November 2010
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The Federal Democratic Republic of Ethiopia: Second Review of the Arrangement under the Exogenous Shocks Facility—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Federal Democratic Republic of Ethiopia

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on November 12, 2010, with the officials of the Federal Democratic Republic of Ethiopia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 18, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- Supplements to the staff report.

- A Press Release summarizing the views of the Executive Board as expressed during its November 12, 2010 discussion of the staff report.

- A statement by the Executive Director for the Federal Democratic Republic of Ethiopia.

The document(s) listed below 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 *
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

Second Review of the Arrangement under the Exogenous Shocks Facility

(African Department in consultation with the Finance, Legal, Monetary and Capital Markets, and Strategy, Policy, and Review Departments)

Approved by Michael Atingi-Ego and Jan Kees Martijn

October 18, 2010

Relations with the Fund: The 2010 Article IV consultation and the first review under the Exogenous Shocks Facility (ESF) arrangement was concluded June 11, 2010, on a lapse-of-time basis. The Executive Board approved a 14-month arrangement under the high-access component of the ESF in the amount of SDR 153.76 million (115 percent of quota) in August 2009 and a short extension was approved in October 2010 to allow for completion of this second and final review and allow for the final disbursement. SDR 40.11 million (30 percent of quota) will become available upon completion of this review. The authorities have not, as of now, conveyed an interest in a successor arrangement with the Fund.

Program performance through the July 7, 2010, test date was satisfactory. All quantitative performance criteria were met with margins and the structural benchmarks were implemented. Inflation continues to ease and external reserves are being built-up. In the attached Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP), the authorities review program implementation and outline their policies for 2010/11.

Policy Discussions focused on a monetary policy framework for 2010/11 consistent with the objective of absorbing excess liquidity in the banking system by end-2010 and removing the bank-by-bank credit ceilings. The mission, in Addis Ababa during September 6–16, met with Prime Minister Meles Zenawi, Minister of Finance and Economic Development Sufian Ahmed, National Bank Governor Teklewold Atnafu, other senior officials, and representatives of the donor community and civil society. The mission team comprised Messrs. Mathieu (head), Honda, Kinoshita, Rayner (all AFR); Mr. Singh, resident representative, assisted. Ms. Teferra (Office of the Executive Directors) participated. Staff collaborated closely with the World Bank and the African Development Bank.

Exchange Regime: The de facto exchange rate regime is a crawl-like peg arrangement. The authorities describe their exchange rate regime as a managed float with no predetermined path for the exchange rate. Ethiopia remains under the Article XIV regime and maintains several exchange restrictions that are not consistent with Article VIII (see Informational Annex I).

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EXECUTIVE SUMMARY

Continued good progress has been made on macroeconomic stability and growth momentum remains strong. Inflation continues to ease in the mid-single digits. Reflecting buoyant exports, strong donor inflows, and financing from the Fund, international reserves are building up. Real GDP growth is estimated to have reached 8 percent in 2009/10. The fiscal stance was tightened with much lower domestic financing than targeted. Monetary policy was tightened considerably with reserve money growth reduced to single digits on lower credit to government. Excess liquidity in the banking system was significantly reduced.

The ESF arrangement remains on track. All of the quantitative performance criteria and indicative targets for July 7, 2010, were met with margins, the structural benchmarks were implemented and completion of the second and final ESF review is recommended.

The macroeconomic outlook for 2010/11 is broadly favorable. After the large devaluation of the currency on September 1, real GDP growth will rise to 8.5 percent, reflecting an anticipated bumper harvest and ongoing strong goods and services exports. The external current account balance would deteriorate as imports pick up, including a large aircraft purchase, and official transfers return to their historic levels. The key policy objectives are to keep inflation in single digits, to continue building international reserves, to implement a monetary policy that promotes monetization and financial deepening, and to maintain fiscal sustainability.

Fiscal policy in 2010/11 aims to continue the strong focus on physical and social infrastructure investment, while raising the revenue effort. The ongoing tax reform measures will help raise the general government tax revenue-to-GDP ratio further. On the expenditure side, capital outlays and social spending would rise while other outlays are maintained in relation to GDP. The fiscal stance is compatible with maintaining the low risk of public external debt distress and the authorities intend to continue effective control of public enterprise borrowing.

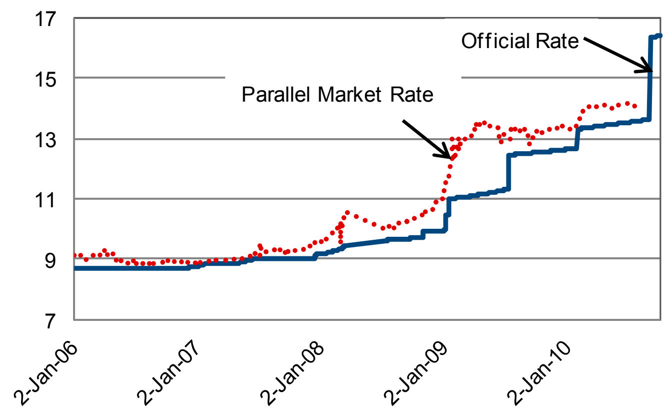
Monetary policy has recently been reframed to target reserve money in support of a monetization effort. Low reserve money growth, backed by a phasing out of new central bank direct credit to government, will enable the absorption of remaining excess liquidity by end-2010 and the removal of the bank-by-bank credit ceilings, shortly thereafter. To ensure monetization is accompanied by financial stability an upgrading of the NBE's supervision and regulation capacity is needed. An FSAP would provide a useful guide for financial sector.

The ESF-supported program has achieved its objectives of reducing inflation and rebuilding external reserves. However, much remains to be done to sustain and accelerate growth. A focus on the investment climate, trade and exchange liberalization, and financial sector development, anchored by sound fiscal and monetary policies, is essential to durable improvements in competitiveness and sustained high growth. A unification of the official and parallel exchange markets would free up significant efficiency gains. Creating more room for private sector activity would leverage the growth impact of the large public investment outlays on infrastructure.

I. Recent Developments and Performance under the Program

1. **Pressures on prices and international reserves have eased further, while strong growth momentum continues**. Real GDP growth is estimated to have reached 8 percent in 2009/10 (Table 1). Overall CPI inflation eased to 5.3 percent in August 2010, but non-food inflation remains high at 15.6 percent. Helped by strong donor inflows (and Fund resources) and macroeconomic adjustment, international reserves rose to 2.1 months of imports by end-2009/10, significantly more than originally targeted under the program, as goods and services exports have been buoyant. The authorities devalued the Birr by 16.5 percent on September 1 to remove an estimated overvaluation of the currency and promote competitiveness (Figure 1).[1] The size of the devaluation, which exceeded the parallel rate spread, surprised economic agents.

Figure 1. Ethiopia: Official and Parallel Exchange Rates
(Birr per US$)



2. **The ESF arrangement has remained on track**. All quantitative targets for July 7, 2010, were met with margins, and all structural benchmarks were implemented (MEFP Tables 1 and 2).

- **The fiscal stance** (MEFP ¶3) was tightened in 2009/10, with higher federal government revenues and much lower domestic financing than targeted (0.4 percent of GDP; Tables 2a, 2b, and 2c). This strong performance was made possible by the ongoing tax reform and strong economic growth.[2] The tax collection of Addis Ababa City was merged with the Ethiopian Revenue and Customs Authority (ERCA; September 2010 structural benchmark). Through the July 7, 2010, test date, the government contracted US$470 million in non-concessional debt for infrastructure, within the US$500 million ceiling.

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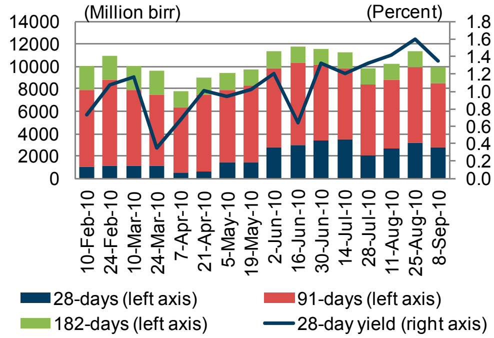
[1] At the time of the 2010 Article IV consultation staff estimates suggested that the exchange rate in 2010 Q1 was overvalued by about 7 percent, using the equilibrium real exchange rate approach, and by about 10 percent, using the macroeconomic balance approach (Box 4, IMF Country Report No. 10/175). The size of the devaluation effected in September was greater than staff estimates, but is broadly appropriate given the standard errors of the estimates, and that external reserves remain well below 3 months of imports.

[2] The government adopted a tax reform strategy in early 2010.

- **Reserve money** (MEFP ¶4) was tightened considerably with growth reduced to the single digits, on lower credit to government (Table 3). As a result, excess liquidity in the banking system was significantly reduced. This performance reflects some strengthening of liquidity management (June 2010 structural benchmark). Concurrently treasury-bill yields have been rising modestly in recent auctions, although insufficiently to result in positive real rates (Figure 2). The bank-by-bank credit ceilings were relaxed significantly in early July, but remain binding for most private sector banks.

Figure 2. Ethiopia: Treasury Bill Outstanding and Yield

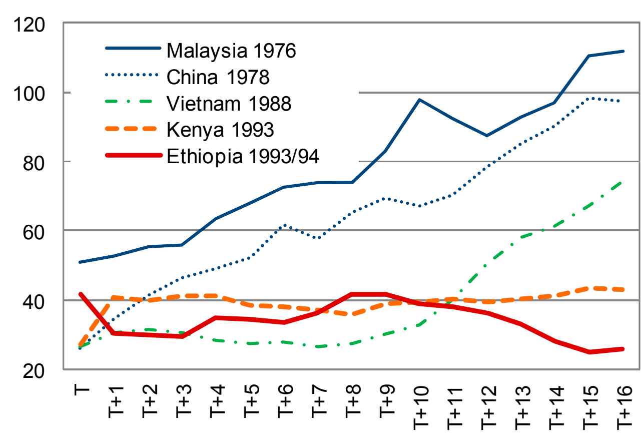


- On the **structural side** (MEFP ¶6), a high-level joint committee of the National Bank of Ethiopia (NBE) and the Ministry of Finance and Economic Development (MoFED) has monitored borrowing by the public enterprises (continuous benchmark). US$296 million of borrowing by the public sector was contracted in September 2010 (compared with a program ceiling of $500 million) to finance public infrastructure in hydro power and a further US$700 million is planned later in the year for shipping and productive investments. These borrowings do not materially affect the public external debt outlook, which remains at low risk of distress. The government adopted an action plan to strengthen national account statistics (August 2010 structural benchmark).

