KPMG

Economic Snapshot H1, 2017

Ethiopia

Inflation overview – Headline inflation increased from 7% year-on-year (y-o-y) in February 2017 to 8.5% y-o-y in March and 8.6% y-o-y in April. The inflation outlook for the remainder of 2017 is pressured by the current drought having a heavy impact on food prices. The number of food insecure Ethiopians increased by almost 40% between mid-January and mid-May.

Growth summary – The Ethiopian economy will during 2017-2018 generate stronger and more stable growth compared to many of its Sub-Saharan African peers. This growth performance over the next few years will be sustained by robust investment in power and transport infrastructure. The International Monetary Fund (IMF) predicts real GDP growth to be 7.5% in 2017 and 2018, despite lingering drought risks.

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.

Trade & Investment SWOT

Strengths	Weaknesses
Ethiopia has a positive growth outlook, and foreign investment in infrastructure - and increasingly manufacturing - is growing.	Government controls sectors such as banking & telecoms, constraining businesses in these sectors, 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.	Weak law enforcement and high levels of perceived corruption expose businesses to lengthier trade processes and dispute resolution.
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 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's strategic alignment with the US and reputation for market-based reforms could encourage aid flows, which are necessary to offset the large and ongoing trade deficit.	Increasingly frequent droughts and climate change are major concerns for the agricultural sector, resulting in lower output 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 government's continued involvement in stemming regional terrorism.

Source: Business Monitor International (BMI)

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	2.48%
Life expectancy at birth	2014	Total: 64.04 years; female: 66.01 years; male: 62.16 years
HIV/AIDS	2015	Total number of people living with HIV: 0.7 million; total adult prevalence: 1.15%; HIV/AIDS orphans (age 0-17): n/a million
Adult literacy rate	2015	Total population: 49.03%; female: 40.97%; male: 62.16%
Urbanisation	2015	Urban population: 19.47% of total; annual urban population growth: 4.78%; rural population: 80.53% of total
Population below $1.90 per day poverty line	2010	9.04%
Unemployment rate	2017	Total: 5.7%; female: 8.6%; male: 3.2%; youth (15 - 24): 8%
Employment	2013	Agriculture: 72.7% of total; industry: 7.4% of total; services: 19.9% of total
Labour participation rate	2017	Total (ages 15+): 83.04% of total population
Business languages	n/a	Amharic, Arabic, English
Telephone & Internet users	2012	Fixed telephone subscriptions: 0.89 million; wired internet subscriptions: 0.21 million; cell phone subscriptions: 42.31 million (2015)

Sources: UNESCO Institute for Statistics, World Telecommunication/ICT indicator database, World Development Indicators, UNAIDS, International Labour Organisation

Human Development Index (HDI) 2015		Index of Economic Freedom 2016		Global Competitiveness Index (GCI) 2016		Doing Business 2017		Corruption Perceptions Index 2016	
174th	out of 188 countries	148th	out of 179 countries	109th	out of 148 countries	159th	out of 189 countries	108th	out of 177 countries

Source: Transparency International, Doing Business, World Economic Forum, UN Human Development Report, The Heritage Foundation

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

S&P Global Ratings affirmed in October 2016 their "B" long-term foreign sovereign credit rating on Ethiopia. This outlook remained stable, due to S&P's "*expectation that political tensions will not escalate, while economic performance will remain robust and current account deficits and the accumulation of public sector debt will not materially deviate from their forecasts over the next 12 months*". The sovereign's weak external position, low monetary policy flexibility and limited institutional effectiveness constrains its ratings to a certain extent. Strong projected economic growth supports positive rating action. Ethiopia's ratings could be raised by S&P if exports increase more than expected due to the completed infrastructure projects – which will effectively reduce the country's external financing needs and external debt burden. Ethiopia's ratings could be lowered if political instability escalated, economic growth slowed, or the fiscal or external position deteriorated.

