January 2009
IMF Country Report No. 09/34

The Federal Democratic Republic of Ethiopia: Request for Disbursement Under the Rapid-Access Component of the Exogenous Shocks Facility—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for The Federal Democratic Republic of Ethiopia

In the context of Request for Disbursement Under the Rapid-Access Component of the Exogenous Shocks Facility, the following documents have been released and are included in this package:

- The staff report for Request for Disbursement Under the Rapid-Access Component of the Exogenous Shocks Facility, prepared by a staff team of the IMF, following discussions that ended on December 11, 2008, 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 January 7, 2009. 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.
- A staff statement of January 23, 2009 updating information on recent developments.
- A Press Release summarizing the views of the Executive Board as expressed during its January 23, 2009 discussion of the staff report that approved the disbursement.
- A statement by the Executive Director for The Federal Democratic Republic of Ethiopia.

The document listed below has been or will be separately released.

Letter of Intent sent to the IMF 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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INTERNATIONAL MONETARY FUND

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

Request for Disbursement Under the Rapid-Access Component of the Exogenous Shocks Facility

(In consultation with the Finance, Fiscal Affairs, Legal, Monetary and Capital Markets, Strategy, Policy, and Review, and Statistics Departments)

Approved by Saul Lizondo and Tessa van der Willigen

January 7, 2009

Context: High global oil, fertilizer, and food prices have contributed to very low international reserves at a time when the economy faces intensified risks from the global economic slowdown. Additional external financing could help smooth the adjustment process and mitigate risks to poverty reduction gains in recent years.

Request for support under the Exogenous Shocks Facility (ESF): The authorities are requesting the rapid-access component of the ESF (SDR 33.425 million, 25 percent of quota) to help the economy adjust to the exogenous shocks. The full amount would become available upon Board approval.

Discussions: Discussions were held in Addis Ababa December 2–11, 2008. The mission met with Prime Minister Meles Zenawi, Minister of Finance and Economic Development Sufian Ahmed, Central Bank Governor Teklewold Atnafu, other senior officials, and representatives of the donor community. The mission team comprised Messrs. Corker (head), Honda, Zhan (all AFR), and Thomas (SPR). Mr. Plant and Mr. Singh, resident representative designate (both AFR), joined the concluding sessions. The mission collaborated closely with the World Bank and African Development Bank missions in Addis Ababa, as well as local representatives from the donor community.

IMF relations: The last PRGF arrangement (SDR 100.28 million) expired on October 31, 2004. Ethiopia reached the completion point under the enhanced HIPC Initiative in April 2004, and received further debt relief under the Multilateral Debt Relief Initiative in January 2006. In November 2006, the authorities requested closer engagement with the Fund and since then staff visits have been held between annual Article IV consultation missions. The Board concluded the 2008 Article IV Consultation on July 14, 2008. Ethiopia is still under the Article XIV regime and maintains several exchange restrictions that are inconsistent with Article VIII.

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Executive Summary

- Ethiopia's pro-growth development policies have helped sustain average growth of 11.5 percent since 2003/04, consistent with the goal of reducing poverty. However, demand has been running ahead of the expansion in the capacity of the economy, contributing to high inflation and strong import growth.

- Steep increases in international prices for key imports have exacerbated strains on the Ethiopian economy and pushed foreign exchange reserves to critically low levels—equivalent to just 1 month of imports of goods and services at end-November 2008.

- The authorities have embarked upon a tightening of monetary and fiscal policies to facilitate necessary rebuilding of foreign exchange reserves. Wheat has been imported on an emergency basis to dampen domestic inflation expectations and alleviate the impact of high food prices on vulnerable groups.

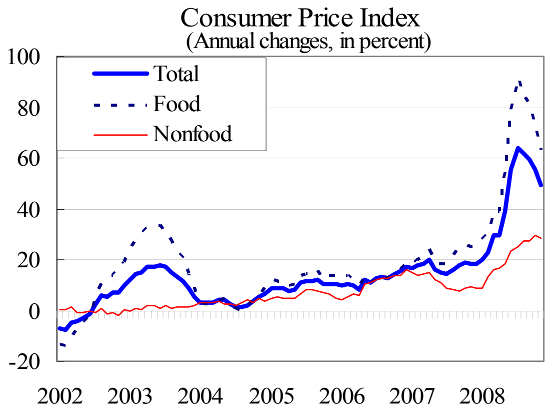
- The recent reversal of the international price hikes suggests that the exogenous shocks may prove temporary. However, with the high import bill yet to subside and the global economy entering a severe downswing, the envisioned adjustment path is subject to considerable risks and uncertainties, particularly given Ethiopia's high dependence on external resource flows from remittances, aid, and FDI.

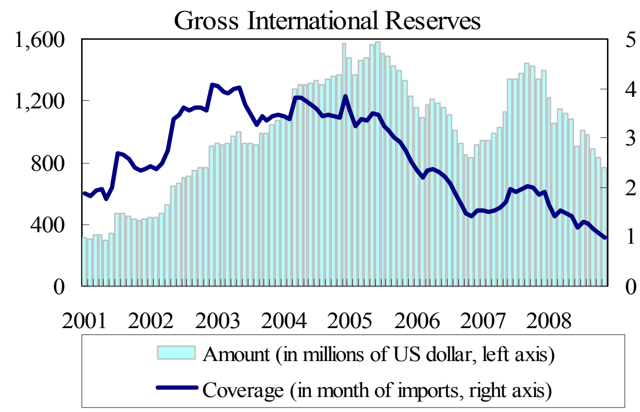
- The rapid-access component of the ESF would contribute to the rebuilding of international reserves and catalyze financing from Ethiopia's other international partners aimed at cushioning the impact of adjustment on the authorities' efforts on growth and poverty reduction.

- The staff supports the authorities' request for the rapid-access component of the ESF. The shock has created an immediate balance of payments need. The authorities' policy commitments, summarized in the attached letter, appropriately address the impact of the external shocks. However, forceful implementation of the planned fiscal and monetary tightening as well as increased exchange rate flexibility will be needed. Strengthened systems will need to be put in place to better monitor and control the domestic borrowing by public enterprises and other public institutions.

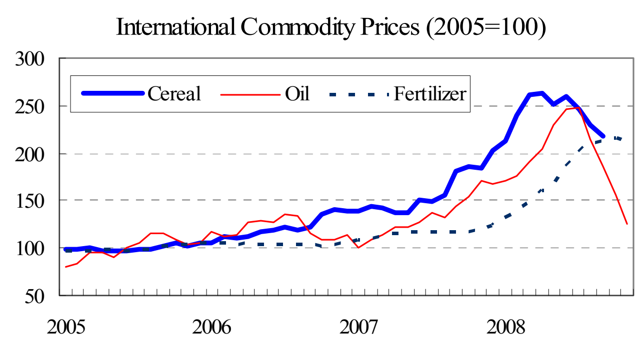
I. Background

1. **Ethiopia's ambitious development policies have delivered rapid economic growth, but also contributed to rising inflation and strong import demand**. Official statistics suggest that since 2003/04 real GDP growth has averaged 11.5 percent, fueled by public development spending.[1] During this period, year-on-year non-food price inflation rose to 28 percent in November 2008, with steep rises in food prices pushing overall CPI inflation to 49 percent. Rising import demand and import prices have steadily eroded a once-comfortable foreign exchange position; by end-November 2008, reserve cover had fallen to just 1 month of imports of goods and services.





2. **Prices of commodities key to the Ethiopian economy rose steeply from early 2007 to mid-2008**. International prices of oil and fertilizers rose by 150 percent and 75 percent, respectively. This contributed to a doubling of the oil and fertilizer import bill in 2007/08 to almost US$2 billion (about 8 percent of GDP). A 28 percent rise in prices of coffee, the largest export item, provided only a partial offset to the trade balance.[2] Commodity prices fell sharply in the second half of 2008, fully reversing, in the case of oil, the earlier run up in prices. However, the oil import bill in the third quarter of 2008 remained substantial at US$0.5 billion.



3. **Sharply rising global cereal prices have also adversely impacted the economy, albeit less directly as most food imports are in the form of aid**. In 2008, the catching-up of Ethiopian food prices to world levels overshot, with inflation expectations and consumer

[1] The fiscal year runs July 8–July 7.

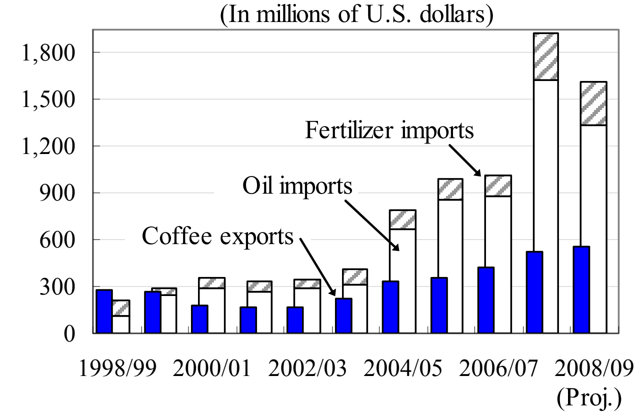
[2] In 2007/08, export prices on average rose slightly more than import prices, contributing to a modest terms-of-trade gain. However, because the value of imports is more than four time that of exports, the impact of the terms of trade on the trade balance was large and negative.

stockpiling perhaps also fanned by growing food security concerns in some regions as the early *Belg* harvest was affected by poor rains.[3] In response, the authorities imported high-priced wheat on an emergency basis in the second half of 2008.

