Talking point

Ethiopia: The African tiger

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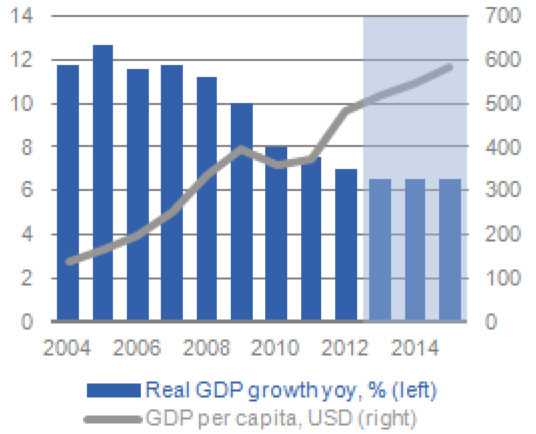
The East African country has been experiencing impressive economic growth: double-digit between 2004 and 2010, it has averaged 8.7% annually over the past five years thanks to the expansion of agriculture and services. Ethiopia has thus been the fastest-growing economy in Sub-Saharan Africa (SSA). Projected at 6.5% annually over the next five years, it is set to remain on a robust growth path.

A fast-growing and sizeable market

At around USD 50 billion, Ethiopia's GDP is one of the largest in SSA, similar to Kenya's and Ghana's. (Based on purchasing power parity, Ethiopia's economy is the fourth largest in SSA, 25% to 35% larger than the economies of Ghana and Kenya.) Ethiopia is also Africa's most populous country after Nigeria, with a population of 87 million which is additionally very young: the median age of 17.5 years is even less than the average for SSA (18.6). It is urbanising fast and a middle class is emerging, especially in the cities. There seems to be a considerable upper class in the making, too: Ethiopia is viewed as the African country where the number of US dollar millionaires will grow the fastest – from 2,700 in 2012 to 4,700 in 2020 according to New World Wealth.

Robust GDP growth



Sources: IMF, DB Research

Today's Ethiopia is a far cry from the pictures of famine in the 1980s and 1990s which are still in some people's minds, but social development is still a problem. At around USD 1,260 at purchasing power parity (USD 600 in nominal terms), its GDP per capita is still one of the lowest in the world. Living standards are steadily improving, though. Ethiopia has experienced a dramatic reduction in its poverty rate, with it falling from 56% in 2000 to 31% in 2010 – compared with an SSA average of 49%. The undernourishment rate is still fairly high – at 40% vs a 27% average – but is steadily decreasing: it was 68% in the early 1990s and 55% in the late 1990s. Nearly all urban children complete first grade but fewer than 80% of rural children do, and over half of the students are not reaching the base primary school level. The government is taking steps to address skill deficits among the youth.

An economy still based on agriculture, which has high untapped potential

Ethiopia's wealth of unusually fertile soils has shaped its history. Arable, densely populated highlands allowed kingdoms to thrive and dominate weaker peoples. Unusual in Africa, Ethiopia was already a strong centralised state before Europeans colonised that continent in the 19th century. Abyssinia (as it was known at the time) was only occupied by Italy from 1936 to 1941. The country's economy is based on agriculture, accounting for nearly 50% of GDP and 85% of employment. Although recent efforts by the government and donors have improved agriculture's resilience, it is still largely rain-fed, thus vulnerable to weather shocks, and drought is a perennial threat. The agricultural sector is also suffering from low use of quality seeds and fertilisers. However, its potential is very high, given that Ethiopia enjoys fertile soils, a tropical climate and water availability.

Ongoing economic diversification, on the back of massive public investments in infrastructure

Ethiopia's main exports are coffee and oilseeds. Together, they account for around 40% of exports and Ethiopia is by far the largest coffee exporter in Africa. However, electricity and gold exports are expected to rise. Ethiopia is set to become a key producer and exporter of power, potentially transforming Africa's power sector, particularly through the construction of hydroelectric generating stations − for a total of 40,000 MW of hydropower by 2035 according to the government of Ethiopia and other sources. This includes the controversial USD 4 bn Grand

Renaissance dam along the Nile River. The largest dam in Africa, it is expected to be completed in 2015 and generate 6,000 MW at full capacity.