II. Policy Discussions

3. **Policy discussions focused on a monetary policy framework needed to absorb the excess liquidity in the banking system and abolish the bank-by-bank credit ceilings**. While the credit ceilings have contained credit growth and helped re-establish single digit inflation, they have contributed to financial repression and intermediation has not been able to play its fundamental role in supporting sustainably higher growth (Figure 3). The key macroeconomic objectives for 2010/11 remain to keep inflation in the single digits, to maintain a competitive exchange rate, continue to build international reserves, implement a monetary policy consistent with financial deepening, and maintain fiscal

Figure 3. Selected Sub-Saharan African and Asian Countries: Broad Money-to-GDP



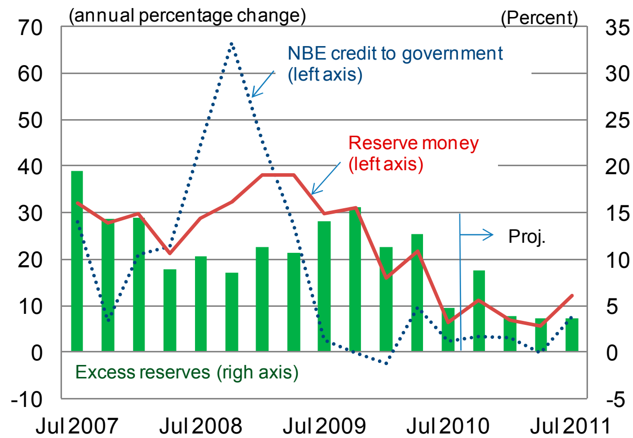
sustainability. These objectives will require low reserve money growth, made possible by the phasing out of direct credit to government.

4. **The macroeconomic outlook for 2010/11 is broadly favorable** (MEFP ¶7). Staff has raised somewhat the expected real GDP growth from that discussed in the 2010 Article IV consultation, to 8.5 percent, primarily reflecting an expected bumper harvest and higher exports, particularly of gold. Inflation may temporarily rise as a result of the large devaluation in September, but is expected to taper off to the single-digits. Broad money and credit to the economy are expected to rise strongly, once the credit ceilings are abolished, in a non-inflationary monetization and financial deepening driven by deposit mobilization.[3] The external current account balance would deteriorate as imports pick up, including a major aircraft purchase, and official transfers return to their historic levels (Table 4).

A. Reforming Monetary and Financial Policies to Promote Monetization

5. **Monetary policy has recently been reframed to target reserve money and end financial repression** (MEFP ¶10). As noted at the time of the 2010 Article IV consultation, Ethiopia's demonetization trend since 2001/02 can be traced to excessive liquidity injection caused by direct NBE credit to government, exacerbated by the bank-by-bank credit ceilings introduced in early 2009. The ceilings have, inter alia, resulted in excess demand for credit, heavy deadweight excess cash costs for banks, and are a constraint on competition. They also remove any incentive for banks to raise deposits. While staff recommended an early removal of the ceilings, the authorities were concerned about the cost of sterilization. Thus the program aims for near single digit reserve money growth, made possible by the phasing out of new credit to government that would permit the remaining excess liquidity to be absorbed by end-2010 (Figure 4). As the ceilings are associated with the fight against inflation in the public mind, the authorities argued that the ceilings be removed once single digit inflation has been entrenched. With a strong harvest expected in November, and the potential inflationary impact of the September devaluation contained by end 2010, the expectation is that the ceilings would be removed shortly after the excess liquidity has been absorbed (by end-2010), subject to confirmation that overall inflation remains in single digits.

Figure 4. Ethiopia: Reserve Money Growth and Excess Reserves



[3] Monetization refers to an increase in the broad money to GDP ratio, while financial deepening refers to the decline in the proportion of currency in broad money.

6. **To ensure that the expected monetization is accompanied by financial stability an upgrading of the NBE's supervision and regulation capacity is urgently needed**. Staff urged the authorities to enhance the ability of the NBE to recruit and retain qualified staff to ensure the institutional absorption of the technical assistance provided by the Fund and other partners in this area. The NBE is committed to modernizing reserve and liquidity requirements regulations by early 2011, and extending the maturity structure and the frequency of auctions for treasury securities. An FSAP would provide a useful guide for financial sector reforms and development.

B. Maintaining Fiscal Sustainability

7. **Fiscal policy in 2010/11 aims to continue the strong focus on physical and social infrastructure investment, while raising the revenue effort** (MEFP ¶8). The tax reform measures, combined with the positive impact of the exchange rate depreciation on custom duties and other taxes, are expected to raise general government tax revenue to at least 11.3 percent of GDP. The measures include the repeal of VAT exemptions on cement and some foods, the reduction in open-ended tax holidays and concessions, and the consolidation of the revenue administration at ERCA. On the expenditure side, capital outlays and social spending would rise while other outlays are maintained in relation to GDP. The general government budget deficit would rise to 2.5 percent of GDP, financed by a mix of external and domestic borrowing. If aid inflows or revenues exceed budgetary projections, the authorities intend to reduce domestic borrowing levels commensurately, as in 2009/10.

8. **The fiscal stance is compatible with maintaining the low risk of public external debt distress** (MEFP ¶9 and 12). While the external public debt to GDP ratio will jump to 25 percent of GDP in 2010/11, the risk of debt distress remains low on account of the outlook for continued strong (double digit) export growth and sustained high remittance (8−9 percent of GDP) levels. In addition to fiscal prudence, the authorities intend to continue effective control of public enterprise borrowing through their monitoring committee. The authorities are fully committed to keeping debt levels under close review, to ensuring that new borrowing is predominantly contracted on concessional terms, and that large foreign-financed projects are subject to rigorous economic appraisals. The authorities are also making progress in implementing the medium-term fiscal framework (MTFF) and preparing to introduce program-based budgeting (PBB) from 2011/12 with FAD technical support. A planned update of the debt management strategy is a welcome step to strengthen debt management.

C. Sustaining Growth Momentum over the Medium Term

9. **The medium-term growth outlook appears somewhat stronger than envisaged during the 2010 Article IV consultation**. Based on a much stronger performance in 2009/10 than anticipated, the medium-term export outlook has been raised on higher gold and service exports, and the growth profile had been raised to center around 8 percent with a recovery in private savings from recent historically low levels. A new 5-year development plan—the Growth and Transformation Plan (GTP)—is being finalized. It includes ambitious real growth objectives of at least 11 percent, with an aim of placing Ethiopia in the ranks of middle-income countries by

2025 (MEFP ¶13).[4] Staff encouraged the authorities to flesh out the structural reform priorities that would unleash a private sector growth response—encompassing financial sector, foreign exchange, and trade liberalization, as laid out in the 2010 Article IV consultation—needed to achieve the ambitious growth objectives. Much of the recent high growth experience has been based on public sector led infrastructure investment. Going forward the growth impact of this investment should be leveraged by allowing greater room for private sector activity. Staff underscored the need to have achievable macroeconomic objectives to frame fiscal and financial policies going forward.

III. Safeguards

10. **Some priority recommendations from the updated safeguards assessment, finalized in December 2009, have been implemented**. The assessment identified some issues relating to the oversight of the external and internal audit functions, and the review of program data. In response, the NBE established an Audit Committee; it will become fully functional once its charter is approved by the NBE board. The NBE also set up an independent review of monetary data submitted for program monitoring purposes by the NBE's internal auditors. All quantitative performance criteria data for this review submitted by the NBE have been verified by the internal auditors. A follow-up audit procedure has been developed, and internal and external auditors' findings and recommendations were addressed.

IV. Staff Appraisal

11. **Ethiopia has successfully implemented policies to reduce inflation and rebuild external reserves under the ESF-supported program**. Public sector domestic borrowing was dramatically reduced in 2010 compared to program targets, and the nominal exchange rate has been adjusted to improve competitiveness. The impact of the global recession has been mild, which has allowed for over performance on the external targets. Inflation has continued lower, reflecting monetary restraint, and aided by external factors and favorable weather conditions. However, progress in reducing non-food inflation will require sustained low reserve money growth. Staff welcomes the authorities' concern to maintain a competitive exchange rate, but notes that durably improving competitiveness requires structural reforms, in addition to supporting fiscal and monetary policy.

12. **Fiscal performance in 2009/10 has been strong and broadly appropriate**. Staff encourages the authorities to maintain the pace of tax reform, in order to durably raise fiscal revenue. In addition to creating fiscal space for the ambitious public investment plans, this effort will play a key supporting role in macroeconomic stability and the monetization of the economy.

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[4] Consultations with various stakeholders are ongoing. A complete document, which serves as a PRSP, is expected to be finalized in November. Once the document has been officially adopted, Fund and World Bank staff will prepare a Joint Staff Advisory Note.

Staff urges the authorities to strengthen further public debt management capacity, particularly regarding public enterprises to maintain the low distress risk outlook for public external debt.

13. **The recent reframing of monetary policy to adopt a reserve money nominal anchor holds out the prospect for the end of financial repression**. Staff welcomes the authorities' adoption of this framework, backed by a phasing out of direct credit to government. Maintaining low reserve money growth is necessary to sustain low inflation and allow for the early elimination of the bank-by-bank credit ceilings. Monetization and financial deepening are powerful forces for growth and economic development and essential for the mobilization of domestic savings that underpin macroeconomic stability and high rates of investment. Staff highlights the need to strengthen financial sector supervision and regulation, particularly in the context of an expected monetization. Staff reiterates the benefits of an FSAP evaluation as a vehicle to identify policies to promote financial sector development and stability.

14. **While the ESF-supported program has achieved its objectives of macroeconomic stabilization and a rebuilding of external reserves, much remains to be done to sustain and accelerate growth**. Staff stands ready to assist the authorities in elaborating a program that could be backed by a successor arrangement with the Fund. A focus on the investment climate, trade and exchange liberalization, and financial sector development, anchored by sound fiscal and monetary policies, is essential to durable improvements in competitiveness and sustained high growth. A unification of the official and parallel exchange markets would free up significant efficiency gains. Creating more room for private sector activity would leverage the growth impact of the large public investment outlays on infrastructure. Staff urges the authorities to build on recent progress and set fiscal and monetary policy within a cautious framework going forward.

