMF staff projections at the time of ECF-EFF approval in December. We would like to highlight, however, that we see the spending increases as strictly temporary and remain committed to the multi-year fiscal adjustment plan under the ECF-EFF arrangements. In this context, and to partially offset the impact of the general government deficit increase on overall public sector debt, we have further constrained spending plans for SOEs that are not engaged in implementing emergency response measures to the pandemic for this year and next.

We commit to a transparent and accountable delivery of policy measures to respond to COVID-19 health and economic challenges and to effectively mitigate corruption concerns. Targeted measures
will include (i) publishing all public contracts related to the COVID-19 response, using open and competitive bidding and strictly limiting the use of emergency non-competitive processes to the extent possible; (ii) publishing online eligibility criteria and budgeted limits for the various relief measures as soon as they are adopted; (iii) channeling donor funding through the budget with full transparency on its utilization; (iv) frequent monitoring of spending on crisis mitigation measures at the end of each month for the duration of the crisis; and (v) making information on how emergency relief funds are spent available to internal auditors and, as soon as practicable, to independent auditors to conduct ex-post audits over COVID-19 related spending and revenue collection.

We also remain committed to strengthening debt sustainability. The first phase of reprofiling we committed to under the ECF-EFF arrangements is expected to be finalized in April. The total cashflow relief under this phase is projected to amount to US$1.65 billion until FY 2022/23. Under the current global context, progress on the second phase is uncertain, but we continue to work toward getting specific and credible financing assurances ahead of the first review.

The National Bank of Ethiopia (NBE) has already undertaken important steps to maintain financial stability during the crisis. This includes redeeming NBE bills held by private banks and providing access to its standing liquidity facility to ensure that adequate liquidity buffers are being maintained. The NBE will also provide additional liquidity to the Commercial Bank of Ethiopia as the bank’s already tight structural liquidity conditions are being exacerbated by the COVID-19 economic shocks. While it is difficult to predict how the COVID-19 shock will affect the inflation trajectory, we will stand ready to adjust our policy stance as needed to ensure that the single-digit inflation objective can be achieved as anticipated at ECF-EFF approval.

We also remain committed to the policies under the ECF-EFF arrangements with the IMF and plan to continue implementing the reforms as conditions permit. This will include gradually ending financial repression through increased T-bill issuances, ceasing new DBE financing from the NBE and gradually reducing direct NBE advances to the government. It also implies continuing to work toward a market clearing exchange rate by steadily reducing overvaluation, strengthening reserve accumulation and implementing the FX roadmap to be finalized in April. In addition, we will continue working toward a solution for SOE debts, where these companies are not able to service their debts themselves, and to strengthen bank balance sheets. Finally, we remain committed to reforms to strengthen governance under the ECF-EFF arrangements, including through publishing the consolidated financial performance report covering all state-owned enterprises supervised by the Public Enterprise Holding and Administration Agency (PEHAA), and by carrying out a Public Investment Management Assessment in cooperation with the IMF. In the context of the ongoing safeguards assessment, we remain committed to following up on IMF staff’s recommendations. We will also provide IMF staff with access to the central bank’s most recently completed external audit reports and authorize its external auditors to hold discussions with Fund staff.

We also commit not to introduce or intensify exchange and trade restrictions and other measures or policies that would compound these difficulties. We have engaged in discussions with some foreign investors regarding potential FX convertibility guarantees that could catalyze foreign investment and reduce FX shortages in the short-term. We underscore that this decision does not undermine in any
way our commitment to moving decisively to achieving a market-clearing exchange rate. We also commit to introducing the necessary safeguards in these contracts, in consultation with IMF staff, to avoid contingent claims on foreign exchange during the ECF-EFF arrangements as well as any risk that such contracts could constitute exchange restrictions or intensifications thereof.

Our external accounts are expected to weaken as a result of COVID-19. The projected drop in import demand, and the strengthening in our terms of trade, are expected to more than offset weaker export demand and remittances in our current account this fiscal year. However, paired with the expected large decline in foreign direct investment, the overall balance of payments is set to weaken relative to projections at the time of ECF-EFF approval, thus opening up a sizable financing gap. We intend to fill this gap by reducing reserve accumulation and seeking assistance from our development partners.

Against this backdrop and given the urgent balance of payments financing need facing our country due to the pandemic, we request emergency financing from the IMF under the Rapid Financing Instrument (RFI) of SDR300.7 million, equivalent to 100 percent of our quota. We request that the funds be disbursed entirely as budget support. In view of this, a memorandum of understanding will be established between the government and the NBE on their respective responsibilities for servicing financial obligations to the IMF. The purchase will help fill our expected fiscal financing gap and strengthen international reserves. IMF involvement in Ethiopia’s response to this emergency will also likely act as a catalyst for additional financing from other development partners. We also request a rephasing of access under our ECF-EFF arrangements and a reduction of access under the EFF arrangement (by SDR 150.35 million, or 50 percent of quota) to accommodate delays in the completion of the forthcoming review and to comply with the applicable annual access limit policies.

In addition, we request grant assistance under the Catastrophe Containment (CC) window of the Catastrophe Containment and Relief Trust (CCRT) to cover our debt service to the IMF falling due from the date of approval of the grant assistance to April 13, 2022. This debt relief will free up budgetary resources to address public health needs and support economic activity in key sectors and will also help contain the exceptional balance of payments need resulting from the pandemic. To further free up resources for our COVID-19 response, we intend to request debt service relief from official bilateral creditors under the recently announced G20 debt service relief initiative.

We authorize the IMF to publish this Letter and the staff report for the request for the purchase under the RFI and grant assistance under the Catastrophe Containment (CC) window of the Catastrophe Containment and Relief Trust (CCRT).

Sincerely 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