Developing Ethiopia:
First-mover Investment Opportunities

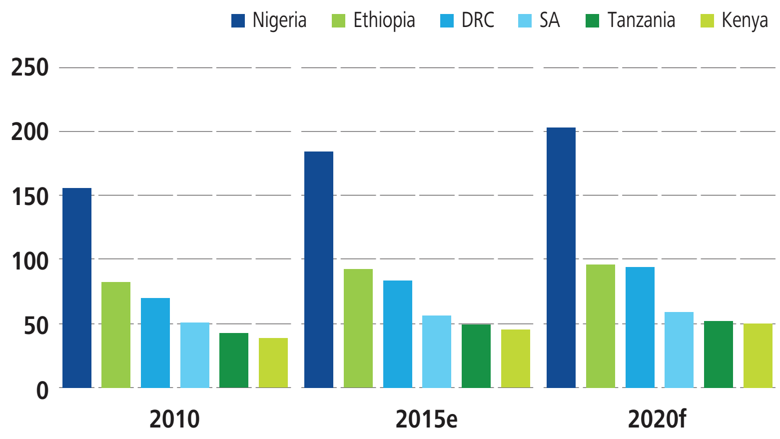
Ethiopia overview

Ethiopia has been among Africa's most impressive growth performers over the past decade, averaging 10.9% annual growth between 2004 and 2014, despite being a non-oil producing country. The government's economic strategy has been premised on sound macroeconomic policies, diversification by promoting agriculture and industrial development, and creating a business environment that is conducive to investment, supported by infrastructure development.

Home to the continent's second largest population of 90 million people in 2015 and a forecasted almost 100 million in 2020, the country is positioned as a yet untapped investment opportunity in Eastern Africa.

To become successful in Ethiopia, firms need to understand and appreciate the Ethiopian government's efforts to transformation and opening up of the economy, given opportunities of positioning as first movers in a variety of industries.

Population of select African economies (m), 2010, 2015e & 2020f



Source: IMF, 2015

Political stability: a platform for pro-poor growth

As the politically dominant party, the ruling Ethiopia People's Revolutionary Democratic Front (EPRDF) holds 546 seats in the 547-seat parliament as of the June 2015 election. Prime Minister Hailemariam Desalegn, who has served as prime minister since the death of Meles Zenawi in August 2012, was unanimously re-elected as the chairman of the EPRDF in August 2015. Despite criticism, the strength of the ruling EPRDF arguably has made it possible for the Ethiopian state to create an enabling environment that has been conducive to its economic growth track record.

Ethiopia is one of a handful of African countries to have made significant progress in achieving the millennium development goals (MDGs), with one of highest reductions in poverty rates globally. Between 1995 and 2011, the country's poverty rate (defined as the percentage of the population living on less than US$1.25 per day) decreased from 63% to 37%. Ethiopia has seen the highest GDP per capita growth on the continent, with a CAGR of 10.93% expected between 2000 and 2020. Ethiopia has also maintained one of the lowest levels of income inequality, ranking third lowest in sub-Saharan Africa and 12th globally in terms of the World Bank Gini co-efficient estimates.

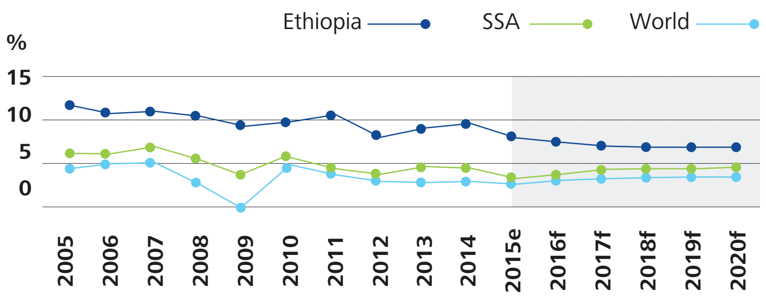
Its political stability, in what is a volatile Horn of Africa region, has cemented its role as a key Western ally. This has been demonstrated by United States (US) President Barack Obama's visit to Addis Ababa in July 2015, where he reiterated the importance of Ethiopia's role in regional security, particularly given the conflict in Somalia and South Sudan. Although terrorist attacks by Somalia-based al-Shabaab remain a threat, the strength of the country's security apparatus has thus far prevented any such attacks – testament to the prevalence of Ethiopia's intelligence agency and a well-managed security service.

