

## Ethiopia An East African 'Renaissance' Story

### Economic Snapshot

Ethiopia's economy has been expanding rapidly over the past decade and was the best performing country on the continent last year, with GDP growth for the 2016/17 fiscal year recorded at 10.90%, according to the World Bank. This rate is expected to slow somewhat to 8.50% in 2018 but will remain Africa's best performer.

Such growth is pretty remarkable if you consider the fact that Ethiopia is landlocked and unlike some of its sub-Saharan neighbours, is not endowed with an abundance of natural resources. Much of the recent economic expansion has been driven by government spending, which whilst admittedly increasing the country's debt load, has also been directed towards developing Ethiopia's long ignored infrastructure and certain priority sectors. New road and rail networks have been a key recipient of this focus and this is highlighted by the fact that national road coverage increased from just 19,000km in 1991 to over 113,000 km by the end of 2017. Meanwhile a 32km light rail system in Addis Ababa was opened in 2015, and a 750km electric railway, that connects the Ethiopian capital to Djibouti's main port and which was financed primarily by China, began operating earlier this year.

Meanwhile a historical lack of adequate power supply has been overcome as a part of the government's infrastructure program. Since 2010 electricity generation has risen from 1800MW to over 4000MW, while the country's 'Grand Renaissance Dam' project (GERD) will add a further 6400MW to the grid once it's completed in 2020. Ethiopia is also home to Africa's first waste-to-energy plant which began operating in January this year and reportedly incinerates 1,400 tons of garbage per day while supplying 30% of Addis Ababa's residential household needs. All this has enabled Ethiopia to begin exporting its spare electricity capacity to Djibouti and Sudan.

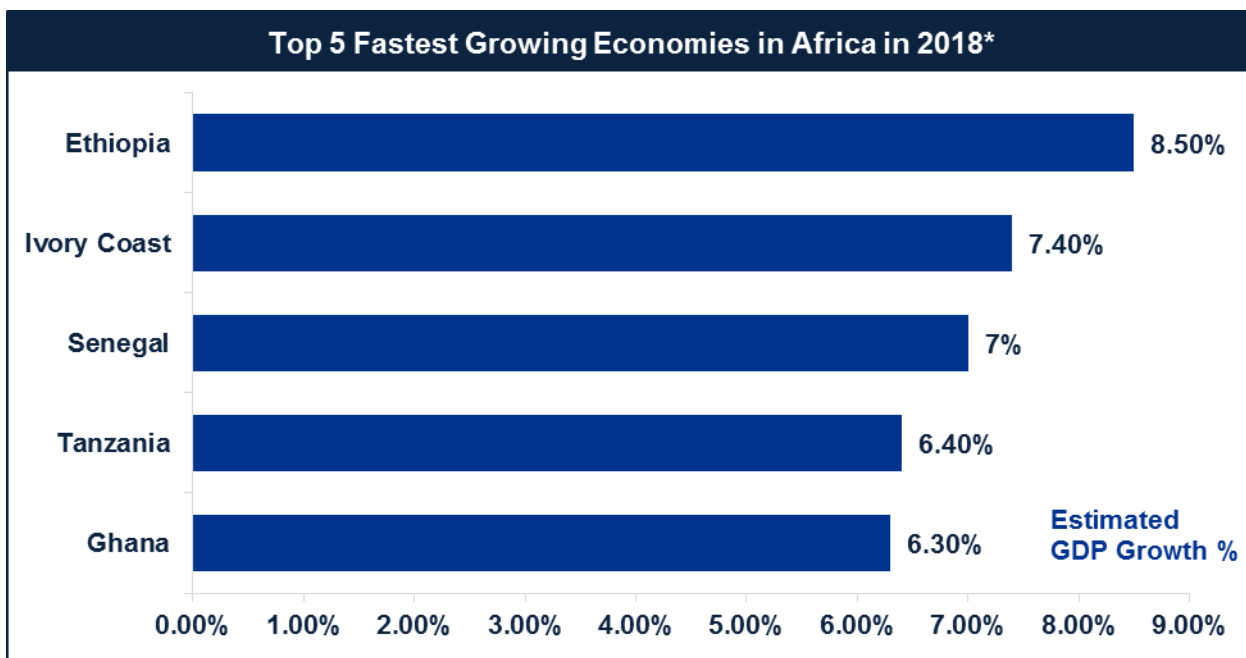
Although coffee and gold remain key export commodities, the government has identified several areas of the economy outside of agriculture and mining, where Ethiopia has an advantage compared to others in the region, and which can be leveraged upon. For example Ethiopia has reasonable cotton production and is the 10<sup>th</sup> largest stockist of hide in the world so leather is also readily available, this combined with low labour costs has helped boost the development of the footwear and garment industry which according to official data, has grown by more than 50% over the past five years. Foreign investors have begun taking note and a number of big international brands have already established clothing factories in the country such as: H&M, Armani, PVH, Levi Strauss, Huajian and Tchibo. Chinese and Turkish textile firms in particular have also reportedly increased their sourcing and investment plans in Ethiopia.