II. THE ECONOMIC IMPACT OF COMMODITY PRICE SHOCKS

4. **The exogenous shocks have been responsible for pushing the balance of payments into a position of immediate and serious vulnerability**. Staff estimates that higher prices for oil and fertilizers as well as the emergency wheat imports will cumulatively cost Ethiopia US$550–770 million (about 2–3 percent of 2007/08 GDP) in foreign exchange over 2007/08 and 2008/09, even accounting for the reversal of the oil price shock during 2008/09 and higher coffee prices (see Table below). The lower estimate calculates the effect of higher commodity prices assuming no volume increase from 2006/07 levels, while the higher end of the range reflects the price effect using current year volumes. The lower estimate likely measures the minimum size of the shock: on the one hand, the constant volume assumption does not allow for demand adjustment of volume in response to higher prices, but nor does it allow for increasing volume to satisfy demand for oil and fertilizers in a growing economy.[4] However, taking the impact of the shocks in 2007/08 alone, even the low estimate almost fully accounts for the decline in gross international reserves in 2007/08, which reduced import cover to 1.2 months of imports from 1.9 months of imports at end-2006/07.

Coffee Exports and Oil and Fertilizer Imports
(In millions of U.S. dollars)



[3] See Box 1 of the 2008 Article IV Consultation Staff Report (IMF Country Report No. 08/264) for more discussion of the factors behind Ethiopia's rapid food price inflation.

[4] Trade price elasticities are hard to measure, but are estimated to be small, while import volumes are highly responsive to changes in real GDP (see IMF Country Report No. 08/264).

Ethiopia: Estimated Net Effect of Commodity Price Shocks, 2007/08-2008/09 1/

(In millions of U.S. dollars, unless otherwise noted)

	2006/07	2007/08	2008/09	Cumulative total
At 2007/08 actual and 2008/09 projected volumes	...	-581	-187	-768
(In percent of GDP)		-2.2	-0.5	-2.7
of which:				
Fuel imports 3/	...	-556	-19	-575
Fertilizer imports	...	-140	-95	-235
Emergency wheat imports 4/	...	0	-182	-182
Coffee exports	...	115	110	225
At 2007/08 volume 2/	...	-581	-178	-760
(In percent of GDP)		-2.2	-0.5	-2.7
of which:				
Fuel imports 3/	...	-556	-16	-572
Fertilizer imports	...	-140	-82	-222
Emergency wheat imports 4/	...	0	-182	-182
Coffee exports	...	115	101	217
At 2006/07 volume 2/	...	-388	-161	-550
(In percent of GDP)		-1.5	-0.5	-1.9
of which:				
Fuel imports 3/	...	-467	-13	-480
Fertilizer imports	...	-40	-71	-111
Emergency wheat imports 4/	...	0	-182	-182
Coffee exports	...	119	105	224
Memorandum items:				
Fuel imports (millions of barrels)	13.2	15.7	19.5	...
Fertilizer imports (metric tons)	415,430	479,400	555,000	...
Emergency wheat imports (metric tons)	-	-	520,000	...
Coffee exports (metric tons)	176,400	170,500	184,140	...
Gross international reserves	1,326	906	1,372	...

1/ The fiscal year runs July 8-July 7.
2/ Reflects price changes since 2006/07, using volumes that are kept constant as indicated.
3/ An average international oil price of US$68.7 per barrel is assumed for 2008/09, in line with WEO assumptions.
4/ Excluding additional emergency cereal imports that the authorities stand ready to effect if necessary.

5. **Incomplete pass-through of international oil prices to domestic consumers dampened the impact of high oil prices on inflation but led to significant quasi-fiscal losses.** The domestic prices of petroleum products are regulated by the government. Up until October 2008, adjustments were ad-hoc and insufficient to achieve full cost recovery. Consequently, the Oil Stabilization Fund, which was set up to smooth the fluctuations in domestic fuel prices, is estimated to have accumulated losses of about 1½ percent of GDP as of October 2008. The financing of these losses through borrowing from the state-owned Commercial Bank of Ethiopia was a significant contributor to a surge in public sector domestic borrowing to 7 percent of GDP in 2007/08.

6. **Soaring food prices have adversely impacted low-income households.** The price of the consumption bundle that the poor consumes is estimated to have risen by 78 percent in urban areas and by 85 percent in rural areas during the last two years. The welfare impact of these changes has been particularly large for urban households. The impact in rural areas was lower but still negative as nearly half of these households are net food buyers.[5]

III. Policies to Address the Shocks

7. **To mitigate the impact of the exogenous shocks on the balance of payments and address domestic economic imbalances while protecting the most vulnerable, the authorities have adjusted domestic fuel prices, introduced measures to alleviate the adverse impact of high food prices, and are tightening monetary and fiscal policies significantly**. The authorities intend to take advantage of the reversal of the commodity price shock to rebuild foreign exchange reserves to 1.8 months of imports by end-2008/09 in line with their medium-term objective of bringing reserve cover to 3 months of imports. Key measures are:

- **Eliminating domestic fuel subsidies**: The Government eliminated the fuel subsidy in October 2008 by adjusting regulated domestic prices to the import parity level: prices of gasoline, diesel, fuel oil, and kerosene were raised by 6 percent, 39 percent, 32 percent, and 50 percent, respectively.[6] Going forward, the authorities will review domestic fuel prices on a monthly basis, adjusting them as necessary, but keeping a margin above world prices in order to repay the debt of the Oil Stabilization Fund.[7]

- **Mitigating the impact of high food prices.** The government imported wheat for the equivalent of more than 3 percent of domestic crop production and distributed it to low-income families and flour mills at import cost—well below prevailing domestic prices. The government is prepared to carry out additional such operations if necessary. Valued added tax, turnover tax, and surtaxes on some food items have been removed. The government has also raised the cash transfer in its safety net programs from 6 to 8 birr per day and is considering further adjustments.

- **Significantly tightening fiscal policy and eliminating domestic borrowing**. The authorities' revised budget targets general government domestic borrowing of zero in 2008/09—it was 2.7 percent of GDP in 2007/08—by containing expenditure and enhancing revenue mobilization through administrative measures (e.g., the integration

[5] World Bank: Ethiopia—Emergency Food Crisis Response Program (Report No. 46658-ET, November 2008).

[6] Fuel subsidies are not necessarily pro-poor. World Bank analysis in 2005 suggested that petroleum product subsidies, including kerosene, are captured disproportionately by the rich. The lowest income quintile receives less than 10 percent of total subsidies, while the top quintile receives about 44 percent.

[7] Reflecting the decline in international oil prices, the government reduced domestic fuel prices in November and December. The Oil Stabilization Fund generated sizable surpluses in October and November 2008.

of the three revenue agencies).[8] The general government deficit is projected to be reduced from 2.9 percent of GDP in 2007/08 to 1.5 percent in 2008/09. Should expected revenue growth disappoint, the authorities stand ready to cut lower priority expenditure particularly those not affecting the poor to ensure the borrowing target is met.[9] The authorities indicated that they would likely postpone investment spending. Keeping wage rates for public workers unchanged would also help to bear down on real current spending.

- **Reducing public enterprises domestic borrowing**. Public enterprise borrowing will be kept to 4–8 billion birr (1.1–2.2 percent of GDP) in 2008/09, compared to 4.4 percent of GDP in 2007/08, through limiting their investment activities and through repaying the debt of the Oil Stabilization Fund. In addition, the authorities are establishing a committee, comprising officials from the Ministry of Finance and Economic Development and the National Bank of Ethiopia, to monitor on a monthly basis the activities of key public enterprises and public institutions, including Ethiopian Telecommunications Corporation, Ethiopian Electric Power Corporation, the Oil Stabilization Fund, and the City of Addis Ababa.[10] The information gathered will feed into high-level policy decision making.

- **Tightening monetary policy**. The National Bank of Ethiopia (NBE) is targeting to reduce broad money growth to below 20 percent in 2008/09 from about 23 percent at end-2007/08. Building on earlier increases in reserve requirements (July 2007 and April 2008) that have helped to reduce banks' excess reserves, the NBE intends to closely monitor and control reserve money creation arising from its net lending to the government.

8. **The staff viewed the policy response as appropriate and urged forceful implementation**:

- The elimination of domestic fuel price subsidies staunches a sizable quasi-fiscal cost. The test would be to maintain the margin of domestic fuel prices above international prices even if world prices begin to rise again.

[8] The original budget allowed for domestic borrowing of 1.5 percent of GDP. The new zero limit has been agreed at the Cabinet level. Because the spending and borrowing will not exceed the original budget, the revision of the budget would not require parliamentary approval.

[9] For the first four months of 2008/09 (July–October 2008), fiscal performance of the federal government was broadly in line with the budget. Domestic revenues increased by 52 percent, compared with the same period in 2007/08, largely owing to significant increase in nontax revenues (including profits transfer from various public enterprises). The pace of increase in expenditures was contained at 25 percent.