Growth outlook remains robust

Ethiopia has been one of the top 20 fastest-growing economies in the world since 2004. Its average real GDP growth rate over the past decade has been double that of SSA's, despite being relatively resource poor, and is expected to remain significantly higher going forward. The country is set to be the second-fastest growing economy globally in 2015, with a GDP growth rate of 8.67%, according to the International Monetary Fund (IMF).

Underpinning this notable growth track record in recent years has been a focus on infrastructure and capacity development, as put forward in Ethiopia's Growth and Transformation Plan (GTP I), which was implemented from 2010 to 2015. The second such plan, GTP II, will run from 2015 to 2020 and explicitly aims to increase the country's manufacturing and agricultural exports, focusing on strategies that promote a globally competitive private sector. This includes government looking to invest in key economically enabling supporting infrastructure, including power generation. GTP II aims to achieve an average GDP growth rate of 11% per year during the five year cycle and plays a key part in the government's aim of becoming a middle income economy by 2025.

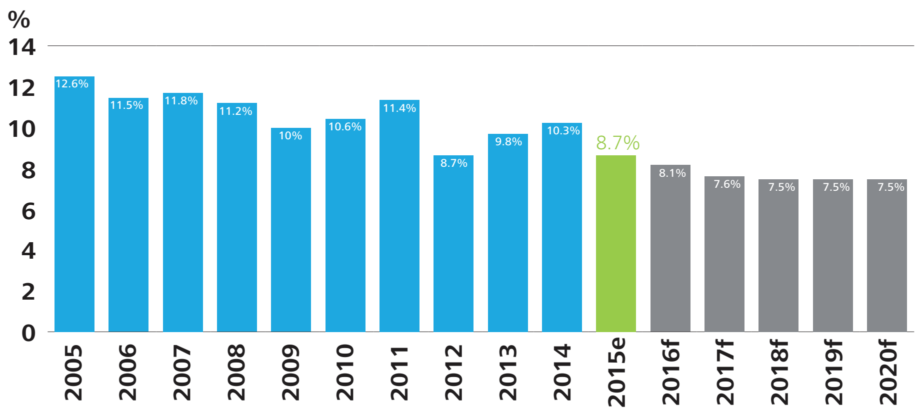
GDP growth rate (%), 2005-2020f



Source: Ethiopia National Statistics Office, as published by IMF, 2015

Looking ahead, the IMF expects the country to achieve an average growth rate of 7.82% between 2015 and 2020. Although this is in contrast to a subdued yet still sturdy average growth outlook of 4.68% between 2015 and 2020 for most of the sub-Saharan African (SSA) region it casts some doubts on the double-digit target set by GTP II.

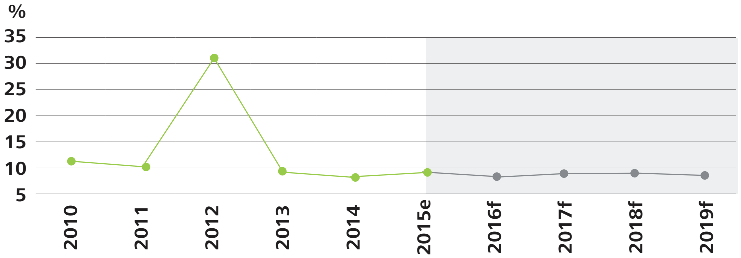
Ethiopia's GDP growth rate (%), 2005-2020f



Source: Ethiopia National Statistics Office, as published by IMF, 2015

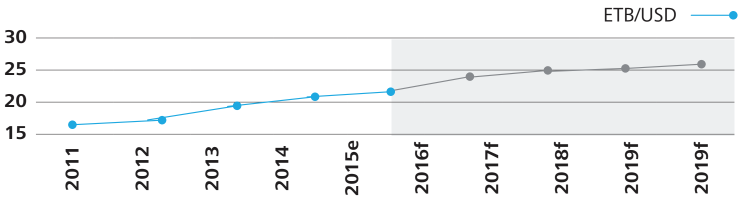
Tighter monetary policy and lower international commodity prices have supported single digit inflation for the last two years, following a spike in inflation because of a drought in the region in 2012. Future inflation patterns are largely dependent on rainfall due to Ethiopia's mainly agricultural economy. Fiscal deficits and the depreciating exchange rate in conjunction with higher international food and raw material prices will however keep inflationary pressures high in the short term. Inflation is expected to average 8.3% per year to 2019.

