On November 30, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation [1] with the Federal Democratic Republic of Ethiopia.

In 2017/18, real gross domestic product (GDP) grew by 7.7 percent, driven by favorable harvests and rapid growth in air transport and manufacturing exports. However, political uncertainty, foreign exchange shortages, and adverse terms-of-trade trends hampered economic activity. The authorities succeeded in reducing the external current account deficit to 6.4 percent of GDP in 2017/18 through determined policies to restrict public sector imports and borrowing and a tight monetary policy stance. Prudent budget execution led to a lower-than-planned fiscal deficit, estimated at 3.7 percent of GDP. Tax revenue continued to disappoint and was offset by expenditure savings, while ring-fencing pro-poor programs. Inflation, at 12 percent in September 2018, has edged down but remains above the National Bank of Ethiopia (NBE)'s single-digit target reflecting lagged effects of public sector credit expansion in 2017, passthrough of the October 2017 devaluation, and political disruptions which affected distribution networks. The NBE reduced the growth of base money from 32 percent in July 2017 to 19 percent in June 2018 to rein in inflation. However, broad money and credit growth remained strong.

Growth is expected to step up in 2018/19 to 8.5 percent, supported by stronger confidence as the political uncertainty of previous years recedes, and external financial inflows, including FDI temporarily ease external financing constraints and foreign exchange shortages. The authorities have announced a budget for the fiscal year ending June 2019 built on prudent expenditure control. Also, they have committed to refrain from non-concessional financing for new projects and to shift ongoing projects to concessional financing when possible. The NBE has adopted a further tightening of the monetary policy stance which should help inflation converge to the authorities' target. The authorities have announced their intention to

open key economic sectors to domestic and foreign private investment and competition, including through privatization, public-private partnerships and concession agreements.

Executive Board Assessment **[2]**

Executive Directors agreed with the thrust of the staff appraisal. They noted that Ethiopia has maintained high and inclusive growth for more than a decade, achieving commendable progress in reducing poverty and improving living standards. However, the public sector led development strategy is reaching its limits, exacerbating external imbalances and raising public debt vulnerabilities. Directors commended the authorities for tightening macroeconomic policies to address these challenges. They welcomed the authorities' ambitious reform program aimed at catalyzing private investment and driving sustainable growth as set out in the Growth and Transformation Plan II.

Directors underscored the need for fiscal consolidation and higher revenue, through tax policy and administrative measures, further prioritization of public projects, reductions in the borrowing requirements of state owned enterprises (SOEs) and phasing out of implicit subsidies. Rationalization of tax exemptions and excise reform would help in this regard. Further improvements in public financial management and SOE governance and transparency are also warranted. Given the risks posed by the high debt burden, Directors called for strengthening public debt sustainability. They noted the efforts at reprofiling of non-concessional debt and welcomed the authorities' intention to contract new debt at concessional terms. Directors commended the authorities for their plans to protect social and pro poor spending.

Directors noted that the tighter monetary stance announced by the National Bank of Ethiopia (NBE) for 2018/19 is warranted to bring inflation down to target. This stance should be supported by restrictive public-sector credit policies, including gradually phasing out central bank financing of the budget. Exchange rate flexibility would help strengthen competitiveness, reduce foreign exchange shortages and support reserve accumulation. Directors recommended the elimination of the remaining exchange restrictions on current transactions.

Directors noted that financial sector reforms would increase the effectiveness of monetary policy and support development goals. These reforms should include the development of a market for government securities with market determined interest rates. Until this market develops, NBE bills should be used solely to manage liquidity in the banking system and delinked from funding of the Development Bank of Ethiopia which needs to complete a comprehensive financial assessment. Directors noted that channeling the payment of taxes through banks could deepen financial intermediation, reduce opportunities for corruption and improve the business climate. Gradual opening of the financial sector to foreign investors could improve services and transfer technology and know how. Directors also noted that continued efforts are required to strengthen the AML/CFT framework.

Directors stressed that implementation of structural reforms is critical to promoting competitive markets and improving the investment climate to catalyze private investment. Privatizations, public private partnerships with adequate safeguards, and removal of obstacles to private investment could support renewed growth momentum while attracting foreign resources and know how. Directors underscored the importance of addressing data gaps and delays to improve the quality of statistics. They welcomed Ethiopia's decision to join the African Continental Free Trade Agreement and looked forward to progress toward World Trade Organization membership. Directors also welcomed the joint analysis conducted with UN Women which shows that further reducing gender disparities would yield large economic benefits over time and commended the authorities' efforts in this direction.

