Euler Hermes Economic Research

Country Risk Analysis

Ethiopia

Sleeping regional giant awakes

General Information

GDP	USD43.133bn (World ranking 82, World Bank 2012)
Population	91.73 million (World ranking 13, World Bank 2012)
Form of state	Federal Republic
Head of government	HAILEMARIAM Desalegn
Next elections	2013, presidential

Strengths

- Political stability (relative) is likely in the short term, with associated continuity in policy implementation.
- The political transition following the death in office of long-serving Prime Minister Meles Zenawi in August 2012 was smooth and without development of a power vacuum.
- The international community is generally supportive, particularly in times of famine.
- High GDP growth rates in recent years, with an annual average +9.8% in 2003-12.
- Large domestic market (population over 90 million).

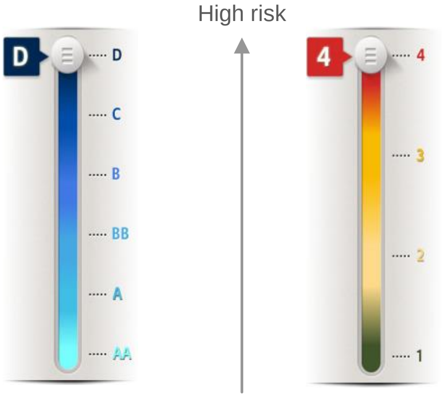
Weaknesses

- International agencies periodically question the commitment to protection of human rights.
- The region (Horn of Africa) is high risk, with borders with Sudan, South Sudan, Eritrea and Somalia all offering challenges.
- 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.
- Weak foreign exchange reserves provide an import cover of below the three months international comfort benchmark.
- Weak structural business environment.

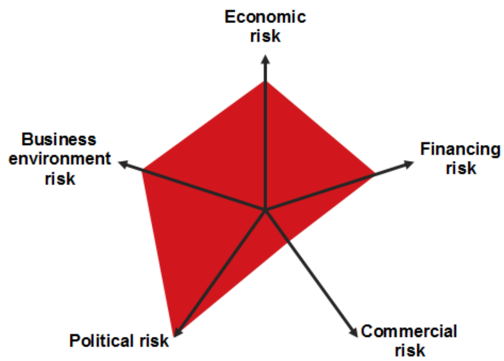
Country Rating

D4

Country Grade **Country Risk Level**



Risk Dimensions



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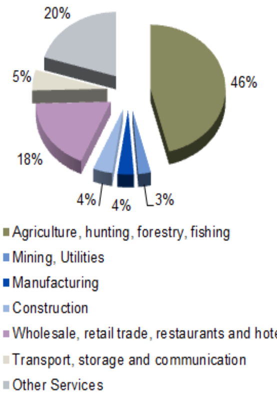
Economic Structure

GDP breakdown (% of total, 2011)



Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

Trade structure (% of total, 2011)

By destination/origin

Exports		Rank		Imports
Germany	12%	1	16%	Saudi Arabia
China	11%	2	15%	China
Somalia	9%	3	11%	United States
Netherlands	7%	4	7%	India
Sudan (…2011)	7%	5	5%	Italy

By product

Exports		Rank		Imports
Coffee, tea, cocoa, spices, and manufactures thereof	34%	1	17%	Petroleum, petroleum products and related
Vegetables and fruits	16%	2	10%	Road vehicles
Oil seeds and oleaginous fruits	14%	3	7%	Specialised machinery
Crude animal and vegetable materials, n.e.s.	8%	4	7%	Cereals and cereal preparations
Live animals other than animals of division 03	7%	5	6%	Iron and steel

Economic Forecast

	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	8.8	12.6	11.2	9.0	9.0	8.5
Inflation (%, end-year)	7.1	14.6	35.9	17.9	9.9	13.2
Fiscal balance (% of GDP)	-0.9	-1.3	-1.6	-3.4	-3.9	-3.7
Public debt (% of GDP)	31.3	36.3	35.5	34.7	32.0	33.2
Current account (% of GDP)	-8.2	-1.9	-2.8	-5.9	-6.7	-6.9
External debt (% of GDP)	18.4	27.6	28.4	27.8	27.0	30.4