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Furthermore such heady economic growth rate and a population of over 100 million potential consumers has enticed companies such as Coca Cola, which announced a US\$200 mio investment plan for Ethiopia over the next 5 years. Volkswagen meanwhile is reportedly considering building an assembly plant in the country, just like China's Lifan automotive Group has already done in the Dukem industrial zone which lies south of Addis Ababa.



Source: IMF/FAB Forecasts

On the privatization front the new administration has announced that it is preparing to offer up stakes in some of the country's state-owned companies such as Ethiopian Airlines and Ethio Telecom, although the profitable domestic banking sector looks set to remain off limits to foreign competition for the time being at least. Meanwhile since the historic peace agreement with Eritrea was signed earlier this year (a subject that we discuss in more detail on the next page) the informal market has also picked up significantly, with trading activity in the towns of Zalambessa and Badme (which lie on either side of the official border crossings between Ethiopia and Eritrea) experiencing a mini-boom for the first time since the borders were closed in the 1990s.

Of course the economic picture is not all good news, as mentioned earlier the splurge in public spending has created a debt to GDP ratio of almost 60% and despite an increase and diversification in exports, Ethiopia still runs a trade deficit and continues to face a chronic shortage of foreign exchange due to its debt repayments, a rising oil bill and a surge in the import of consumer goods. Another important issue that needs to be overcome is the reams of government red-tape and bureaucracy that hampers investment and the development of the private sector. According to a recent World Bank survey Ethiopia is ranked at 161 out of 190 countries when it comes to the ease of doing business. Meanwhile the country is currently hosting over 900,000 refugees fleeing war, famine or extreme poverty from around 24 countries, although the bulk of these migrants come from South Sudan, Somalia, Eritrea and Yemen. To its credit Ethiopia has a long history of welcoming refugees and is the 6<sup>th</sup> largest hosting country in the world according to a recent UNHCR report; however such a large influx of people puts further pressure on limited government resources despite support from various international aid agencies.

## Political Background

Ethiopia was until the 1970's, ruled by a single dynasty and is one of only two countries in Africa that were never colonized, (although it was occupied by the Italians between 1936 and 1941). Emperor Haile Selassie ruled from 1930 before being deposed in a military coup led by Mengistu Haile Mariam in 1974. Mengistu quickly sealed his grip on power by creating a one-party state and appointing himself both President and head of the armed forces. Then in 1987 he amended the constitution and renamed the country 'The People's Democratic Republic of Ethiopia' whilst running the economy on Marxists-Leninist ideology. These policies, including the detention and/or execution of thousands of people, ended up destroying the economy especially the agricultural sector, which in turn worsened the effects of a severe drought in the mid-1980s and triggered mass starvation. Mengistu was eventually overthrown by rebel groups in 1991 and a new constitution was enacted in 1994 converting the country into a Federal state. Then in 1995 the country's first multiparty elections were conducted and which were won by Meles Zenawi's 'Ethiopian People's Revolutionary Democratic Front.' In 1998 a border dispute with Eritrea led to a two-year war and years of fraught bilateral relations, a situation which was only resolved very recently.

Prime Minister Zenawi led the country until 2012 when he was succeeded by his Foreign Minister, Hailemariam Desalegn. The latter was eventually forced to resign over ongoing anti-government protests in February 2018 and replaced by the young and charismatic Abiy Ahmed a former intelligence officer. Almost immediately after assuming office, Ahmed introduced a raft of political and economic reforms leading to the lifting of the long-running state of emergency and release of thousands of political prisoners. On the foreign policy front he has managed to ease building tensions with Egypt over his country's controversial GERD project, and then with diplomatic support from Saudi Arabia and the UAE, Ahmed sealed a peace agreement with Eritrea which has finally restored normal relations between Addis Ababa and Asmara for the first time in over 20 years.

