KPMG

Ethiopia Economic Snapshot H2, 2017

Trade & Investment SWOT

Strengths	Weaknesses
Ethiopia has a positive growth outlook, and foreign investment in infrastructure - and increasingly manufacturing - is growing.	Sectors such as banking and telecoms are closed to foreign competition and heavily influenced by government policy, constraining businesses in these sectors and limiting access to credit.
Ethiopia is a member of a number of regional trade agreements, which reduce trade barriers with many Sub-Saharan Africa (SSA) countries.	Ethiopia's economy is predominantly cash-based and financial inclusion is low.
The contract enforcement process is one of the more efficient in East Africa, reducing overall operational costs for businesses.	Ethiopia's economy is predominantly cash-based and financial inclusion is low, posing risks to businesses, particularly in the retail sector.
Ethiopia has the most effective counterterrorism and military forces in the region, which significantly limits the threat of terrorism and political violence.	The fragile regional security environment in the Horn of Africa and poor bilateral relations with neighbouring countries such as Eritrea and Somalia could escalate the risk of interstate conflict.
Opportunities	**Threats**
Several industrial parks are due to open between during 2017-2019, providing trade incentives for investors, particularly in manufacturing.	Continued corruption in the public and private sectors threatens to deter investment and hinder competition.
Government is working to improve the efficiency of trade regulation under the Second Growth and Transformation Plan (GTP II), which will reduce investment barriers in the medium term.	Ethiopia's dependence on government investment and Chinese foreign investment exposes the country to risks if government spending is constrained and if China reduces its investments.
Ethiopia has large hydropower resources that it plans to exploit to a greater extent. This should help it remain a self-sufficient power consumer and increase its revenues from power exports.	Increasingly frequent droughts and climate change are major concerns for the agricultural sector, resulting in lower output (and exports) and forcing Ethiopia to increase imports.
Increased government spending on general education and healthcare will make the labour market more competitive in the long term.	Ethiopia faces the risk of increased retaliation from terrorist groups due to the state's continued involvement in stemming regional terrorism.

Source: Business Monitor International (BMI), KPMG research

Economic structure - The primary sector employs three out of four Ethiopians through farming activity. Coffee, vegetables, grains and flowers are key export commodities produced by small-scale operations. The country's livestock population is also believed to be the largest on the continent. The secondary sector is small due to limited mineral resources, though the country has seen recent investments in potash mining and growing interest in extracting natural gas for domestic consumption. The construction sector is growing rapidly on the back of significant infrastructure spending by the state as well as private money being channelled to residential and commercial property. The $4.8 billion Grand Ethiopian Renaissance Dam (GERD) is one of the nation's most expensive developments. The tertiary sector's largest component is the financial industry, accounting for around 10% of GDP. While the insurance industry is in the very early stages of development, commercial banking is growing quickly as robust economic growth raises disposable incomes, thereby boosting demand for credit and transactional accounts.

Recent economic developments – The Ethiopian Investment Commission (EIC) indicated in October 2017 that the country secured $4.18 billion worth of foreign direct investment (FDI) in the 2016/17 fiscal year, surpassing the amount secured at the same time in the preceding period by over $900 million. S&P Global Ratings and Fitch Ratings affirmed their "B" ratings for the Ethiopian sovereign in April and June 2017, respectively, with Moody's Investors Service maintaining a rating one notch higher in an August publication. Headline inflation increased from 10.8% y-o-y in September 2017 to 12.2% y-o-y in October, largely due to price increases of foodstuffs. The 15% devaluation of the Ethiopian birr in October 2017 is likely to give rise to further imported inflation. The International Monetary Fund (IMF) predicts real GDP growth at 8.5% in both 2017 and 2018, despite the on-going drought. The government has started with substantial investment in power infrastructure so as to diversify exports away from agriculture, and plans to commence electricity exports to Kenya within the next few years.

