

## AFRICA RISK CONSULTING

### Ethiopia Monthly Briefing December 2015

#### Ethiopia Summary 7 December 2015

*Ethiopia ends 2015 with a number of concerns overshadowing a year of political and economic stability. Power cuts will continue to increase business costs including in the important manufacturing sector. Violent protests in the Oromia Regional State highlight continued uncertainty over the Addis Ababa and Oromia Integrated Development Master Plan. The continuing drought poses a humanitarian crisis. Tension between Ethiopia and Eritrea is increasing but conflict in 2016 is unlikely. Foreign currency shortages force importers to turn to the black market. The World Bank says limited economic liberalisation is a prerequisite to Ethiopia sustaining its rate of economic growth. The Ethiopian National Defense Force (ENDF) kills three Kenyan police officers in a cross-border raid.*

#### Power cuts, protests, drought and Eritrea undermine 2016 confidence

Prime minister **Hailemariam Desalegn** (2012- present) finishes 2015 in a strong position after his **Ethiopian People's Revolutionary Democratic Front (EPRDF)** won every seat in the May general election (see *ARC Briefing Ethiopia June 2015*). The victory gave Hailemariam a personal mandate to govern, whereas previously he was seen as predecessor **Meles Zenawi's** (1995-2012) man. Nevertheless, a number of negative economic and political trends will curb his authority and detract from his efforts to address the disproportionate influence of the **Tigray People's Liberation Front (TPLF)** within the EPRDF.

Electricity shortages notably are expected to continue into the New Year.

*"Current chronic power interruptions have left the public in shock. Many people in Ethiopia were confident that power interruptions were things of the past owing to the massive dam projects that recently started electricity production. But recent trends have shown that that is not the case."*<sup>1</sup>

Parts of Ethiopia including **Addis Ababa** are experiencing power cuts that last for several days.<sup>2</sup> The government has attributed the problem to old transmission lines but there are fears that some dams are also not functioning properly due to lack of water in the reservoirs.<sup>3</sup>

*"Many local and foreign investors engaged in the manufacturing sector are complaining that the persistent power outages and the inability of the national electricity supplier to meet the ever growing demand is detrimentally affecting their operation by inducing a fall in output and an upsurge in wastage."*<sup>4</sup>

Manufacturers are resorting to costly diesel generators that increase production costs. This is a concern for the government's \$10 billion plans to develop industrial plants and low-cost manufacturing parks.<sup>5</sup> Nevertheless, additional **Chinese** investment in light manufacturing and production distribution is expected in 2016.

<sup>1</sup> Source, journalist, Addis Ababa

<sup>2</sup> Source, journalist, Addis Ababa

<sup>3</sup> Source, journalist, Addis Ababa

<sup>4</sup> Source, journalist, Addis Ababa

<sup>5</sup> Source, business consultant, Addis Ababa

Another concern for the government is the resumption of protests in the **Oromia Regional State**. There is longstanding tension over the **Addis Ababa and Oromia Integrated Development Master Plan**. The plan sets out the government's vision for the growth of Addis Ababa over the next 25 years including the development of manufacturing parks. Protesters claim that rapidly expanding Addis Ababa will increasingly spread into Oromia and undermine the **Oromia Special Zone**. Violent protests over the issue erupted again in November.<sup>6</sup> The recent violence is a repetition of protests in April and May 2014, when security forces allegedly killed dozens of protesters and arrested a number of protest leaders, the majority of whom remain detained. The trigger for the recent resumption of violence is speculation that Oromia residents will face eviction without appropriate compensation.

*"Social media is filled with images of bloodied protesters; there are credible reports of injuries and arrests in a number of towns; and local police have publicly acknowledged that three students have died so far. These protests are still ongoing and will continue into the New Year."*<sup>7</sup>

The ongoing drought will continue to have humanitarian, political and economic impacts in 2016. Parts of the **Amhara** and the **Afar Regional States** remain the worst affected.

*"Reports suggest students are dropping out of school to take their livestock to wherever water is available and farmers are selling their livestock at highly devalued prices. There are also reports of widespread migration of hungry people to urban areas. The government has admitted that agricultural productivity has significantly declined in some locations to a point where there will not be any harvest this season. Crops of staples such as wheat, beans and lentils have failed but the remnants are being used to feed animals."*<sup>8</sup>

International humanitarian organisations are gearing up to launch a full response in the first quarter of 2016.<sup>9</sup> The success or otherwise of the main *Kiremt* rains in June to September 2016 will determine the scale of the humanitarian catastrophe.

Tension between Ethiopia and **Eritrea** is also increasing. Hailemariam is increasingly aggressive in his rhetoric. In November, Hailemariam said **Saudi Arabia** and the **United Arab Emirates** will potentially face Ethiopian sanctions due to their involvement in the **Port of Assab** (Eritrea).<sup>10</sup> The **United Nations (UN) Monitoring Group on Somalia and Eritrea (SEMG)** has reported that the two **Gulf States** have leased the Port of Assab for 20 years to support their military intervention in **Yemen**.<sup>11</sup> However, Hailemariam reiterated that Ethiopia will respond to Eritrean actions in a proportionate manner.

