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Ethiopia completes the sale of its debut $1 billion Eurobond which is heavily oversubscribed. International companies are facing pressure to increase wages to local employees. Ethiopian and Kenyan security forces detain suspected al Shabaab militants near the Moyale border crossing. Eritrean and Ethiopian nationals face espionage charges.

Ethiopia completes sale of $1 billion Eurobond despite domestic economic risks...

Ethiopia completed the sale of its debut $1 billion **Eurobond** on 4 December. The sale attracted bids of $2.5 billion from investors based in the **United States** (50%), the **United Kingdom** (35%) and the **Eurozone** (14%). The oversubscription is indicative of Ethiopia's strong growth records, but concerns remain about its level of domestic and international debt.[1] Dedicated fund managers received 96% of allocations. More adventurous frontier market investors ensured lower pricing than more conservative emerging market investors would have obtained. The 10-year bonds were priced to yield 6.625%, at the lower end of the price guidance that extended to 6.75% and *"low by historical standards"*,[2] especially for a debut launch. The low pricing level was even more impressive due to the less than optimum global market conditions amid declining oil and commodity prices.

An overly cautious risk prospectus failed to deter investors. The prospectus encouraged investors to consider the probability of the resumption of conflict with **Eritrea** (see below), relatively limited market knowledge, and the high level of state financing of large-scale infrastructure projects. Ethiopia is expected to return to the international markets in the medium term but the timing and size of any future bond are uncertain. In October, finance minister **Sufian Ahmed** announced that Ethiopia will require approximately $50 billion in investment over the next five years, of which $10 – 15 billion could come from foreign investors.

Although Ethiopia's strong record of growth has attracted investors, the government's continued commitment to a state-led financing model raises questions about its sustainability. The **International Monetary Fund (IMF)** estimates growth over the past decade at 10.9% and forecasts growth of 8.2% this year and 8.5% in 2015. The IMF and other international financial institutions share concerns about structural constraints on continued growth, notably the government's commitment to its state-led financing model. It is unlikely that there will be any radical change of direction in the next **Growth and Transformation Plan** expected in 2015. According to **Standard & Poor's**, Ethiopia will use the proceeds of the bond to fund state-backed capital investments, including the development of industrial zones and sugar and energy sectors, as well as general budgetary expenses.[3] State-owned enterprises (SOEs) continue to squeeze out private sector lending by financing large infrastructure investments through domestic bank credit, with SOE debt amounting to 25% of GDP in June 2013.[4] This is more than double the level in 2010. When public debt is added to SOE debt, it accounts for 46.7% of GDP, which is increasing contingent liability for the Ethiopian government.[5]

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[1] Finance ministry statement, 5 Dec 2014.

[2] Source, business consultant, Addis Ababa

[3] Finance ministry statement, 5 Dec 2014.

[4] www.fitchratings.com

[5] www.fitchratings.com

There is also a high level of government capital and control in the banking sector. State-owned banks dominate Ethiopia's banking sector – the **Commercial Bank of Ethiopia** accounted for 63% of total assets in 2013.[6] According to a March 2011 **National Bank of Ethiopia (NBE)** directive, private banks must set aside 27% of their lending portfolios to purchasing government bonds. The directive forces commercial banks to buy bonds from the state-owned **Development Bank of Ethiopia** to channel national savings into financing state-owned long-term infrastructure projects.[7] This increases pressure on domestic credit. The economic base is low with GDP per capita at approximately $632 (up from $558 in 2005) and economic activity over-dependent on the unreliable agriculture sector.[8] There is also a shortage of foreign exchange and all foreign transactions still require the approval of the NBE.