15. **Staff recommends completion of the second ESF review**.

Table 1. Ethiopia: Selected Economic and Financial Indicators, 2008/09–2014/15 [1]

	2008/09	2009/10		2010/11	2011/12	2012/13	2013/14	2014/15
		Rev. prog.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Annual percentage change)							
National income and prices								
GDP at constant prices (at factor cost)	9.9	7.0	8.0	8.5	8.0	8.0	8.0	8.0
GDP deflator	24.4	4.9	8.3	8.9	7.3	6.5	6.1	6.1
Consumer prices (period average)	36.4	3.8	2.8	9.0	7.3	6.0	6.0	6.0
Consumer prices (end period)	2.7	10.5	7.3	9.8	6.0	6.0	6.0	6.0
External sector								
Exports, (In U.S. dollars, f.o.b.)	-1.0	16.4	38.3	16.6	17.4	19.3	16.3	16.4
Imports, (In U.S. dollars, c.i.f.)	13.4	12.7	7.0	16.5	12.9	4.7	10.1	10.2
Export volume	-1.2	3.1	11.0	14.1	16.2	14.8	13.8	13.9
Import volume	20.5	14.1	8.3	12.9	11.1	3.2	8.1	8.2
Terms of trade (deterioration –)	7.8	14.9	29.0	-1.1	-0.5	2.9	0.5	0.5
Nominal effective exchange rate (end of period)	-5.0	...	-8.0	…	…	…	…	…
Real effective exchange rate (end of period)	26.3	...	4.7	…	…	…	…	…
	(Percent of beginning-period stock of broad money, unless otherwise indicated)							
Money and credit								
Net foreign assets	11.3	2.3	9.6	6.6	…	…	…	...
Net domestic assets (including other items)	8.6	15.7	14.7	29.4	…	…	…	...
Broad money	19.9	18.0	24.3	36.0	…	…	…	...
Reserve money (annual percentage change)	29.9	10.3	6.5	12.3	…	…	…	...
Velocity (GDP/broad money)	4.01	3.85	3.83	3.35	…	…	…	...
Lending rates (maximum rate)	16.5	…	16.5	…	…	…	…	...
Treasury bill (91-day maturity)	0.9	…	0.9	…	…	…	…	...
	(In percent of GDP, unless otherwise indicated)							
Financial balances								
Gross domestic saving	6.6	4.6	5.4	3.5	5.0	8.9	11.2	14.9
Government saving	2.6	2.4	3.7	2.8	3.1	3.2	3.5	3.7
Private saving	4.0	2.2	1.7	0.6	1.8	5.7	7.7	11.2
Gross domestic investment	22.4	24.2	22.0	24.2	26.4	27.4	28.9	31.9
Government investment	17.5	16.3	15.1	16.6	17.0	16.6	16.0	16.3
Private investment	4.9	7.9	6.9	7.6	9.4	10.9	12.9	15.5
Resource gap	-15.8	-19.6	-16.6	-20.8	-21.4	-18.5	-17.7	-17.0
External current account balance, including official transfers	-5.0	-7.7	-3.9	-8.0	-8.3	-5.6	-5.2	-4.7
Government finances								
Revenue	12.0	14.1	13.4	13.4	13.6	13.8	14.0	14.2
Tax revenue	8.6	10.5	10.7	11.3	11.6	11.8	12.0	12.1
Nontax revenue	3.3	3.6	2.6	2.0	2.0	2.0	2.0	2.0
External grants	4.3	3.5	3.2	4.0	4.2	4.2	3.8	3.8
Expenditure and net lending	17.2	19.7	18.1	19.8	20.0	19.9	19.5	19.7
Fiscal balance, excluding grants (cash basis)	-5.2	-5.6	-4.7	-6.5	-6.3	-6.1	-5.5	-5.5
Fiscal balance, including grants (cash basis)	-0.9	-2.1	-1.5	-2.5	-2.2	-1.9	-1.7	-1.7
Total financing (including residuals)	0.9	2.1	1.5	2.5	2.2	1.9	1.7	1.7
External financing	0.9	1.2	1.0	1.0	0.9	0.8	0.7	0.7
Domestic financing (not including privatization)	-0.1	0.7	0.4	1.5	1.3	1.1	1.0	1.0
Public debt [2]	36.0	40.6	37.0	43.7	44.4	43.9	43.0	41.9
Domestic debt [3]	22.0	21.5	20.2	18.8	16.9	15.2	13.7	12.5
External debt (including to the IMF)	14.1	19.0	16.8	24.9	27.5	28.7	29.2	29.4
Overall balance of payments (in millions of U.S. dollars)	377	236	779	412	367	453	490	492
Gross official reserves (in millions of U.S. dollars)	1523	1901	2017	2291	2659	3112	3602	4094
(in months of imports of goods and nonfactor services of following year)	1.9	2.1	2.1	2.3	2.5	2.6	2.7	2.8
GDP at current market prices (in billions of birr)	336.1	380.1	399.2	474.1	550.2	633.4	726.6	833.8

Sources: Ethiopian authorities and IMF staff estimates and projections.

1. Except for data on external sector which is based on July 1-June 30, data pertain to the period July 8-July 7.
2. Including debt of major public enterprises.
3. The programmed figure in 2009/10 does not include some public enterprise debt.
4. After enhanced HIPC and MDRI relief.

Table 2a. Ethiopia: General Government Operations, 2008/09–2014/15
(MIllions of birr)

	2008/09	2009/10		2010/11		2011/12	2012/13	2013/14	2014/15
	Act.	Rev. prog.	Est.	Proj.	Rev. proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	54,627	67,015	66,022	74,583	82,054	97,864	114,323	129,382	149,869
Revenue	40,174	53,732	53,292	59,406	63,310	74,996	87,487	101,697	118,243
Tax revenue	28,998	40,019	42,831	48,770	53,735	63,789	74,584	86,895	101,258
Direct taxes	9,858	14,198	14,507	17,319	17,969	21,570	25,266	29,490	34,428
Indirect taxes	19,139	25,821	28,325	31,451	35,766	42,219	49,318	57,405	66,831
Domestic indirect taxes	7,325	9,626	10,640	11,993	12,707	15,000	17,570	20,508	23,942
Import duties and taxes	11,814	16,195	17,685	19,458	23,059	27,219	31,747	36,896	42,889
Nontax revenue	11,176	13,713	10,461	10,636	9,575	11,207	12,903	14,802	16,984
Grants	14,454	13,283	12,730	15,177	18,744	22,868	26,836	27,685	31,626
Emergency assistance (food and nonfood aid)	340	290	290	371	408	510	1,320	1,344	1,579
Program grants [1]	9,595	7,599	6,816	8,619	10,163	10,026	11,580	13,251	15,448
Project grants	4,518	5,394	5,624	6,187	8,173	12,332	13,936	13,090	14,599
Total expenditure and net lending (cash basis) [2]	57,774	74,873	72,056	89,783	93,982	109,833	126,176	141,604	164,050
Recurrent expenditure [2]	27,176	34,957	32,994	40,840	43,008	49,316	58,196	66,499	75,851
Defense spending	4,000	4,000	4,000	4,000	4,581	5,316	6,120	7,021	8,056
Poverty-reducing expenditure [3]	12,629	17,812	16,361	21,077	22,350	26,271	30,641	35,151	40,333
Interest payments	1,286	2,173	1,587	2,298	3,013	2,849	3,570	4,003	4,105
Domestic interest and charges	1,036	1,326	1,220	1,664	2,219	2,206	2,799	3,087	3,025
External interest payments	251	847	368	634	794	643	771	916	1,080
Emergency assistance (food and other emergency aid)	340	290	290	371	408	510	1,320	1,344	1,579
Other recurrent expenditure	8,921	10,682	10,755	13,094	12,656	14,370	16,545	18,980	21,778
Capital expenditure	30,599	39,916	39,062	48,943	50,974	60,518	67,980	75,105	88,199
Central treasury	22,713	29,516	28,992	34,543	35,522	42,464	48,353	56,220	66,523
External project grants	4,518	5,394	5,624	6,187	10,163	12,332	13,936	13,090	14,599
External project loans	3,368	5,006	4,446	8,213	5,290	5,722	5,690	5,795	7,077
Overall balance									
Including grants	-3,147	-7,858	-6,034	-15,200	-11,928	-11,969	-11,853	-12,222	-14,181
Excluding grants	-17,601	-21,141	-18,764	-30,377	-30,672	-34,837	-38,689	-39,907	-45,807
Financing	3,232	7,858	6,586	15,200	11,928	11,969	11,853	12,222	14,181
Net external financing	3,176	4,671	4,131	7,853	4,562	5,069	4,853	4,822	5,881
Gross borrowing	3,368	5,006	4,446	8,213	5,290	5,722	5,690	5,795	7,077
Amortization	-191	-335	-315	-360	-727	-653	-837	-973	-1,196
Total net domestic financing	-417	2,787	1,758	6,981	7,000	6,900	7,000	7,400	8,300
Privatization	472	400	697	366	366	0	0	0	0
Float/unidentified financing	-85	0	-552	0	0	0	0	0	0
Memorandum items:									
Poverty-reducing expenditure	43,064	52,230	52,505	61,285	65,280	76,088	87,998	100,951	115,833
External grants and loans (US dollars per capita)	24	21	21	22	22	22	22	24	24
Primary fiscal balance, including grants	-1,861	-5,685	-4,446	-12,902	-8,915	-9,120	-8,283	-8,219	-10,076
Domestic fiscal balance, including grants	-9,124	-9,604	-8,036	-14,972	-14,018	-15,630	-16,972	-18,762	-21,473
Gross domestic government debt	51,251	54,038	53,009	61,019	60,009	66,909	73,909	81,309	89,609

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

[1] Including the disbursements under the PBS operations starting from 2005/06.

[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.