Mega trends

Population	2017	Total: 104.34 million; female: 52.26 million; male: 52.08 million; age 0-14: 40.3% of total; age 15+: 59.7% of total; age 65+: 3.54% of total
Population growth rate	2015	2.5%
Life expectancy at birth	2015	Total: 65.01 years; female: 66.91 years; male: 63.2 years
HIV/AIDS	2016	Total number of people living with HIV: 0.71 million; total adult prevalence: 1.1%; HIV AIDS orphans (age 0-17): n/a million
Adult literacy rate	2015	Total population: 49.03%; female: 40.97%; male: 57.28%
Urbanisation	2016	Urban population: 19.92% of total; annual urban population growth: 4.79%; rural population: 80.08% of total
Population below $1.90/day poverty line	2010	9.04%
Unemployment rate	2017	Total: 5.7%; female: 8.6%; male: 3.2%; youth (15 - 24): 8%
Employment	2017	Agriculture: 70.5% of total; industry: 8.4% of total; services: 21.1% of total
Labour participation rate	2017	Total (ages 15+): 83.04% of total population
Business languages	n/a	Amharic, English
Telephone & internet users	2012; 2016	Fixed telephone subscriptions: 1.15 million (2016); wired internet subscriptions: 0.21 million (2012); cell phone subscriptions: 51.22 million (2016)
Quality of infrastructure	2017	3.52

Sources: UNESCO Institute for Statistics, World Telecommunication/ICT indicator database, World Bank, UNAIDS, International Labour Organisation, Analyse Africa

Business Environment									
Human Development Index (HDI) 2015		Index of Economic Freedom 2017		Global Competitiveness Index (GCI) 2017-18		Doing Business 2018		Corruption Perceptions Index 2016	
174th	out of 188 countries	142nd	out of 180 countries	108th	out of 137 countries	161st	out of 190 countries	108th	out of 176 countries

Source: World Bank, The Heritage Foundation, World Economic Forum (WEF), Transparency International

Economic policy – The Second Growth and Transformation Plan (GTP II) 2015/16 - 2019/20 aims to help Ethiopia achieve lower middle-income status by 2025. The scheme aims to achieve rapid, sustainable and broad-based economic growth through enhancing productivity of agriculture and manufacturing, improving quality of production and stimulating competition in the economy. The first GTP enabled remarkable achievements in real GDP growth, infrastructure development, social development and capacity building at all levels (albeit off a low base). The second iteration of the plan aims to achieve the 2025 goal of sustaining rapid, broad based and inclusive economic growth. In order to achieve this, the GTP II has set out four specific objectives, namely: 1) achieve an annual average real GDP growth rate of 11% within a stable macroeconomic platform; 2) develop the domestic engineering and fabrication capacity and improve productivity, quality, and competitiveness of the domestic productive sectors; 3) further solidify the on-going public mobilisation and organised participation in the program; and 4) deepen the developmental political economy by strengthening a stable democratic developmental state.

Sovereign Risk Ratings		
S&P Global Ratings	Fitch Ratings	Moody's Investors Service
B/Stable	B/Stable	B1/Stable

Source: Trading Economics

S&P Global Ratings affirmed in April 2017 their "B" long-term foreign sovereign credit rating on Ethiopia. This outlook remained stable on expectations that the country's economic performance would remain robust and socio-political tensions will not escalate. The country's ratings are supported by high growth prospects – on the back of large government infrastructure spending - that exceed those of other economies at a similar stage of development. Admittedly, this has been funded by rising public debt. S&P indicated it could raise the country's ratings if completed infrastructure projects increase the country's exports by a larger volume than is currently expected. This would reduce the country's external financing needs and external debt burden. Conversely, the agency could lower Ethiopia's ratings if socio-political tensions escalated towards mid-2018, GDP growth slowed, or if the fiscal or current account position deteriorated. Social stability is a point of concern following the government declaring a state of emergency (the first in two decades) in October 2016 in response to rising protest action – it was subsequently lifted in August 2017.

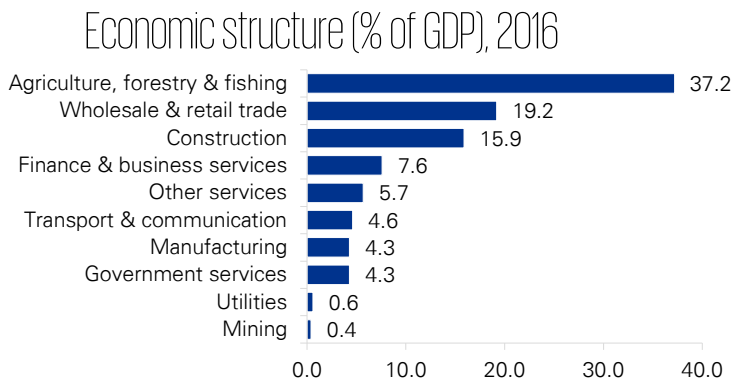
Fitch Ratings affirmed Ethiopia's long-term foreign Issuer Default Ratings (IDR) in June 2017 at "B", with a stable outlook. The agency cited ratings strengths as including low levels of government debt (mostly concessional in nature) as well as a track record of robust economic growth. The list of ratings weaknesses is however more extensive, including low development indicators, large current account deficits, rapid increases in debt owed by state-owned entities (SOEs), significant external imbalances, weak governance indicators and recent social unrest. However, from a debt perspective, Fitch expects aggregate debt (the combined value of obligations linked to the government and SOEs) to stabilise towards 2020 on the back of sustained strong economic growth, a slowdown in capital expenditure growth, moderate fiscal deficits and low debt servicing costs. Factors that could pressure the current "B" rating include increases in government indebtedness, external vulnerabilities and political instability.