Ethiopia's yearly inflation rate (%), 2010-2019f



Source: EIU, 2015

Exchange rate movements (ETB/USD), 2011-2019f

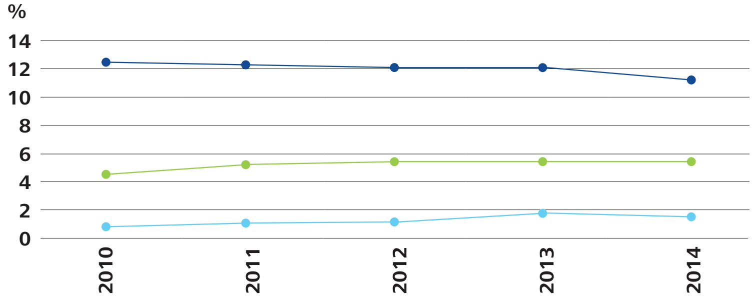


Source: EIU, 2015

The National Bank of Ethiopia (NBE) has closely managed the Ethiopian birr and government is likely to continue using the exchange rate as a policy tool, devaluing the currency to maintain export competitiveness. The birr is estimated to depreciate from an estimated average of ETB 22/USD in 2015 to ETB 26.18/USD in 2019.

Interest rates have remained stable for the last five years due to the tight monetary policy implemented by the NBE. The relatively stable interest rates should result in increased accessibility of credit for investment.

Interest rate movements (%), 2010-2014



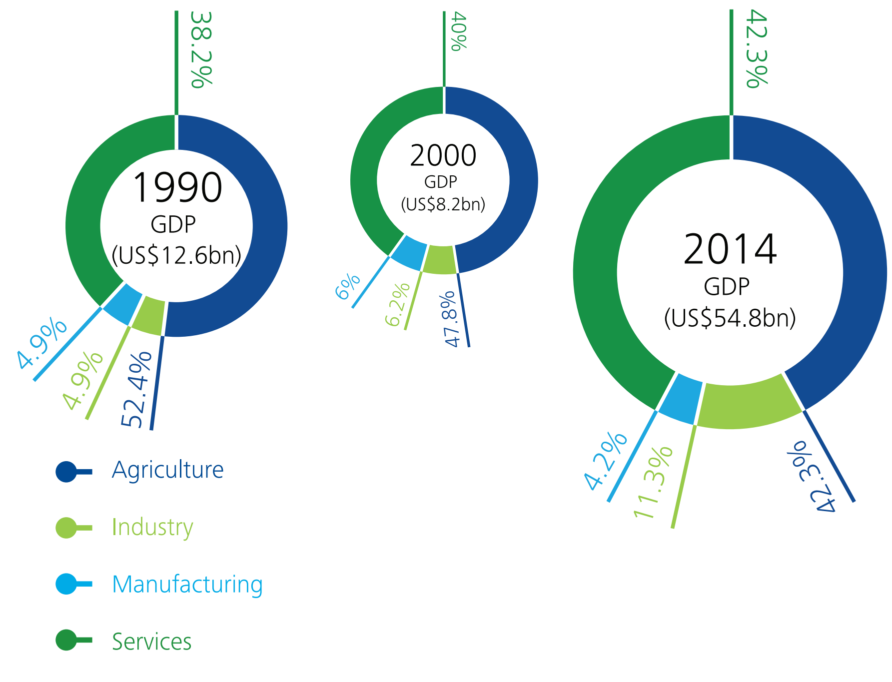
Source: NBE, 2015

Industrial sector expansion during economic growth

Although agriculture remains an important contributor to Ethiopia's economy, its share of GDP has been steadily decreasing. In 2014 the sector made up 42% of value-add to GDP (down from 52% in 1990), followed by services (42%), and industry (15%). The latter includes a small but growing manufacturing (4%) sector. Despite its share of GDP declining, agriculture remains the backbone of Ethiopia's economy, accounting for almost 80% of employment and for 70% of export earnings. GTP II aims to double food crop production by 2020. The somewhat relative expansion of the services sector, up from 38% in 1990, has been on the back of increasing tourism volumes and financial intermediation.

The industrial sector has been the main driver of economic growth in recent years. The sector (including construction, mining and manufacturing) increased by 21.2% during the 2013/14 financial year – almost twice as fast as the services sector, and four times that of the mostly rain-fed agricultural sector. This positive growth is likely to continue into the future, especially if restraints on private sector development are relaxed. Ethiopia is also making an effort to link into global value chains by targeting export-orientated light manufacturing and has already attracted a number of investors into the garment and textile industry. The GTP II aims to have the manufacturing contribution to GDP grow from 4% to 8% by 2020, supported by attracting investment on the back of the expansion of industrial parks and attractive investment incentive to foreign investors.