Table 2b. Ethiopia: General Government Operations, 2008/09–2014/15
(Percent of GDP)

	2008/09	2009/10		2010/11		2011/12	2012/13	2013/14	2014/15
	Act.	Rev. prog.	Est.	Proj.	Rev. proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	16.3	17.6	16.5	16.8	17.3	17.8	18.0	17.8	18.0
Revenue	12.0	14.1	13.4	13.4	13.4	13.6	13.8	14.0	14.2
Tax revenue	8.6	10.5	10.7	11.0	11.3	11.6	11.8	12.0	12.1
Direct taxes	2.9	3.7	3.6	3.9	3.8	3.9	4.0	4.1	4.1
Indirect taxes	5.7	6.8	7.1	7.1	7.5	7.7	7.8	7.9	8.0
Domestic indirect taxes	2.2	2.5	2.7	2.7	2.7	2.7	2.8	2.8	2.9
Import duties and taxes	3.5	4.3	4.4	4.4	4.9	4.9	5.0	5.1	5.1
Nontax revenue	3.3	3.6	2.6	2.4	2.0	2.0	2.0	2.0	2.0
Grants	4.3	3.5	3.2	3.4	4.0	4.2	4.2	3.8	3.8
Emergency assistance (food and nonfood aid)	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2
Program grants [1]	2.9	2.0	1.7	1.9	2.1	1.8	1.8	1.8	1.9
Project grants	1.3	1.4	1.4	1.4	1.7	2.2	2.2	1.8	1.8
Total expenditure and net lending (cash basis) [2]	17.2	19.7	18.1	20.2	19.8	20.0	19.9	19.5	19.7
Recurrent expenditure [2]	8.1	9.2	8.3	9.2	9.1	9.0	9.2	9.2	9.1
Defense spending	1.2	1.1	1.0	0.9	1.0	1.0	1.0	1.0	1.0
Poverty-reducing expenditure [3]	3.8	4.7	4.1	4.7	4.7	4.8	4.8	4.8	4.8
Interest payments	0.4	0.6	0.4	0.5	0.6	0.5	0.6	0.6	0.5
Domestic interest and charges	0.3	0.3	0.3	0.4	0.5	0.4	0.4	0.4	0.4
External interest payments	0.1	0.2	0.1	0.1	0.2	0.1	0.1	0.1	0.1
Emergency assistance (food and other emergency aid)	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2
Other recurrent expenditure	2.7	2.8	2.7	2.8	2.7	2.6	2.6	2.6	2.6
Capital expenditure	9.1	10.5	9.8	11.0	10.8	11.0	10.7	10.3	10.6
Central treasury	6.8	7.8	7.3	7.8	7.5	7.7	7.6	7.7	8.0
External project grants	1.3	1.4	1.4	1.4	2.1	2.2	2.2	1.8	1.8
External project loans	1.0	1.3	1.1	1.8	1.1	1.0	0.9	0.8	0.8
Overall balance									
Including grants	-0.9	-2.1	-1.5	-3.4	-2.5	-2.2	-1.9	-1.7	-1.7
Excluding grants	-5.2	-5.6	-4.7	-6.8	-6.5	-6.3	-6.1	-5.5	-5.5
Financing	1.0	2.1	1.6	3.4	2.5	2.2	1.9	1.7	1.7
Net external financing	0.9	1.2	1.0	1.8	1.0	0.9	0.8	0.7	0.7
Gross borrowing	1.0	1.3	1.1	1.9	1.1	1.0	0.9	0.8	0.8
Amortization	-0.1	-0.1	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1
Total net domestic financing	-0.1	0.7	0.4	1.6	1.5	1.3	1.1	1.0	1.0
Privatization	0.0	0.1	0.2	0.1	0.1	0.0	0.0	0.0	0.0
Float/unidentified financing	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Poverty-reducing expenditure	12.8	13.7	13.2	13.8	13.8	13.8	13.9	13.9	13.9
Primary fiscal balance, including grants	-0.6	-1.5	-1.1	-2.9	-1.9	-1.7	-1.3	-1.1	-1.2
Domestic fiscal balance, including grants	-2.7	-2.5	-2.0	-3.4	-3.0	-2.8	-2.7	-2.6	-2.6
Gross domestic government debt	15.2	14.2	13.3	13.7	12.7	12.2	11.7	11.2	10.7

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

1 Including the disbursements under the PBS operations starting from 2005/06.

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.

Table 2c. Ethiopia: Federal Government Operations, 2008/09–2010/11
(Millions of birr)

	2008/09	2009/10			2010/11		
	Act.	Prog.	Proj.	Act.	Proj.	Budget	Rev. proj.
Total revenue and grants	46,376	54,145	59,581	56,469	63,967	64,282	70,169
Revenue	31,923	39,712	44,402	44,029	48,475	48,475	51,833
Tax revenue	23,215	30,180	33,480	35,310	41,100	41,100	44,458
Direct taxes	5,437	7,620	9,198	8,801		10,858	10,901
Indirect taxes	17,778	22,560	24,282	26,509		30,242	33,557
Domestic indirect taxes	5,964	7,518	8,087	8,824		9,811	10,498
Import duties and taxes	11,814	15,042	16,195	17,685		20,431	23,059
Nontax revenue	8,708	9,532	10,922	8,719	7,375	7,375	7,375
Grants	14,454	14,433	15,179	12,440	15,492	15,807	18,336
Program grants [1]	9,737	7,141	7,887	6,816	7,046	7,046	8,173
Project grants	4,717	7,292	7,292	5,624	8,446	8,761	10,163
Total expenditure (cash basis) [2]	32,386	42,492	45,292	42,947	51,052	52,402	57,695
Recurrent expenditure [2]	10,307	13,381	13,381	11,885	15,361	15,269	16,496
Defense spending	4,000	4,000	4,000	4,000	4,000	4,400	4,581
Poverty-reducing expenditure [3]	2,181	3,404	3,404	2,885	4,003	4,171	4,350
Interest payments	1,286	2,173	2,173	1,587	2,298	2,326	3,013
Domestic interest and charges	1,036	1,731	1,220	1,220	1,664	1,664	2,219
External interest payments	251	442	953	368	634	662	794
Other recurrent expenditure	2,840	3,805	3,805	3,412	5,060	4,372	4,552
Capital expenditure	22,079	29,111	31,911	31,062	35,691	37,133	41,199
Central treasury	14,193	19,404	22,204	20,992		23,812	25,747
External assistance	7,886	9,707	9,707	10,070		13,321	15,452
Regional transfers	16,556	20,933	20,933	19,556	24,750	23,556	24,402
Overall balance (including grants)	-2,565	-9,280	-6,645	-6,034	-11,835	-11,676	-11,928
Overall balance (excluding grants)	-17,019	-23,713	-21,824	-18,474	-27,327	-27,483	-30,264
Financing	2,565	9,280	6,644	6,034	11,835	11,676	11,928
Net external financing	3,176	3,457	3,457	4,131	4,489	3,954	4,562
Total net domestic financing	55	5,823	3,187	2,455	7,347	7,722	7,366
Domestic (net)	-417	5,823	2,787	1,758	6,981	7,356	7,000
Banking system	-857	5,823					
Nonbank sources	440	0					
Privatization	472	0	400	697	366	366	366
Float/unidentified financing	-666	0	0	-552	0	0	0

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

1 Including the disbursements under the PBS operations starting from 2005/06.

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.

Table 3. Ethiopia: Monetary Survey and Central Bank Accounts, 2008/09–2010/11[1]

	2009	2010				2011		
	July 7	July 7		Sep.	Dec.	Mar	July 7	
	Act.	Rev. prog.	Act.	Proj.	Proj.	Proj.	Proj.	Rev. proj.
				(Millions of birr)				
Monetary survey								
Net foreign assets	19,882	21,803	27,905	30,270	30,055	33,109	24,652	34,787
Central bank	13,934	15,574	15,895	17,443	16,398	18,611	18,423	19,436
Commercial banks	5,948	6,229	12,010	12,827	13,657	14,498	6,229	15,351
Net domestic assets	63,862	77,038	76,212	86,129	92,467	101,244	95,929	106,812
Domestic credit	89,549	105,821	105,331	114,618	122,650	133,133	128,432	139,651
Claims on government (net)[2]	33,312	36,099	34,695	37,370	38,445	41,320	42,080	40,195
Claims on nongovernment	56,236	69,722	70,636	77,248	84,206	91,814	86,352	99,457
Public enterprises	25,763	32,331	31,361	33,461	36,491	39,913	39,531	41,561
Private sector	30,474	37,391	39,276	43,788	47,715	51,901	46,821	57,896
Other items (net)	-25,687	-28,783	-29,119	-28,489	-30,183	-31,889	-32,503	-32,839
Broad money	83,744	98,841	104,117	116,399	122,522	134,353	120,581	141,599
Money	43,088	50,314	51,985	56,346	59,102	64,780	60,457	67,638
Currency outside banks	19,695	23,577	23,950	23,658	24,581	26,910	27,331	26,888
Demand deposits	23,393	26,737	28,034	32,689	34,521	37,870	33,126	40,750
Quasi money	40,656	48,527	52,133	60,053	63,420	69,573	60,124	73,961
Savings deposits	37,378	44,675	48,196	55,402	58,509	64,185	55,351	68,090
Time deposits	3,278	3,852	3,937	4,650	4,911	5,388	4,773	5,871
Central bank								
Net foreign assets	13,934	15,574	15,895	17,443	16,398	18,611	18,423	19,436
Foreign assets	17,895	26,483	26,805	28,353	28,353	30,565	30,185	31,390
Foreign liabilities	3,961	10,909	10,910	10,910	11,955	11,955	11,761	11,955
Net domestic assets	31,779	34,870	32,774	34,686	32,986	34,586	37,531	35,204
Domestic credit	35,599	38,386	36,421	38,221	36,921	38,921	41,367	39,171
Government (net)	35,599	38,386	36,421	38,221	36,921	38,921	41,367	39,171
Of which : sterilization					-1,500	0	-2,000	-750
Other items (net)	-3,820	-3,516	-3,647	-3,535	-3,935	-4,335	-3,836	-3,967
Reserve money	45,713	50,444	48,670	52,129	49,384	53,197	55,954	54,640
Currency outside banks	19,695	23,577	23,950	23,658	24,581	26,910	27,331	26,888
Commercial bank reserves	26,018	26,867	24,719	28,471	24,803	26,287	28,623	27,752
Cash in vault	4,272	6,380	4,977	5,061	5,144	5,227	6,510	5,310
Reserve deposit	21,746	20,488	19,742	23,411	19,660	21,060	22,113	22,441
				(Annual percentage change, unless otherwise indicated)				
Net foreign assets	66.2	9.7	40.4	55.0	44.5	31.0	13.1	24.7
Net domestic assets	10.3	20.6	19.3	27.4	31.4	43.3	24.5	40.2
Domestic credit	10.9	18.2	17.6	24.6	32.0	35.0	21.4	32.6
Claims on government (net)	-2.5	8.4	4.1	15.0	34.6	37.6	16.6	15.9
Claims on nongovernment	20.7	24.0	25.6	29.9	30.8	33.9	23.9	40.8
Public enterprises	34.4	25.5	21.7	21.8	30.4	35.0	22.3	32.5
Private sector	11.1	22.7	28.9	36.8	31.1	33.0	25.2	47.4
Broad money	19.9	18.0	24.3	33.6	34.4	40.0	22.0	36.0
Money	17.1	16.8	20.6	28.6	28.9	34.9	20.2	30.1
Quasi money	23.0	19.4	28.2	38.6	40.0	45.2	23.9	41.9
Memorandum items:								
Reserve money growth	29.9	10.3	6.5	11.2	6.9	5.7	10.9	12.3
Excess reserve deposit (billions of birr)	9,030	7,765	3,838	8,624	4,093	4,068	6,697	4,359
in percent of deposits	12.6	9.2	4.2	8.7	3.9	3.6	6.5	3.6
Money multiplier (broad money/reserve money)	1.83	1.96	2.14	2.23	2.48	2.53	2.15	2.59
Velocity (GDP/broad money)	4.01	3.85	3.83	…	…	…	3.68	3.35
Gross official foreign reserves (US$ millions)	1,581	1,901	1,979	2,074	2,074	2,205	2,175	2,254
Net foreign assets of NBE (US$ millions)	1,231	1,152	1,174	1,268	1,205	1,337	1,362	1,385
Birr per US dollar (end of period)	11.318	…	13.543	...	...	...	…	…
Currency-deposit ratio	0.307	0.313	0.299	0.255	0.251	0.250	0.293	0.234
Nominal GDP (billions of birr)	336,106	380,080	399,152	…	…	…	444,033	474,094

