Ethiopia's IMF Program

Macro Research
Ethiopia

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The Ethiopian Government announced yesterday its intention to seek the support of the IMF as part of a nearly $3bn loan package to be disbursed over the next three years. The agreement with the IMF is unambiguously positive, in our view, and will address head-on some of Ethiopia's most pressing short-term macro challenges (fx constraints and high inflation). While the details of the agreement are not yet publicly available and are likely to be released only after next week's IMF Board meeting, we offer below some early observations.

- **Background**: The Ethiopian Government and the International Monetary Fund both issued press statements on December 11, 2019 announcing a staff-level agreement on a $2.9bn IMF lending program. The agreement follows an IMF staff visit that took place in November 2019, and is to be formally approved at an IMF Board meeting expected to take place on December 18, 2019. The agreement will represent the first time in a decade that Ethiopia is signing onto an IMF program; the last IMF loan to Ethiopia was in 2010 and outstanding debt owed to the Fund (reflecting many subsequent repayments) stood at only $38mn as of June 2019, equal to just 0.1 percent of external debt and 0.04 percent of GDP.

- **Exceptional support**: At nearly $3bn, the level of support being committed to Ethiopia amounts to one of the highest levels of financial assistance that can possibly be provided under the IMF's lending rules. IMF loans are determined by a country's 'quota' which (simplifying) is dependent on the size of its economy and per capita income. Ethiopia's quota at the IMF amounts to around $415mn and a lending package of $2.9bn is thus equivalent to 7 times Ethiopia's quota (most IMF lending is normally limited to 3 times a country's quota). Based on our review of outstanding IMF lending data, the funding committed to Ethiopia will be by far the highest in Sub-Saharan Africa and well above recent Fund programs with countries such as Ghana ($918mn), Kenya ($509mn), and Cote d'Ivoire ($300mn). Indeed, seen in proportion to a country's economic size (quota), the lending commitment to Ethiopia (at 700% of quota) is almost in the same league as exceptional IMF lending facilities provided over the past decade to countries such as Argentina (1000% of quota), Egypt (422% of quota), Ukraine (342% of quota), Ireland (300% of quota), and Portugal (188% of quota). The size of the financial package thus represents a very strong demonstration of support—to Ethiopia's reformist government—from the IMF and its major shareholders.

- **Loan terms and modalities:** As a combined 'Extended Credit Facility' (ECF) and 'Extended Fund Facility' (EFF), the IMF's lending will be tapping into two credit lines that focus on medium-term external adjustment (with the former tailored to low-income countries and the latter generally utilized by middle-income countries). Based on the usual norms of such facilities, the credit will be provided over three years and be disbursed at six-monthly intervals subject to the fulfilment of certain conditions (see below). The terms of the IMF loan—based on ECF rates posted on the IMF website—are very favourable: interest rates of near zero percent, a grace period of 5.5 years, and a repayment period of 10 years.

- **Conditionality**: As with all IMF programs, the lending comes with conditions covering both quantitative targets and qualitative reform measures—or 'performance criteria' and 'structural benchmarks' in IMF jargon. Typical quantitative targets included in IMF programs are: (1) a ceiling on money supply growth; (2) a ceiling on government borrowing from the banking system; (3) a ceiling on arrears accumulation by the government; and (4) a floor (i.e. minimum level) on the central bank's stock of foreign exchange reserves. We'd expect such performance criteria to feature in the Ethiopia's IMF loan agreement, which is of course positive for helping secure macro stability: the cap on money supply ensures that it's growth does not contribute to excessive inflation; the cap on domestic government borrowing helps limit the government's use of local funding (thus avoiding a squeeze on private credit); the cap on arrears prevents an accumulation of unpaid liabilities to finance deficits; and the floor on fx reserves allows the exchange rate to better adjust to reflect market forces (as the central bank cannot indefinitely support an artificial rate if and when it faces a minimum reserves target). Structural benchmarks generally cover policy and regulatory reforms that have important macro consequences and, based on the IMF press release, these would appear targeted to include in Ethiopia's case: (1) state enterprise reforms (likely covering those in the power, sugar, railway sectors); (2) central bank reforms; (3) financial sector reforms; and (4) revenue mobilization and public expenditure reforms.