## Ethiopia's Grand Renaissance Dam Project



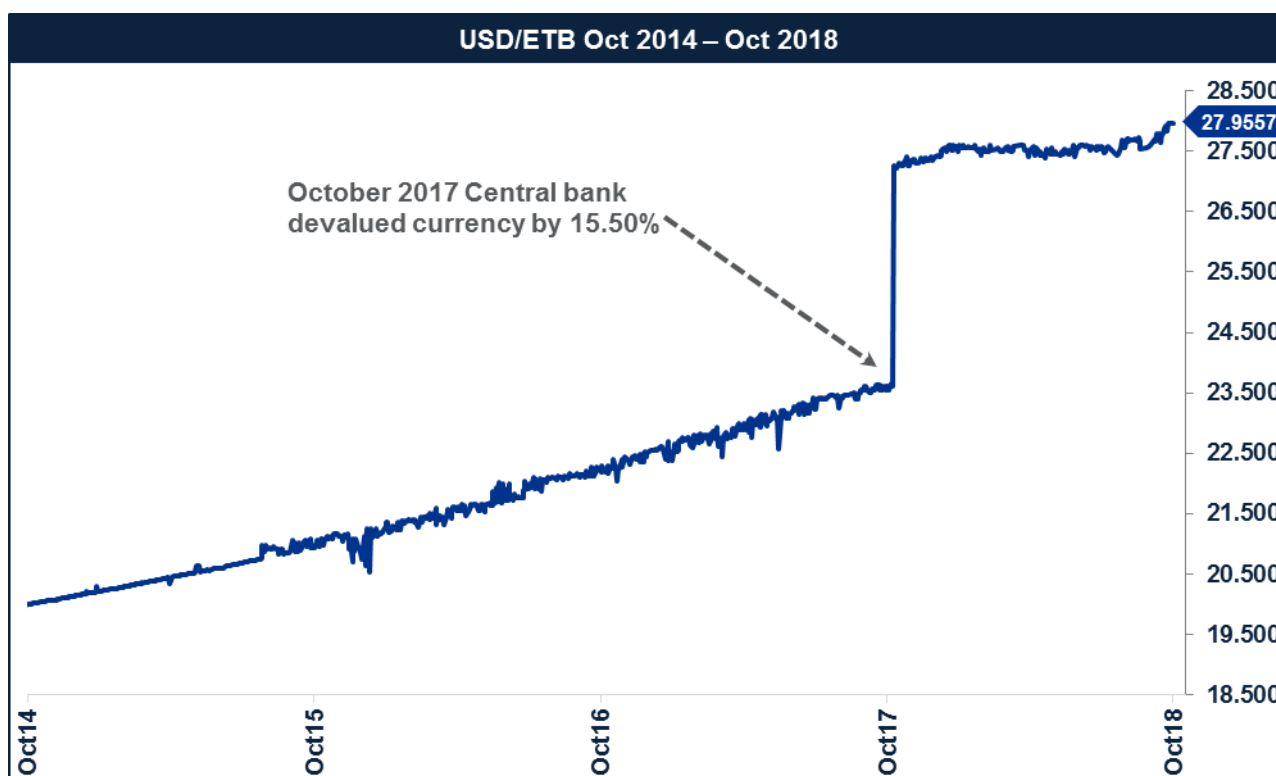
Source : BBC

These steps have been welcomed by a large section of the population especially the young, and many hope more reforms will follow. However the new Prime Minister still has much to do if he is to heal some of the country’s ethnic divisions which were built up during the previous decades of autocratic rule. Ahmed is a member of the Oromo clan which makes up more than a third of Ethiopia’s population, but there are over 80 ethnic groups in the country and this underlines the sensitive political path he will need to follow in order to achieve true national unity.

## Currency Overview

The National Bank of Ethiopia currently employs a heavily ‘managed float’ regime on the local currency, It also maintains a series of capital controls in order to try and preserve its limited reserves that in May this year reportedly stood at around US\$3.2 bio, which was equal to about 1.2 months of import cover. Thus foreign exchange allocations are directed towards strategic import requests first, although it’s worth noting that in June 2018 the Abu Dhabi Fund for Development pledged to provide Ethiopia with around US\$3 bio in financial assistance, of which US\$1 bio will be placed at the Central Bank in order to help ease the country’s acute FX shortage.

The Birr was devalued sharply late last year in the Central Bank’s first major exchange rate adjustment since 2010 in an effort to boost competitiveness for the country’s exports, and reduce the gap between the official USD/ETB exchange rate and the black market. In fact the latter issue has improved significantly since then with both the unofficial and official rates now currently almost in line with each other, a situation that has probably been helped by the general rise in confidence across the country since the beginning of this year. However a more flexible FX regime is needed to enhance transparency and attract more foreign investors. The effect of the weaker currency had an initial inflationary impact but that has since dissipated somewhat with Ethiopia’s annual inflation rate reported at 12% last month compared to 15.60% in February this year.



Source: Bloomberg/FAB

## Conclusion

Ethiopia's economic growth continues to be impressive and the initial steps taken by the country's young and energetic Prime Minister have already borne fruit both internally and externally. However, as outlined above serious political and economic challenges remain. The treaty with Eritrea is an important and welcome event but the ink is still wet and thus the accord remains fragile for now, while the controversy over Ethiopia's GERD project, especially around its potential impact on the flow of the Nile which is Egypt's primary source of water, remains a thorny issue between Cairo and Addis Abba despite their recent agreement to work together to resolve it.

On the economic front, debt consolidation, the removal of unnecessary red tape, more support for the private sector including easier access to bank credit, and a focus on export led growth is essential for the country to realize its full potential and truly ensure Ethiopia's 'renaissance.'

## Ethiopia - Key Indicators 2018\*

Population	Real GDP Growth	Debt-to-GDP	Unemployment	Inflation	FX Reserves	FX Regime
105 mio	8.50%	59%	17%	12%	US\$3.2 bio	Managed Float

\*Estimates: IMF/WB/FAB

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