Composition of Ethiopia's GDP (% value added), 1990, 2000 & 2014

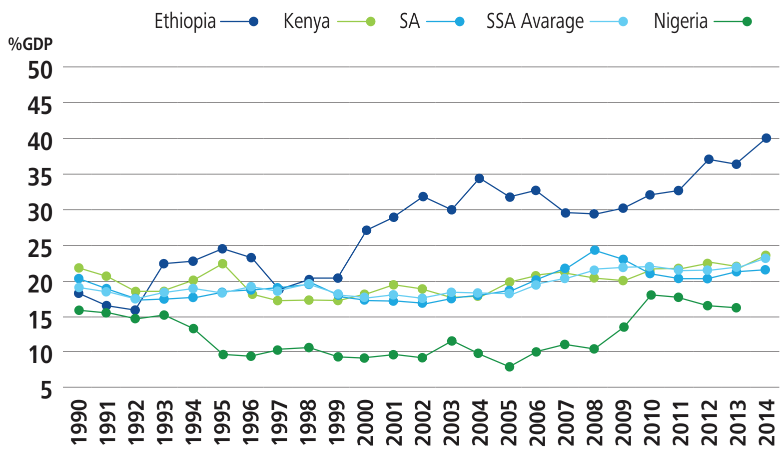


Source: World Bank, 2015

The largest industrial sub-sector underpinning growth has been the construction sub-sector. Accounting for almost half of the industrial sector, key investments in roads, railways, dams and residential buildings have seen this sub-sector expand by more than 35% between 2012 and 2014. Given government's prioritisation of infrastructure investment in GTP II, growth in infrastructure construction (particularly energy projects) is expected to continue, supported by the US$1 billion Eurobond issue by government in December 2014. A key project expected to be operational in early 2016 includes the 750km railway connecting Ethiopia and the Port of Djibouti, with plans to add 5 000km of railway line across Ethiopia by 2020.

Given this, relative to GDP, Ethiopia now has one of the highest gross fixed capital formation (GFCF) ratios globally, spending 40% of its GDP in 2014 on land improvements, equipment purchases, the construction of roads and railways, social, commercial and industrial buildings. In 2010 the World Bank estimated that Ethiopia would need to invest US$5.1 billion annually for a decade to overcome development constraints. Since 2007 World Bank data indicate that Ethiopia has exceeded this value each year, spending US$12.2 billion on average annually between 2007 and 2014. The Ethiopian Finance Minister has however indicated that Ethiopia will need to invest US$50 billion by 2020 in order to meet its development goals, of which US$10 billion - US$15 billion is anticipated to be provided by foreign investors.

Select economies by gross fixed capital formation (as % GDP), 1990-2014



Source: World Bank, 2015

Sound fiscal management underpins new sources of funding

Given Ethiopia's prudent macroeconomic management, the country has maintained its stock of public debt at 26% of GDP for the last four years. This is significantly below the SSA average of 47% with Ethiopia at low risk of debt distress. This is largely due to government's success in restricting the fiscal deficit below 4% of GDP for the last decade.

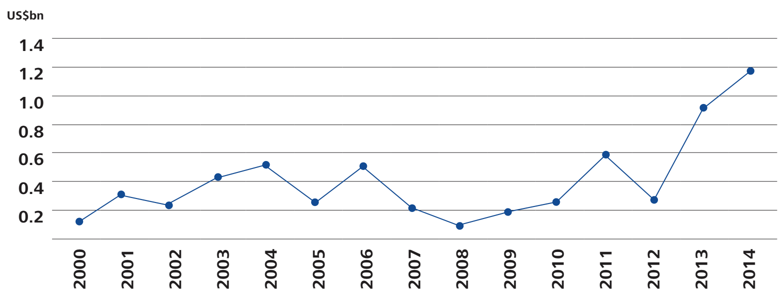
In December 2014 Ethiopia raised US$1 billion at a rate of 6.625% in its debut international bond issue, making history as the least developed country to date to have used the international capital market to raise financing. The bond, which has a ten-year maturity rate and the funds of which will be used to finance new infrastructure, namely an industrial park and a sugar manufacturing plant, was oversubscribed by 260%. Ethiopia may return to the international bond market in 2016. This is supported by fairly confident ratings of Moody's Ratings Services (rating Ethiopia's credit worthiness a B+) as well as Standard & Poor's and Fitch Ratings (both rating the country a B), which indicate a stable outlook and positive economic growth are likely to continue in the short to medium term.