[10] Financing for low-cost housing projects by the City of Addis Ababa is channeled through a public enterprise.

- On budget implementation, the staff agreed that investment expenditure might be the place for expenditure restraint because the real value of the budget spending allocation was comparatively generous when taking into account much slower increases for capital goods prices than general inflation. In addition, investment spending has a high import content.

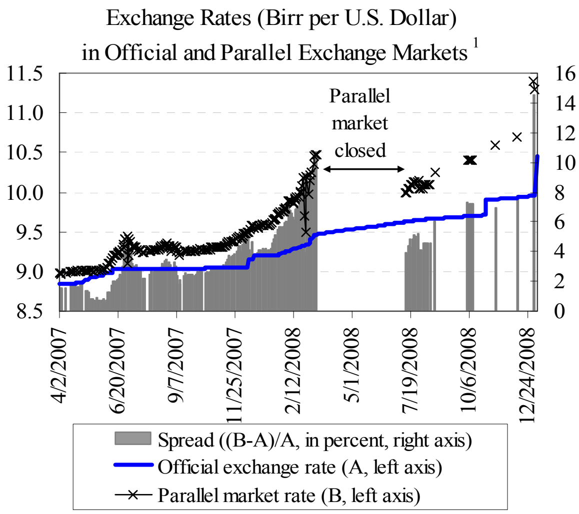
- Close monitoring of the financing of the public enterprises will be key to fiscal discipline. Public enterprise borrowing in recent years has undermined the overall fiscal stance and crowded out private sector borrowing. In the first five months of 2008/09, public enterprise borrowing amounted to about 1.6 percent of full-year GDP, although the debt of the Oil Stabilization Fund is expected to be gradually repaid from early 2009.

- Stricter liquidity control will be required to contain broad money growth, which remained high at 22.7 percent in November 2008. Liquidity control would require a more determined effort to eliminate net central bank advances to the government. Staff also recommended that treasury bill sales be stepped up as a monetary management tool, rather than relying on increases in reserve requirements. This would require raising treasury bill rates, which are currently under 1 percent. Guiding interest rates higher would also serve medium-term policy objectives of encouraging saving and financial deepening: highly negative real interest rates are currently fostering a decline in real growth in deposits in the banking system.

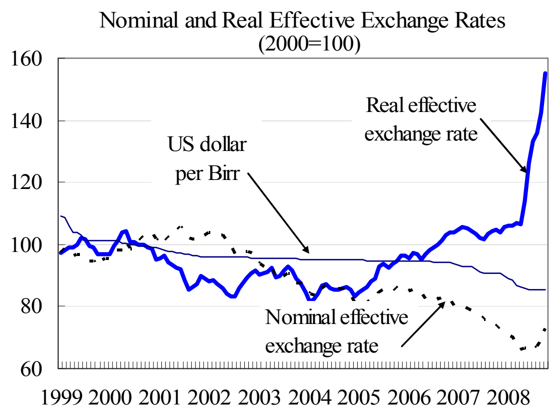
- Stepped-up bank supervision is needed to forestall risks to the financial system. The prospect of a sharp slowdown in real growth and inflation could expose loan quality problems. Failure of private banks would set back progress in developing the financial system.

9. **The authorities recognize the need for increased exchange rate flexibility to address growing competitiveness concerns**. In the presence of modest nominal adjustment in the exchange rate, high inflation has contributed to a rise in the real effective exchange rate in the past year by over 30 percent. Staff agreed that a sizable step-adjustment of the exchange rate could be counterproductive at a time when the authorities are still trying to get inflation expectations under control. But competitiveness needed to be kept under close review to ensure a sustainable medium-term balance of payments. In the meantime, the authorities agreed with the need for a stepped-up pace of depreciation, while carefully monitoring its implications for inflation expectation.[11]

[11] The birr-dollar exchange rate in the inter-bank market depreciated by 5 percent on January 2, 2009.



1. Data on paralle markets are only sporadically available in recent months.



IV. Macroeconomic Outlook and Risks

10. **The staff projects that the adjustment to the shocks and domestic imbalances will lead to a significant slowdown in Ethiopia's economic growth in 2008/09**. Tighter economic policies will restrain domestic demand and reduce overall GDP growth to 6.5 percent. Stepped-up donor assistance (see below) will help to soften the impact on the economy by providing financing for capital projects and foreign exchange for essential imports. This, along with lower import prices, would permit the rebuilding of foreign exchange reserves in line with the authorities' objective. On the assumption that food prices have reached a turning point (prices fell somewhat in October and November 2008 and, with the harvest reported to be good, further declines are expected in the next few months), 12-month inflation would decline to below 20 percent by the end of 2008/09. But given the steep price rises at the beginning of the fiscal year, average CPI inflation will be above 40 percent.

11. **The risks to the outlook are decidedly on the downside given the intensifying global economic downturn**. Demand for Ethiopia's exports, remittances, aid, and foreign direct investment could all be significantly lower than assumed in the projection. Should the risks materialize, the objective of rebuilding the foreign exchange reserves would be jeopardized and economic growth would likely be reduced further, setting back Ethiopia's efforts to reduce widescale poverty.

V. External Financing Needs and Donor Support

12. **Ethiopia's international partners have recognized Ethiopia's difficult situation and plan to raise their concessional project financing and budget support substantially**

in 2008/09. The staff estimates external financing could be up to US$750 million higher than loan and grant disbursements in 2007/08 (Table 5). This includes recently approved emergency support for food and fertilizer purchases of US$275 million from the World Bank and US$64 million from the African Development Bank.

13. **The authorities request the Fund's support under the rapid-access component of the ESF in the amount of SDR 33.425 million (25 percent of quota).** The full amount would become available upon Board approval. ESF access would not only close the remaining financing gap in 2008/09, but also strengthen the credibility of Ethiopia's macroeconomic policy commitment. Several donors have been delaying disbursements because of concerns about Ethiopia's macroeconomic situation. Approval of the authorities' request for the rapid-access component of the ESF, based on sound policy commitments from the authorities, would provide them with considerable reassurance.

VI. Capacity to Repay the Fund

14. **Ethiopia has adequate capacity to repay the Fund (Table 6)**. Following HIPC assistance and MDRI debt relief, Ethiopia's NPV of external debt has declined to less than 7 percent of GDP and under 50 percent of exports. Future repayments to the Fund would be negligible in relation to exports (estimated to peak at only 0.14 percent of exports in 2015). However, the investment plans of the public enterprises are likely to sharply raise the ratio of NPV of debt to exports in coming years.[12] Therefore, the mission continued to urge the authorities to strengthen debt management capacity and cautioned against contracting nonconcessional external loans.

15. **The authorities have requested a safeguards assessment update**. The last assessment was conducted in 2001. Most recommendations of that assessment were implemented.

VII. Staff Appraisal

16. ***Staff supports the authorities' request for the rapid access component of the exogenous shocks facility:***

- Unexpectedly sharp increases in commodity prices have pushed Ethiopia's foreign reserves position into critical territory and contributed to high inflation.

- In consultation with staff, the authorities have put together an appropriate policy package to address the shocks as well as underlying domestic economic imbalances and stand ready to take additional actions should risks to the balance of payments

[12] See IMF Country Report No. 08/264 for the latest joint Bank-Fund Debt Sustainability Analysis for Ethiopia. The conclusion that Ethiopia remains at moderate risk of debt distress still holds.

materialize. Sustained implementation of the package would lay the ground for a durable solution to the current balance of payments difficulties. The package includes appropriate domestic fuel price adjustments and substantial fiscal and monetary policy tightening. The authorities have also committed not to introduce or intensify exchange and trade restrictions.

- The authorities have already taken significant steps to implement these policy commitments, as demonstrated in their policies to eliminate fuel subsidies and to implement the revised budget.

- The disbursement from the rapid-access component of the ESF would close the remaining financing gap in 2008/09 and, more importantly, contribute to a broader effort by Ethiopia's development partners to help Ethiopia adjust to the shocks and limit the impact of adjustment on poverty reduction.

17. ***At the same time the authorities' adjustment efforts are subject to significant risks***:

- The commodity price shocks are unwinding rapidly but at the same time the global economic environment has deteriorated considerably. Thus, although improved terms of trade provide an opportunity to rebuild foreign exchange reserves, the balance of payments situation is likely to remain difficult in the coming year.

- Poor control over the activities of the public enterprises threatens efforts to ensure fiscal discipline and risks crowding out private sector credit.

- Money growth has yet to be reined in sufficiently. Liquidity control will require discipline in the use of central bank advances to the government.

- The rapid appreciation of the real effective exchange rate is a concern and requires greater exchange rate flexibility.