Sources: National Bank of Ethiopia; and IMF staff estimates and projections.

[1] Year ending July 7. Including commercial bank claims and liabilities to Eritrea.

[2] Claims on general government (federal and regional governments and other public agencies) by the banking system less deposits of the general government with the banking system.

Table 4. Ethiopia: Balance of Payments, 2008/09-2014/15

(Millions of U.S. dollars, unless otherwise indicated) [1]

	2008/09	2009/10		2010/11	2011/12	2012/13	2013/14	2014/15
	Est.	Rev. prog.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-1,620	-2,397	-1,222	-2,411	-2,627	-1,963	-1,970	-1,966
(Percent of GDP)	-5.0	-7.7	-3.9	-8.0	-8.3	-5.6	-5.2	-4.7
Current account balance, excl. official transfers	-3,194	-4,011	-3,136	-4,053	-4,517	-4,068	-4,186	-4,337
(Percent of GDP)	-9.9	-12.9	-10.1	-13.5	-14.2	-11.7	-11.0	-10.4
Trade balance	-6,279	-7,022	-6,266	-7,295	-8,131	-8,113	-8,727	-9,381
Exports of goods	1,448	1,685	2,003	2,335	2,742	3,271	3,805	4,429
Imports of goods	7,727	8,707	8,269	9,630	10,873	11,383	12,532	13,810
Of which: aircraft	0	73	73	650	1,050	560	560	560
Services (net)	419	424	513	572	885	1,243	1,588	1,936
Exports	1,934	1,850	2,044	2,278	2,783	3,352	3,930	4,548
Imports	1,514	1,426	1,531	1,707	1,899	2,109	2,342	2,611
Income (net)	-42	-109	-92	-96	-162	-195	-234	-249
Of which: gross official interest payments	-31	-86	-69	-85	-169	-235	-284	-311
Private transfers (net)	2,707	2,696	2,708	2,766	2,891	2,996	3,187	3,357
Official transfers (net)	1,574	1,614	1,915	1,642	1,890	2,105	2,215	2,372
Capital account balance	2,275	2,932	2,690	2,823	2,995	2,416	2,460	2,458
Foreign direct investment (net)	880	1,056	956	1,049	1,130	1,267	1,405	1,453
Other investment (net) [2]	1,395	1,696	1,554	1,774	1,865	1,149	1,056	1,005
Official long-term loans	1,533	1,469	1,327	1,794	1,878	1,134	1,078	1,053
Disbursements	1,581	1,554	1,412	1,959	2,076	1,444	1,509	1,599
Amortization	49	85	85	165	198	309	432	546
Monetary Authority	…	180	180	…	…	…	…	…
Errors and omissions	-277	-299	-690	0	0	0	0	0
Overall balance	377	236	779	412	367	453	490	492
Financing	-377	-236	-779	-412	-367	-453	-490	-492
Central bank (net; increase –)	-429	-301	-418	-212	-367	-453	-490	-492
Reserves (increase –)	-617	-377	-494	-275	-367	-453	-490	-492
Liabilities (increase +)	188	76	76	63	0	0	0	0
Commercial banks (net; increase –)	52	65	-361	-200	0	0	0	0
	(In percent change, unless otherwise indicated)							
Memorandum items:								
Exports of goods	-1.0	16.4	38.3	16.6	17.4	19.3	16.3	16.4
Export volume index	-1.2	3.1	11.0	14.1	16.2	14.8	13.8	13.9
Imports of goods	13.4	12.7	7.0	16.5	12.9	4.7	10.1	10.2
Import volume index	20.5	14.1	8.3	12.9	11.1	3.2	8.1	8.2
Services exports	21.0	-4.3	5.7	11.5	22.2	20.4	17.2	15.7
Services imports	2.9	-5.8	1.1	11.5	11.3	11.1	11.0	11.5
Exports of goods and services (percent of GDP)	10.5	11.6	13.1	15.4	17.4	19.0	20.4	21.6
Imports of goods and services (percent of GDP)	28.6	33.1	31.7	37.8	40.3	38.8	39.2	39.6
Gross official reserves (in millions U.S. dollars)	1,523	1,901	2,017	2,291	2,659	3,112	3,602	4,094
(Months of following year imports of G and S)	1.9	2.1	2.1	2.3	2.5	2.6	2.7	2.8
Terms of trade index	7.8	14.9	29.0	-1.1	-0.5	2.9	0.5	0.5

Sources: Ethiopian authorities and IMF staff estimates and projections.

1 Data pertain to the period July 1-June 30.

2 For 2008/09 and 2009/10, other investment (net) includes a correction for the timing difference between entry of ETC imports and corresponding loan disbursements.

Table 5. Ethiopia: Indicators of Capacity to Repay the Fund, 2009–20

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Fund obligations based on existing credit												
(in millions of SDRs)												
Principal	0.0	0.0	0.0	0.0	0.0	3.3	25.4	29.4	29.4	29.4	26.1	4.0
Charges and interest	0.3	0.1	0.2	0.6	0.6	0.6	0.5	0.5	0.4	0.3	0.3	0.2
Fund obligations based on prospective credit[1]												
(in millions of SDRs)												
Principal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	8.0	8.0	8.0	8.0	8.0
Charges and interest[2]	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Total obligations based on existing and prospective credit[2]												
In millions of SDRs	0.1	0.1	0.2	0.7	0.7	4.0	26.1	38.0	37.9	37.8	34.4	12.3
In millions of U.S. dollars	0.1	0.1	0.3	1.1	1.1	6.3	41.2	60.1	59.9	59.8	54.3	19.4
In percent of exports of goods and services	0.0	0.0	0.0	0.0	0.0	0.1	0.5	0.6	0.5	0.5	0.4	0.1
In percent of quota	0.0	0.0	0.2	0.5	0.5	3.0	19.5	28.4	28.4	28.3	25.7	9.2
In percent of gross international reserves	0.0	0.0	0.0	0.0	0.0	0.2	1.0	1.7	1.6	1.6	1.5	0.4
In percent of total external debt service	0.1	0.1	0.1	0.3	0.2	0.9	4.8	6.1	5.6	5.2	4.6	1.6
Outstanding Fund credit[1]												
In millions of SDRs	107.0	187.2	187.2	187.2	187.2	183.8	158.4	121.0	83.6	46.1	12.0	0.0
In millions of U.S. dollars	167.7	295.9	295.9	295.9	295.9	290.6	250.4	191.3	132.1	72.9	19.0	0.0
In percent of exports of goods and services	5.0	7.3	6.4	5.4	4.5	3.8	2.8	1.9	1.2	0.6	0.1	0.0
In percent of quota	80.0	140.0	140.0	140.0	140.0	137.5	118.5	90.5	62.5	34.5	9.0	0.0
In percent of gross international reserves	11.0	14.7	12.9	11.1	9.5	8.1	6.1	5.3	3.6	2.0	0.5	0.0
In percent of total external debt stock	4.0	5.9	4.2	3.5	3.0	2.7	2.1	1.5	1.0	0.5	0.1	0.0
Memorandum items												
Exports of goods and services (millions of U.S. dollar)	3,381	4,047	4,613	5,525	6,623	7,735	8,977	10,072	11,308	12,695	14,274	16,051
Quota (millions of SDRs)	133.7	133.7	133.7	133.7	133.7	133.7	133.7	133.7	133.7	133.7	133.7	133.7
Gross international reserves (millions of U.S. dollar)	1,523	2,017	2,291	2,659	3,112	3,602	4,138	3,640	3,681	3,661	3,708	4,362

Source: IMF staff projections.

.

APPENDIX I

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA
LETTER OF INTENT

October 8, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund

Dear Mr. Strauss-Kahn:

1. **The attached Memorandum of Economic and Financial Policies (MEFP) describes Ethiopia's performance in 2009/10 and policies for 2010/11**. The government of Ethiopia has implemented the policies contained in the economic and financial program supported by the 14-month arrangement under the High-Access Component of the Exogenous Shock Facility (HAC-ESF), approved by the IMF Executive Board on August 26, 2009.

2. **We request completion of the second review of the HAC-ESF arrangement and disbursement of the third tranche of the arrangement equivalent to SDR 40.11 million (30 percent of quota)**. All the quantitative performance criteria for July 7, 2010, were observed. The structural benchmarks were implemented.