As a result of the government's large development spend, expenditure growth is expected to continue to exceed revenue growth and it is likely that Ethiopia will face financing pressures in the medium to long term. This will put pressure on the state to pursue more market-orientated reforms going forward, in order to attract capital.

Private sources of funding and investment have increasingly complemented Ethiopia's investment sources in recent years. A record US$1.5 billion in foreign direct investment (FDI) inflows is expected in 2015, up from US$1.2 billion in 2014 and an average of US$430.5 million per annum over the period 2000-2014. This is attributed to efforts by the government to attract foreign manufacturing firms. The largest investors have been from Turkey and India with noteworthy investment also coming from Europe and the US.

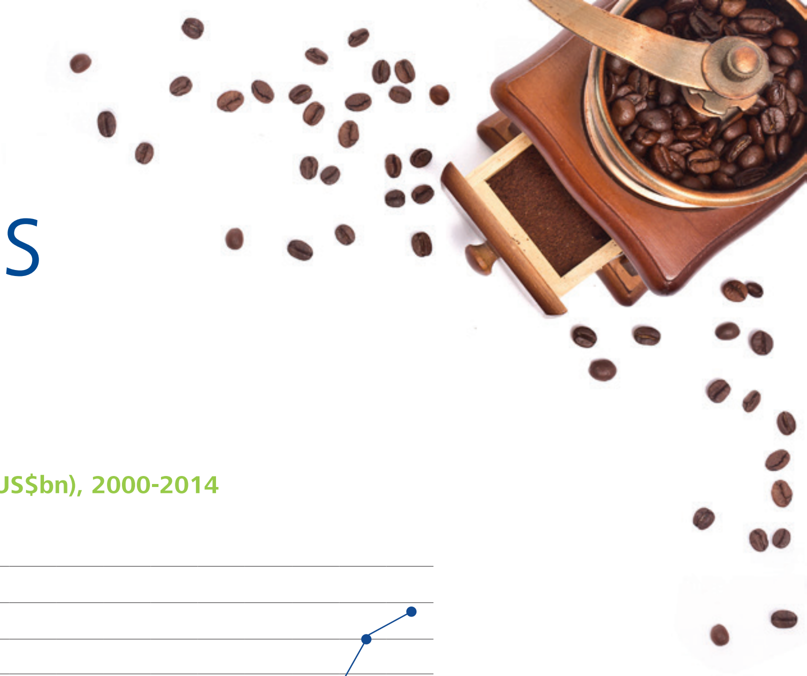
China has been the source of the largest number of foreign investments. It is forecast that FDI into Ethiopia will continue to average US$1.5 billion per annum until 2018 with government targeting US$8 billion in cumulative FDI flows between 2015 and 2020.