Moody's Investors Services currently rates Ethiopia "B1", with a stable outlook. In an annual report released in August 2017, the agency commented that the stable outlook reflects continued high levels of economic growth and low debt-servicing costs. This is offset by high consumer price inflation, low foreign exchange reserves and a weak institutional framework. Moody's sees the country as having 'moderate' fiscal strength due to the low public debt burden, affordable interest payments and a favourable debt structure, balanced by a low government revenue/GDP ratio, large potential contingent liabilities from SOEs as well as a large proportion of foreign currency debt within the public borrowing portfolio. The agency warned that upward pressure on Ethiopia's sovereign rating "is unlikely in the short-term", but added that factors such as export diversification and a decline in domestic and geopolitical tension in the region would be supportive.

Finance & Banking				
Central bank	Number of commercial banks	Bank branches per 100 000 adults	ATMs per 100 000 adults	Deposit accounts per 1 000 adults
National Bank of Ethiopia (NBE)	18	2.93	0.46	136.13
Stock market	**Listed companies**	**Market capitalisation**	**Largest sectors**	**Weekly trading value**
No	N/A	N/A	N/A	N/A
Capital market	**Level of development**	**Maturity range**	**Municipal bonds**	**Corporate bonds**
Yes	Limited	28 to 364 days	No	Yes (but limited)

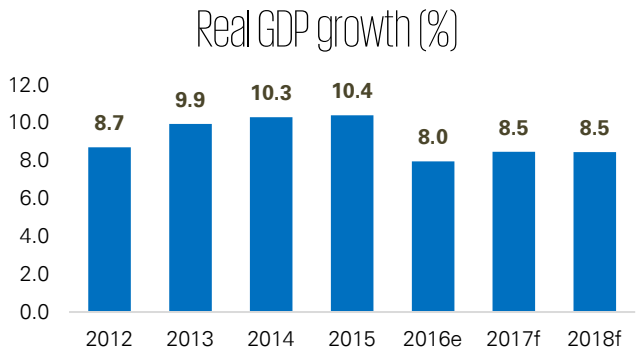
Sources: World Bank, African Alliance, Analyse Africa, KPMG research

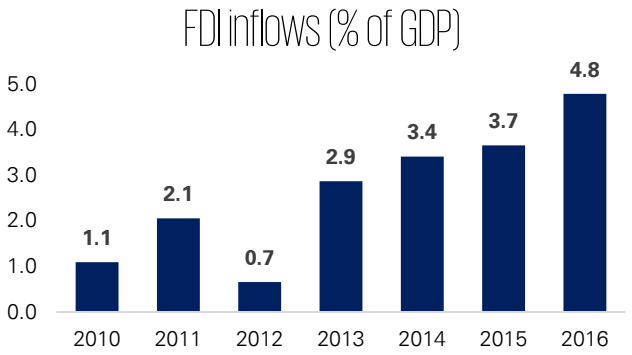
Macroeconomic overview



Source: African Economic Outlook (AEO)

