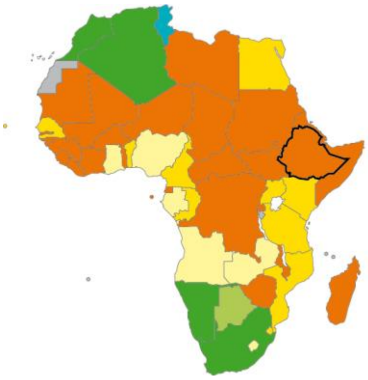
COUNTRY RISK ANALYSIS

Ethiopia

DIN SÄKERHET I EXPORTAFFÄRER ekn



COUNTRY RISK CATEGORY

7/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.

0 1 2 3 4 5 6 7

EKN'S OUTSTANDING GUARANTEES TO THE COUNTRY

SHORT-TERM TRANSACTIONS: SEK 32 MILLION

MEDIUM AND LONG-TERM TRANSACTIONS: SEK 913 MILLION

DATE

8/12/2014

Government playing leading role

Ethiopia's growth has been among the highest in Africa over the past 10-year period and the country's growth prospects for the period ahead are also looking good. As opposed to many other countries in Africa, Ethiopia's growth is not driven by raw material extraction, but by massive public investments, mainly in infrastructure. This is reflected in EKN's exposure, with the majority in the transport sector. It is however questionable whether this political strategy where the government has a fully central role is the most effective for the country's long-term growth. This government micro-management and priorities that promote government interests ahead of private interests are leading to a difficult business climate, which risks decreasing interest from foreign investors. It is however highly likely that the current strategy will remain in place after the next election year in 2015.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- High growth
- Low external debt, with the majority comprising development assistance loans
- Great potential in the energy sector

Weaknesses

- Widespread poverty and low level of development
- Low hard currency reserves and extensive hard currency regulation
- Government control and political priorities that impede commercial interests
- Ethiopia is landlocked and is in a politically unstable region

EKN'S POLICY

Restrictiveness in all buyer categories

EKN places Ethiopia in country risk category 7, for both short and long-term guarantees – an assessment made in collaboration with the other OECD countries. Some form of restrictiveness applies to all buyer categories in Ethiopia. For public buyers such as state energy and transport companies or line ministries, EKN requires a government guarantee from the ministry of finance or a bank guarantee. For private buyers (companies and banks), this policy gives EKN a more restrictive approach. As a result of the country's limited international reserves and the extensive regulations with respect to the allocation of hard currency, only direct risks of companies with their own hard-currency earnings are deemed possible to assess. For government or government owned-counterparties, there may be restrictions on commercial borrowing.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made less restrictive in the event of

- The liberalisation of the economy where the private sector is given more leeway
- An improvement in institutional capacity and the business environment
- Increased diversification of the economy

The policy may be made more restrictive in the event of

- Failure on the part of the government to respect the restrictions on new commercial borrowing
- The significant deterioration of the political situation in the Horn of Africa
- The withdrawal of development assistance (for example as a result of human rights violations)

EKN'S EXPOSURE AND EXPERIENCE

Transport sector dominant

The majority of EKN's exposure consists of a guarantee for deliveries involving a project to build a rail network in Ethiopia. The rest of the exposure consists of guarantees for other transport-related exports. In addition, there have been a few letter of credit guarantees opened by the country's two largest banks, Commercial Bank of Ethiopia and Dashen Bank. EKN has limited but good payment experience. There are no delays or claims at this time.

COUNTRY ANALYST

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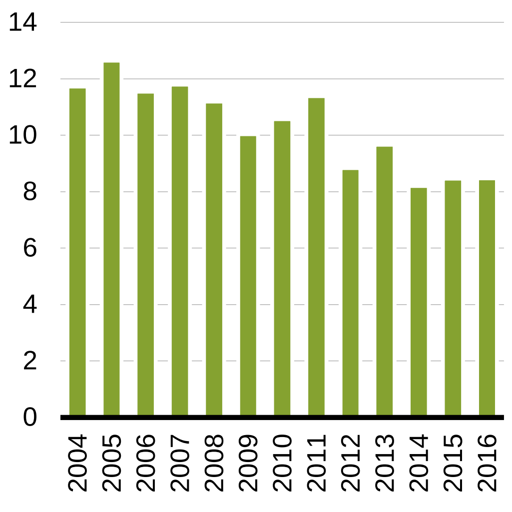
Economic strategy centred around the government

Ever since the Marxist regime fell in 1991, the domestic situation in Ethiopia has been stable. The governing EPRDF party completely dominates the political scene, and is expected to win the elections in 2015. Prime Minister Hailemariam Desalegn, who took over when Meles Zemawi died after 20 years in power, does not have the same political support as his predecessor, but regardless of who takes over the prime minister's post, it is considered likely that the government will stick with its current government-driven strategy. The government-driven growth plan, the GTP[1], expires next year, but all indications are that a new plan with the same focus will be implemented.