Fitch Ratings affirmed Ethiopia's long-term foreign Issuer Default Ratings (IDR) in October 2016 at "B", with a stable outlook. Some of the main factors that could lead to negative ratings action are rising external vulnerability, a rise in public sector debt, an increase in macroeconomic imbalances, and political instability relating to widespread social violence. On the other hand, some of the factors that could lead to positive rating action are stronger external indicators such as stronger exports, foreign direct investment (FDI) and international reserves, further improvement in the macro-policy environment, and further structural improvements.

Moody's Investors Services affirmed, in December 2016, Ethiopia's long-term issuer bond rating at "B1", with a stable outlook. The key drivers of this confirmation is the strong growth prospects displayed by the country, the low and stable fiscal deficits and the moderate debt burden. Upward pressure on the "B1" rating could occur if business conditions improves (and effectively attracts more FDI inflows and boosts the private sector) and a successful shift to a private sector driven investment model. Downward pressure could be exerted on the rating if there is a large withdrawal of donor support, an acceleration in external debt build-up, or a significant escalation of political and social tensions that would hinder the country's medium term growth prospects.

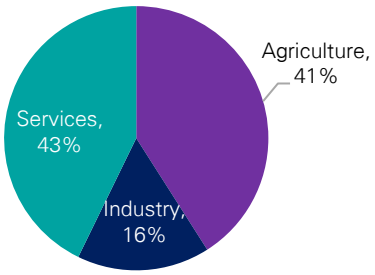
Quality of infrastructure	Economic diversity	Banking sector	Continuity of economic policy	GDP growth	Fiscal / current account balances	Foreign investment	Socio-economic development	Forex reserves
Improving off a low base	Dominated by agriculture and state spending	Small and under-developed	Stable	Strong	Twin deficits	Stronger in recent years	Low	Limited

Stock market	Listed companies	Liquidity	Market capitalisation	Largest sector	Weekly trading volume
N/A	N/A	N/A	N/A	N/A	N/A
Capital market	**Level of development**	**Liquidity**	**Maturity range**	**Municipal bonds**	**Corporate bonds**
Yes	Limited	Low	28 to 364 days	No	Yes

Macroeconomic overview

Economic structure - The primary sector employs almost three out of four Ethiopians through farming activity. Coffee vegetables 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 relatively small due to the country's limited mineral resources, though the country has seen recent investments in the 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 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 raise disposable incomes, thereby boosting demand for credit and transactional accounts.

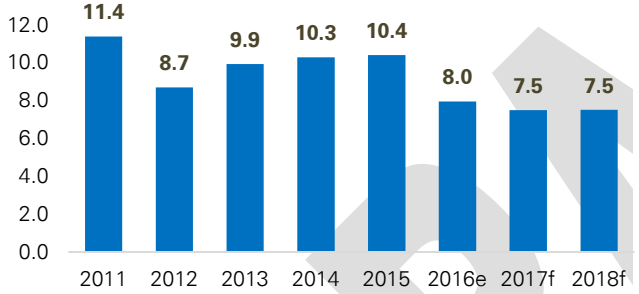
Economic structure as % of GDP 2015



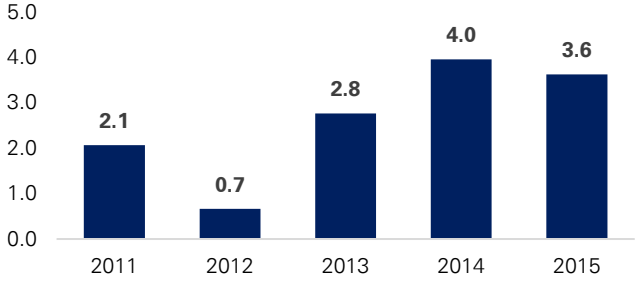
Source: World Bank: World Development Indicators