Sources: IHS Global Insight, National sources, Euler Hermes

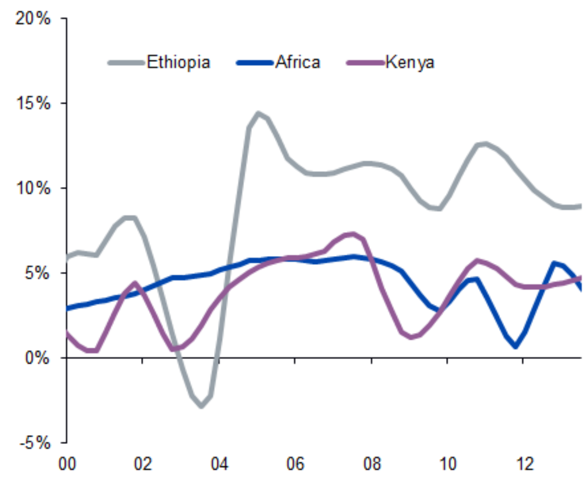
Economic Overview

Annual real GDP growth averaged only +2.9% in 1991-2000 but +9.8% in 2003-12. Relatively rapid growth in the latter period reflected a buoyant world economy in most years, inflows of donor aid and investment (particularly from the Gulf States and Asia, including China) and Ethiopia's focus on agricultural-led industrialisation (including expansion of horticultural output), infrastructure projects and development of the service sector.

Assuming rainfalls are adequate, international commodity prices do not collapse and that stability and security are maintained at current levels, EH expects GDP growth of +9% in 2013 and +8.5% in 2014, compared with a ten-year annual average up to 2012 of +9.8%.

A longer-term outlook for growth is generally positive, although much depends on maintenance of domestic and regional stability and on uncertain availability of water supplies. Expenditure on infrastructure will be a key growth driver, with a major dam project on the Nile and planned road construction and repair programmes but all these are subject to potential implementation delays and/or lack of finance.

GDP growth (%)



Sources: IHS Global Insight, Euler Hermes

Economic Overview (continued)

Inflationary pressures are a structural weakness of the economy and annual consumer price growth averaged almost 20% between 2007 and 2010, reflecting sharp increases in food and fuel prices but also government borrowing from the central bank because of limited alternative sources of domestic deficit financing. EH expects average inflation of around 10% in 2013, perhaps deteriorating to around 13% in 2014, subject to uncertain commodity price movements. EH also expects the ETB to continue to depreciate against the USD, partly as a way of enhancing export competitiveness.

Another structural weakness is the annual current account deficit, which averaged almost 7.5% of GDP between 2007 and 2010, financing of which requires international assistance. EH expects the current account deficit to be over 6.5% of GDP in 2013 and 6.9% in 2014. Partly as a result of the weak external sector, including competitiveness pressures on the birr (ETB), FX reserves are low. At USD2.26 billion at end-2012 (and probably USD2.4 billion at end-2013) reserves provide less than the internationally-acknowledged "safe" minimum of three months of import cover.

Ethiopia does not have an IMF financial facility currently in place but tries to follow a Fund-style policy programme in order to maintain support from the wider donor community. Ethiopia completed its programme under the HIPC initiative in April 2004 thereby signifying an effective exit from the debt relief process and allowing the country to access an approximate USD300 million in additional annual concessional financing. The IMF and World Bank granted full debt relief of USD1.3 billion, as well as USD707 million in 'topping up' in order to meet its (then) target of foreign debt/exports of 174%. Having exited the HIPC process the challenge for the government is to maintain its relatively lower level of indebtedness. Given the economy's fragility there is a risk of failure in this regard going forward, particularly if external developments (including international coffee prices and exchange rate movements) work against the country. In any event, Ethiopia will remain highly aid-dependent.

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