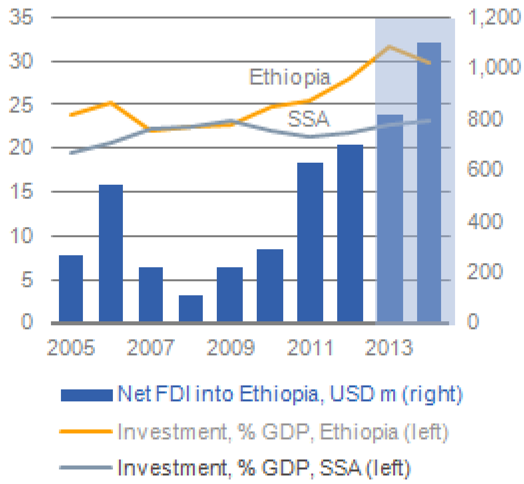
As part of its five-year "Growth and Transformation Plan" which started in 2010, Ethiopia is undergoing major infrastructure development expected to transform the economy, including the development of road, air, rail and telecommunication facilities. This will benefit both industry and agriculture. Overall investment accounts for around 30% of GDP, mostly from the state, with public projects in energy and transport accounting for around 20% of GDP. Public investment in Ethiopia is the third highest in the world as a share of GDP. With public debt at 23% of GDP, Ethiopia seems to have room for financing public investment, although it needs to pursue prudent fiscal policy under the commitments of the Multilateral Debt Relief Initiative.

A state-led development model gradually opening up

The Ethiopian government is at the centre of economic and political activity. Its strong policy focus on boosting growth through high public spending has brought success in terms of GDP growth and human development but also high inflation and large current account deficits. The government continues both to reject private-sector involvement in a few industries − including telecommunications, banking and airlines − and to ban foreign ownership in the banking industry (except from Kenya). Public banks account for an unusually high 70% of total banking sector assets and provide close to 80% of loans (as of December 2012). A directive from September 2011 stipulates that private banks must purchase bills from the Central Bank of Ethiopia equivalent to 27% of any new loan. This regulation, combined with low savings, reduces banks' capacity to lend. Limited access to credit for private firms is one reason why private investment as a share of GDP is decreasing. Some private equity groups are taking advantage of this financing gap.

The start of the transition into the post-Zenawi era (Meles Zenawi was in power from 1991 until his death in August 2012) has been smooth, as Prime Minister Hailemariam Desalegn is working on rebalancing the ruling EPRDF party. The government hopes to join the WTO by end-2015. Its ambition to turn Ethiopia into a middle-income economy by 2025 will likely only be achieved if the private sector is developed. This includes improving the business environment, including trade logistics, which is a particular concern in Ethiopia − and deteriorating, according to the World Bank: trade costs and transit times are very high, thus penalising both importers and exporters. The government is privatising various companies and has unlocked some sectors to foreign investors. For instance, a couple of years ago, Heineken bought one of Ethiopia's state-owned beer companies and a few companies are currently being offered for privatisation in the agricultural, transportation and pharmaceutical sectors.

High level of public investment



Sources: EIU, IMF, DB Research

FDI inflows to Ethiopia are steadily increasing (forecast at close to USD 1 bn in 2014) due to long-term growth opportunities in sectors such as agriculture, infrastructure, consumer goods, manufacturing, oil and gas. The FDI originates in India, China, Europe, the Middle East and the US, including the Ethiopian diaspora. African investors are also active in agro-processing and manufacturing. For instance, Ethiopia has been looking at expanding its garment industry for a few years and global retailers like H&M are increasing their presence in the country.

Geopolitical importance fosters good relationship with donors

Foreign aid to Ethiopia is estimated by the IMF at USD 2.9 billion for 2013 and it amounted to around 6% of GDP. Ethiopia's strategic position in the unstable Horn of Africa makes it a key Western ally in the region, particularly in fighting terrorism. In an effort to weaken Islamist militant groups, Ethiopia sent troops into Somalia both in 1996 and in 2006. Ethiopia also contributes to regional stability and integration by facilitating negotiations between Sudan and South Sudan. Such geopolitical importance ensures substantial foreign aid inflows in spite of concerns about governance.

See also:

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