- **Alignment with Ethiopia's economic policies:** With the Ethiopian Government already having initiated (on its own) major macro and structural reforms since mid-2018, we don't expect the set of measures in the IMF program to be radically different from the direction already taken with recent policies. Economic policies over the last two years have given high priority to prudent macro policies and to private sector led growth—the clearest manifestation of which has been the 2019-20 budget (with a 3% deficit and restrained borrowing), the privatization program, the launch of PPPs, extensive SOE reform, and wide-ranging initiatives to improve the ease of doing business. However, in at least two areas, the IMF program is likely to bring a more distinctive emphasis than has perhaps been the norm so far: (1) inflation control should be expected to be given higher urgency and attention; and (2) exchange rate flexibility is also likely to be more clearly prioritized to ensure the Birr is more reflective of its market rate. But even in these areas, we would not expect major departures from recent policy directions but rather incremental adjustments: monetary growth was not that excessive over the past two years and thus probably requires only a modest tightening to support disinflation, while exchange rate policy (already being modified since early November) will show a stepped-up pace of adjustment over the coming months but no sharp devaluations, in our view.

- **Use of IMF funds:** Unlike loans from the World Bank or other multilateral lenders, IMF funding provides fx resources that go to the central bank and not to the government budget. Thus, the IMF's support will not provide new additional fiscal resources but rather make available fx resources to cover routine government imports and other general uses of fx funds within the broader economy. Funds are deposited into the central bank, contributing to an immediate jump in reported fx reserves, and those funds are gradually drawn down as the government uses fx funds for its outlays on (its own) imports, debt service, or other public sector payments. Central banks may choose to sell some portion of the new fx reserve stock to commercial banks (to boost the latter's fx supplies), but we would not expect such sales in any substantial amounts as Ethiopia's central bank has not—other than a few exceptional times—traditionally provided fx funds to Ethiopia's private banks (who instead secure fx funds from their own exporting clients and from remittance and foreign investment flows that are channelled through their respective banks).

- **Impacts:** The IMF program will have its greatest impact in: (1) ensuring continued fiscal and monetary discipline in macro policy-making; (2) sending a very positive signal to external lenders; (3) helping attract foreign investors who had—thus far—been reluctant to invest in Ethiopia due to its fx policies; and (4) potentially addressing (once and for all) the chronic fx shortages—and many associated distortions—seen within the local economy in recent years. With a stronger macro framework being put in place, increased financial support from multilateral lenders (World Bank, African Development Bank, EIB) should be one of the most immediate positive impacts—thus providing additional resources from funders for the full range of activities supported by budgetary spending. Improved assessments by external rating agencies are also possible in the near-term. The gradual move of the Birr to a more realistic level should address long-standing constraints in this area and work to boost (over the medium-to-longer term) foreign investment flows as previously reluctant foreign investors are convinced to take a second look at Ethiopia. Within the domestic economy, we expect local banks could be somewhat affected by tighter monetary conditions (thus likely facing reduced credit growth and interest income), but could potentially benefit from a possible removal of the 30 percent mandatory surrender requirement on their monthly fx inflows if the NBE believes its enhanced reserve position is now strong enough to consider lifting this requirement. Over the medium-term, the local private sector overall should expect to see lower inflation, shorter fx waiting times, much improved fx access (though of course at a *higher price*), and more durable investment and growth prospects.

- **Risks:** IMF programs across the globe have brought significantly positive economic turnarounds in many instances but have also, in some cases, left unaddressed major pre-existing economic imbalances and crises. The IMF's reviews of its own past programs suggest that the determinant of successful programs has often been linked to the level of commitment by policy-makers, the degree of program implementation, the extent of parallel support that is generated from other financiers (donors, lenders, private investors), and the exogenous conditions at the time of the program (e.g. global prices). In Ethiopia's case, the policy commitment and readiness to reform is high, exogenous conditions currently look good (improving global growth, stable commodity prices), but notable risks include the upcoming political transition and potentially related domestic shocks.