Inward FDI flows into Ethiopia (US$bn), 2000-2014



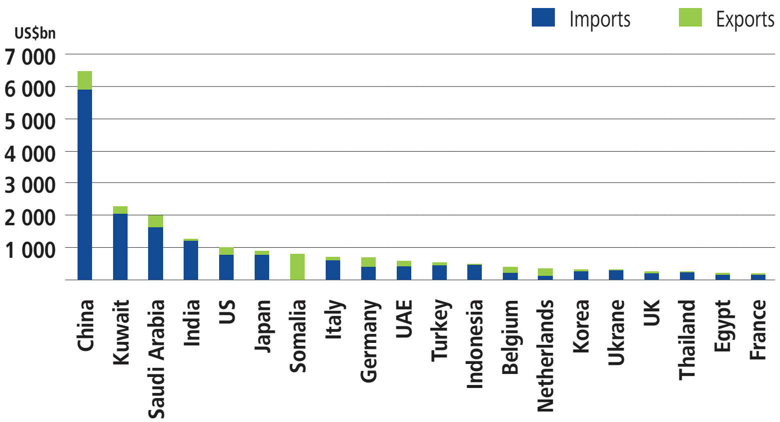
Source: UNCTAD, 2015

International trade relations support growth



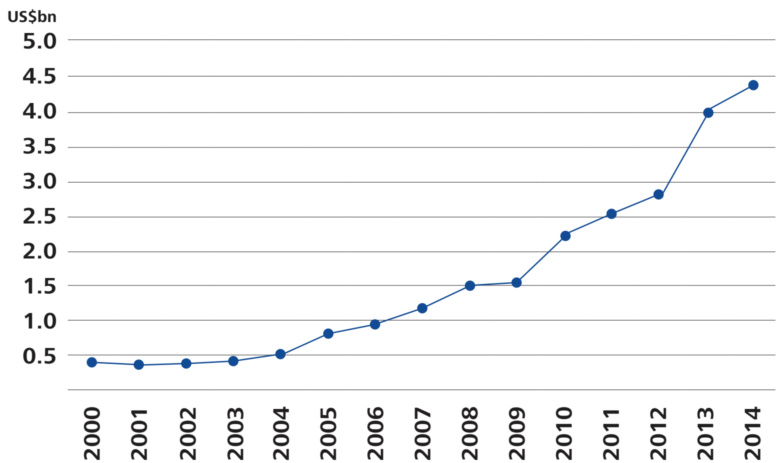
Liberalisation of merchandise trade has supported exports and in turn Ethiopia's economic boom. In 2014, the country's total bilateral merchandise trade was valued at US$22.4 billion, up from US$3.5 billion in 2004. China, Kuwait, Saudi Arabia, India and the US have been Ethiopia's top five trading partners, accounting for 57% of its total bilateral merchandise trade basket, with China alone accounting for 28%.

Ethiopia's top 20 bilateral trading partners (US$m), 2014



Source: UNCTAD, 2015

Value of Ethiopia's exports (US$bn), 2000-2014



Source: EIC, 2015

Despite a nine-fold increase in exports between 2000 and 2014, Ethiopia runs a trade deficit, largely importing goods that aid the construction and agriculture sectors.

In 2014 the country imported goods four times the value of goods exported, with the main import being petroleum (19% of imports. Other top imports are motor vehicles for the transport of goods, telecommunication equipment, fertilisers and civil engineering equipment, all of which are important inputs for development.

Ethiopia’s three largest exports by value are all agricultural in nature: vegetables, coffee and oil seeds followed by petroleum products (not crude) and live animals. These account for 81% of Ethiopia’s export earnings, with vegetables and coffee alone making up 39.5% of the total value of exports.

Ethiopia has not been as negatively affected by the decline of the commodity super cycle as some of its African peers as the economy is relatively resource poor. However, declining commodity prices, particularly of coffee and gold, have resulted in exports only increasing by 8.8% between 2013 and 2014, significantly lower than the 40% increase between 2012 and 2013. The government is planning to increase export revenue by 29% in each year of the GTP II, targeting US$16 billion by 2020, with manufacturing to account for 25% of total export earnings by the end of the GTP II period. Exports grew by 90.5% between 2010 and 2014.

Visible business environment improvements

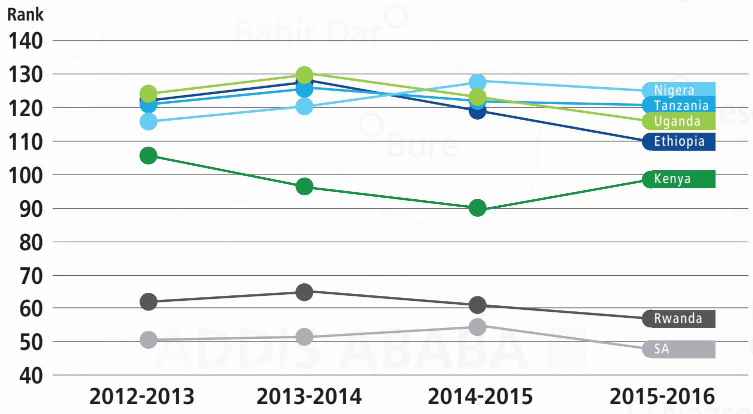
Although Ethiopia's business environment still lags behind other regional factors in terms of ease of doing business and competitiveness, part of government's economic strategy has been a number of significant changes to facilitate business operations and to reduce the cost of doing business. Between 2012 and 2015, Ethiopia moved up from position 121 to 109 out of 140 in the Global Competitiveness Report ranking. The government has made trading easier by addressing internal bureaucratic inefficiencies, reducing delays in courts and thereby making it easier to enforce contracts, streamlining registration procedures and making the transfer of property easier by decentralising administrative tasks.