Economic growth – Ethiopia is very reliant on agricultural exports, which is evident in its export of coffee, vegetables and flowers that account to more than 50% of the country's exports. Incidences of drought will therefore hamper GDP growth significantly. Ethiopia experienced a severe drought during 2015-2016, which lead to widespread food insecurity, crop failures and livestock deaths. However, looking ahead, the economy will generate stronger and more stable growth compared to its Sub-Saharan African peers. This growth performance over the next few years will be sustained by robust investment in power and transport infrastructure. These large-scale infrastructure investment plans will boost both short-term and long-term growth, in an attempt to increase the country's productive capacity and reduce its reliance on agriculture. Fixed investment will seemingly be the main driver of economic growth in 2017. The IMF predicts real GDP growth to be 7.5% in 2017 and 2018, despite lingering drought risks.

Real GDP growth (%)



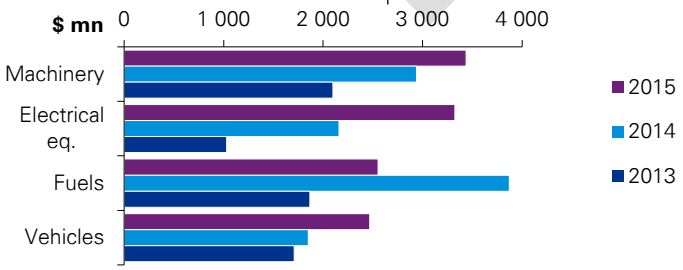
FDI inflows (% of GDP)



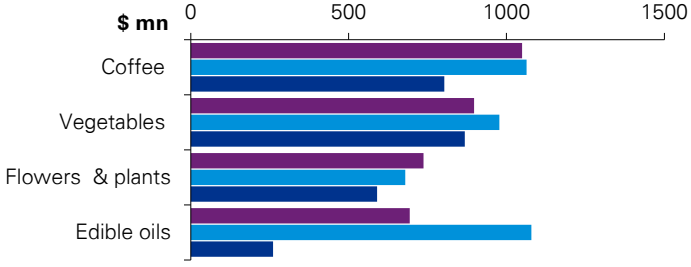
Sources: IMF, United Nations Conference on Trade and Development (UNCTAD)

Foreign investment – In February 2017, the Ethiopian Investment Commission (EIC) announced that the country attracted $1.2 billion in FDI in the first half the fiscal year ending June 2016, a slight reduction compared to the same period in the previous financial year. Ethiopia declared a state of emergency in October 2016 to deal with unrest accompanying protests by ethnic Oromo and Amhara communities, which had a negative impact on FDI in the latter part of 2016. Nonetheless, in a tribute to the viable economic policies of the current government and its engagement to make the country a destination for foreign-owned businesses, FDI inflows reached $2.2 billion in the 2015/16 fiscal year. The figure placed Ethiopia among the leading FDI destinations in SSA with FDI inflows increasing by an average of 12% per annum in recent years. The political and social stability, rapid economic growth, favourable climate and fertile soils, abundant labour force, competitive incentive packages and access to wide market are some of the reasons that are contributing to growth of FDI.

