20/12/2018

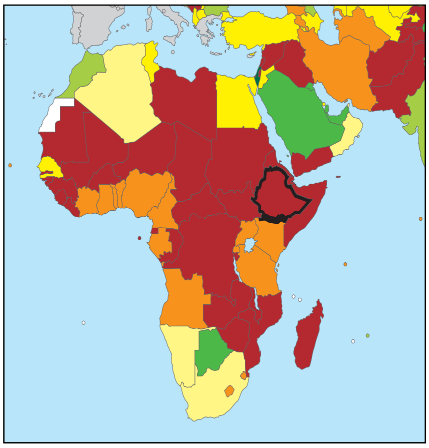
7/7 COUNTRY RISK CATEGORY

COUNTRY RISK ANALYSIS

Ethiopia

0 1 2 3 4 5 6 7

The country risk categories are arranged on a scale from 0 to 7.
The lower the figure, the better the country's creditworthiness.



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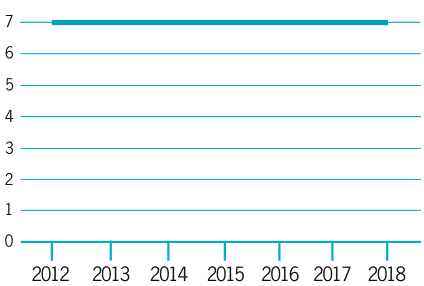
BASIC FACTS

Population	91.2 million (2016)
Nominal GDP	USD 80.9 billion (2017)
GDP/capita	USD 802 (2017)

Source: IMF WEO

COUNTRY CLASSIFICATION HISTORY



Source: EKN

High level of indebtedness dominates the risk structure

In the last decade, Ethiopia has experienced a very high level of growth. GDP has increased by an average of ten per cent annually, and continued high growth is expected in 2019. The Government has indicated that several previously non-competitive industries and state-owned enterprises will be opened up for private and foreign investment, which is a positive development. However, Ethiopia is facing great challenges. The greatest cause for concern is Ethiopia's external debt. The external debt is mostly public and has increased sharply in recent years. In a short period of time, the country's new Prime Minister has introduced political and economic reforms that have shaken up the political landscape, and it remains to be seen whether this course of action will have the anticipated positive outcome. So far, it appears as if Ethiopia has taken the first steps towards economic reform and increased democracy.

THE COUNTRY'S STRENGHTS AND WEAKNESSES

STRENGTHS

+ High and stable level of economic growth.
+ Robust inflow of foreign direct investment through major infrastructure initiatives.

WEAKNESSES

- The economy is predominantly dependent on the agricultural sector.
- A weak export sector causes significant trade and current account deficits.
- High risk of payment difficulties for state undertakings.

SWEDISH EXPORT TO ETHIOPIA, MSEK

	MSEK
2017	202
2016	443
2015	1 348
2014	245
2013	233

Source: SCB

EKN:S EXPOSURE

	MSEK
Guarantees	2, 386
Offers	32

EKN:S POLICY

EKN has Ethiopia in country risk category 7 of 7, for both short and long-term guarantees – an assessment that was made in collaboration with other OECD countries. For state or state-owned counterparties, there are currently restrictions on commercial borrowing. Due to the limited access to hard currency, direct risk is only assessed for enterprises with their own hard currency earnings or which receive external aid.

EKN:S COMMITMENT AND EXPERIENCE

EKN's total guarantee commitment in Ethiopia amounts to SEK 2.4 billion, which makes it one of the countries in Sub-Saharan Africa where EKN has the largest commitment. The majority of the guarantee commitment relates to infrastructure projects. These concern the expansion of the railway and electricity networks. In addition to these projects, EKN is guaranteeing a flow of confirmed letters of credit. Since 2014, EKN has provided guarantees for 81 transactions to Ethiopia with just over ten different exporters, of which 75 guarantees were letter of credit guarantees. EKN's payment experience of providing guarantees for Ethiopia has been generally positive. EKN currently has no outstanding arrears. No arrears have been reported in 2018 and only one in 2017, which was paid after 35 days. No claims have been paid in 2017 or 2018.

EKN assesses the risk of negative impact on environment and human rights in transactions. Out of the six transactions that EKN has guaranteed in Ethiopia since 2014, which were not short-term letter of credit guarantees, two were Class A and four were Class B. Class A means that the transaction has a significant negative impact, and Class B indicates a limited negative impact.

In the infrastructure projects where EKN has provided guarantees to state enterprises, compensation for land and transfer has proven to be a challenge compared to the international standards that EKN requires. The enterprises have limited understanding and experience of international environmental and social standards. Local authorities have varying competence and experience when it comes to managing compensation for land and transfers.