Overall, Ethiopia's macro outlook is—in our view—now considerably brighter with the support of an IMF program. We expect to modify our near-term economic projections, but would await the details of the macro framework agreement (to be released on the IMF website soon after the Board meeting) before such an undertaking. The start of an IMF program reinforces our medium-term expectations of continued strong growth, improving debt ratios, declining inflation, and rising fx reserves—but the pace of disinflation should be somewhat faster, the rise in fx reserves more rapid, and the rate of exchange rate adjustment likely larger. For the current fiscal year, we expect the most notable changes will be seen in *modestly slower monetary growth* (likely to be held below 20 percent, with implications for credit growth), *higher year-end fx reserves* (potentially reaching $5bn by June 2020 if privatization proceeds are also received by then), and a *more competitive exchange rate* (a slightly weaker rate is now much more likely compared to the 32.8 Birr/USD we had recently forecast for June 2020). Inflation for the coming six months is unlikely to be that much different from our recent expectations, given its underlying sources (mostly due to food supply shocks in our view) and considering also the lag times involved for any new monetary policy actions to begin having an impact on prices. Considering a longer-term horizon, namely 2021 and beyond, our expectations for key fx sources (exports, grants, loans, and FDI) would be notably higher, while prospects for other macro variables such as inflation, private investment, and growth will also look much better. All things considered, if Ethiopia can complete its mid-2020 political transition in a smooth manner, macroeconomic conditions in the second half of 2020 should be the best that the country has seen in many years.

Table 1: Ethiopia and the IMF

Ethiopia's Membership in the IMF	Joined December 27, 1945
Quota at the IMF:*	SDR 300.7 mn or USD 415mn
Outstanding loan with IMF:	USD 38mn (June 2019)
Most Recent IMF financial programs:	ESF: August 2009--Nov 2011 PRGF (now ECF): March 2001--Oct 2004 PRGF (now ECF): Oct 1996--Oct 1996
HIPC Debt Reduction by the IMF:	$61 mn debt reduction in April 2004
HIPC Debt Reduction by all creditors:	$1,982 mn debt reduction in April 2004

*Source: IMF website. *Quota affects the country's voting rights and borrowing ability at the IMF.*

Table 2: Ethiopia's External Debt as of June 2019

	USD mns	% Total Debt	% GDP
Total External Debt	**27,039**	**100.0%**	**28.4%**
Multilateral debt	**11,684**	**43.2%**	**12.3%**
IDA (World Bank)	8,877	32.8%	9.3%
AfDF	1,985	7.3%	2.1%
IFAD	352	1.3%	0.4%
AfDB	144	0.5%	0.2%
OFID	92	0.3%	0.1%
BADEA	89	0.3%	0.1%
EIB	79	0.3%	0.1%
IMF	38	0.1%	0.0%
NDF	26	0.1%	0.0%
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Bilateral debt	8,420	31.1%	8.8%
Non-Paris Club	7,863	29.1%	8.3%
Paris Club	558	2.1%	0.6%
	-		
Private Debt	6,935	25.6%	7.3%
Commercial Banks	3,919	14.5%	4.1%
Suppliers	2,016	7.5%	2.1%
Bond and Notes Holders (Eurobond)	1,000	3.7%	1.0%

Source: MOFEC Public Debt Bulletin

Table 3: IMF's Current Lending Programs: Amounts Committed

Ranked by size

		SDR mns	USD mns
Stand-By and EFF Programs			
1	Argentina	40,714	56,185
2	Egypt	8,597	11,864
3	Iraq	3,831	5,287
4	Ecuador	3,035	4,188
5	Ukraine	2,800	3,864
6	Angola	2,673	3,689
7	Morocco	2,151	2,968
8	Tunisia	1,952	2,694
9	Jamaica	1,195	1,649
10	Sri Lanka	1,071	1,478
11	Jordan	515	711
12	Gabon	464	640
13	Bosnia-Herzegovina	443	611
14	Cote d'Ivoire	434	599
15	Mongolia	315	435
16	Georgia	210	290
17	Barbados	208	287
18	Armenia	180	248
19	Moldova	86	119
ECF programs			
1	Cameroon	483	667
2	Madagascar	251	346
3	Chad	224	309
4	Cote d'Ivoire	217	299
5	Togo	176	243
6	Central African Rep.	134	185
7	Sierra Leone	124	171
8	Guinea	120	166
9	Niger	118	163
10	Mauritania	116	160
11	Benin	111	153
12	Burkina Faso	108	149
13	Malawi	78	108
14	Moldova	43	59
15	Afghanistan	32	44
16	Guinea-Bissau	23	32
Ethiopia's proposed program		2,105	2,900

Source: IMF Website