3. **We believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program**, but will take additional measures as needed to reach these goals. We will consult with IMF staff on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the agreed IMF policies on such consultations.

4. The Government of Ethiopia authorizes the IMF to publish the contents of this letter, and the attached MEFP, on its website after consideration of our request by the Executive Board.

Sincerely yours,

/s/	/s/
Sufian Ahmed	Teklewold Atnafu
Minister	Governor
Ministry of Finance and Economic Development	National Bank of Ethiopia

Attachment:
Memorandum of Economic and Financial Policies

APPENDIX I
ATTACHMENT

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA
MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2010/11

October 8, 2010

I. INTRODUCTION

1. This memorandum:

   a. Reviews macroeconomic and financial performance under the program through July 7, 2010.

   b. Updates the MEFP of April 28, 2010, detailing our policy commitments through October 2010.

   c. Describes macroeconomic and financial policies for 2010/11.

II. ECONOMIC DEVELOPMENTS UNDER THE PROGRAM THROUGH JULY 7, 2010

2. The key objective of our economic and financial program for 2009/10—to make further progress on macroeconomic stability in the face of the difficult external environment—has been met. Macroeconomic conditions continued to improve while broad-based growth momentum has been maintained. Overall CPI inflation decelerated further to 5.7 percent (end-period) in July 2010; non-food inflation has declined only modestly to 18 percent. Thanks to strong external assistance (including the SDR allocation and ESF disbursement), strong export growth, and moderate import growth, international reserves rose to 2.1 months of import cover. All quantitative targets set for July 7, 2010, were met, with margins (Table 1). The structural measures covered by benchmarks were implemented (Table 2).

3. **Fiscal performance was well within program objectives**. Overall general government revenue is estimated to have risen strongly and expenditure was below target, resulting in domestic financing of only 1.8 billion birr, of which 0.8 billion birr from the NBE, against an adjusted program borrowing limit of 4.2 billion birr. The good revenue performance reflected the impact of strong economic growth, administrative efforts, and the lagged effect of inflation. Net external financing and grants were somewhat below projections.

4. **Monetary policy was consistent with the program objectives**. Reserve money growth was limited to 5.4 percent in the first half of 2010, against a program target of 9.2 percent, on account of lower credit extension to government by the NBE. On an annual basis, reserve money growth declined markedly to 6.5 percent from about 16 percent at end-2009. As a result, excess liquidity in the banking system was significantly reduced. T-bill rates have risen somewhat in

recent auctions. Broad money growth rose to 24 percent from 20 percent at end-2009, reflecting a significant increase in bank credit to the private sector, as credit ceilings were eased.

5. **The birr was allowed to depreciate by 16.5 percent (in foreign currency) on September 1**. This was aimed at removing any remaining overvaluation of the currency; boosting exports further by strengthening the country's external competiveness; promoting import substitution; and encouraging remittances. The contracting of non-concessional external loans of US$470 million was completed in late June (within the program limit) to finance infrastructure projects. No external payment arrears have been incurred during the period.

6. **Our structural reform agenda is being implemented as agreed**. A liquidity control framework is being implemented by NBE. The tax reform strategy is being implemented with the repeal of the exemptions on cement and some foods from the VAT, the review of exemptions, and the merger of the collection of taxes of Addis Ababa City with ERCA. A high level joint committee of the NBE and the Ministry of Finance and Economic Development (MoFED) staff has been monitoring borrowing by the public enterprises from the domestic banking system. An action plan to strengthen national account statistics was adopted in August 2010, based on technical assistance by the IMF's Statistics Department.

III. Macroeconomic Policies for 2010/11

7. **We remain committed to implementing the policies and meeting the quantitative and structural reform objectives described in our previous MEFP**. We are aiming at real GDP growth of about 11 percent in 2010/11, but maintain the conservative assumption for the purpose of the program of 8.5 percent in 2010/11. We aim to keep inflation in the single digits. The external current account deficit is expected to widen to 8.0 percent of GDP on account of a sizable increase in capital goods imports associated with new aircraft purchases and large hydro power investments. The gross official reserves coverage target at end 2010/11 is 2.3 months of imports. The macroeconomic priority for 2010/11 is to contain inflation, strengthen international reserves, and reform monetary policy to promote financial deepening. This will require limited domestic financing, consistent with the intention to contain reserve money growth, the vigorous implementation of tax reforms aimed at raising fiscal revenue. Sustained levels of concessional external financial assistance remain critical to our development needs.

Fiscal policy for 2010/11

8. **Fiscal policy in 2010/11 aims at continuing our strong investment in physical and social infrastructure while preserving our low external public debt distress risk rating and low domestic financing**. The tax reform measures, combined with the positive impact of the exchange rate depreciation on custom duties and other taxes, are expected to raise general government tax revenue to at least 11.3 percent of GDP. This somewhat cautious revenue forecast recognizes the uncertainties of the exact impact of the reform effort. In this light, we intend to use the bulk of any domestic revenues or external financial support over and above the budget projections to raise pro-poor expenditure and reduce domestic financing. Expenditure will be contained at about 19.8 percent of GDP with recurrent expenditure maintained at 9.1 percent

and capital expenditure rising to 10.8 percent. The overall deficit, excluding grants, is targeted at 6.5 percent of GDP. We also intend to further our efforts to enhance expenditure management.

Action	Timing
• Prepare for the introduction of Program Based Budgeting in 2011/12	2010/11
• Complete study to move to a standard single tax rate on investment income (excluding interest income).	The study is on progress and will be completed by November 2010.

Public sector

9. **We will continue to monitor closely the domestic borrowing of the public enterprises and agencies**. An inter agency committee is now monitoring enterprise borrowing on a monthly basis. The limit on the aggregate domestic financing of public enterprises and agencies will be set at 10 billion birr or 2.1 percent of GDP in 2010/11. We believe this target is consistent with overall credit and money growth that allows for sufficient credit expansion to the private sector and avoids a build-up of excess demand pressures on the economy. Domestic fuel prices have been adjusted monthly since October 2008 with prices set somewhat higher than import costs to enable the Oil Stabilization Fund to repay its accumulated debt to the banking system.

Monetary policy

10. **We have recently adopted reserve money as our nominal anchor**. The objective of monetary policy is to maintain inflation in the single digits and promote a remonetization of the economy to foster credit to the productive sectors, thereby stimulating growth and employment. To support these objectives, we aim to absorb the remaining excess liquidity in the banking system by end-2010 and will abolish the exceptional bank-by-bank credit ceilings as soon as possible thereafter, subject to confirmation that inflation remains in the single digits. We are committed to achieving positive real interest rates on deposits. We aim to contain reserve money growth in the single digits in 2010/11, aided by very low credit from the NBE to government. We are working to refine our liquidity management capability, including through a move to weekly T-bill auctions and introduction of 1 year T-bills. Broad money is projected to grow by 35–40 percent in 2010/11, on stronger deposit growth and credit demand from the private sector. We are also strengthening our oversight of the financial system. We will also modernize our reserve and liquidity requirements regulations by early 2011.

Action	Timing
• Introduce weekly treasury bill auctions	December 2010
• Modernize reserve and liquidity requirement regulations	March 2011
• Introduce a 1 year Treasury bill	December 2010

Exchange rate and external policy

11. **The government is committed to adjusting the nominal exchange rate in order to preserve external competitiveness and to continue to gradually rebuild official external reserves**. For 2010/11, a further rebuilding of net external reserves by US$210 million to 2.3 months of imports is targeted. Exchange rate adjustment on September 1, 2010, has brought Ethiopia's real effective exchange rate close to that consistent with external equilibrium. We have not introduced, nor will we introduce, any new, or intensify any existing, exchange restrictions.

12. **Avoiding an unsustainable accumulation of public external debt is a key objective of the government economic policy**. In September 2010, the government contracted for non-concessional external loans of US$296 million to finance hydropower infrastructure with a further US$700 million planned later in 2010/11 for infrastructure and productive investments. These borrowings are consistent with a cautious approach to non-concessional debt and maintaining our low risk external public debt rating. The government is committed to maintaining effective oversight over the evolution of public sector external debt, including that incurred by the public enterprises, and will update its debt management strategy. While the debt sustainability analysis provides a reassuring assessment of Ethiopia's low external debt distress risk, we will continue to keep debt levels under close review and we will make every effort to ensure that new borrowing is contracted on concessional terms and that large foreign-financed projects are subject to rigorous economic appraisals before being approved.

IV. Medium-Term Outlook

13. **Our new 5 year Growth and Transformation Plan has recently been finalized and submitted to parliament for approval**. It covers the period 2010/11−14/15 and has benefitted from broad consultations across all segments of the population as well as with development partners. The plan seeks to achieve at least an 11 percent real growth rate, aiming to enhance social development and achieve the MDGs. We aim to maintain inflation in the single digits, preserve macroeconomic stability, and ensure our public debt remains sustainable. Agriculture will continue to be the engine of growth and the main focus of efforts to improve productivity and rural income growth, but aim to have the industrial sector play a key role in economic development. Large public investments in transportation and energy infrastructure are planned. A high case scenario aims at 14.9 percent real growth. While these objectives are ambitious, we believe they are achievable with greater mobilization of domestic savings and donor financial support.

V. National Account Statistics

14. **We are committed to improving the quality of macroeconomic statistics, in particular the compilation methodologies and institutional arrangements for the national accounts**. We have adopted and are implementing an action plan to strengthen national accounts statistics. We will seek further technical assistance support from the IMF Statistics department and other relevant external statistical agencies to implement this plan.

VI. Safeguards and Reporting

15. **The 2001 safeguards assessment was updated in December 2009** and identified some issues relating to the oversight of the external and internal audit functions. In response, the NBE established a functional Audit Committee and set up an independent review of monetary data submitted for program monitoring purposes by the NBE's internal auditors.

16. **We continue to benefit from the policy and technical advice of IMF staff and wish to maintain close engagement**. To help ensure regular and close surveillance by IMF staff, we are committed to submitting economic and financial data to the Fund, as laid out in Table 3.