> *"[Foreign exchange is] ...possibly the largest deterrent to doing business in Ethiopia, especially because of the overvalued real exchange rate. Shortages of foreign currency are beginning to affect the government's ability to implement mega projects."*[9]

The limited availability of hard currency raises questions about Ethiopia's debt servicing capacity. According to the NBE quarterly bulletin published on 4 December, foreign exchange reserves only cover 2.2 months' worth of imports compared to 4.3 months in 2010 – 2011, and Ethiopia has a narrower foreign-exchange reserve buffer than its **East Africa** neighbours. The NBE quarterly report further noted that the trade deficit increased 45.3% to $2.7 billion in the second quarter of 2014. Ethiopia's construction boom relies on high levels of imported goods. The Eurobond prospectus warned investors that depressed foreign exchange reserves mean that

> *"...it may not be possible for the NBE to manage the exchange rate as effectively in the future as it has in the past"*.

In a statement on 2 December, **Moody's** criticised the policy making capacity of Ethiopia's financial institutions, noting their mixed monetary record in trying to contain volatile inflation rates.

Pressure grows on government to intervene on wages

Pressure is mounting on the government to address a growing perception that multinational corporations are exploiting Ethiopian workers.[10] Trends show that workers have not felt the benefit of increased income following increasing levels of international investment in Ethiopia. This raises the risk of labour disputes, currently an infrequent occurrence in Ethiopia.[11]

Despite the government's state-led economic model, there are few labour regulations, and relatively cheap labour is one of the pull factors for international manufacturers. Data from 2011 shows that manufacturing costs per unit in Ethiopia were half those in **China.**[12] Competitive labour and energy costs are two incentives for manufacturing companies to locate investments in Ethiopia. The other reasons companies cite include Ethiopia's relatively low interest rates, cheap land, and tax breaks. Chinese companies continue to lead the way in foreign direct investment.[13] According to data obtained from the industry ministry, 131 Chinese companies have invested approximately $5.8 billion since 1999, creating some 55,000 permanent and temporary jobs.[14]

Ethiopia's major labour unions, the **Confederation of Ethiopian Trade Unions** and the **Ethiopian Employers' Federation,** both actively support foreign direct investment. There is growing popular

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[6] www.moodys.com
[7] Addis Fortune, 10 Nov 2013.
[8] Finance ministry figures.
[9] Source, business consultant
[10] Source, journalist, Addis Ababa
[11] Source, journalist, Addis Ababa
[12] Wall Street Journal, 19 August 2013
[13] Source, journalist, Addis Ababa
[14] Source, journalist, Addis Ababa

frustration at their inability to secure improved working conditions for Ethiopian employees, especially in the agricultural sector.[15] Detailed provisions in Ethiopia's labour laws make collective labour action difficult. A worker at a **French**-owned vineyard said,

> *"I'm now paid less than 700 Birr ($35) per month after working with the company for the past five years. We are not even allowed to establish our own employees' association as we are not permanent workers. So, we are afraid to ask for salary increments independently because they might fire us."* [16]

Reliable wage data is not readily available and the resulting uncertainty adds to a perceived sense of grievance amongst some workers. At the vast factory complex of China-based shoemaker **Huajian Group** in **Dukem District** just outside **Addis Ababa**, workers are paid $40 per month, although the company claims it also provides meal services and transportation for its employees.[17]

The government says it is aware of the need to ensure that benefits of international investment are felt locally, although it claims that international companies may be unfairly targeted for criticism. During an interview with an ARC analyst, labour and social affairs minister **Zerihun Kebede** claimed that wages are no lower than those within either the Ethiopian state-owned enterprises or some locally-owned private enterprises,

> *"It is sound to assume that the locals should benefit from the huge investments that the country is attracting. However, we still realise they are being paid better wages than most government offices in the country."* [18]

The government is conscious that it needs to strike a balance between addressing populist concern, especially with the ruling **Ethiopian People's Revolutionary Democratic Front (EPRDF)** facing elections in May 2015, and not scaring away foreign investors. The government is not currently planning to introduce a minimum wage but may seek to intervene in the medium term.[19]

