Euler Hermes Economic Research

Country Report

Ethiopia

I feel it still: Country risk still there despite high growth

General Information

GDP	USD 72.37bn (World ranking 66, World Bank 2016)
Population	102.4 mn (World ranking 13, World Bank 2016)
Form of state	Federal parliamentary republic
Head of government	Hailemariam Desalegn
Next elections	2019, Presidential

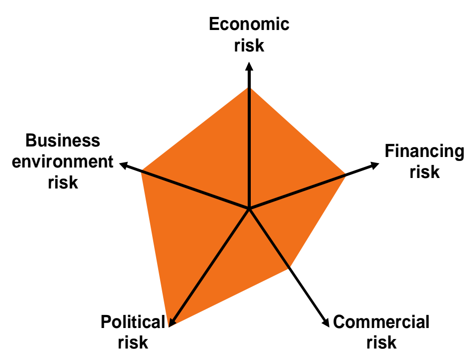
Strengths

- Key partnership with China on Africa's new silk road.
- State committed to meeting development objectives such as the MDGs and SDGs.
- The international community is supportive, particularly in times of drought-induced famine.
- High GDP growth rates in recent years, with an annual average +10.2% in 2006-16.
- Large domestic market (population over 95mn).
- Fastest growing manufacturing sector in Africa.
- Strong track record of attracting FDI from both advanced and emerging economies.

Weaknesses

- International agencies periodically question the commitment on protection of human rights.
- The region (Horn of Africa) is high risk. Ethiopia has borders with Sudan, South Sudan, Eritrea and Somalia - all offering challenges.
- The country is landlocked, which increases transport costs and vulnerability to external shocks.
- High dependence on rain-fed agricultural output but recurrent drought, locust infestations etc. Water rights are a source of potential conflict in the Nile area.
- Continuing aid dependence, despite significant external debt forgiveness and re-profiling.
- Fiscal and current account deficits and weak foreign exchange reserves (about 3 months of import cover).

Country Rating D3



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Somalia	15%	1	32%	China
China	10%	2	8%	United States
Kuwait	8%	3	8%	Kuwait
Netherlands	8%	4	7%	India
Saudi Arabia	7%	5	4%	Saudi Arabia

By product (% of total)

Exports		Rank		Imports
Coffee, tea, cocoa, spices, and manufactures thereof	30%	1	12%	Petroleum, petroleum products and related materials
Vegetables and fruits	11%	2	7%	Road vehicles
Crude animal and vegetable materials, n.e.s.	8%	3	7%	Iron and steel
Leather, leather manufactures and dressed furskins	5%	4	6%	Electrical machinery, apparatus and appliances, n.e.s.

Source: UNCTAD (2016)

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Economic Overview

Leveraging advantages

Ethiopia is one of the top performers in Africa when it comes to growth. GDP expanded by more than +9% per year on average during the last 5 years. Some might claim the impressive figure stems from backwardness. With 95mn inhabitants, Ethiopia is the second most populous African country (after Nigeria). About half of population is engaged in subsistence farming.

The country attracts high levels of foreign direct investment as it began to develop its capital stock albeit from very low levels. This process is ongoing despite a poor regulatory environment – Ethiopia is ranked 168th in the World Bank Doing Business survey made by the World Bank. It is also leveraging its growth potential, low labour costs, and infrastructure improvements as well as the good ties with key foreign investors in the manufacturing sector such as China and Turkey. The high growth rate of household income and urbanization fuelled the development of consumer related sectors (e.g. car plants).

Developing power generation is central to a manufacturing hub strategy. The Grand Ethiopian Renaissance Dam (6000 MW) on the Blue Nile is one such project. Its key target is increasing hydro-electric capacity to 37,000 MW by 2037. Yet there are risks related to its negative impact on neighbouring countries like Egypt.

As Ethiopia is landlocked, relations with Djibouti, which allows access to the red sea and Suez Canal through a railway network, are crucial to Ethiopia partaking in China's East Africa "new silk road".

Imbalances and inequality: on a tightrope

Ethiopia's growth model of Ethiopia produces current account deficits. The country needs to import capital goods to build its capital stock. The current account deficit widened from -2.5% of GDP in 2011 to -11.6% in 2015. Increasing export potential led by the construction of textile plants should help to reduce it to -8% of GDP in 2018.

Yet, the current level of imbalances implies a liquidity risk for the country. Foreign reserves cover a mere 3 months of imports. This exposes the country to a downturn in case of capital flow reversal, also given the increasing external debt ratio (37% of GDP in 2018). Moreover, it means that with such a tight level of foreign exchange liquidity some debtors may well not have an appropriate access to it.

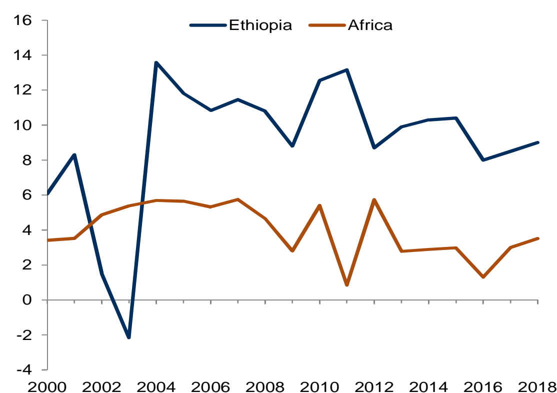
Regular droughts and the political divide that still exist within the country go frequently hand in hand to nurture some downside risk to the overall favourable growth scenario.

Key economic forecasts

	2015	2016	2017f	2018f
GDP growth (% change)	10.4	8.0	8.5	9.0
Inflation (%)	10.0	7.3	9.5	10.0
Fiscal balance (% of GDP)	-1.9	-2.4	-2.5	-3.0
Public debt (% of GDP)	60.0	57.9	60.5	61.0
Current account (% of GDP)	-11.6	-9.9	-8.5	-8.0
External debt (% of GDP)	25.6	30.0	34.0	37.0

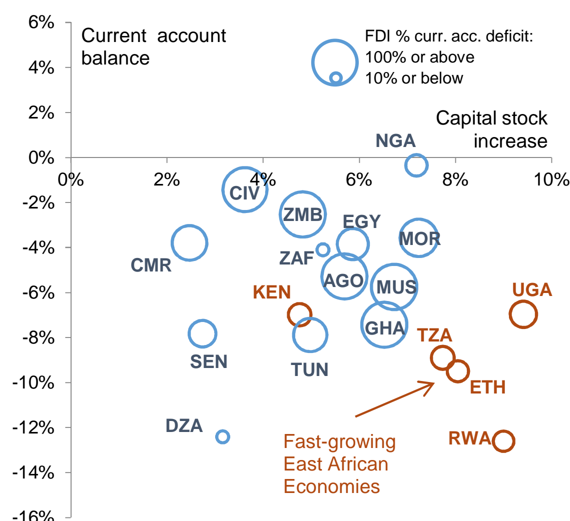
Sources: National sources, IHS, Euler Hermes

GDP growth (%)



Sources: National statistics, IHS, Euler Hermes

Capital stock increase, current account balance (% of GDP), and share of the deficit financed through FDI



Sources: Penn World Table, IHS, Euler Hermes

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