18. ***The authorities are thus urged to implement their policy commitments forcefully.***

Table 1. Ethiopia: Selected Economic and Financial Indicators, 2004/05–2009/10 [1]

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
				Est.	Proj.	Proj.
	(Annual percentage change)					
National income and prices						
GDP at constant prices (at factor cost)	12.6	11.5	11.5	11.6	6.5	7.0
GDP deflator	9.9	11.6	16.8	25.9	42.7	13.7
Consumer prices (period average)	6.8	12.3	15.8	25.3	42.2	13.3
Consumer prices (end period)	13.0	0.0	15.1	55.3	15.7	12.1
External sector						
Exports, (In U.S. dollars, f.o.b.)	41.1	18.1	18.8	23.3	10.6	8.9
Imports, (In U.S. dollars, c.i.f.) [2]	40.4	29.5	12.5	33.2	3.4	8.1
Export volume	21.1	5.1	11.5	1.0	12.1	9.2
Import volume [2]	28.6	21.2	3.5	13.8	10.8	11.1
Terms of trade (deterioration –)	7.3	4.4	-1.6	2.5	6.3	2.8
Nominal effective exchange rate (end of period)	-1.5	-1.8	-7.5	-13.0	...	...
Real effective exchange rate (end of period)	8.2	6.0	3.8	24.2	...	...
	(Percent of beginning-period stock of broad money, unless otherwise indicated)					
Money and credit						
Net foreign assets	-0.3	-1.6	1.4	-3.1	10.6	11.2
Net domestic assets (including other items)	19.9	19.0	18.3	25.8	7.7	7.6
Net claims on the government (net)	9.3	7.1	9.0	6.8	0.0	1.5
Claims on public enterprises	11.3	4.9	6.1	19.0	9.3	5.3
Claims on private sector	8.9	8.8	9.2	7.9	4.3	6.1
Broad money	19.6	17.4	19.7	22.7	18.3	18.8
Velocity (GDP/broad money)	2.63	2.77	3.01	3.52	4.40	4.51
Lending rates (maximum rate)	14.0	14.0	15.0	15.0	…	…
Treasury bill (91-day maturity)	0.05	0.04	0.79	0.58	…	…
	(In percent of GDP, unless otherwise indicated)					
Financial balances						
Gross domestic saving	3.0	3.7	5.6	3.2	1.8	0.8
Government saving	2.4	2.7	1.4	1.5	2.8	2.7
Private saving	0.6	0.9	4.2	1.7	-0.9	-1.8
Gross domestic investment	23.0	24.2	25.0	21.2	19.9	16.7
Government investment	14.7	16.7	18.2	15.3	14.5	12.8
Private investment	8.3	7.6	6.7	5.9	5.4	4.0
Resource gap	-20.0	-20.6	-19.3	-18.0	-18.1	-15.9
External current account balance, including official transfers	-6.3	-9.1	-4.5	-5.6	-5.8	-5.2
Government finances						
Revenue	14.6	14.8	12.7	12.1	12.6	12.4
Tax revenue	11.6	10.8	10.1	9.7	9.4	9.4
Nontax revenue	3.0	4.1	2.6	2.4	3.2	3.0
External grants	4.3	3.6	4.4	4.0	3.9	3.1
Expenditure and net lending	23.3	22.3	20.7	19.1	17.9	16.8
Fiscal balance, excluding grants (cash basis)	-8.7	-7.4	-8.0	-7.0	-5.4	-4.5
Fiscal balance, including grants (cash basis)	-4.4	-3.9	-3.6	-2.9	-1.5	-1.4
Total financing (including residual)	4.4	3.9	3.6	2.9	1.5	1.4
External financing	2.2	1.1	1.1	1.0	1.3	1.1
Domestic financing (not including privatization)	3.3	2.1	3.6	2.7	0.0	0.3
Public debt	79.6	68.1	40.7	35.9	31.4	31.7
Domestic debt [3]	30.7	30.9	28.9	24.0	17.0	14.1
External debt (including to Fund)	48.9	37.3	11.8	11.9	14.5	17.6
Net present value (NPV) of external debt-to-exports ratio (including to Fund) [4]	n.a.	n.a.	48.5	57.3	94.2	128.3
External debt-service ratio [5]	4.0	3.7	3.7	1.2	3.0	6.1
Overall balance of payments (in millions of U.S. dollars)	-102	-316	21	-174	416	544
Gross official reserves (in millions of U.S. dollars) [6]	1,555	1,158	1,326	906	1,372	1,916
(in months of imports of goods and nonfactor services of following year)	3.4	2.2	1.9	1.2	1.8	2.3
GDP at current market prices (in billions of birr)	106.5	131.7	170.9	245.6	363.0	441.8

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. Excluding aircraft and telecom purchases.

3. Whole series was revised.

4. Including debt of major public enterprises.

5. After enhanced HIPC and MDRI relief.

6. From 2005/06, data is on end-June basis.

Table 2. Ethiopia: General Government Operations, 2004/05–2009/10

(Millions of birr)

	2004/05	2005/06	2006/07	2007/08	2008/09		2009/10
					Revised	Staff	Staff
	Act.	Act.	Act.	Act.	Budget	Proj.	Proj.
Total revenue and grants	20,147	24,251	29,381	39,705	63,801	59,847	68,450
Revenue	15,582	19,530	21,797	29,794	46,858	45,593	54,589
Tax revenue	12,398	14,159	17,354	23,801	33,382	34,117	41,351
Direct taxes	3,930	4,461	5,168	7,015	11,592	10,230	12,349
Indirect taxes	8,468	9,698	12,186	16,785	21,790	23,887	29,002
Domestic indirect taxes	2,721	3,111	3,997	5,092	6,560	7,010	8,462
Import duties and taxes	5,746	6,587	8,189	11,693	15,230	16,877	20,540
Nontax revenue	3,184	5,371	4,444	5,993	13,476	11,476	13,237
Grants	4,565	4,721	7,583	9,911	16,942	14,254	13,861
Emergency assistance (food and nonfood aid)	721	586	411	401	500	635	775
Program grants [1]	2,331	950	4,091	5,477	9,798	8,526	7,521
Multilateral Debt Relief Initiative [2]	...	989	...	...	...	...	...
Project grants	1,513	2,196	3,081	4,034	6,645	5,093	5,566
Total expenditure and net lending (cash basis) [3]	24,796	29,325	35,607	46,915	67,449	65,152	74,429
Recurrent expenditure [3]	13,229	15,234	17,165	22,794	30,475	31,223	38,156
Defense spending	2,920	3,009	3,005	3,453	4,000	4,000	4,788
Poverty-reducing expenditure [4]	4,968	6,493	7,795	10,627	13,097	14,461	17,600
Interest payments	1,011	1,054	1,207	1,133	2,207	2,242	3,209
Domestic interest and charges	525	621	727	908	1,777	1,812	2,875
External interest payments [5]	486	433	480	225	430	430	334
Emergency assistance (food and other emergency aid)	721	586	411	401	500	635	775
Other recurrent expenditure	3,609	4,091	4,748	7,181	10,671	9,886	11,785
Capital expenditure [3]	11,343	14,041	18,398	24,121	36,974	33,930	36,273
Central treasury	8,376	10,785	13,832	18,277	26,849	24,982	25,722
External project grants	1,513	2,196	3,081	4,034	6,645	5,093	5,566
External project loans	1,454	1,061	1,484	1,810	3,480	3,854	4,985
Special programs [6]	224	50	44	0	0	0	0
Overall balance							
Including grants	-4,649	-5,074	-6,227	-7,210	-3,648	-5,305	-5,979
Excluding grants	-9,214	-9,795	-13,810	-17,121	-20,591	-19,559	-19,841
Excluding MDRI	...	-6,063	...	...	...	...	...
Financing	5,886	3,259	8,159	9,984	3,648	5,305	5,979
Net external financing	2,384	1,512	1,913	2,396	3,188	4,845	4,779
Gross borrowing	2,507	1,520	1,774	1,810	3,480	5,137	4,985
Capital budget	1,454	1,061	1,484	1,810	3,480	3,854	4,985
Special program	273	459	290	0	0	1,283	0
HIPC debt relief [5]	728	926	1,057	988	165	165	0
Amortization [5]	-851	-934	-919	-402	-457	-457	-205
Total net domestic financing	3,492	1,747	6,246	6,580	0	0	1,200
Domestic (net)	3,492	2,736	6,246	6,580	0	0	1,200
Banking system	3,156	2,876	4,259	3,879	0	0	1,200
Nonbank sources	336	-141	1,988	2,701	0	0	0
MDRI, account held at NBE [2]	...	-989	...	...	...	...	...
Privatization	10	0	0	1,008	460	460	0
Float/unidentified financing	-1,237	1,816	-1,932	-2,774	0	0	0
Memorandum items:							
Poverty-reducing expenditure	14,004	18,290	22,366	30,051	42,871	47,335	57,612
Direct budget support (loans plus grants, US$ millions)	360	109	465	588	935	814	626
External grants and loans (US dollars per capita)	11	10	14	16	24	23	19
Primary fiscal balance, including grants	-3,638	-4,020	-5,020	-6,077	-1,441	-3,063	-2,770
Domestic fiscal balance, including grants	-5,039	-5,520	-8,354	-10,651	-9,536	-9,547	-8,181
Gross domestic government debt	31,911	38,841	45,088	51,668	51,668	51,668	52,868

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. Debt relief from the IMF under the MDRI is recorded in 2005/06. Withdrawal from the special account at the NBE is assumed to take place from FY2006/07 and FY2007/08.
3. Excluding special programs (demobilization and reconstruction).
4. Poverty-reducing spending is defined to include total spending on health, education, agriculture, roads, and food security.
5. External interest and amortization are presented before HIPC debt relief from the World Bank and African Development Bank.
6. Demobilization and reconstruction.