### Foreign currency crunch curbs business activity

A foreign currency crunch is expected to continue into 2016, undermining investor confidence and limiting business activity. The government has attributed the current foreign currency shortfall to low exports during the first quarter of the budget year.

*"Hailemariam has said the current problem will fizzle out from the second quarter of the current budget year onwards as the country's export performance, remittances and investment revenues are expected to improve. He argues it is natural for any economy in transition and points to China and Korea."*<sup>12</sup>

<sup>6</sup> Source, journalist, Addis Ababa

<sup>7</sup> Source, journalist, Addis Ababa

<sup>8</sup> Source, journalist, Addis Ababa

<sup>9</sup> Source, senior INGO official, London

<sup>10</sup> The Reporter, 1 Dec 2015.

<sup>11</sup> The Reporter, 1 Dec 2015.

<sup>12</sup> Source, journalist, Addis Ababa

Both state-owned and private banks in Ethiopia are limiting foreign currency supply owing to acute shortages.<sup>13</sup> This shortage of foreign currency has resulted in a thriving black market from which importers are forced to get their foreign currency.<sup>14</sup>

*"I have no other option [but to access the black market]. The **Awash International Bank** downgraded my request for foreign currency. Opening a letter of credit takes as long as one year or even more, and even then, there is no guarantee that the requested amount of foreign currency will be availed."*<sup>15</sup>

There are allegations that bank officials are accepting payments from businesses in exchange for privileged access to foreign currency.

*"Anxious importers are willing to pay whatever cost they are made to pay to avoid penalties during delivery of imported goods. And some corrupt bank staff and managers take advantage of the situation. Due to this, the foreign exchange shortage has worsened."*<sup>16</sup>

Analysts attribute the shortages in part to the global economic slowdown, the large infrastructure projects that Ethiopia is currently building, and the depletion of the foreign currency after the government bought hundreds of millions of dollars' worth of food aid due to the impact of the **El Nino** weather phenomenon (see *ARC Briefing Ethiopia November 2015*). Experts argue that Ethiopia's mega projects in hydroelectric generation, sugar production, and rail transport continue to drain the country's hard currency reserves, with high demand for public investment.<sup>17</sup>

The other reason for the foreign currency depletion is the slow pace of growth in Ethiopia's exports. The central bank, **National Bank of Ethiopia (NBE)**, said the country's export trade has been registering steady growth in the recent past, with exports worth roughly \$2 billion in 2009/10, increasing to \$3.25 billion in 2013/14 and more than \$1.6 billion dollars in the first two quarters of the current fiscal year.<sup>18</sup> However, imports have also accelerated, negating any positive impact.<sup>19</sup>

### World Bank calls for limited economic reform

The **World Bank** has called on Ethiopia to embark on limited economic liberalisation to sustain its rate of economic growth and obtain middle income status by 2025.<sup>20</sup> Ethiopia has previously disregarded similar calls from the **International Monetary Fund (IMF)** and would only need to follow policy prescriptions if dependent on international financial institute support. The World Bank warned that maintaining the current state-led economic model under the **Growth and Transformation Plan II (GTP II)** will only result in maintaining the current level of growth in optimistic scenarios.<sup>21</sup>

The World Bank proposed three policy recommendations to help sustain growth. It advocated that Ethiopia continue its infrastructure investment, but increase financing through tax revenue and private sector participation as part of more effective investment management.<sup>22</sup> The World Bank also suggested that Ethiopia develop its financial capital markets to support private sector access to credit, and to accelerate liberalisation in the services sector. The recommended reforms would reduce reliance on debt financing and release domestic credit for the private sector. There is some indication that Ethiopia is increasingly receptive to considering new economic financing models.

<sup>13</sup> Source, journalist, Addis Ababa

<sup>14</sup> Source, journalist, Addis Ababa

<sup>15</sup> Source, importer, Addis Ababa

<sup>16</sup> Source, analyst, Addis Ababa

<sup>17</sup> Source, journalist, Addis Ababa

<sup>18</sup> Source, journalist, Addis Ababa

<sup>19</sup> Source, journalist, Addis Ababa

<sup>20</sup> World Bank, 24 Nov 2015.

<sup>21</sup> World Bank, 24 Nov 2015.

<sup>22</sup> World Bank, 24 Nov 2015.

*“The government is considering its options about how to sustain growth. The government is doing its homework, and consulting with lots of people including the private sector.”<sup>23</sup>*

NBE governor **Teklewold Atnafu** on 20 November said the central bank is revising the March 2011 directive that requires private banks to set aside 27% of their lending portfolios to purchasing government bonds.<sup>24</sup> The directive forces commercial banks to buy low-yield bonds from the state-owned **Development Bank of Ethiopia** to channel national savings into financing state-owned long-term infrastructure projects.<sup>25</sup> The diversion of hard currency into state infrastructure projects exacerbates concerns about foreign exchange (see above). Under the GTP II, the NBE will increase the reserve requirement ratio by approximately 30%.<sup>26</sup>

The NBE loosening will encourage growth but won't address the major concern of international investors who will note that Teklewold made no mention of loosening foreign exchange controls.