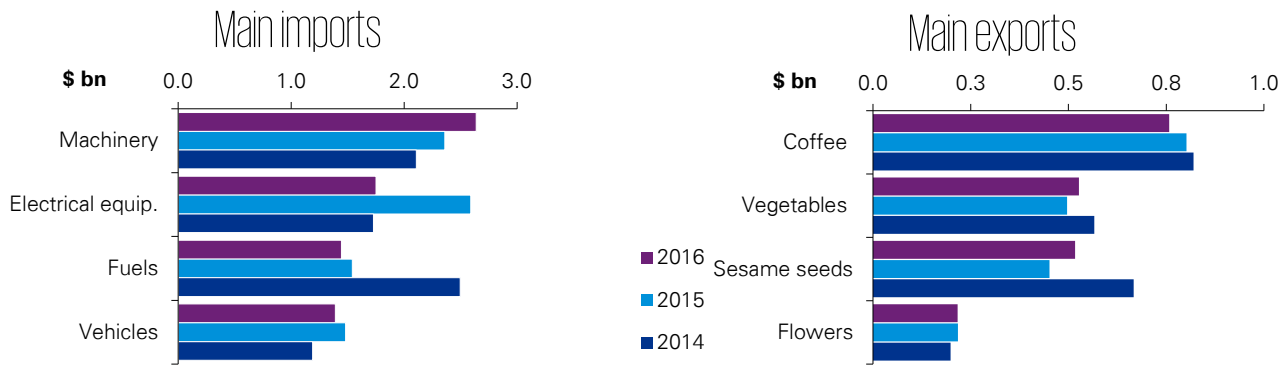
Economic growth - Ethiopia is very reliant on agricultural exports which contributed more than 80% of export revenues in 2016. The country's economy showed resilience in 2016-2017 amid continued weak global prices for key exports and the re-emergence of drought conditions in parts of the country, which weighed on the agriculture sector. The medium-term growth outlook is still favourable, supported by strong private investment, completion of key supporting infrastructure projects under the GTP II, and rising productivity as export-oriented industries become more established. The IMF predicts real GDP growth at 8.5% in both 2017 and 2018, despite the on-going drought. The country has in recent years had amongst the highest growth rates on the continent. However, the Ibrahim Index of African Governance 2017 reported that sustainable economic opportunities are deteriorating (and at an accelerating pace) despite the country's largely Chinese-funded attempt to copy Beijing's development model.





Sources: IMF, United Nations Conference on Trade and Development (UNCTAD)

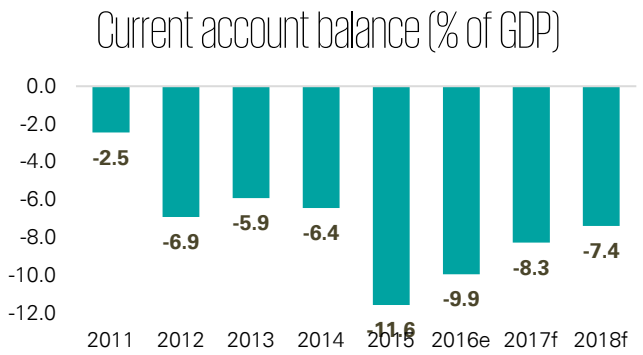
Foreign investment – The government's long-term goal for Ethiopia to become a manufacturing hub will also lead to increased expenditure in the sector. The first phase of the 200-hectare Hawassa Industrial Park became operational in June 2017, with a number of foreign apparel and textile firms starting production within the new facilities. The government announced plans for the Industrial Parks Development Corporation to build similar parks in the future, with the country's low labour and electricity costs seen as positive for investor sentiment. The EIC indicated in October 2017 that the country secured $4.18 billion of FDI inflows in the 2016/17 fiscal year, surpassing the amount secured at the same time in the preceding period by over $900 million. Admittedly, the increase came off a weak base: Ethiopia declared a state of emergency in October 2016 (subsequently lifted in August 2017) to deal with unrest accompanying protests by ethnic Oromo and Amhara communities, which contributed to a decline in FDI during the second half of 2016 and early 2017.

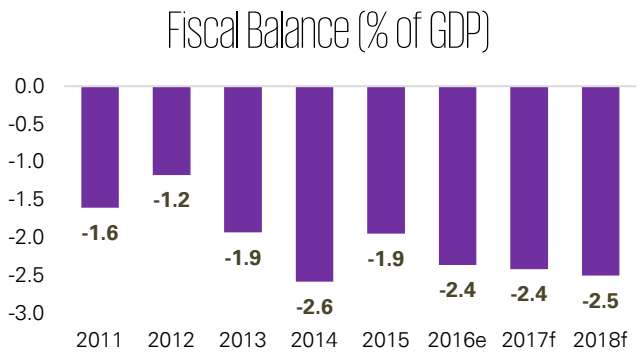


Main Imports: % share of total	2014	2015	2016	Main Exports: % share of total	2014	2015	2016
Machinery	14.3%	14.5%	16.1%	Coffee	27.5%	29.7%	28.9%
Electrical equipment	11.7%	15.9%	10.7%	Vegetables	19.0%	18.4%	20.1%
Fuels	17.0%	9.5%	8.8%	Sesame seeds	22.4%	16.7%	19.8%
Vehicles	8.1%	9.1%	8.5%	Flowers	6.7%	8.1%	8.3%