Ethiopia is the second poorest country in the world[2] and international development assistance – the largest in Africa in nominal terms – is a key source of income for Ethiopia's public finances, although it is decreasing. Besides poverty and a skewed distribution of power between ethnic groups, there is also a growing threat from Islamist extremists. As a result, discontent is boiling among the population, which the government is suppressing with the help of the security service. Many donor countries are partially turning a blind eye to the government's human rights violations, which can be explained by the value of Ethiopia as a Western ally in the "War on Terror". Backing from the West and a strong domestic military limits the risk of conflicts in neighbouring countries spreading to Ethiopian territory.

Agriculture serves as the foundation of the Ethiopian economy, accounting for nearly half of GDP and 85% of export revenues. Export revenues are expected to primarily come from the energy sector in the long term. After DR Congo, Ethiopia has the largest energy resources in the whole of Africa and there is enormous potential to expand the sector. Ethiopia has exhibited very high growth over the past 10-year period, driven by massive public investments, mainly in infrastructure. This has however led to a sharp increase in imports of input goods and capital goods, which has resulted in relatively sizable trade deficits and current account deficits. Imports are expected to be three times the size of exports this year, which has contributed to the erosion of the international reserves. Inflation has been driven up by high food prices caused by dry spells. The government has chosen to reduce inflation by selling currency, which put additional pressure on the international reserves. The reserves now do not even cover two months of imports, which is very low in consideration of the country's vulnerability to extreme weather, which reduces revenues from coffee exports. The Ethiopian currency is relatively heavily regulated and is allocated to the country's banks by the central bank's estimate of supply and demand.

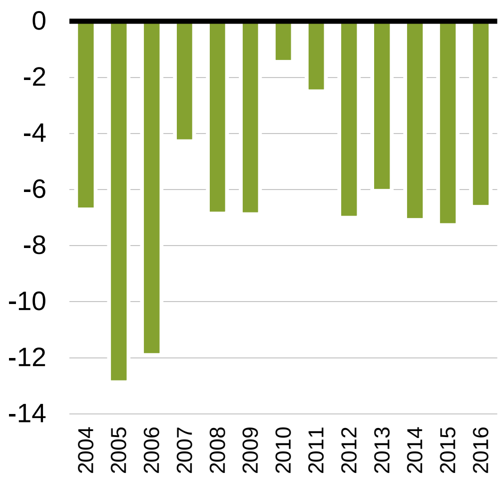
GDP GROWTH, %



Source IMF, the forecast years are 2014-16

[1] Growth and Transformation Plan
[2] According to Oxford University's Global Multidimensional Poverty Index

CURRENT ACCOUNT BALANCE, % OF GDP



Source: IMF, the forecast years are 2014-16

As a result of low tax revenues and falling development assistance, government revenues are low, at 14% of GDP. Nevertheless, the government is expected to continue making substantial investments. It therefore seems less likely that the government will fulfil its intention to finance the GTP and its successor with domestic funds. This past spring, Ethiopia received a credit rating, and the government has announced that it plans to issue an international bond next year. In the long term, the government will probably also seek financing from the IMF, on the condition that an agreement can be reached concerning the rate of liberalisation of the economy. The country's external debt is 30% of GDP after debt relief. This number excludes the debts of state-owned companies, which are not reported by the government. A large portion of its debt is made up of development assistance loans, and the IMF estimates that the risk of the country going into a debt crisis is low. As a result of the debt relief, there are restrictions from the World Bank on government borrowing. Even though the government is expected to undergo diversification in the long term with respect to financing the GTP, the political strategy with the government playing the key role is largely expected to remain unchanged after next year's elections.

BUSINESS ENVIRONMENT

Small changes to the business environment

Extensive detailed regulation and government intervention make the business environment difficult to manoeuvre, and the private sector takes a backseat to government initiatives. Ethiopia fell 3 places in the World Bank *Doing Business Index* and is now in 132nd place out of 189 countries and in 13th place out of 47 countries in sub-Saharan Africa. However, the country has solid rankings in the “resolving insolvency” and “enforcing contracts” sub-categories, which are both key parameters from EKN's perspective. Ethiopia also performed worse in the World Bank *Governance Indicators*, which is a reflection of the country's weak democratic development. For Ethiopia, all indicators were poor, with “government effectiveness” the strongest indicator. The lack of progress, and in certain cases set-backs, is indicative of insufficient political interest in making improvements in this area. No turnaround of this trend is expected.

Government influencing and dominating banking sector

The banking sector consists of 17 banks with the state-owned Commercial Bank of Ethiopia holding around 70% of the stock of assets. Private banks are allowed, but not foreign banks. On the industry level, the proportion of bad loans is low and capitalisation exceeds the prescribed level. The government's financing needs have led to a rapid increase in lending, albeit from a low level, in spite of the fact that new regulations for banks stipulate that the equivalent of 27% of their loans must be invested in government securities in order to finance the GTP with domestic funds. The government's high rate of intervention, which can be seen in how its financing needs are allowed to affect regulations, make the market less attractive for commercial interests.