Table I.1. Ethiopia: Quantitative Performance Criteria and Benchmarks 1/

(In millions of birr, unless otherwise indicated)

	2009/10												2010/11
	September			December			March		July 7				September
	QB	Adjusted QB	Act.	PC	Adjusted PC	Act.	QB		PC		Adjusted PC	Act.	QB
							Prog.	Act.	Prog.	Rev. prog			
A. Quantitative performance criteria (PCs) and quantitative benchmarks (QBs)													
Net foreign assets of the National bank of Ethiopia (floor) 2/ (In millions of U.S. dollar)	-260	-228	-111	-350	-377	-111	-278	-13	-80	-80	-171	-35	-150
Net domestic assets of the National Bank of Ethiopia (ceiling) 3/	3,420	3,021	2,439	4,784	5,122	1,722	6,214	4,783	6,945	5,945	7,181	3,237	1,380
Net domestic financing of the general government (ceiling) 3/	2,496	2,097	-899	1,983	2,321	-4,340	2,895	-2,700	5,823	3,000	4,236	1,758	1,000
Net credit to public enterprises (ceiling)	1,806	1,806	1,060	3,338	3,338	1,805	5,258	2,940	6,270	6,570	6,570	4,422	2,100
New non-concessional external debt contracted or guaranteed by the public sector (ceiling) 4/ (In millions of U.S. dollar)	500	500	0	500	500	0	500	0	500	500	500	470	500
Outstanding external payments arrears (ceiling) 5/	0	0	0	0	0	0	0	0	0	0	0	0	0
B. Adjusters to quantitative performance criteria													
Disbursed non-project external assistance (In millions of U.S. dollar)	0	32	32	250	223	223	350	412	670	659	…	568	0
C. Quantitative benchmarks													
Reserve money (ceiling)	478	478	1,182	824	824	472	3,069	4,637	6,604	4,800	4,800	2,957	-649
Federal government revenue collection (floor)	8,774	8,774	9,716	20,105	20,105	22,606	29,840	31,090	39,711	44,000	44,000	44,029	10,900

1/ Cumulative flow from the start of Ethiopia's fiscal year (July 8).
2/ Adjusted upward/downward for 100 percent of any non-project external assistance that exceeds/falls short of programmed amounts, subject to specified caps.
3/ Adjusted upward/downward for 100 percent of any non-project external assistance that falls short of/exceeds programmed amounts, subject to specified caps.
4/ Excluding the Ethiopian Airlines.
5/ This shall be a continuous performance criterion.

Table I.2. Ethiopia: Structural Benchmarks

Measure	Date	Status
Ensuring close monitoring of public enterprises		
• The public enterprise monitoring committee to receive annual financing and investment plans from all key public enterprises (ETC, EEPCo, Housing Agencies, etc.).	September 2009	Met. The Committee has focused on enforcing domestic bank borrowing limits. Focus being extended to non-bank borrowing.
• Report progress in compliance with borrowing targets to the Minister of Finance and Economic Development on a monthly basis.	Continuous	Met.
Establishing a liquidity control framework		
• Establish a high level joint committee, comprised of NBE and MoFED staff, to exchange information on liquidity needs on a weekly basis.	September 15, 2009	Met.
• Develop a formal liquidity forecasting framework in manual form and prepare fortnightly forecasts of liquidity needs for use in setting auction volumes.	January 2010	Met. Manual produced and initial forecasts made.
• Implement liquidity control framework.	June 2010	Met.
Tax reforms		
• The Minister of Finance and Economic Development to approve a tax reform strategy with a time-bound action plan covering both tax policies and administration.	January 2010	Met. Strategy approved February 2010 with action plan being implemented.
• Transfer the collection of some taxes from Addis Ababa City to ERCA.	September 2010	Completed.
National Accounts Statistics		
• Adopt action plan to strengthen national accounts statistics.	August 2010	Completed.

Table I.3. Ethiopia: Data Reporting

Information	Provider	Periodicity and due date
Gross international reserves and foreign liabilities of the National Bank of Ethiopia (NBE) Breakdown between liquid and unencumbered reserves and reserves that are pledged, swapped or encumbered	NBE	Monthly within thirty 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 domestic financing of the general government Regional government's fiscal data	Ministry of Finance and Economic Development (MOFED)	Monthly within six weeks of the end of each month Quarterly within twelve weeks of the end of each month
Domestic credit to public enterprises	NBE/MOFED	Monthly within six weeks of the end of each month
Federal Government Revenue	MOFED	Monthly within six weeks of the end of each month
New Nonconcessional External Debt contracted or guaranteed by the government	MOFED	Quarterly within four weeks
Non-project financial assistance	MOFED/NBE	Quarterly within thirty days
Consumer Price Index	NBE	Monthly within four weeks
National Accounts	MOFED	Within three weeks of any revision
Consolidated Budget Report of Federal and Regional Government	MOFED	Quarterly within twelve weeks
Monetary Survey	NBE	Monthly within six weeks
T-Bill auction details	NBE	Monthly within two weeks
BoP data: Exports, imports, services, private transfers and capital account transactions	NBE	Quarterly within eight weeks
Volume and prices of fuel imports	NBE	Monthly within four weeks
Coffee exports	NBE	Monthly within four weeks

INTERNATIONAL MONETARY FUND

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

Second Review of the Arrangement Under the Exogenous Shocks Facility

Informational Annex

Prepared by the African Department
(In consultation with other departments)

October 26, 2010

- **Relations with the Fund**. Describes financial and technical assistance from the Fund and provides information on the safeguards assessment and the exchange rate system. Outstanding credit amounted to SDR 147.08 million (110 percent of quota) at end-September 2010.
- **Joint Management Action Plan—July 2010–June 2011**. Describes the Fund and World Bank Group's joint work programs.

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ANNEX I

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA
RELATIONS WITH THE FUND

(as of September 30, 2010)

I. Membership Status: Joined: December 27, 1945; Article XIV

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	133.70	100.00
Fund holdings of currency	126.20	94.39
Reserve Tranche Position	7.51	5.62
Lending to the Fund		
Holdings Exchange Rate		

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	127.93	100.00
Holdings	57.36	44.84

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ESF Arrangement	113.65	85.00
ESF RAC Loan	33.43	25.00

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ESF	Aug 26, 2009	Oct 25, 2010	153.76	113.65
ECF [1/]	Mar 22, 2001	Oct 31, 2004	100.28	100.28
ECF [1/]	Oct 11, 1996	Oct 22, 1999	88.47	29.49

[1/] Formerly PRGF.

VI. Projected Payments to Fund
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2010	2011	2012	2013	2014
Principal					3.34
Charges/Interest	0.05	0.21	0.58	0.58	0.58
Total	0.05	0.21	0.58	0.58	3.92

VII. Implementation of HIPC Initiative:

		Enhanced Framework
I.	Commitment of HIPC assistance	
	Decision point date	November 2001
	Assistance committed	
	by all creditors (US$ Million) [1/]	1,982.20
	of which: IMF assistance (US$ million)	60.85
	(SDR equivalent in millions)	45.12
	Completion point date	April 2004
II.	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 [2/]	1.54
	Total disbursements	46.66

[1/] 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 can not be added.

[2/] 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.

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI):

I.	MDRI-eligible debt (SDR Million)[1/]	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

[1/] The MDRI provides 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.

IX. Safeguards Assessment

An update safeguards assessment of the National Bank of Ethiopia (NBE) was completed in December 2009 in connection with Ethiopia's ESF-RAC approved on January 23, 2009. The assessment found that, since the previous assessment in 2001, the NBE has implemented some improvements to the safeguards framework but that several initiatives were a work-in-progress and substantial gaps remained. Financial transparency has improved through the publication of independently audited financial statements, and internal audit capacity has been strengthened. In response to the assessment's recommendations, action has been taken to commence Audit Committee (AC) oversight, and introduce controls and independent reviews over program data reporting to the Fund. The authorities are also in the process of addressing remaining safeguards issues relating to enhancing AC oversight of the external audit mechanism, further strengthening of reserve management capacity, and introducing bank-wide risk management practices. Going forward, the NBE Law will need to be strengthened with regard to independence of the central bank and the potential scope for unlimited financing of the government.

X. Exchange Rate Arrangement

The de facto exchange rate regime is classified as a crawl-like arrangement, in light of the recent market developments. The authorities describe their exchange rate regime as a managed float with no predetermined path for the exchange rate. The pace of the depreciation, however, has been stable. The NBE supplies foreign exchange to the market based on plans established at the beginning of each fiscal year that takes into account estimates of likely supply and demand. The transaction-weighted average interbank market exchange rate on September 29, 2010, was Br 16.3868 = US$1.

Ethiopia currently maintains four restrictions on the payments and transfers for current international transactions, which relate to (a) the tax certification requirement for repatriation of dividend and other investment income; (b) restrictions on repayment of legal external loans and supplies and foreign partner credits; (c) rules for issuance of import permits by commercial banks; and (d) the requirement to provide a clearance certificate from NBE to obtain import permits. These restrictions are inconsistent with Article VIII, Section 2(a), of the IMF's Articles of Agreement and remain unapproved.

The staff is continuing to assess whether a general finance and economic cooperation agreement signed between the government of Ethiopia and China in 2006 gives rise to exchange restrictions under Article VIII.

XI. Article IV Consultation

The Executive Board concluded the last Article IV consultation on June 11, 2010 (IMF Country Report No. 10/175). Ethiopia will follow Article IV consultation cycles for program countries.

XII. Technical Assistance (2005–present)

Department	Purpose	Time of Delivery
FAD	Program/performance budgeting	January–February 2005
STA	Balance of payments statistics	January–February 2005
MFD	Bank supervision	June–July 2005
STA	Balance of payments statistics	July 2005
STA	Government finance statistics	August 2005
FAD	Tax administration	September 2005
MCM	Bank supervision	February 2006
MCM	Modernization of payment systems	March 2006
STA	Consumer price data	March 2006
AFE	Program budgeting	April 2006
AFE	Treasury reforms review	April 2006
FAD	Tax policy assessment	May 2006
MCM	Bank supervision	July 2007
MCM	Monetary operations	July 2007
MCM	Payment system	July 2007
AFE	Customs administration	October 2007
FAD	Public expenditure management	December 2007
AFE	Program budgeting	December 2007
AFE	Macro-fiscal	January 2008
AFE	Program budgeting	January 2008
AFE	Banking supervision	February 2008
AFE	Consumer price index	March 2008
MCM	Islamic banking regulation	April 2009
AFE	Banking supervision	June 2009
AFE	Program budgeting chart of accounts	July 2009
FAD	Revenue administration	September 2009
FAD	Program budgeting	November 2009
FAD	Tax policy	December 2009
AFE	Cash management and treasury single account	February 2010
AFE	Price statistics	February 2010
AFE	Risk-based supervision	May 2010
AFE	Medium-Term Expenditure Framework	August 2010

XIII. Resident Representative

The IMF has had a resident representative office in Addis Ababa since 1993. The current Resident Representative, Mr. Sukhwinder Singh, took up the post in January 2009.