Table 3. Ethiopia: General Government Operations, 2004/05–2009/10
(In percent of GDP)

	2004/05	2005/06	2006/07	2007/08	2008/09		2009/10
					Revised	Staff	Staff
	Act.	Act.	Act.	Act.	Budget	Proj.	Proj.
Total revenue and grants	18.9	18.4	17.1	16.2	19.4	16.5	15.5
Revenue	14.6	14.8	12.7	12.1	14.3	12.6	12.4
Tax revenue	11.6	10.8	10.1	9.7	10.2	9.4	9.4
Direct taxes	3.7	3.4	3.0	2.9	4.6	2.8	2.8
Indirect taxes	8.0	7.4	7.1	6.8	6.6	6.6	6.6
Domestic indirect taxes	2.6	2.4	2.3	2.1	3.0	1.9	1.9
Import duties and taxes	5.4	5.0	4.8	4.8	6.4	4.6	4.6
Nontax revenue	3.0	4.1	2.6	2.4	4.1	3.2	3.0
Grants	4.3	3.6	4.4	4.0	5.2	3.9	3.1
Emergency assistance (food and nonfood aid)	0.7	0.4	0.2	0.2	0.2	0.2	0.2
Program grants [1]	2.2	0.7	2.4	2.2	3.0	2.3	1.7
Multilateral Debt Relief Initiative [2]	...	0.8	0.0	0.0	...	...	...
Project grants	1.4	1.7	1.8	1.6	2.0	1.4	1.3
Total expenditure and net lending (cash basis) [3]	23.3	22.3	20.7	19.1	20.5	17.9	16.8
Recurrent expenditure [3]	12.4	11.6	10.0	9.3	9.3	8.6	8.6
Defense spending	2.7	2.3	1.7	1.4	1.4	1.1	1.1
Poverty-reducing expenditure [4]	4.7	4.9	4.5	4.3	4.0	4.0	4.0
Interest payments	0.9	0.8	0.7	0.5	0.7	0.6	0.7
Domestic interest and charges	0.5	0.5	0.4	0.4	0.5	0.5	0.7
External interest payments [5]	0.5	0.3	0.3	0.1	0.1	0.1	0.1
Emergency assistance (food and other emergency aid)	0.7	0.4	0.2	0.2	0.2	0.2	0.2
Other recurrent expenditure	3.4	3.1	2.8	2.9	2.9	2.7	2.7
Capital expenditure [3]	10.7	10.7	10.7	9.8	11.2	9.3	8.2
Central treasury	7.9	8.2	8.0	7.4	9.0	6.9	5.8
External project grants	1.4	1.7	1.8	1.6	2.0	1.4	1.3
External project loans	1.4	0.8	0.9	0.7	1.1	1.1	1.1
Of which: poverty-reducing expenditure [5]	8.5	9.0	8.5	7.9	9.1	9.1	9.1
Special programs [6]	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance							
Including grants	-4.4	-3.9	-3.6	-2.9	-1.1	-1.5	-1.4
Excluding grants	-8.7	-7.4	-8.0	-7.0	-6.3	-5.4	-4.5
Excluding MDRI	...	-4.6	... ..	...	...	...	...
Financing	5.5	2.5	4.7	4.1	1.1	1.5	1.4
Net external financing	2.2	1.1	1.1	1.0	1.0	1.3	1.1
Gross borrowing	2.4	1.2	1.0	0.7	1.1	1.4	1.1
Capital budget	1.4	0.8	0.9	0.7	1.1	1.1	1.1
Special programs	0.3	0.3	0.2	0.0	0.0	0.4	0.0
HIPC debt relief [5]	0.7	0.7	0.6	0.4	0.1	0.0	0.0
Amortization [5]	-0.8	-0.7	-0.5	-0.2	-0.1	-0.1	0.0
Total net domestic financing	3.3	1.3	3.6	2.7	0.0	0.0	0.3
Domestic (net)	3.3	2.1	3.6	2.7	0.0	0.0	0.3
Banking system	3.0	2.2	2.5	1.6	0.0	0.0	0.3
Nonbank sources	0.3	-0.1	1.2	1.1	0.0	0.0	0.0
MDRI, account held at NBE [2]	...	-0.8	0.0	0.0	0.0	0.0	0.0
Privatization	0.0	0.0	0.0	0.4	0.1	0.1	0.0
Float/unidentified financing	-1.2	1.4	-1.1	-1.1	0.0	0.0	0.0
Memorandum items:							
Poverty-reducing expenditure	13.2	13.9	13.0	12.2	13.0	13.0	13.0
Direct budget support (loans plus grants, as a percent of GDP)	2.9	0.7	2.4	2.2	3.0	2.3	1.7
Primary fiscal balance, including grants	-3.4	-3.1	-2.9	-2.5	-0.4	-0.8	-0.6
Domestic fiscal balance, including grants	-4.7	-4.2	-4.9	-4.3	-2.9	-2.6	-1.9
Gross domestic government debt	30.0	29.5	26.2	21.0	15.7	14.2	12.0

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

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

2. Debt relief from the IMF under the MDRI is recorded in 2005/06. Withdrawal from the special account at the NBE is assumed to take place from FY2006/07 and FY2007/08.

3. Excluding special programs (demobilization and reconstruction).

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

5. External interest and amortization are presented before HIPC debt relief from the World Bank and African Development Bank.

6. Demobilization and reconstruction.

Table 4. Ethiopia: Monetary Survey, 2004/05–2009/10 [1]

	2004/05	2005/06	2006/07	2007/08 est.	2008/09 Proj.	2009/10 Proj.
			(Millions of birr)			
Net foreign assets	13,896	13,251	13,927	12,141	19,544	28,802
National Bank of Ethiopia (NBE)	9,670	7,312	8,179	6,472	12,883	21,342
Assets	13,477	9,389	11,807	9,233	16,127	24,975
Liabilities	3,807	2,077	3,628	2,761	3,244	3,633
Commercial banks	4,227	5,939	5,748	5,670	6,661	7,460
Assets	6,133	7,684	7,719	8,075	9,487	10,625
Liabilities	1,906	1,745	1,971	2,405	2,826	3,165
Net domestic assets	26,556	34,235	42,923	57,600	62,984	69,263
Domestic credit	41,652	50,044	61,595	80,778	90,253	100,814
Claims on government (net) [2]	23,156	26,040	30,297	34,169	34,169	35,369
NBE	19,071	18,804	24,065	34,716	34,716	34,716
Commercial banks	4,085	7,236	6,232	-547	-547	653
Claims on nongovernment	18,496	24,003	31,297	46,609	56,084	65,445
NBE	0	0	0	0	0	0
Commercial banks	18,496	24,003	31,297	46,609	56,084	65,445
Public enterprises	5,967	7,936	10,845	21,654	28,162	32,530
Private sector	12,529	16,069	20,452	24,955	27,922	32,915
Other items (net)	-15,095	-15,810	-18,672	-23,178	-27,269	-31,551
Broad money	40,451	47,486	56,850	69,741	82,528	98,065
Money	21,429	24,701	29,763	36,699	42,950	50,745
Currency outside banks	10,063	11,360	13,704	17,613	20,090	23,413
Demand deposits	11,366	13,341	16,060	19,086	22,860	27,333
Quasimoney	19,022	22,784	27,087	33,042	39,577	47,320
Savings deposits	17,403	20,688	23,759	29,847	35,750	42,744
Time deposits	1,619	2,097	3,328	3,195	3,827	4,576
			(Annual percent change, unless otherwise indicated)			
Net foreign assets	-0.7	-4.6	5.1	-12.8	61.0	47.4
Net domestic assets	34.0	28.9	25.4	34.2	9.3	10.0
Domestic credit	31.5	20.1	23.1	31.1	11.7	11.7
Claims on government (net)	15.7	12.5	16.3	12.8	0.0	3.5
Claims on nongovernment	58.5	29.8	30.4	48.9	20.3	16.7
Public enterprises	178.3	33.0	36.7	99.7	30.1	15.5
Private sector	31.5	28.3	27.3	22.0	11.9	17.9
Broad money	19.6	17.4	19.7	22.7	18.3	18.8
Money	18.1	15.3	20.5	23.3	17.0	18.1
Quasimoney	21.3	19.8	18.9	22.0	19.8	19.6
Memorandum items:						
Reserve money growth	73.9	-10.2	27.4	32.3	14.1	16.5
Money multiplier	1.8	2.3	2.2	2.0	2.1	2.1
Velocity (GDP/broad money)	2.63	2.77	3.01	3.52	4.40	4.51
Net foreign assets of the banking system (US$ millions)	1,603	1,524	1,542	1,258	1,723	2,268
Excess reserves (percent of deposits)	33.1	16.2	19.4	10.4	6.8	6.3

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 5. Ethiopia: Balance of Payments, 2005/06–2009/10