WHAT MIGHT CAUSE A CHANGE IN THE COUTRY POLICY

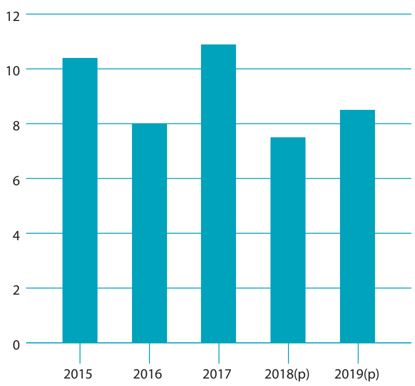
LESS RESTRICTIVE

- A liberalisation of the economy and increased access to hard currency.
- Increased export revenues and thereby a less vulnerable debt situation.

MORE RESTRICTIVE

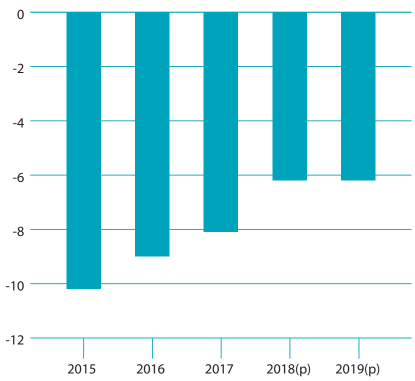
- Continued negative trend in external debt.
- Depleted international reserves, for example, due to reduced inflow of direct investment and remittances.

GDP-GROWTH (% PER ANNUM)



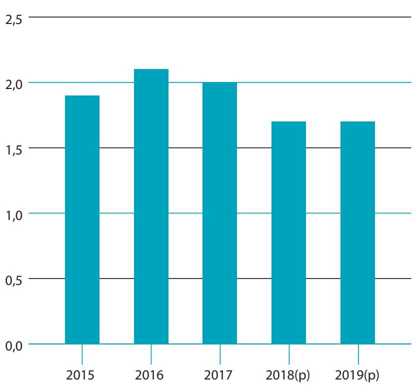
Source: Macrobond/IMF

CURRENT ACCOUNT (% OF GDP)



Source: Macrobond/IMF

INTERNATIONAL RESERVE (MONTHS OF IMPORT)



Source: IMF

COUNTRY ANALYSIS

BACKGROUND

The foundation of the Ethiopian economy is the agricultural and service sectors, which each represent forty per cent of the gross national product. Unlike in many other African countries, GDP growth is not driven by raw material extraction but primarily by increased industrialisation of the agricultural sector and by public infrastructure investments. The significant dependence on the agricultural sector makes the economy vulnerable to weather changes and price fluctuations in agricultural products.

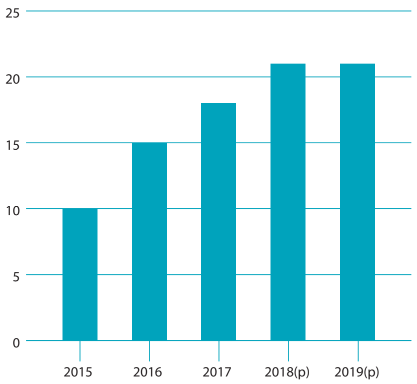
Despite a very high growth rate, the country has a large current account deficit. The most important reason for this is that the export sector comprises less than ten per cent of GDP, which is low for a country of Ethiopia's size and development needs. The current account deficit is primarily funded through foreign direct investments and loans. The country has no coast of its own and is therefore dependent on good relations with its neighbours, primarily Djibouti, for access to harbours and other transport routes. Government investments in infrastructure and industrial zones are aimed at increasing exports and diversifying the economy, for example by increasing production within the manufacturing industry.

RECENT DEVELOPMENTS

At the beginning of 2018, the country's Prime Minister resigned following a period of civil unrest. Ethiopia's new Prime Minister, Abiy Ahmed, took office in March at the age of 42 years. Abiy comes from one of the larger population groups, which is seen as a symbolic step towards reducing the social divides in the country. He has already shown a desire for change by signing a peace treaty with Eritrea, promising tougher measures against the widespread corruption in the country and by opening up to the possibility of private investments in state enterprises.

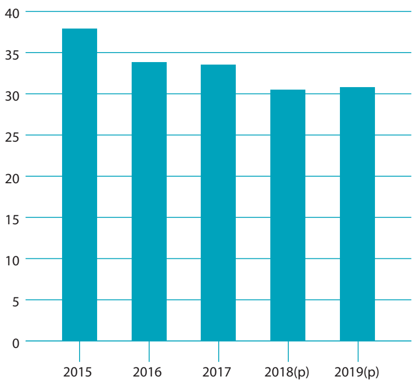
In the past decade, Ethiopia has experienced a very high level of growth. GDP has increased by an average of ten per cent per year. At the same time, the proportion of poor people in the population has fallen from 44 per cent in 2000 to 24 per cent in 2015, according to the International Monetary Fund (IMF). The Government has gradually managed to reduce the current account deficit since the catastrophic year of 2015, primarily by reducing imports. Export revenues have remained more or less unchanged in recent years. Lower food prices have counteracted the positive effects of greater export volumes. Export revenues only constitute one third of import expenditure, which makes it more difficult to build up a reserve. The country's international reserves were increased in June 2018 by USD 1 billion in the form of a favourable loan from the United Arab Emirates. This meant that the international reserves increased to 2.5 months of import coverage, compared to just under two months in the previous prognosis. The relatively low level entails a risk of a hard currency deficit in the economy.