*“The problem is foreign debt financing. It is easy enough to register additional outside funds with the NBE. The difficulty comes when you need to repay debts and therefore need foreign currency. The NBE is especially uncomfortable if your profits are local currency.”<sup>27</sup>*

### **ENDF kills Kenyan police officers in cross-border raid**

Ethiopia temporarily closed **Kenyan** border crossings after the **Ethiopian National Defense Force (ENDF)** killed three Kenyan police officers. Border insecurity is fairly common due to the porous border that allows pastoralist militias and other armed groups to cross. The secessionist **Oromo Liberation Front (OLF)** on 20 November killed Ethiopian traditional chief **Guyo Harake** before crossing the Kenyan border into **Sololo (Marsabit County)**.<sup>28</sup> Ethiopia has previously accused Kenya of overlooking the presence of OLF forces in Marsabit.<sup>29</sup> The ENDF soldiers pursued the OLF members before attacking a Kenyan police vehicle in **Anona**, killing at least three officers, before seizing weapons and returning across the border.<sup>30</sup> Kenya deployed additional **Kenya Defence Forces (KDF)** personnel and a **Rapid Deployment Unit** to **Ramole** and **Anona** along the Kenya-Ethiopia border.<sup>31</sup> In response Ethiopian officials temporarily closed the **Moyale, Sololo, Forolle, Dukana** and **Illeret** border points.<sup>32</sup> The temporary closure prevented the movement of livestock traders.

Kenyan security officials have recorded five ENDF incursions between March and November 2015 in Illeret, Sololo and Moyale.<sup>33</sup> However, the unexplained attack on the police vehicle is a considerably rarer incident. The ENDF is well disciplined and responds to civilian control.<sup>34</sup> There was a high-level response to the incident. Kenyan president **Uhuru Kenyatta** (2013- present) and Hailemariam on 7 December launched the **Marsabit County/Kenya-Borana zone/Ethiopia Integrated Cross Border and Area-based Programme** to improve stability and economic growth along the border.<sup>35</sup> The **United Nations (UN)** and **Inter-Governmental Authority on Development (IGAD)** facilitated project will:

- improve infrastructure through **Lamu Port-South Sudan-Ethiopian Transport (Lapsset)** projects;
- control cross border conflict through improved resolution mechanisms;

<sup>23</sup> Source, lawyer, Addis Ababa

<sup>24</sup> Reuters, 20 Nov 2015.

<sup>25</sup> Addis Fortune, 10 Nov 2013.

<sup>26</sup> Reuters, 20 Nov 2015.

<sup>27</sup> Source, lawyer, Addis Ababa

<sup>28</sup> Africa Review, 22 Nov 2015.

<sup>29</sup> Source, security analyst, East Africa

<sup>30</sup> Africa Review, 22 Nov 2015.

<sup>31</sup> Africa Review, 22 Nov 2015.

<sup>32</sup> Africa Review, 22 Nov 2015.

<sup>33</sup> Africa Review, 22 Nov 2015.

<sup>34</sup> State Department, 2012 Human Rights profile

<sup>35</sup> Daily Nation, 7 Dec 2015.

- curb illegal human and arms trafficking through more effective search and surveillance measures.<sup>36</sup>

The UN-backed trade deal is worth \$200m.<sup>37</sup>

### Implications

The challenges facing Ethiopia in 2016 do not pose long-term risks to its political stability. Ethiopia in the medium term will register strong growth in power generation capacity as major geothermal and hydropower projects come online. Donors have learned from their mistakes in the 2011 **East Africa** drought, and are mobilising resources quickly. A timely and well-financed international humanitarian response will mitigate the impact of the drought. Relationships between Eritrea and Ethiopia will remain poor. However, outright conflict remains improbable due to the human and financial cost to both countries. Ethiopia will continue to push the international community to strengthen sanctions on Eritrea.

The foreign exchange crunch will undermine business confidence in 2016, and highlights the challenges facing investors in Ethiopia which will remain a daunting destination for companies with a limited risk appetite.

While Ethiopia will look to broaden its infrastructure financing sources, progress towards economic liberalisation in the key banking and telecommunications sectors will remain haphazard. The NBE loosening will increase liquidity, credit to the private sector and foreign exchange access.

The IGAD and UN initiative is part of an established strategy whereby Ethiopia and Kenya use dialogue to stop cross-border tensions escalating. Close political, security, infrastructure and economic ties between Ethiopia and Kenya will contribute to a more stable and prosperous **Horn of Africa**.

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<sup>36</sup> Daily Nation, 7 Dec 2015.

<sup>37</sup> BBC, 7 Dec 2015.

### About Africa Risk Consulting:

**Africa Risk Consulting (ARC)** is a pan-African consulting company that provides timely, relevant information and advice that enables its clients to take informed investment decisions and to safeguard their reputations.

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