It is expected that the next Article IV consultation with The Federal Democratic Republic of Ethiopia will be held on the standard 12-month cycle.

The Federal Democratic Republic of Ethiopia: Selected Economic Indicators

2016/17

2017/18

2018/19

2019/20

2020/21

2021/22

2022/23

Actual

Estimate

IMF staff projections

(Annual percentage change, unless otherwise indicated)

National income and prices

GDP at constant prices (at factor cost)

10.7

7.7

8.5

7.6

7.1

7.0

7.0

GDP deflator

6.4

10.3

11.7

8.9

8.5

8.2

7.9

Consumer prices (period average)

7.3

13.0

10.6

8.2

8.0

8.0

8.0

Consumer prices (end period)

8.8

14.7

9.0

8.0

8.0

8.0

8.0

External Sector

Exports of goods and services (U.S. dollars, f.o.b.)

2.9

13.2

12.7

12.6

12.6

13.6

14.3

Imports of goods and services (U.S. dollars, c.i.f.)

-4.8

0.2

13.6

5.9

7.5

6.0

6.4

Export volume (goods)

-1.1

2.9

11.0

9.8

8.3

10.7

14.0

Import volume (goods)

-5.4

-9.2

9.5

4.4

6.6

4.6

5.0

Nominal effective exchange rate (end of period)

-3.7

-16.1

…

…

…

…

…

Real effective exchange rate (end of period)

2.1

-7.1

…

…

…

…

…

Money and Credit

Change in net foreign assets

66.8

3.5

-18.9

62.2

64.8

66.9

49.8

Change in net domestic assets (including other items net)

26.7

31.0

24.6

20.5

19.3

19.2

20.2

Broad money

28.8

29.2

22.3

22.0

21.4

22.2

22.8

Base money

22.7

19.1

13.3

13.5

13.5

14.0

14.0

Velocity (GDP/broad money)

3.15

2.89

2.84

2.72

2.61

2.47

2.34

(Percent of GDP, unless otherwise indicated)

Financial balances [1]

Gross domestic savings

24.1

23.4

22.2

23.4

23.8

26.6

28.2

Public savings

1.6

0.6

0.7

0.8

0.8

0.8

2.2

Private savings

22.6

22.8

21.5

22.6

23.0

25.7

26.0

Gross domestic investment

39.0

38.2

37.3

37.5

37.4

39.2

39.8

Public investment

14.6

13.9

12.2

12.2

9.9

9.7

9.8

Private investment

24.4

24.3

25.1

25.3

27.5

29.5

30.0

Resource gap

-14.9

-14.9

-15.1

-14.1

-13.5

-12.6

-11.6

[1] Based on data fro

External current account balance, including official transfers

-8.1

-6.4

-6.2

-5.8

-5.2

-4.2

-3.8

Government finances

Revenue

14.3

12.8

13.0

13.1

13.3

13.5

13.9

Tax revenue

11.6

11.1

11.2

11.3

11.6

11.9

12.2

Nontax revenue

2.6

1.8

1.8

1.8

1.7

1.6

1.7

External grants

0.7

0.8

1.4

0.6

0.5

0.5

0.4

Expenditure and net lending

18.2

17.4

17.5

16.7

16.7

16.7

16.9

Fiscal balance, excluding grants (cash basis)

-4.0

-4.6

-4.5

-3.6

-3.4

-3.2

-3.1

Fiscal balance, including grants (cash basis)

-3.3

-3.7

-3.1

-3.0

-2.9

-2.8

-2.7

Total financing (including residuals)

3.3

3.7

3.1

3.0

2.9

2.8

2.7

External financing

1.6

1.3

1.2

0.7

0.6

0.5

0.5

Domestic financing

1.8

2.8

1.9

2.3

2.3

2.3

2.1

Public debt [2]

57.2

61.0

57.5

56.5

55.7

55.5

54.6

Domestic debt

27.8

28.8

28.1

28.9

29.8

31.3

32.1

External debt (including to the IMF)

29.4

32.3

29.4

27.6

25.9

24.2

22.5

Overall balance of payments (in millions of U.S. dollars)

658

202

550

474

829

1,158

1,642

Gross official reserves (in millions of U.S. dollars)

3,197

2,847

3,397

3,872

4,700

5,858

7,500

(months of imports of goods and nonfactor services of following year)

2.0

1.6

1.8

1.9

2.1

2.5

3.0

GDP at current market prices (billions of birr)

1,807

2,138

2,573

3,009

3,500

4,053

4,706

2

Non-financial pub

Sources: Ethiopian authorities and IMF staff estimates and projections.

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

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. ***--IMF__Press Release No. 18/452