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

	2005/06	2006/07 Est.	2007/08 Est.	2008/09 Proj.	2009/10 Proj.
Trade balance	-3,592	-3,939	-5,344	-6,092	-6,027
Exports of goods	1,001	1,189	1,466	1,622	1,766
Coffee	354	424	525	552	589
Horticulture	22	64	112	136	177
Other	647	701	829	933	1,000
Imports of goods	4,593	5,128	6,811	7,714	7,793
Semi-Finished	821.6	800	1260		
Fuel	861	895	1,621	1,339	1,289
Capital goods	1,453	1,869	1,777	2,476	2,485
Of which: aircraft	68	38	30	0	210
Of which: Public investment related imports [2]	853	1,064	1,312	1,598	1,486
Nonfactor services (net)	149	161	126	164	184
Exports of nonfactor services	1,105	1,301	1,597	1,779	1,969
Imports of nonfactor services	955	1,140	1,472	1,616	1,785
Income (net)	-38	14	33	-20	-72
Of which : gross official interest payments [3]	-62	-35	-19	-63	-135
Private transfers (net)	1,229	1,696	2,393	2,240	2,353
Current account balance, excl. official transfers	-2,252	-2,069	-2,793	-3,709	-3,563
(Percent of GDP)	-14.8	-10.6	-10.6	-10.7	-9.7
Excluding EAL imports	-14.4	-10.5	-10.5	-10.7	-9.1
Official transfers (net)	866	1,199	1,306	1,692	1,647
Current account balance, incl. official transfers	-1,386	-870	-1,487	-2,017	-1,915
(Percent of GDP)	-9.1	-4.5	-5.6	-5.8	-5.2
Excluding EAL imports	-8.7	-4.3	-5.5	-5.8	-4.6
Capital account balance (incl. errors and omissions)	1,070	891	1,313	2,433	2,460
Foreign direct investment (net)	365	482	815	641	662
Other investment (net)	163	215	653	1,792	1,798
Official long-term loans	80	239	742	1,792	1,896
Disbursements	343	345	759	1,832	1,989
Public Enterprises			357	962	1,131
Amortization [3]	263	106	17	39	93
Public Enterprises	41	40	0	0	57
Other public sector long-term loans (net) [4]	-7	0	0	0	-49
Other (net)	90	-24	-89	0	-49
Errors and omissions	542	194	-154	0	0
Overall balance	-316	21	-174	416	544
Financing	316	3	263	-416	-544
Central bank (net; increase –)	293	-39	244	-466	-544
Reserves (increase –)	397	-168	420	-466	-544
Liabilities (increase +)	-104	129	-176	0	0
Financing Gap [8]				50	
Memorandum items:					
Exports of goods (percent change)	18.1	18.8	23.3	10.6	8.9
Export price index (percent change)	13.1	7.3	22.3	-1.5	-0.3
Export volume index (percent change)	5.1	11.5	1.0	12.1	9.2
Imports of goods (percent change) [7]	29.5	12.5	33.2	3.4	8.1
Import price index (percent change)	8.3	9.0	19.4	-7.4	-3.0
Import volume index (percent change) [7]	21.2	3.5	13.8	10.8	11.1
Gross official reserves	1,158	1,326	906	1,372	1,916
(Months of imports of goods and nonfactor services of following year)	2.2	1.9	1.2	1.8	2.3
Terms of trade index, percent change	4.4	-1.6	2.5	6.3	2.8

Sources: Ethiopian authorities, and IMF staff estimates and projections.

1. Data pertain to the period July 1-June 30.
2. Assuming an import content of 50 percent except for ETC (65 percent).
3. For 2006/07, incorporates MDRI debt relief.
4. Public enterprises.
5. Includes 1997 and 2001 Paris Club rescheduling agreements (including Russia) on Naples terms, 2002 Paris Club topping up to Cologne terms, and HIPC relief (including interim relief including estimates of relief beyond HIPC and relief on non-Paris Club debt under negotiation).
6. Foreign aid is defined as official transfers and inflows of loans to the government.
7. Excluding aircraft and telecom purchases
8. The financing gap is expected to be closed by the projected ESF.

Table 6. Ethiopia: Indicators of Capacity to Repay the Fund, 2007–18

			Projections									
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Fund obligations based on existing credit												
(in millions of SDRs)												
Principal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.5	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
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	3.3	6.7	6.7	6.7	6.7
Charges and interest	0.5	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.0
Total obligations based on existing and prospective credit [1]												
In millions of SDRs	0.5	0.3	0.3	0.3	0.3	0.3	0.3	3.6	6.9	6.9	6.9	6.8
In millions of U.S. dollars	0.7	0.5	0.4	0.4	0.4	0.4	0.4	5.5	10.6	10.6	10.5	10.4
In percent of exports of goods and services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1
In percent of debt service [2]	0.5	0.4	0.3	0.2	0.1	0.1	0.1	0.7	1.2	1.1	1.1	1.1
In percent of quota	0.3	0.2	0.2	0.2	0.2	0.2	0.2	2.7	5.2	5.2	5.1	5.1
In percent of gross international reserves	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.2	0.3	0.2	0.2	0.2
Outstanding Fund credit												
In millions of SDRs	0.0	0.0	33.4	33.4	33.4	33.4	33.4	30.1	23.4	16.7	10.0	3.3
In millions of U.S. dollars	0.0	0.0	50.7	50.8	51.0	51.1	51.2	46.1	35.9	25.6	15.4	5.1
In percent of exports of goods and services	0.0	0.0	1.5	1.4	1.2	1.1	0.9	0.7	0.5	0.3	0.2	0.0
In percent of debt service [2]	0.0	0.0	41.5	19.0	12.6	8.8	7.4	5.8	4.0	2.6	1.6	0.5
In percent of quota	0.0	0.0	25.0	25.0	25.0	25.0	25.0	22.5	17.5	12.5	7.5	2.5
In percent of gross international reserves	0.0	0.0	3.7	2.7	2.3	2.0	1.8	1.4	0.9	0.6	0.3	0.1
Memorandum items:												
Exports of goods and services (millions of U.S. dollars) [3]	2,490	3,064	3,401	3,735	4,164	4,830	5,681	6,620	7,646	8,840	10,052	11,182
Debt service (millions of U.S. dollars) [2, 3]	142	119	122	268	405	577	691	800	896	980	990	961
Quota (millions of SDRs)	134	134	134	134	134	134	134	134	134	134	134	134
Gross international reserves (millions of U.S. dollars) [3]	1,326	906	1,372	1,916	2,230	2,497	2,881	3,208	3,948	4,633	5,058	5,065
GDP (millions of U.S. dollars) [3]	19,431	26,351	34,659	36,760	39,071	41,297	44,518	48,079	51,925	56,079	60,566	65,411

Sources: Fund staff estimates and projections.

1. Assumes a disbursement of 25 percent of quota under the rapid access component of the ESF in January 2009.
2. Including IMF repurchases and repayments in total external debt service.
3. Figures are based on fiscal year (June-July).

Appendix

Ethiopia—Letter of Intent

Addis Ababa, December 15, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington DC

Dear Managing Director:

The pursuit of growth-oriented policies crucial for poverty reduction, the direction of efforts at maintaining supportive macroeconomic stability, and the advancement of structural reforms have contributed to the Ethiopian economy making significant progress in recent years. Effective implementation of these policies has induced robust real GDP growth averaging 11.5 percent per annum during the last five years. The strong growth, sustained mainly by increased agricultural production, public-private investment in construction, manufacturing, power, tourism, and financial services, has contributed to significant poverty reduction and better prospects for the achievement of the MDGs. Agriculture will continue to be the major contributor to economic growth, given substantial investment in irrigation schemes, with non-agricultural sectors also playing an increasing role.

In the meantime, Ethiopia is facing the challenge of sustaining high growth as the slowing global economy dampens demand for and revenue from commodity exports. This situation is further compounded by increasing inflationary pressure, driven largely by high food and fuel prices. The annual average CPI inflation stood at about 15.8 percent in 2006/07 and increased to 25.3 percent in 2007/08. The inflation rate is expected to slow down during the course of 2008/09 owing to an envisaged good harvest and the prudent fiscal and monetary policies being pursued.

Unexpectedly high oil and fertilizer prices have also undermined the balance of payments. The rapid economic growth witnessed in recent years has been supported by strong exports, which have registered an annual average growth rate of 20.9 percent during the last two years. However, with import costs rising rapidly, the country's current account as well as the overall balance of payments deficit has widened and the international reserves have come under heavy pressure, dropping to about 6 weeks of imports of goods and services at end - November 2008.

Impact of the Shocks

In addition to the traditional concerns of ensuring fiscal prudence and debt sustainability, containing inflation, and sustaining growth, we thus have to find immediate solutions to the shock to the economy caused by high food, fertilizer and fuel import costs.

Let us elaborate further on the pervasive impact of these shocks and the challenges they pose. The inflationary hike, caused mainly by higher food prices and to a lesser extent by non-food inflation of commodities such as fuel, fertilizer and construction materials, is having a severe negative impact particularly on the urban poor as well as on overall economic performance. In turn, even with the more recent decline in world food, fertilizer and fuel prices, we see that a weak balance of payments will persist in the coming years. In 2008/09, emergency wheat imports of US$182 million are needed to help stabilize domestic prices and reduce the impact on the poor. Imports of oil, even with the decline in price, will remain very high by historical standards at close to US$1.5 billion.

Policies to Address the Shocks

To mitigate the impact of these shocks on Ethiopia's economy, the Ethiopian government has taken concerted fiscal, monetary and administrative measures and will continue to do so

- The government has eliminated the entire fuel subsidy in October 2008.