ANNEX II
THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA
JOINT MANAGEMENT ACTION PLAN
JULY 2010–JUNE 2011

Title	Products	Provisional and actual timing of missions	Expected and actual delivery date
A. Mutual information on relevant work programs			
The World Bank work program in the next 12 months	**Economic policy analysis and advice** • Annual Public Finance Review-2011 • Policy dialogue on economic reform issues • Regional Growth Report (Addis Ababa) • Trade in Services Report	July 2010–June 2011 July 2010–June 2011 July–December 2010 July 2010–June 2011	Q1 2011 Q2 2011 Q2 2010 Q2 2011
	Technical Assistance • Financial sector capacity building project • Strengthen the capacity of public sector (PSCAP-2) • Support for new 5-year development plan	July 2010–June 2011 July 2010–June 2011 July 2010–June 2011	June 2010 – Q1 2011
The Fund work program in the next 12 months	**Macroeconomic policy analysis and advice** **IMF Program** • The second review of the High Access Component Exogenous Shocks Facility • Article IV consultation	September 2010 March 2011	November 2010 June 2011
	Technical assistance • Revenue administration • Public financial management • Statistical capacity (national accounts, CPI)	December 2010 May 2010–April 2011 May 2010–April 2011	
B. Requests for work program inputs			
Fund request to Bank	• Periodic update on progress on financial sector capacity building project. • Macroeconomic and financial data to be shared regularly.	Ongoing	
Bank request to Fund	• Periodic update on all TA activities. • Macroeconomic and financial data to be shared regularly.	Ongoing	
C. Agreement on joint products and missions			
Joint products in the next 12 months	Debt sustainability analysis		June 2011

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 10/432
FOR IMMEDIATE RELEASE
November 15, 2010

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second and Final Review Under Ethiopia's ESF Arrangement and Approves US$62.67 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) approved on November 12, 2010 the second and final review of Ethiopia's economic performance under the 14-month arrangement under the high-access component of the Exogenous Shocks Facility (ESF). The approval will enable Ethiopia to draw SDR 40.11 million (about US$62.67 million), bringing total disbursements to the total available under the arrangement (SDR 153.755 million; about US$240.24 million).

The Executive Board approved a 14-month arrangement under the high-access component of the ESF in August 2009, which was extended in October 2010 to allow for completion of this second and final review and allow for the final disbursement.

Following the Executive Board's discussion on Ethiopia, Mr. Naoyuki Shinohara, Deputy Managing Director and Acting Chair, stated:

"The Federal Democratic Republic of Ethiopia has successfully implemented policies to reduce inflation and rebuild external reserves under the Exogenous Shocks Facility supported program. Program performance has been satisfactory with all of the quantitative performance targets met with margins and structural benchmarks implemented. Inflation has continued to decline, reflecting monetary restraint and aided by favorable weather conditions. International reserves have risen to about 2.1 months of imports coverage. The mild impact of the global recession on the Ethiopian economy has allowed for better performance on the external targets.

"Fiscal performance in 2009/10 was strong. Continuing the pace of tax reforms will be important for durably raising revenues and creating fiscal space for the ambitious public investment plans while maintaining macroeconomic stability.

“The recent reframing of monetary policy to adopt a reserve money nominal anchor, backed by a phasing out of direct credit to government, holds out the prospect of ending financial repression. This would set the stage for monetization, financial deepening and faster economic growth through increased domestic savings and investment.

“The ESF-supported program has achieved its objectives but much remains to be done to sustain and accelerate growth. A focus on improving the investment climate, trade and exchange liberalization, and development of the financial sector, anchored by sound fiscal and monetary policies, is essential to improve competitiveness and sustain high growth. Continued flexibility of the exchange rate and strengthening of financial sector supervision and regulation, particularly in the context of the expected monetization, will also be important” Mr. Shinohara added.

Statement by Mr. Majoro, Executive Director
for The Federal Democratic Republic of Ethiopia
November 12, 2010

My Ethiopian authorities' prudent macroeconomic policies, progress in structural reforms, and swift response to the challenges of the global economic downturn, enabled Ethiopia to weather the adverse effects of the crisis. They remain confident that persevering with this macroeconomic framework, they stand a good chance of mitigating the fallout from the slow global economic recovery and the sovereign debt risks in advanced economies.

My authorities are appreciative of the Fund's candid and constructive engagement and support under the ESF-HAC. Going forward, they are determined to further strengthen their macroeconomic framework, and achieve key objectives set out in their draft PRSP – Growth and Transformation Plan (GTP). In view of the strong performance under the program—with all July 7, 2010 (end-Fiscal year) quantitative performance criteria observed with good margins, and implementation of structural reforms on track—they request Directors' support for the completion of the second and final review of the ESF.

RECENT ECONOMIC DEVELOPMENTS

Ethiopia's impressive economic performance has been uninterrupted over the past several years reflecting the continuous economic reforms with macroeconomic stability achieved and strong growth momentum. Following the continued global economic recovery, the Ethiopian external sector continues to show improvement. Pressures on prices and international reserves have eased and reserve buildup is significantly more than originally targeted under the ESF program. Inflation remains in single digits at 7.5 percent in September 2010.

The fiscal outturn in 2009/10 represented a much tighter fiscal stance than programmed. Despite lower external financing and grants than targeted in the program, my authorities restrained domestic borrowing by the public sector. This, together with higher federal government revenue due to the ongoing tax reform and administrative efforts, and lower expenditure than targeted ensured a much lower domestic financing.

Monetary policy also achieved the program's objective of restraining reserve money growth. This was helped by the tighter fiscal stance that also implied a lower credit extension to government by the NBE. In addition to the increase in T-bills rate, the low reserve money growth contributed to the significant reduction in the excess liquidity in the banking system.

The birr depreciated by 16.5 percent at the beginning of September 2010. My authorities expect that this depreciation would address any overvaluation of the currency; boost exports further by strengthening the country's external competiveness; promote import substitution; and encourage remittances.

FISCAL POLICY AND PUBLIC SECTOR MANAGEMENT

The thrust of government spending remained in conformity with the overall macroeconomic framework—to maintaining the level of spending on the key MDG clusters and infrastructure. To protect spending in priority areas, my authorities will continue to strengthen domestic and concessional resource mobilization in the medium term. Cognizant of the overall resource limitations, they intend to facilitate greater participation of the private sector and mobilize a modest level of non-concessional financing while remaining vigilant of the contingent liabilities and debt sustainability implications and strengthen their debt management strategy.

My authorities also intend to continue and expand their regular scrutiny of public enterprises' borrowing. To this end, a high level joint committee of the NBE and the Ministry of Finance and Economic Development staff has been monitoring borrowing by the public enterprises from the domestic banking system. My authorities also recognize the important role played by these public enterprises, particularly in the improvement of infrastructure critical to socio-economic development. While staff's concern with the buildup of external debt is understandable, the compelling need for such financing of major infrastructure investment that the country is in need of should also be appreciated. Moreover, the debt sustainability analysis undertaken by the Fund in conjunction with the last Article IV consultation reaffirms that the level of debt distress and the country's ability to repay the Fund will not worsen.

MONETARY AND EXCHANGE RATE POLICIES

My authorities' monetary policy will continue supporting their macroeconomic framework through maintaining sufficient liquidity in the financial system, containing inflation and supporting the gradual replenishment of international reserves. They will remain vigilant of the inflation pressures arising from the depreciated exchange rate. To achieve the objective of anchoring its monetary policy on low and stable inflation, the NBE will further bolster its open market operations, enhance exchange rate flexibility, and continue to improve liquidity forecasting. To this end they have adopted reserve money as the nominal anchor and have undertaken significant steps to depreciate the birr to enhance exchange rate flexibility. However, they also recognize the need to move judiciously and gradually in this respect in order to maintain expectations and not reignite inflation. In this respect, the authorities are convinced that the still low level of reserves dictate caution in the tempo of adjustment. The NBE is also committed to maintain the transparency of its policy stance.

My authorities remain committed to abolishing the exceptional bank-by-bank credit ceilings as soon as conditions permit and once there is clear assurance that inflation remains in the single digits. In this regard, the low reserve money will be aided by very low direct credit to the government from the NBE.

STRUCTURAL REFORMS

My Ethiopian authorities' commitment to the implementation of a wide range of reforms underpins the draft Five Year National Growth and Transformation Plan objectives. Improving the stock and quality of infrastructure—from road and rail networks to energy, irrigation and telecommunications projects—is a priority with the aim of enhancing productivity in the primary sectors and competitiveness of the country as a whole. The plan, in addition to aiming at expanding and ensuring quality health and education services towards meeting MDGs targets in the sectors and ensuring food security at household and national level, would facilitate for the industry sector to take the lead in the overall development activities in the country. The plan also eyes at building the capacity of government institutions and ensure transparency.

In addition, a liquidity control framework is being implemented by NBE. The authorities' tax reform strategy that was implemented in early 2010 repeals some of the exemptions, such as on cement and some foods from the VAT while continues to review other exemptions.

CONCLUSION

The authorities' macroeconomic fundamentals and continued commitment to strong policies helped the country sustain the growth momentum of the last five years even in the face of the global economic downturn. They have demonstrated a track record of speedy response and strong implementation of policies and programs. They consider that the objectives of the ESF-HAC to increase reserves to 2.1 months of import cover and ameliorate the adverse impact of the global recession have been attained. In the near term, my authorities are determined to focus on sustaining macroeconomic stability, enhancing domestic resource mobilization, promoting broad-based and pro-poor growth, and increasing investment in infrastructure, primary sectors and core MDG clusters.

In line with the GTP objectives, my authorities are determined to ensure that the economy continues, at a minimum, to sustain its growth trajectory in the near to medium term. Going forward, they will continue to consult with the Fund and seek the support of development partners in order to achieve their development goals, including poverty reduction and the MDGs.