Main imports



Main exports

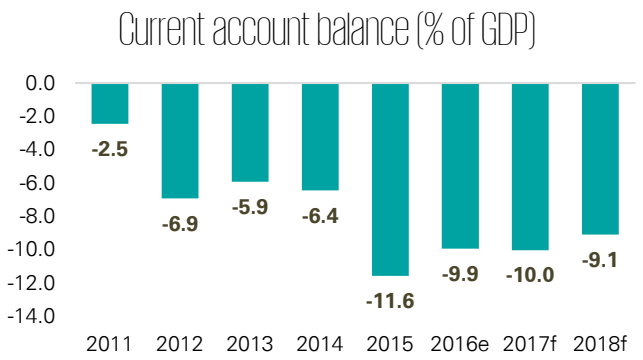


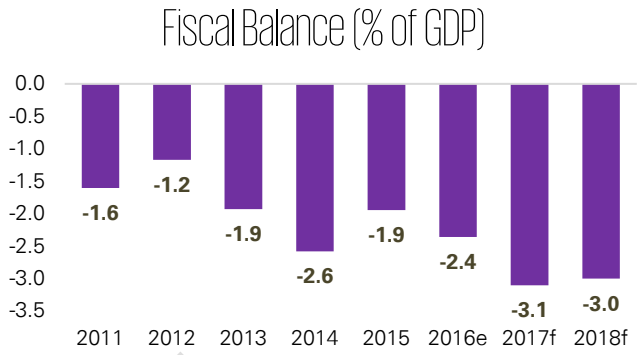
Main Imports: % share of total	2013	2014	2015
Machinery	14.1%	13.4%	13.3%
Electrical eq.	6.9%	9.9%	12.9%
Fuels	12.5%	17.7%	9.9%
Vehicles	11.5%	8.4%	9.6%

Main Exports: % share of total	2013	2014	2015
Coffee	19.7%	18.8%	20.9%
Vegetables	21.3%	17.2%	17.9%
Flowers & plants	14.5%	12.0%	14.7%
Edible oils	6.4%	19.0%	13.8%

Source: Trade Map

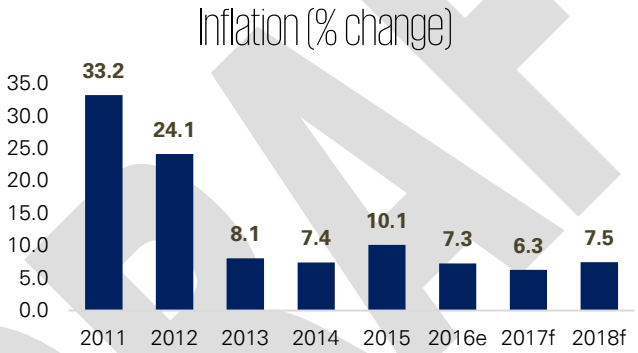
External trade – A persistent and recently widening-current account deficit is evident in Ethiopia. The country's heavy reliance on agriculture and exposure to adverse weather conditions makes the current account vulnerable to agricultural shocks that can be unpredictable and volatile. The government 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 2018. 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. The IMF estimates that the current account deficit will narrow to 9.1% in 2018 from the large 11.6% GDP growth level experienced in 2015.





Source: IMF

Fiscal policy – Government expenditure continuously outweighs revenue collections in Ethiopia. The fiscal deficit is set to expand up to 3% of GDP in 2018, due to the government's extensive expenditure under the GTP II. The state-led infrastructure programme aims to diversify the economy away from agriculture and establish the country as an export hub in East Africa. From 2018 onwards, the fiscal deficit is however set to narrow as revenue growth picks up and capital spending eases. The GTP II will come to an end in 2020, where after capital spending will fall even more and therefore ease pressure on the fiscal balance. Investment into these projects will also eventually provide a boost to fiscal intakes once the country begins to export power and as manufacturing activity rise.



Source: IMF

Monetary policy - Ethiopia has not always been successful in controlling inflation, evident from the double-digit averages recorded in 2011-2012. While inflation was notably lower in 2013-16, it still represents a key risk to macroeconomic stability. Unpredictable weather is a constant threat with the concern of food price inflation, especially for an agriculture dependent economy like Ethiopia. Indeed, severe drought conditions pushed average inflation up again in 2015. Most recently, headline inflation increased from 7% y-o-y in February 2017 to 8.5% y-o-y in March and 8.6% y-o-y in April. The inflation outlook for the remainder of 2017 is pressured by the current drought having a heavy impact on food prices. According to the Food and Agricultural Organisation (FAO), the number of food insecure Ethiopians increased by almost 40% between mid-January and mid-May, with 7.8 million people in need of emergency food aid.

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