Source: Trade Map

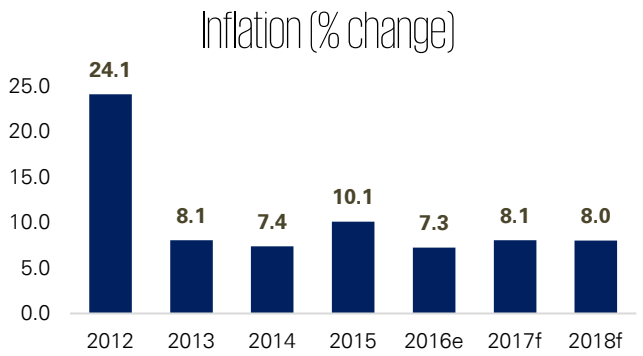
External trade – Ethiopia's current account deficit will remain wide in 2018 owing to weak agricultural exports and elevated capital import demand, though the recent 15% devaluation in the birr will help mitigate these factors somewhat. The country's heavy reliance on agriculture and exposure to adverse weather conditions makes the current account vulnerable to agricultural shocks that can be unpredictable and volatile. The government has therefore started with substantial investment in power infrastructure so as to diversify exports away from only agriculture. The plan is to commence electricity exports to Kenya in the next few years. These export earnings will help to narrow Ethiopia's current-account deficit in coming years, while the cheap power will additionally provide a timely boost to Ethiopia's emerging manufacturing sector. As a result, the IMF estimates that the current account deficit will narrow to 7.4% of GDP in 2018 from the large 11.6% of GDP level experienced in 2015. Import cover - the number of months of imports covered by a country's foreign reserves - is projected by BMI to equal 3.3 months in 2018, compared to a global benchmark of at least three months.

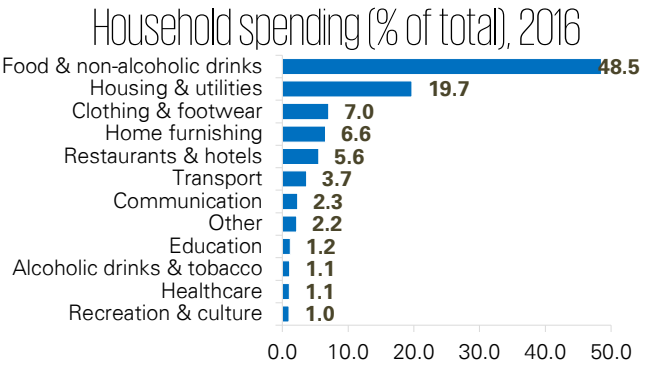




Source: IMF

Fiscal policy – Ethiopia's budget will remain in deficit in 2018 owing to aggressive capital expenditure. However, government spending has been highly conducive to growth, which has kept the country's debt ratios in check and its deficits are small compared to many other SSA countries. The nature of public debt is also relatively favourable due to an elongated maturity profile and low interest rates from concessional loans. The IMF expects Ethiopia's fiscal deficit to reach around 2.5% of GDP by 2018, as revenue growth is not expected to fully compensate for increased capital outlays. Rising fiscal deficits place upward pressure on debt dynamics. In order to help finance capital infrastructure in the country, the EIC indicated in October 2017 that it has set a target to secure FDI of $4.5 billion in the 2017/18 fiscal year. Ethiopia is already a recipient of donor aid and development financing from abroad, and these programmes provide a backing for the government's planned reforms.





Source: IMF, BMI, country statistics agencies

Monetary policy – Headline inflation increased from 6.1% y-o-y in January 2017 to 10.8% y-o-y in September 2017 to 12.2% y-o-y in October 2017. The most recent monthly increase was largely due to price increases of cereals such as teff, maize, wheat, barley, beans and sorghum coupled with the holiday season. While adverse weather conditions, the resulting effects on agricultural output and a 15% devaluation in the birr during October 2017 will pose the greatest risk for rising inflation heading into 2018, the country should experience improved price stability towards 2019 as agricultural production recovers. Ethiopia's central bank does not have an official policy rate, but targets monetary aggregates in order to control inflation. The National Bank of Ethiopia (NBE) has limited control over inflation due to food price volatility, and it is unlikely that recent interest rate increases and lending caps for banks will have much of an impact on the upward pressure on inflation in the short term.

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