According to the World Bank's Ease of Doing Business Report Ethiopia ranked 146th out of 189 countries in the 2015-2016 edition. The country ranks high for dealing with construction permits and enforcing contracts, but ranked poorly in terms of getting access to credit, protecting minority investments and trading across borders. One of the greatest hindrances to the operating environment remains the strength and pervasiveness of state-owned and party-affiliated firms. Government has furthermore been hesitant to ease restrictions on non-state participation in the energy, telecoms and financial services sectors.

The five most problematic factors for doing business in the country, as per the Global Competitiveness Report, include access to financing, inefficient government bureaucracy, foreign currency regulations, corruption and tax rates.

Although companies are taxed at 30%, Ethiopia ranks comparatively well in 44th position globally, for its relatively low total tax rate as a percentage of profits. Ethiopia ranked favourably for its lack of favouritism in decisions of government officials and gross national savings as a percentage of GDP. The country also ranked 18th in the world for its level of general government debt as a percentage of GDP, indicating the relative strength of Ethiopia's macroeconomic environment.

Global Competitiveness Report ranking and score, 2012-2015



Source: WEF, 2015

Lower rank indicates higher competitiveness (score out of seven)

The Ethiopian government is in the process of revising its commercial code in order to facilitate private investment and enhance the business operating environment. This will include a focus on simplifying regulations for potential investors, standardising accounting practises to accurately assess operating liabilities such as tax, increasing protection of shareholders and modernising trade and registration procedures and processes.

In 2015 Ethiopia became a full member of the Common Market for Eastern and Southern Africa (COMESA). COMESA ultimately aims to create a common market with free movement of capital and labour, with no tariffs levied on goods. Through COMESA, Ethiopia enjoys preferential access to 19 countries with a population of 390 million.

Despite suggestions by government officials that Ethiopia will join the World Trade Organisation (WTO) in the fourth quarter of 2015, this is unlikely and negotiations are still ongoing. Until it is granted membership, Ethiopia will remain an observer of the WTO.

Investment opportunities

A nascent consumer market, a stable economy and competitive labour, customs and energy costs are key elements driving investment opportunities in Ethiopia. By aligning with the goals of the GTP II and the government's efforts to transform the economy, businesses may find it easier to enter the Ethiopian market.

Ethiopia has implemented tax incentives for investment in high priority sectors, namely tourism, agro-processing, sugar and related products, leather and leather goods, manufacturing, textiles, chemicals and pharmaceuticals, and mineral and metal processing.

In 2012 the state introduced provisions for the creation of both state-run and private industrial zones. These include a range of investment, tax and infrastructure investment incentives. In July 2015 China Civil Engineering Construction Corporation (CCECC) signed a US$246 million deal to construct the first of these new parks, the Hawassa Industrial Park, with another four being planned. Ethiopia also has five privately-owned industrial zones. Investors in the industrial zones receive a number of incentives.

Overview of Industrial Zones in Ethiopia

Zone	Ownership	Status
Bole Lemi-I	Government	Operational
Bole Lemi-II	Government	In planning
Kilinto	Government	In planning
Dire-Dawa	Government	In planning
Combolcha	Government	In planning
Hawassa	Government	Under construction
Eastern Industrial Zone	Private	Operational
Ethio-Turkish Industrial Zone	Private	In planning
Huajian Industrial Zone	Private	In planning

Source: EIC, 2015

Financial services, banking, insurance, power transmission and distribution, wholesale and retail trade, telecommunications and some transportation services are currently closed to foreign investment. However, foreign firms can supply goods and services to domestic firms in closed sectors. The Ethiopian government has indicated that foreign private sector expertise could benefit some of the closed sectors and the restrictions on providing such services may be lifted in the near future, given greater service liberalisation expected going forward.

Among other incentives, new investors (in manufacturing, agro-processing or the production of prioritised agricultural products) that export more than 50% of their products or services or supply over 75% of their product to an exporter as a production input are exempt from paying income tax for a period of five years. Investors who only supply the local market, or export less than 50% of their product are tax exempt for two years. Income tax exemptions ranging from one to ten years are applicable to investors in a range of prioritised industries across a range of sectors, namely manufacturing of a wide range of products, the production of agriculture, ICT, the generation of electrical energy and those involved in the development of industrial zones.

A number of multinational companies such as Huajian Shoes, Heineken, the Blackstone Group, KKR, GE, Orange, Etur Textile, the BDL Group, Jiangsu Lianfa Textile Co, Diageo, SABMiller, PPC, and Starwood Hotels have made significant investments in Ethiopia in the last few years, illustrating the country's attractiveness as a market.