- In order to provide a more effective subsidy to the poor, we will continue to import grains and distribute them at cost through local markets.

- In the monetary area, minimum deposit interest rate was increased and reserve and liquidity requirements of banks raised to restrain domestic credit expansion and monetary growth. We intend to contain the broad money growth below 20 percent in the current fiscal year. To achieve this target, the National Bank of Ethiopia (NBE) has committed to maintain net claims of the domestic banking system on the general government at zero over the course of 2008/09.

- On the fiscal front, the government will continue to focus on maintaining the deficit at a sustainable level, while at the same time, increasing spending in key poverty–oriented sectors. For this current year, we have decided to tighten fiscal policy well beyond original budget intentions. To this end, the government is committed in its revised budget to not borrow domestically from the banking system on net basis in

- the current fiscal year compared with the originally budgeted level of domestic borrowing of 1.5 percent of GDP and domestic borrowing of 2.7 percent of GDP in 2007/08. To achieve this, considerable efforts are being made to mobilize domestic revenue and reduce lower priority expenditure.

- Along with lowering the government's ceiling on domestic borrowing, we will closely follow the activities of public enterprises and reduce their domestic borrowing to between 4–8 billion birr (no more than 2½ percent of GDP) in 2008/09. A committee comprising officials from the Ministry of Finance and Economic Development and the NBE will be established to conduct monthly follow up. It will closely monitor the domestic financing of public enterprises and other public institutions and inform high-level policymakers who will seek corrective actions if necessary.

- Regarding the external sector, the government has continued to create a conducive environment for enhancing exports and private remittance transfers. The Government is committed to introduce greater flexibility in the foreign exchange market and will continue undertaking structural reforms to improve productivity and external competitiveness.

The government stands ready to implement other policy measures should the shocks turn out to be worse than expected.

Request for Fund Assistance under the ESF

Despite the foregoing efforts, the challenge remains huge in the short run. Cognizant of the difficulties, development partners such as the World Bank and AfDB have come up with mechanisms to help mitigate these problems. So far, agreements have been reached with the World Bank to redeploy US$137 million through restructuring the existing portfolio and to allocate new financing of US$130 million. The AfDB is to redeploy US$64 million in response to the food crisis and with the aim of improving domestic agricultural productivity in a sustainable manner, taking advantage of prevailing price incentives to promote an immediate supply response.

The challenges outlined above require urgent additional support. We therefore request that the IMF allow the Ethiopian government the maximum access of 25 percent of quota through the rapid access component of the Exogenous Shocks Facility (ESF) to help mitigate the problems. We intend to engage strongly with the Fund with respect to policy advice and have no intention of introducing or intensifying exchange and trade restrictions. We also will request an update of the safeguards assessment for the NBE.

With best regards,

_______/s/_______	_______/s/_______
Sufian Ahmed	Teklewold Atnafu
Minister	Governor

Statement by the IMF Staff Representative
January 23, 2009

1. The information below has become available since the staff report was issued. It does not alter the thrust of the staff appraisal.

2. Inflation eased further in December 2008. Food prices declined by some 8.9 percent compared with November 2008 helped by a good harvest and the distribution of the imported wheat at cost. With nonfood prices broadly unchanged from their November level, 12-month inflation declined sharply to 39.2 percent in December 2008 from 49.4 percent in November 2008. The latest data are consistent with staff's projection that 12-month inflation will fall to below 20 percent by mid-2009.

3. The authorities have taken the following measures, in line with their policy commitments laid out in the staff report:

- In the context of declining inflation, the official exchange rate against the U.S. dollar depreciated by 5 percent on January 15, 2009. This, together with a similar-size depreciation on January 2, brings the cumulative depreciation since end-2008 to over 10 percent.

- The inter-agency monitoring committee on public enterprise borrowing, comprising staff of the Ministry of Finance and Economic Development and the National Bank of Ethiopia, has been established. The committee has distributed a data request to concerned public enterprises. The committee will discuss the information collected and its findings will be reported on a monthly basis to high-level macroeconomic policy makers.

- The Oil Stabilization Fund continued to accumulate a surplus in December 2008. Its debt outstanding has been reduced by 728 billion birr (0.2 percent of full-year GDP) since October 2008.

Press Release No. 09/13
FOR IMMEDIATE RELEASE
January 23, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$50 Million Disbursement to the Federal Democratic Republic of Ethiopia Under the Exogenous Shocks Facility

The Executive Board of the International Monetary Fund (IMF) approved today a disbursement in an amount equivalent to SDR 33.425 million (about US$50 million) to the Federal Democratic Republic of Ethiopia under the rapid-access component of the Exogenous Shocks Facility (ESF).

In September 2008, the Executive Board approved modifications to the ESF, which make it faster to access, easier and more flexible to use, and capable of providing more financing. Those modifications came info effect in late November 2008. The disbursement to Ethiopia under the rapid-access component of the ESF helps mitigate the impact of higher fuel, food and fertilizer prices experienced by Ethiopia on its balance of payments in 2008.

Following the Executive Board's discussion, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, stated:

"Ethiopia's economy has been adversely affected by high commodity prices. Last year's steep increases in international prices of fuel, fertilizers, and cereals have considerably weakened Ethiopia's international reserves position and contributed to inflationary pressure. The more recent reversal of the commodity price hikes should help Ethiopia to replenish its international reserves and lower inflation. However, balance of payments pressures are likely to remain in the face of the severe global economic slowdown.

"The Ethiopian authorities have adopted an appropriate macroeconomic policy package to address the strains on the balance of payments and to reduce inflation. The package includes domestic fuel price adjustments, substantial fiscal and monetary policy tightening, and measures to protect vulnerable groups. To ensure a tight fiscal stance, the government is committed to avoiding net domestic financing for the current fiscal year and improving control over public enterprise borrowing. Monetary growth is to be slowed to under 20 percent.

“The authorities are urged to continue to implement their adjustment policies forcefully. This would enhance the basis for sustainable economic growth. In the current global economic environment, there are significant risks that exports, remittances, and foreign direct investment may fall short of expectations. If this proves to be the case, additional policy tightening will be needed to preserve the viability of the balance of payments.

“Together with stepped-up assistance from Ethiopia’s other international partners, the IMF’s financial support under the Exogenous Shocks Facility will help to mitigate the risk of an erosion of Ethiopia’s gains in poverty reduction in recent years,” Mr. Kato said.

ANNEX

Recent Economic Developments

Ethiopia's ambitious development policies have helped sustain average growth of 11.5 percent since 2003/04, consistent with the goal of reducing poverty. However, demand has been running ahead of the expansion in the capacity of the economy, contributing to high inflation and strong import growth. Twelve-month inflation eased to 40 percent in December 2008 as earlier food price increases are reversing. International reserves are equivalent to just one month of imports of goods and services.

International prices of oil and fertilizers rose from early 2007 to mid-2008 by 150 percent and 75 percent, respectively. This contributed to a doubling of the oil and fertilizer import bill in 2007/08 to almost US$2 billion (about 8 percent of GDP). The exogenous shocks have been responsible for pushing the balance of payments into a position of immediate and serious vulnerability. Soaring food prices have adversely impacted low-income households.

Policies to Address Shocks

The IMF's support under the rapid access component of the ESF will help smooth adjustment to a sizeable terms of trade shock, contribute to the rebuilding of international reserves and catalyze financing from Ethiopia's other international partners. To mitigate the impact of the exogenous shocks on the balance of payments and address domestic economic imbalances while protecting the most vulnerable, the authorities have adjusted domestic fuel prices, introduced measures to alleviate the adverse impact of high food prices, and are tightening monetary and fiscal policies significantly.

The authorities intend to take advantage of the reversal of the commodity price shock to rebuild foreign exchange reserves to 1.8 months of imports by end-2008/09 in line with their medium-term objective of bringing reserve cover to 3 months of imports.

Key measures are: the elimination of domestic fuel subsidies in October 2008 by adjusting regulated domestic prices to the import parity level; mitigating the impact of high food prices on low-income families through targeted assistance; significantly tightening fiscal policy by eliminating domestic borrowing; reducing public enterprises domestic borrowing to 1.1-2.2 percent of GDP in 2008/09, compared to 4.4 percent of GDP in 2007/08; and tightening monetary policy by targeting to reduce broad money growth to below 20 percent in 2008/09 from about 23 percent at end-2007/08.