PUBLIC SECTOR DEBT SERVICE (% OF EXPORT)



Source: IMF

PUBLIC EXTERNAL DEBT (% OF GDP)



Source: IMF

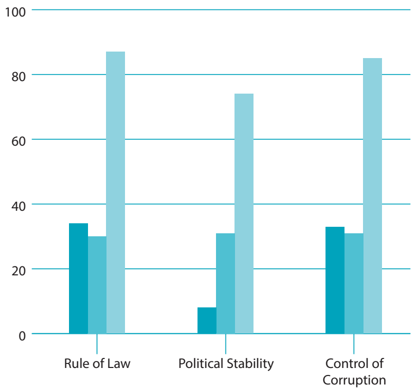
LONG-TERM TRENDS

GDP growth is expected to remain high in 2019. The indications that the Government will open up for private and foreign investment in previously non-competitive industries and state enterprises represent a positive development.

The greatest cause for concern is Ethiopia's external debt. The external debt mostly comprises public debt and has, in absolute terms, doubled since 2013. From USD 12 billion to USD 24 billion in 2017. Due to low export earnings, the IMF has classified Ethiopia in its debt sustainability analysis as a country with a high risk of payment problems. The country's debt service ratio, i.e. debt payments which the state or public sector must make in relation to exports, is expected to exceed twenty per cent in 2018–2019, which is a very high level. However, since GDP is increasing by nearly ten per cent annually, the debt ratio in relation to GDP is not alarmingly high (34 per cent). The debt structure is advantageous in the sense that it consists largely of loans on favourable terms, around 70 per cent of the total debt, and the trend has been stable over recent years. For several years, Ethiopia has had a restrictive policy in terms of taking new loans on commercial terms. In all likelihood, commercial loans will only be taken for high-priority projects that cannot be financed otherwise in the coming years. A large proportion of imports and state borrowing will go to long-term capital investments intended to generate future revenue. A growing manufacturing industry, a streamlined agricultural sector and improved infrastructure will increase export revenues in the long term and thus reduce vulnerability. However, one significant risk factor for Ethiopia is that indebtedness continues to increase. Unfavourable weather conditions constitute another risk factor. A drought can both ruin crops and reduce the water flows necessary for electricity production. Ethiopia has not been involved in any IMF financing programme since 2010. A closer collaboration with IMF would build confidence in the economic policy and constitute a stabilising factor for the debt and budget issues.

In a short period of time, the new Prime Minister has introduced political and economic reforms that have shaken up the political landscape, and it remains to be seen whether this course of action will have the anticipated positive outcome. This relates both to the many divided ethnic groups in the country and to foreign investors. So far, it appears as if Ethiopia has taken the first steps in the right direction. It is also important that the debt trend shifts.

BUSINESS ENVIRONMENT



Ethiopia
Africa South of Sahara
High Income OECD

Ranking from 0 (worst) to 100 (best)

Source: The World Bank

BUSINESS ENVIRONMENT

A hard currency deficit, burdensome tax administration and licence requirements are perceived as obstacles to investment in Ethiopia. In October 2017, the central bank allowed the currency, Birr, to depreciate by 15 per cent in order to help the export industry. The IMF estimated that the currency was overvalued by approximately 20 per cent at the time. At the same time, the central bank eased certain currency regulations, which means that Ethiopian exporters can retain 30 per cent of their export income in hard currency, compared to the previous ten per cent.

The business environment has a high degree of state involvement, where public interests take priority over private ones. The Government's unwillingness, at least previously, to adapt the economy to the market has been a stumbling block for collaboration with multilateral institutions and the main reason why the country has no agreement with the IMF. The state-owned bank, Commercial Bank of Ethiopia, currently controls two thirds of the financial sector.

In the World Bank's Doing Business Index, Ethiopia is ranked 161 out of a total of 190 countries globally. Measured in terms of distance to "best performer", Ethiopia is at 48 on a scale between 0 and 100, with 100 being the highest. The average for Sub-Saharan Africa is 50. The country also has a modest position on the World Bank's Governance Indicators, and is seeing a deterioration over time. The lack of progress, and in some cases decline, indicates that there is not enough political interest to prompt improvement in this area.