Key sector opportunities based on limits on foreign control

Agriculture & Agroprocessing Sector	Investor
Export of raw coffee, chat, oil seeds, pulses, natural forestry products, hides and skins bought from the market, and live sheep, goats, camel, equines and cattle not raised by the investor	Domestic investors
Tanning of hides and skins below finished level	Domestic investors
Leather and leather products industry	Foreign investors
Wood products industry	Foreign investors
Paper and paper products industry	Foreign investors
Crop production	Foreign investors
Animal production	Foreign investors
Mixed (crop and animal) farming	Foreign investors
Forestry	Foreign investors
Export trade excluding raw coffee, chat, oil seeds, pulses, natural forestry products, hides and skins bought from the market, and live sheep, goats, camel, equines and cattle not raised by the investor	Foreign investors

Source: EIC, 2015

Key sector opportunities based on limits on foreign control (continued)

Construction Sector	Investor
Manufacture of clay and cement products	Domestic investors
Construction, water well and mining exploration drilling companies below Grade 1	Domestic investors
Grade 1 Construction contracting (including water well drilling and drilling for mineral exploration)	Foreign investors
Real estate development	Foreign investors
Architectural and engineering works and related technical services, technical testing and analysis	Foreign investors

Energy & Resources Sector	Investor
Transmission and supply of electrical energy through the Integrated National Grid System	Government
Other non-metallic mineral products industry	Foreign investors
Basic metal industry	Foreign investors
Generation, off- grid transmission and supply of electrical energy	Foreign investors
Importation of LPG and bitumen	Foreign investors
Supply of petroleum and its by-products as well as whole sale of own products	Foreign investors

ICT Sector	Investor
Postal services except courier services	Government
Telecommunication services	Joint-venture with the government
Broadcasting and mass media services	Ethiopian nationals
ICT	Foreign investors

Source: EIC, 2015

Key sector opportunities based on limits on foreign control (continued)

Manufacturing & Consumer Business Sector	Investor
Production of weapons and ammunition	Joint-venture with the government
Manufacturing of ice crème and cakes	Domestic investors
Finishing of fabrics, yarn, warp and weft, apparel and other textile products by bleaching, dyeing, shrinking, sanforizing, mercerizing or dressing	Domestic investors
Manufacturing of plastic shopping bags	Domestic investors
Manufacturing of corrugated metal sheet for roofing and nails	Domestic investors
Food industry	Foreign investors
Beverage industry	Foreign investors
Textiles and textiles products industry	Foreign investors
Chemical and chemical products industry	Foreign investors
Basic pharmaceutical products and pharmaceutical preparations industry	Foreign investors
Rubber and plastics products industry	Foreign investors
Fabricated metal products industry	Foreign investors
Computer, electronic and optical products industry	Foreign investors
Electrical products industry	Foreign investors
Machinery and equipment industry	Foreign investors
Integrated manufacturing with agriculture	Foreign investors
Vehicles, trailers, and semi trailer industry	Foreign investors
Manufacturing of office and household furniture	Foreign investors
Manufacturing of other equipment (jewelers and related articles, musical instruments, sports equipment, games and toys and similar products)	Foreign investors
Preparation of indigenous traditional medicines	Ethiopian nationals

Key sector opportunities based on limits on foreign control (continued)

Services Sector	Investor
Tour operation below grade 1	Domestic investors
Kindergarten, elementary and junior secondary education by constructing own building	Domestic investors
Diagnostic center service by constructing own building	Domestic investors
Clinical service by constructing own building	Domestic investors
Capital goods leasing (this does not include leasing of motor vehicles)	Domestic investors
Printing industries	Domestic investors
Banking, insurance, micro-credit and saving services	Ethiopian nationals
Attorney and legal consultancy services	Ethiopian nationals
Advertisement, promotion and translation works	Ethiopian nationals
Packaging, forwarding and shipping agency services	Ethiopian nationals
Star designated hotels /including resort hotels/motels, lodges and restaurant	Foreign investors
Tour operation of grade 1	Foreign investors
Secondary and higher education by constructing own building	Foreign investors
Technical and vocational training service including sport	Foreign investors
Hospital service by constructing own building	Foreign investors
Publishing	Foreign investors

Transport Sector	Investor
Passenger air transport services using aircraft with a capacity of more than 50 passengers	Government
Domestic air transport services using aircraft with a seating capacity of up to 50 passengers	Ethiopian nationals

Source: EIC, 2015

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