Ethiopia: Selected Economic and Financial Indicators, 2004/05–2009/10[1]

	2005/06	2005/06	2006/07	2007/08 Est.	2008/09 Proj.	2009/10 Proj.
	(Annual percentage change)					
National income and prices						
GDP at constant prices (at factor cost)	12.6	11.5	11.5	11.6	6.5	7.0
Consumer prices (period average)	6.8	12.3	15.8	25.3	42.2	13.3
Consumer prices (end period)	13.0	11.6	15.1	55.3	15.7	12.1
External sector						
Exports (In U.S. dollars, f.o.b.)	41.1	18.1	18.8	23.3	10.6	8.9
Imports (In U.S. dollars, c.i.f.)[2]	40.4	29.5	12.5	33.2	3.4	8.1
Export volume	21.1	5.1	11.5	1.0	12.1	9.2
Import volume[2]	28.6	21.2	3.5	13.8	10.8	11.1
Terms of trade (deterioration -)	7.3	4.4	-1.6	2.5	6.3	2.8
	(Percent of beginning-period stock of broad money, unless otherwise indicated)					
Money and credit						
Net foreign assets	-0.3	-1.6	1.4	-3.1	10.6	11.2
Net domestic assets (including other items)	19.9	19.0	18.3	25.8	7.7	7.6
Net claims on the government (net)	9.3	7.1	9.0	6.8	0.0	1.5
Claims on public enterprises	11.3	4.9	6.1	19.0	9.3	5.3
Claims on private sector	8.9	8.8	9.2	7.9	4.3	6.1
Broad money	19.6	17.4	19.7	22.7	18.3	18.8
Velocity (GDP/broad money)	2.63	2.77	3.01	3.52	4.40	4.51
	(In percent of GDP, unless otherwise indicated)					
Financial balances						
Gross domestic saving	3.0	3.7	5.6	3.2	1.8	0.8
Government saving	2.4	2.7	1.4	1.5	2.8	2.7
Private saving	0.6	0.9	4.2	1.7	-0.9	-1.8
Gross domestic investment	23.0	24.2	25.0	21.2	19.9	16.7
Government investment	14.7	16.7	18.2	15.3	14.5	12.8
Private investment	8.3	7.6	6.7	5.9	5.4	4.0
Resource gap	-20.0	-20.6	-19.3	-18.0	-18.1	-15.9
External current account balance, including official transfers	-6.3	-9.1	-4.5	-5.6	-5.8	-5.2
Government finances						
Revenue	14.6	14.8	12.7	12.1	12.6	12.4
External grants	4.3	3.6	4.4	4.0	3.9	3.1
Expenditure and net lending	23.3	22.3	20.7	19.1	17.9	16.8
Fiscal balance, excluding grants (cash basis)	-8.7	-7.4	-8.0	-7.0	-5.4	-4.5
Fiscal balance, including grants (cash basis)	-4.4	-3.9	-3.6	-2.9	-1.5	-1.4
Total financing (including residual)	4.4	3.9	3.6	2.9	1.5	1.4
External financing	2.2	1.1	1.1	1.0	1.3	1.1
Domestic financing (not including privatization)	3.3	2.1	3.6	2.7	0.0	0.3
Public debt	79.6	68.1	40.7	35.9	31.4	31.7
Domestic debt[3]	30.7	30.9	28.9	24.0	17.0	14.1
External debt (including to Fund)	48.9	37.3	11.8	11.9	14.5	17.6
Net present value (NPV) of external debt-to-exports ratio (including to Fund)[4]	n.a.	n.a.	48.5	57.3	94.2	128.3
External debt-service ratio[5]	4.0	3.7	3.7	1.2	3.0	6.1
Overall balance of payments (in millions of U.S. dollars)	-102	-316	21	-174	416	544
Gross official reserves (in millions of U.S. dollars)[6]	1,555	1,158	1,326	906	1,372	1,916
(in months of imports of goods and nonfactor services of following year)	3.4	2.2	1.9	1.2	1.8	2.3
GDP at current market prices (in billions of birr)	106.5	131.7	170.9	245.6	363.0	441.8

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. Excluding aircraft and telecom purchases.
3. Whole series was revised.
4. Including debt of major public enterprises.
5. After enhanced HIPC and MDRI relief.
6. From 2005/06, data is on end-June basis.

Statement by Samuel Itam, Executive Director for The Federal Democratic Republic of Ethiopia

We thank staff for their concise and excellent paper and the quality of their dialogue with the authorities during the mission.

1. Ethiopia's committed drive to achieve socio-economic development under the Program for Accelerated and Sustainable Development (PASDEP) has achieved impressive results over the last five years. Growth has averaged 11 percent per year since 2003 bringing the Millennium Development Goals within reach and building a strong development momentum. However, the recent high price increases of imports of fuel, fertilizers, food and building materials coupled with an elevated import bill resulting from the development boom have diminished external reserves to critically low levels. The unfolding global economic and financial crisis will further exacerbate the pressure on the balance of payments. The authorities have therefore, requested disbursement from the Rapid Access Component of the Exogenous Shocks Facility to support their efforts to address the macroeconomic imbalances and to complement the assistance of other development partners in dealing with the shocks.

Recent Economic Developments (since Board discussions in July 2008)

2. It will be recalled that the Board in completing the Article IV Consultation with Ethiopia in July welcomed the sustained strong and diversified economic growth in recent years and noted that this was consistent with the achievement of the MDGs. Real economic growth has maintained its impressive track and inflation, which was propelled by high cereal, fuel and other import prices peaked in September and has begun to decline. The current good harvest is also expected to further alleviate some of the inflationary pressure. However, the exogenous shocks have reduced the external reserves to six weeks of import cover. As staff have noted, the balance of payments is in a position of immediate and serious vulnerability.

3. There have also been significant changes to the economic environment that Ethiopia has to confront. The serious global slowdown is expected to have substantial adverse impact on the local economy in regard to demand for the country's exports and FDI inflows. It also poses downside risks in regard to donor support (although donors remain overwhelmingly well disposed to the country), and concessional aid as well as remittances on which the economy relies heavily.

4. While the exogenous shock associated with the prices of most of the critical import commodities have passed, it has inflicted serious damage as it has forced the country to use a significant portion of its scarce reserves to absorb the shock. Moreover the

lagged impact inherent in early locked supply tenders for example as in the case of fertilizers still continues to put pressure. Additionally it is difficult to recover or build the reserves under the current global environment. Coffee exports, which had seen a large increase in 2007/08 are expected to be impacted by the slowdown. A drop of over 20 percent in coffee prices are likely in the current year. However, it is expected that the trading of coffee on the Ethiopian Commodity Exchange (ECEX) that started in November 2008 may mitigate the drop slightly.

Policies to address imbalances

5. The authorities are keenly aware of the seriousness of the current macroeconomic imbalances manifested in high inflation and low reserves as they are of the need to maintain their pro-growth policies and meet the long-term development challenges. They have thus continued to tackle the direct adverse impact of the exogenous shock while simultaneously undertaking a broad range of concerted fiscal, monetary and administrative policies and measures to address the vulnerabilities. They are committed to maintaining short term stability as they pursue long range structural transformation and reform. In this context they are committed to addressing inflationary overheating and building up of reserves as a matter of priority.

6. In this regard, the authorities have eliminated the entire fuel subsidy program and are implementing a policy of monthly adjustment of pump prices since October. The domestic fuel price is, however, still higher than the current import price or full cost recovery in order to replenish the Oil Stabilization Fund, thus contributing to the reduction of the debt of the public sector. The Fund has already recorded some surpluses. On the other hand, they will continue to import cereals and distribute them at cost. At the same time, taxes on some food items have been removed and cash transfers to safety net programs have been increased to mitigate the effect of high prices on the poor in a more effective way while ensuring food security.

7. The authorities have made a strong commitment to tighten fiscal policy by revising the budget targets so as to reduce domestic borrowing, contain expenditure and strengthen revenue collection. They have also resolved to rein in domestic borrowing by public enterprises and have established a high level committee of representatives of Ministry of Finance and National Bank of Ethiopia (NBE) to monitor implementation on a monthly basis. The authorities have indicated a willingness to cut lower priority expenditure, and in some instances even postpone investment spending if these do not compromise their commitment to the poor and achievement of the MDGs.

8. In regard to monetary policy, the authorities are committed to reduce broad money growth to below 20 percent in the 2008/09 financial year so as to curb inflation and

anchor inflation expectations. The NBE has also agreed to tightly manage the reserve money creation that arises from its lending to Government. Simultaneously, the authorities see the importance of addressing competitiveness concerns through ensuring exchange rate flexibility and have accordingly agreed to an increased pace of Birr (local currency) depreciation. In this regard, the Birr depreciated by 5 percent against the US Dollar on January 2.

Conclusion

9. The authorities are committed to the implementation of their PASDEP which is succeeding in generating meaningful growth and reducing poverty. The growth strategy which focuses on developing agriculture and other productive sectors, building infrastructure, expanding the service sector and developing human resources has garnered solid support from Ethiopia's development partners. These partners are, in addition to their support for the PASDEP, also ready to provide and in some instances have already extended supplemental assistance to help mitigate the impact of the exogenous shocks. The World Bank and the African Development Bank have reconfigured some of their support to address the shock and other bilateral and multilateral donors, according to staff estimates are ready to help contribute up to US$750 million dollars needed requiring the government to seek financing under the rapid access component of the ESF to cover the gap of about US$50 million.

10. The authorities recognize that the immediate priority for the coming months is to address the impact of the exogenous shocks and address the associated vulnerabilities. The sudden and exogenous shock has had serious negative consequences on the Ethiopian economy and exacerbated existing weaknesses and vulnerabilities. They are convinced that the support of the Fund and the other development partners in bridging the balance of payments gap will put them in a better position to undertake the broad long term reforms that they believe necessary to sustain the robust growth in the face of complex and difficult challenges. They believe that the policies and measures they have instituted will mitigate the shock and its after effects and are committed to complement these with any other additional action that is necessary. They value the Fund's financial support as well as the advice and appreciate the encouragement the institution provides to other development partners in their engagement with Ethiopia.