> *"I think the government should wait for some time before enacting any law regarding wages for low skilled workers. It should do so once its work force is well trained and competitive enough in the international market. That is exactly what most economies, including China, did."* [20]

Ethiopia cracks down on insecurity on Eritrean and Kenyan borders

A number of incidents in December underline the warnings of ratings agencies that Ethiopia's **Horn of Africa** neighbours pose a risk to its economic prospects. However, economic considerations continue to guide Ethiopia's security policies:

> "*The government believes that Ethiopia's economic development depends on a stable neighbourhood."* [21]

In the first incident Ethiopian and **Kenyan** security forces carried out a joint operation raid on the twin **Moyale** towns either side of the border crossing.[22] The security forces detained three suspected **al Shabaab** militants and seized communication equipment. Security forces claimed that the detained individuals were Kenyan nationals and had received training in **Somalia** but provided no evidence to back up this assertion. As the headquarters of the **African Union Mission in Somalia (Amisom)**, Addis Ababa is a high priority target for al Shabaab. However, the Ethiopian security services continue to be adept at infiltrating and disrupting terror plots. There is also speculation that Ethiopia

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[15] Source, journalist, Addis Ababa
[16] Source, journalist, Addis Ababa
[17] Source, journalist, Addis Ababa
[18] Source, analyst, Addis Ababa
[19] Source, journalist, Addis Ababa
[20] Source, business consultant, Addis Ababa
[21] Source, senior Western diplomat, Addis Ababa
[22] The Reporter, 9 Dec 2014.

and Kenya are working in concert to develop buffer zones along their respective borders with Somalia to reduce the risk of al Shabaab launching cross-border raids. This comes amid increased al Shabaab activity in northern Kenya. On 1 December, the group claimed responsibility for an attack on a quarry in which approximately 36 non-Muslim quarry workers were killed.[23]

In a separate incident, an Ethiopian high court charged seven Ethiopian and two Eritrean nationals with espionage on 28 November.[24] The charge sheet details allegations that the **Eritrean Intelligence Agency** paid the individuals for information about the movement and capacity of **Ethiopian National Defence Force** units along the mutual border. The prosecution also alleged that one of the suspects trafficked weapons across the border. The allegations come amid heightened tensions between Eritrea and Ethiopia over the number of Eritrean refugees crossing the border. On 17 November, the **United Nations High Commissioner for Refugees** announced that more than 5,200 refugees crossed the border into Ethiopia in October.[25] Most Eritrean refugees are housed in four camps in the **Tigray Region** and two camps in **Afar**. The situation is, however, unlikely to deteriorate rapidly. The protracted border feud over the town of **Badme**, ongoing since the 1998-2000 war, will remain unresolved in the medium term without any real risk of escalation.[26]

Implications

Even if the successful Eurobond launch encourages Ethiopia to return to the international markets, it will not lead to a break from its state-led development model. Ethiopia already has a number of loan agreements with bilateral and multilateral institutions and private sector lenders. The only departure from its state-centered approach would be if Ethiopia needed to turn to the IMF for support. Increasing debt obligations will leave it increasingly vulnerable to exogenous shocks and investor sentiment.

The wage issue is indicative of the wider pressure on the Ethiopian government to ensure benefits from its economic growth are broadly felt. With investors still wary of Ethiopia, the government will not intervene in the short term to avoid making risk committees jittery.

While al Shabaab will continue to look for opportunities to attack Addis Ababa, its distance from Ethiopia's borders and the capacity of the Ethiopian security forces reduces the risk of a successful attack. Relationships between Eritrea and Ethiopia will remain frosty in the medium term. Outright conflict remains, however, improbable in this time frame, with the government in **Asmara** lacking the popularity or military capacity to sustain a campaign.

[23] Bar-kulan, 1 Dec 2014.
[24] The Reporter, 29 Nov 2014.
[25] UNHCR, 17 Nov 2014.
[26] Source, Western diplomat, Addis Ababa